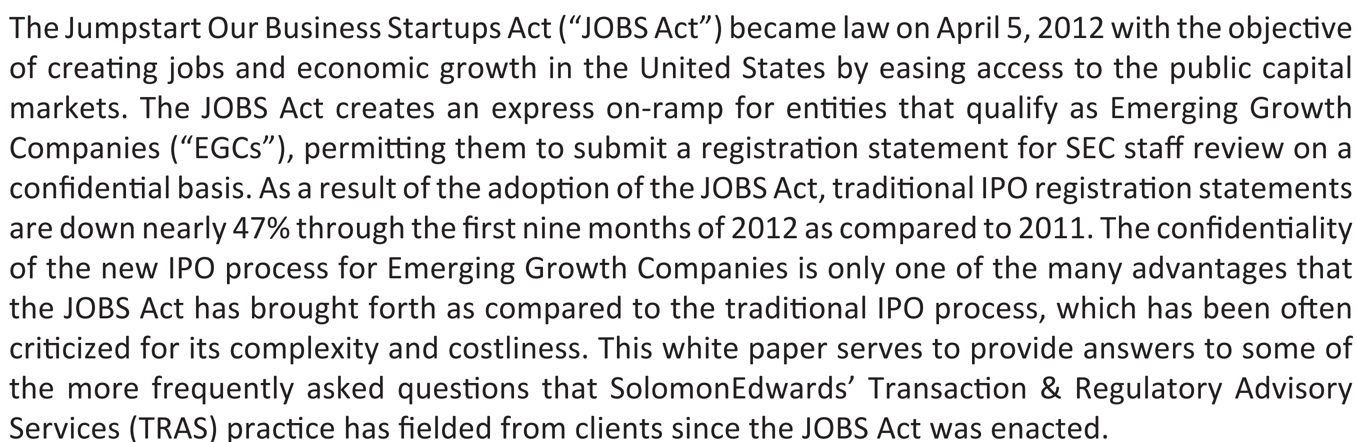
SolomonEdwards

JOBS Act In Practice

The New IPO Process for Emerging Growth Companies

Transaction & Regulatory Advisory Services



The Jumpstart Our Business Startups Act ("JOBS Act") became law on April 5, 2012 with the objective of creating jobs and economic growth in the United States by easing access to the public capital markets. The JOBS Act creates an express on-ramp for entities that qualify as Emerging Growth Companies ("EGCs"), permitting them to submit a registration statement for SEC staff review on a confidential basis. As a result of the adoption of the JOBS Act, traditional IPO registration statements are down nearly 47% through the first nine months of 2012 as compared to 2011. The confidentiality of the new IPO process for Emerging Growth Companies is only one of the many advantages that the JOBS Act has brought forth as compared to the traditional IPO process, which has been often criticized for its complexity and costliness. This white paper serves to provide answers to some of the more frequently asked questions that SolomonEdwards' Transaction & Regulatory Advisory Services (TRAS) practice has fielded from clients since the JOBS Act was enacted.

What is the definition of an Emerging Growth Company?

An EGC is an issuer that has total annual gross revenues of less than $1 billion during its most recently completed fiscal year. An issuer that qualifies as an EGC on the first day of that fiscal year shall continue to be an EGC until the earliest of:

(a) the last day of the fiscal year of the issuer during which it had total annual gross revenues of $1 billion or more;
(b) the last day of the fiscal year of the issuer following the fifth anniversary of the date of the first sale of common equity securities of the issuer pursuant to an effective registration statement under this title;
(c) the date on which such issuer has, during the previous 3-year period, issued more than $1 billion in non-convertible debt;
(d) the date on which such issuer is deemed to be a 'large accelerated filer,' as defined in section 240.12b–2 of Title 17, Code of Federal Regulations, or any successor thereto.

The billion dollar threshold shall be adjusted for inflation every five years by the SEC to reflect the change in the CPI as published by the Bureau of Labor Statistics, setting the threshold to the nearest billion during its most recently completed fiscal year.

Issuers that qualify as EGCs under the JOBS Act are not required to become EGCs. If such issuers choose to forego EGC status, they are subject to the same SEC registration and filing requirements that would be applicable to non-EGCs.

How should the EGC apply the revenue threshold test when evaluating its eligibility under the JOBS Act?

The revenue threshold test applies only to the most recently completed fiscal year. Revenues in excess of $1 billion in years prior to the most recent would not disqualify an issuer. The revenue threshold test is total revenues as presented on the income statement presentation under U.S. GAAP, or IFRS as issued by the IASB, if used as the basis of reporting by a foreign private issuer.

Can registered investment companies and issuers of asset backed securities qualify as EGCs?

No. In an FAQ issued on May 3, 2012, the SEC noted that registered investment companies and issuers of asset backed securities would not qualify as EGCs under the provisions of the JOBS Act.

How does the confidential filing process with the SEC work?

An EGC is allowed to submit a confidential draft IPO registration to the SEC for review in advance of its initial public offering. The issuer and SEC are prohibited from publicly disclosing the confidential filing, comments and amendments during this review process. As the EGC moves closer toward a successful IPO, the JOBS Act does require that these filings be made available to the public. The EGC would be required to publicly file said draft, with any applicable amendments, with the SEC no later than 21 days before its road show. Moreover, the SEC staff will publicly release its comment letters and issuer responses to staff comment letters on confidential draft submissions after the registration statement for the IPO becomes effective (no earlier than 20 days after the effective date).

How does the JOBS Act change the requirements for the financial information that an EGC must include in its registration statement?

Only two years (rather than the traditional three) of audited financial statements are required to be included in the registration statements filed by an EGC under the JOBS Act. Moreover, the periods required for selected financial data in both registration statements and periodic filings do not extend to periods before the first year presented in the EGC's IPO. This means that an EGC can limit its selected financial data disclosure to only two years as well, which is significantly less than the traditionally required five years of selected financial data normally included in an SEC registration statement. Furthermore, an EGC is allowed to adopt new accounting standards on the basis of effective dates applicable to private (non-issuer) companies.

IPO Compliance Requirements

Initial Public Offering Requirement	Traditional IPO Registrant	JOBS Act Relief for EGCs
Registration Process	Public	Confidential
Audited Financial Statements	3 Years	2 Years
Selected Financial Data	5 Years	2 Years
Executive Compensation Disclosures	Full	Reduced (same as smaller reporting companies)
Auditor Attestation Report on Sarbanes-Oxley Compliance	Required	Not Required

What impact does the JOBS Act have for EGCs in terms of compliance with the provisions of the Sarbanes-Oxley Act?

An EGC is exempt from the requirement to obtain an attestation report on internal control over financial reporting (ICFR) from its auditor. New PCAOB rules that are adopted after the passage of the JOBS Act would apply to EGCs only if the SEC determines that those new rules are designed to promote investor protection, and that applying such rules to EGCs would be in the best interest of the investing public. EGCs are exempted from any future PCAOB rules that may require auditor rotation or potential rules calling for the expansion of the auditor's report to include an auditor's discussion and analysis of the company under audit. This exemption is likely to facilitate a substantial cost savings for EGCs in terms of the fees that are required to be paid to their external auditors related to their transition to becoming a public company.

Must EGCs comply with existing XBRL requirements in their filings with the SEC?

Yes. The JOBS Act does not exempt EGCs from complying with the data tagging requirements established by the XBRL requirements applicable to SEC registrants.

How does the JOBS Act change the disclosures required by EGCs with respect to executive compensation?

Executive compensation disclosures are eased for an EGC by providing the same reduced disclosures that are required of smaller reporting companies under Rule 12b-2 of the Exchange Act (generally those with public float less than $75 million). Since 2007, SEC registrants have been annually required to include a comprehensive Compensation Disclosure & Analysis ("CD&A") under Regulation S-K. Instead of this more onerous CD&A, EGCs are permitted to provide a concise narrative description of the material factors necessary to understand the Summary Compensation Table ("SCT"). EGCs are required to disclose compensation information for only three Named Executive Officers ("NEOs") as opposed to the disclosure of five NEOs mandated for other issuers. Those NEO disclosures are significantly reduced for EGCs as they need only include two supplemental tables (Outstanding Equity at Fiscal Year-End and the Director Compensation Table) in addition to the SCT. Also, the SCT must provide information for only the last two years as opposed to the three years required for most issuers. Finally, the JOBS Act provides EGCs with an exemption from calculating and disclosing the ratio of the CEO's compensation to the median compensation of all other employees.

Does the JOBS Act permit an EGC to "test the waters" prior to an initial public offering?

Prior to the JOBS Act, issuers were prohibited from making oral or written offers in connection with public offerings of securities before filing a registration statement for the offering. The JOBS Act provides a significant exception to these gun-jumping restrictions. Under the JOBS Act, EGCs can engage in oral or written communications with potential investors that are "qualified institutional buyers" (as defined in Rule 144A of the Securities Act) and institutions that are "accredited investors" (as defined in Rule 501 of Regulation D of the Securities Act) before or after the initial filing of a registration statement in order to determine whether such investors might have an

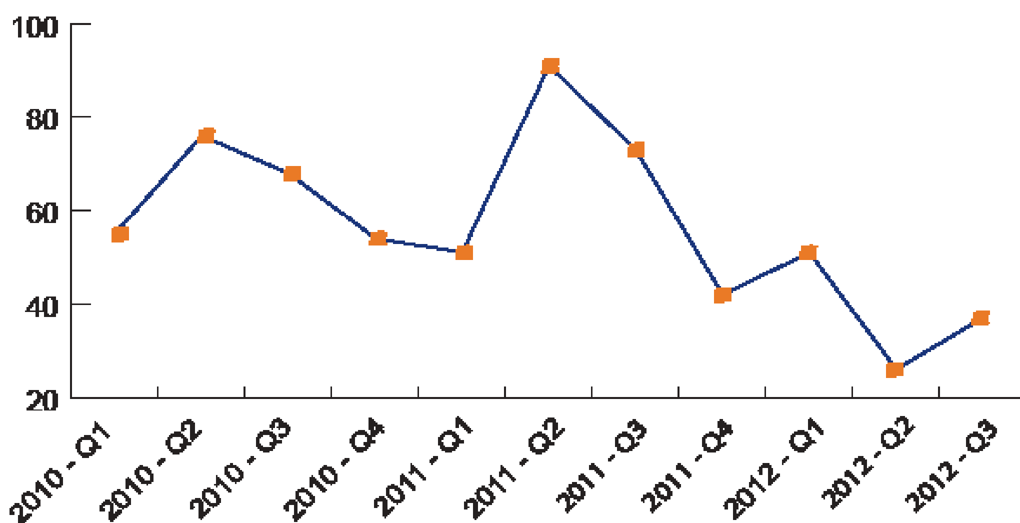
interest in a contemplated securities offering. By enabling the EGC to openly discuss an IPO with these institutional investors, they can effectively test the waters for a proposed offering without concern to those restrictions that normally govern the pre-offering solicitation process for larger companies.

How might the JOBS Act broaden an EGC's ability to offer securities to a broader array of investors?

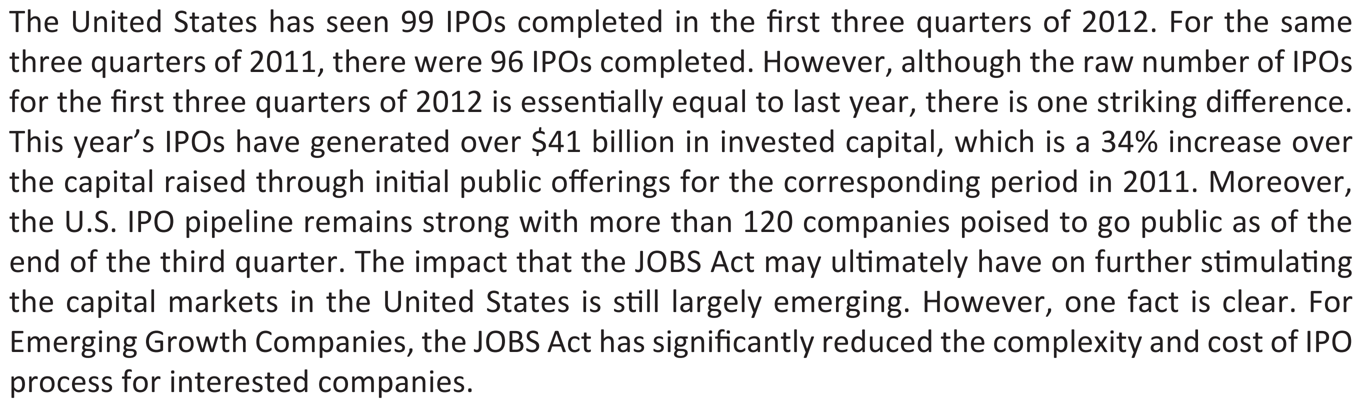
The JOBS Act directs the SEC to create an exemption for crowdfunding (access to public through social media or other means), allowing an issuer to offer up to $1 million of securities annually through this channel. The offering intermediary would be prohibited from advertising the sale of the securities, offering investment advice and soliciting the details of the offering. This exemption to the SEC's existing rules governing general solicitation in securities offerings may enable more people to invest in IPOs and thereby stimulate the capital markets in the United States. A key next step in realizing this potential economic benefit depends upon the SEC's approach to loosening the guidelines on general solicitation without sacrificing the important investor protection purpose that these rules were originally designed to promote.

Has the SEC provided any guidance for companies considering an IPO and the implications of the JOBS Act on those considerations?

Yes. The SEC has issued a series of frequently asked question ("FAQ") publications that provide detailed explanations to prospective registrants on the impact of the JOBS Act. The FAQ is posted on the SEC's website at: http://www.sec.gov/divisions/corpfin/guidance/cfjjobsactfaq-title-i-general.htm.



The JOBS Act's confidential filing process for EGCs is likely to reduce the number of publicly filed IPO registrations



The United States has seen 99 IPOs completed in the first three quarters of 2012. For the same three quarters of 2011, there were 96 IPOs completed. However, although the raw number of IPOs for the first three quarters of 2012 is essentially equal to last year, there is one striking difference. This year's IPOs have generated over $41 billion in invested capital, which is a 34% increase over the capital raised through initial public offerings for the corresponding period in 2011. Moreover, the U.S. IPO pipeline remains strong with more than 120 companies poised to go public as of the end of the third quarter. The impact that the JOBS Act may ultimately have on further stimulating the capital markets in the United States is still largely emerging. However, one fact is clear. For Emerging Growth Companies, the JOBS Act has significantly reduced the complexity and cost of IPO process for interested companies.

For more information about the JOBS Act or the key requirements in the transition to becoming a public company, contact your local SolomonEdwards office.

Atlanta **P** 404.497.4141 | Chicago **P** 312.466.0101 | Houston **P** 713.960.8880 | New York **P** 212.545.9500

Philadelphia **P** 610.902.0440 | San Francisco **P** 415.391.1038 | Washington, D.C. **P** 703.738.9600

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The Transaction & Regulatory Advisory Services practice at SolomonEdwards works closely with private equity firms, portfolio company clients as well as corporate buyers and sellers executing mergers and acquisitions. We partner to meet their unique business objectives along the full cycle of a deal. Our experienced and knowledgeable consultants provide support with pre-deal evaluation, transaction reporting, post M&A integration and regulatory compliance to ensure clients are prepared to meet and overcome any challenges that emerge throughout the transaction.