

Technology IPO Insights

Q4 2015



ORRICK

Market Update

Initial public offerings for technology companies had a slower year in 2015, particularly in the second half of the year, and the start of 2016 has basically seen a complete closing of the IPO window.

After two robust years for IPOs, 2015 was a disappointment for tech IPOs. In fact, proceeds raised by IPOs across all industries have been estimated to be in the range of \$30 billion, which is a six-year low. More alarming was the clear downtrend in offerings in the second half of the year, followed by the extreme stock market volatility that has plagued the first few months of 2016. Several companies have pulled offerings over the past few months, although they have generally indicated that they are delaying their offerings until markets stabilize and not abandoning their going public efforts entirely. It took until February 2 for the first IPO of 2016 (a biotech company) to price.

There have been a wide variety of factors contributing to both the lack of momentum for IPOs in general and the turbulence in the capital markets:

- the availability of private financing for late stage companies at strong valuations until the fourth quarter of 2015;
- the poor performance of recent IPOs, with more than half of newly public companies in 2015 trading below their initial offering prices by year-end; and
- economic issues including the collapse in oil and certain other commodity prices, concerns regarding the Chinese and various emerging market economies, and uncertainty over Federal Reserve and European monetary policies.

The recent state of the public capital markets has been contributing to a more challenging environment for private financing, at least at the same lofty valuations tech companies were receiving as the number of unicorns continued to climb in 2015. Certainly the performance of several IPOs has shown a disconnect between the valuations being set by private and public investors, with private investors beginning to mark down the value of some of their investments in private companies. The IPOs of Box Inc. and Square Inc. were eye-opening for investors,

both pricing their shares at levels significantly below their most recent private rounds.

A drying up of private financing may turn into a tailwind for the IPO market. At some point, VCs may begin to feel pressure to monetize their investments and force the hand of some of their portfolio companies to pull the trigger, even at valuations that will constitute down rounds – which will also have a greater impact on the stakes held by founders and employees due to down round protections frequently obtained by late-stage investors. Other companies in need of capital may find they have no alternatives. Public investors will be paying closer attention to financial performance, and existing investors may need to adjust their pricing expectations in exchange for liquidity. Ultimately, we would expect investor interest to be available for strong IPO candidates with a demonstrated ability to generate revenues, although less established or struggling companies may face greater scrutiny.

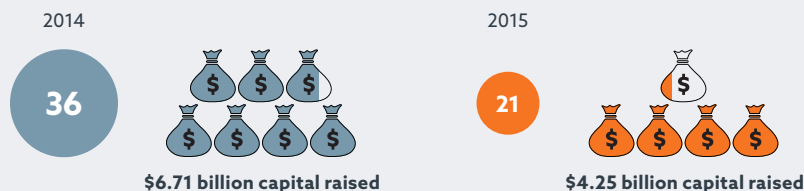
Despite the turbulent stock market and poor investor sentiment, there are still signs of life to point to for IPOs. First, a strong pipeline of IPO-ready tech companies continues to grow. There is a large backlog of companies with registration statements already publicly on file with the SEC (including those that chose to delay offerings over the past few months), and anecdotally it is understood that there are many more companies that have already made confidential submissions so or are planning to in the first or second quarter of 2016. While companies and VCs will remain cautious until the market shows some signs of stability, companies planning to go public will want to be in a position to launch quickly when a window emerges. The recently adopted FAST Act has reduced the number of days emerging growth companies need to be on file publicly before they commence their road show to 15 days from 21 days, which may result in companies waiting until the last possible moment to flip to a public filing. The key questions are when will the current market roller coaster begin to subside and whether any of the largest unicorns decide to take the plunge in 2016.

U.S. Tech IPOs

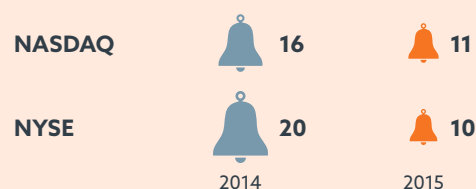
January – December 2015



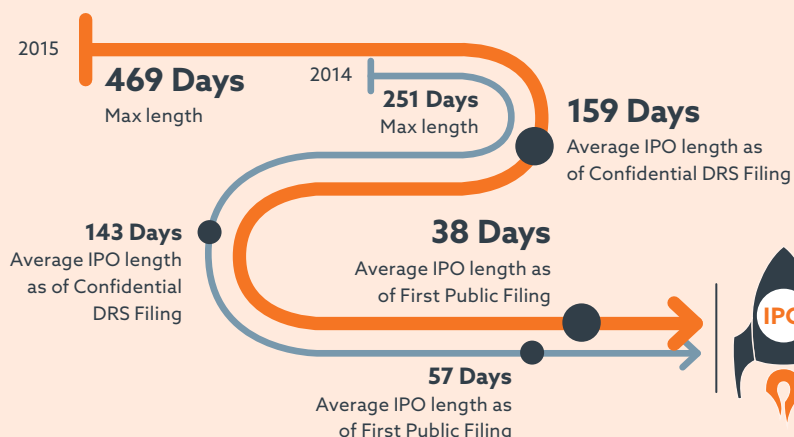
NUMBER OF IPOs



EXCHANGE SELECTION

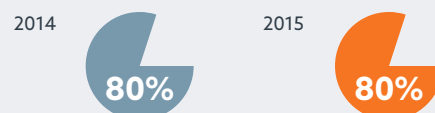


LENGTH OF IPO PROCESS



COMMON STOCK PRICE

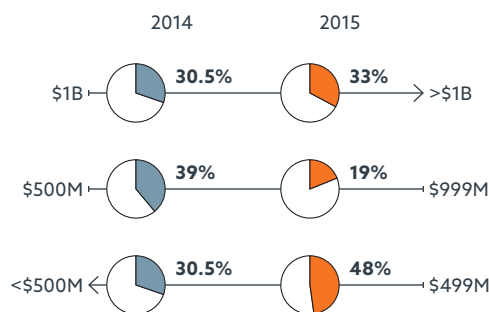
Above or within initial range



2015 HQs



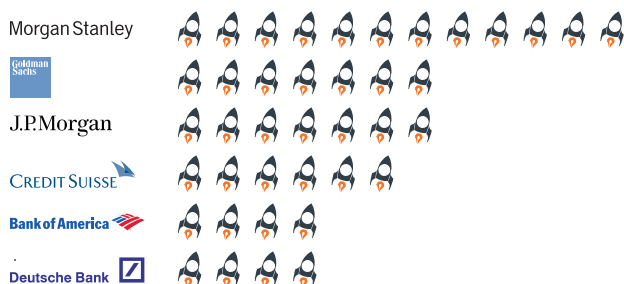
POST-MONEY VALUATIONS



2015 IPO COMPANIES

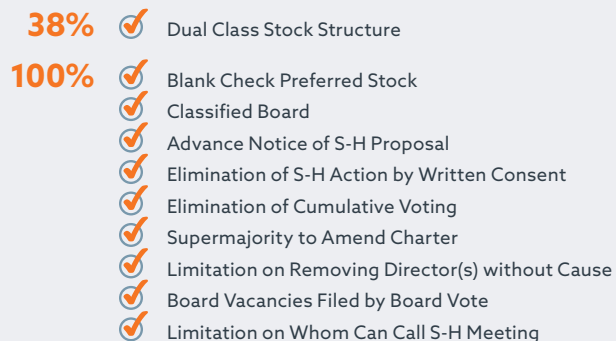


TOP 2015 BOOKRUNNERS*



* For IPOs with more than one bookrunner, credit was given to each joint bookrunner.

ANTI-TAKEOVER DEFENSES



Data includes U.S. technology companies with principal executive offices in the U.S. and was gathered leveraging public resources such as the U.S. Securities and Exchange Commission website, press articles and market information.

Assembling Your Public Company Board of Directors

Begin Planning Early to Navigate Both Applicable Rules and Business Considerations

By Brian B. Margolis and Stephen C. Ashley

An IPO is a complicated process and companies have to be prepared to meet the many related reporting and corporate governance requirements that begin to apply immediately following the closing of the offering. One topic that can be overlooked in the early planning stages is what the composition of the company's board of directors will be post-IPO.

A public company's board must comply with various SEC and stock exchange rules meant to guarantee board independence and competence. Most private company boards do not meet these standards and advance planning prior to the IPO can help avoid problems during the transition process. This article summarizes the various requirements for public company boards and the dates as of when such standards must be met, as well as other factors that should be taken into consideration.

At a glance

6 Tips to Setting Your Public Company Board

-  Determine which of your current directors meet Board and committee independence requirements or Audit Committee standards.
-  Decide on your target Board size, including how many independent directors will be needed.
-  Consider whether the Board is lacking sufficient industry, accounting, financial and/or public company experience, as well as whether to add more diversity to the Board's current composition.
-  Plan a path to identify and retain suitable director candidates, possibly including the use of external consultants, to ensure the Board (at a minimum) meets all applicable compliance deadlines.
-  Adopt a director compensation policy in time to use for discussions with director candidates.
-  Evaluate any changes to Board composition beyond minimum requirements that may help with IPO marketing efforts.



CONSIDERATIONS IN DETERMINING THE POST-IPO BOARD

We will go into some detail about the actual independence requirements and phase-in periods for setting up a fully-compliant independent Board. Notwithstanding these phase-in periods that give newly public companies some time to fully comply with the rules, a company should be in a position at the time of its IPO to know how it will meet the independence requirements at the end of those grace periods. Also, a company's underwriters will often suggest (or require) a fully compliant Board and governance structure at the time of the IPO for marketing purposes. Some of the factors private companies should consider in determining the composition of its Board post-IPO include:

Recruitment of Additional Directors

Since many privately-held companies operate with a relatively informal Board structure, and many do not have a majority of independent directors on their Board or independent committees, most companies considering an IPO will have to recruit one or more new directors that meet the independence and knowledge requirements. Recruiting new directors can require a significant amount of lead time, and companies may be searching for someone with experience in its particular industry, public companies generally, or accounting or financial matters sufficient to qualify as a member of the Audit Committee. Today, companies are also paying more attention to diversity considerations. All of the foregoing factors can increase the time companies will need to spend searching for suitable public-company director candidates.

Board Size

Although there are no specific minimum Board size requirements for public companies, filling out the committees with independent directors can present logistical difficulties. For example, if the Board has only five directors, even if four are independent, each director will sit on at least two committees. The Audit Committee, in particular, will have a greatly expanded role following the IPO, and many Audit Committee members are reluctant to sit on multiple committees. As a practical matter, therefore, some public companies, particularly those with a larger market capitalization, will choose to have at least six independent directors.

Director Compensation

The company will also need to develop and adopt a competitive director compensation policy for independent directors, which will typically include annual cash retainers, chair retainers and committee fees, as well as equity awards. Generally speaking, the directors of public companies have more specific responsibilities than the directors of private companies, and therefore tend to receive a higher level of compensation. There are no fixed standards for Board compensation, and the company will need to determine what level of compensation (and the mix of cash versus equity compensation) is appropriate. Many companies will pay certain key directors, such as the Audit Committee chairperson, additional compensation in recognition of that director's additional responsibilities. A company's planned director compensation policy is generally of interest to potential candidates, so this is something the company needs to have given consideration



to before beginning a search for any necessary additions to its Board in connection with the IPO.

Overview of Legal Requirements for Boards

1. BOARD REQUIREMENTS

With certain exceptions for controlled companies (see below), both the NYSE and NASDAQ require that a majority of Board members be independent, and the Board must conduct regular executive sessions of the independent directors (at least two times per year under the NASDAQ listing standards). Neither exchange provides for a minimum number of Board members.

2. COMMITTEE REQUIREMENTS

SEC rules and exchange listing standards impose certain requirements on the committee structure of a public company's Board. In general, there are three committees required: Audit, Compensation and Nominating/Corporate Governance. NASDAQ listing standards also allow independent oversight of director nominations in lieu of a specific Nominating Committee. Each of these committees must have a charter that includes the responsibilities and authority prescribed by applicable SEC rules and listing standards. The charters generally provide that the committees have the power to engage outside advisors and counsel.

Audit Committee

Exchange and SEC rules require public companies to have an Audit Committee comprised of at least three independent directors who meet the SEC's enhanced independence standards for audit committee members.

Each member of the Audit Committee must be able to read and understand fundamental financial statements or become financially literate within a reasonable period of time after his or her appointment. In addition, the NYSE listing standards provide that at least one member of the Audit Committee must have accounting or related financial management expertise, while the NASDAQ listing rules require at least one member to be “financially sophisticated” (i.e., have past employment experience in finance or accounting, professional certification in accounting or other comparable experience or background). SEC rules require a company to disclose whether at least one member of the Audit Committee is an “audit committee financial expert,” as defined under Regulation S-K.

The Audit Committee has many responsibilities, the core of which are engaging and overseeing the company’s auditors, overseeing the integrity of the company’s financial statements and its internal audit function, and preapproving all audit and non-audit services. It must review interim and annual financial statements and related disclosures with management and the auditors and recommend to the Board the inclusion of the audited financial statements in the company’s Form 10-K. The Audit Committee is also required to establish and manage a whistleblower policy and procedures for receiving and handling complaints received by the company regarding accounting, internal accounting controls or auditing matters.

Compensation Committee

The Compensation Committee develops compensation policies and practices applicable to executive officers, including the criteria upon which executive compensation is based, the specific relationship of corporate performance to executive compensation and the components of executive compensation, including salary, cash bonus, deferred compensation and incentive or equity-based compensation. The Compensation Committee must review the company’s disclosure of its compensation practices, determine whether to recommend to the Board its inclusion in the Company’s annual report and include a report to that effect in the company’s annual proxy statement. The Compensation Committee also administers the company’s equity plans.

In general, the Compensation Committee needs to be comprised of independent, non-employee directors.

Nominating/Corporate Governance Committee

The NYSE listing standards call for the formation of a fully independent Nominating/Corporate Governance Committee, although it allows for its duties to be allocated by the Board to other committees so long as they are likewise comprised entirely of independent directors. The Nominating/Corporate Governance Committee’s primary functions include identifying individuals qualified to be Board members and to select or recommend director nominees for the next annual meeting of shareholders, developing corporate governance guidelines for the company and overseeing the evaluation of the Board and management. The NASDAQ listing standards simply require director nominations to be approved by a majority of the Board’s independent directors or a nominations committee comprised solely of independent directors.

3. DIRECTOR INDEPENDENCE REQUIREMENTS

The standards for director independence are complex and vary by exchange. In general, a director may not be considered independent if he or she has been recently employed by the company or its auditors, is or represents a significant shareholder of the company, has material transactions with the company or is in a control position with respect to an entity that has a significant business relationship with the Company. The Board must affirmatively determine whether each non-management director is “independent.” Although the NYSE and NASDAQ have slightly different standards, in general independence means what one would think – free of material relationships outside the Board position that would interfere with the director exercising independent judgment.



Each of the NYSE and the NASDAQ has identified a number of relationships that are considered significant impairments of independence. The amounts and precise definitions are slightly different for each exchange, but generally cover the same ground. The following are some of the specific relationships that make a director not independent:

- the director has been employed by the company at any time during the past three years
- a family member of the director has been employed by the company as an executive officer at any time during the past three years
- the director or a family member has received more than \$120,000 in direct compensation from the listed company during any 12-month period within the last three years, other than compensation for board or committee service
- the director or a family member is a current partner or employee of the company's external auditor, or was a partner or employee of the Company's auditor who worked on the Company's audit at any time during any of the past three years
- the director or a family member has been employed as an executive officer of another entity where any of the company's present executive officers served on that entity's compensation committee at any time during the past three years (this is often referred to as compensation committee interlocks, and the goal is to not have executives padding each others' compensation)
- the director or a family member is affiliated with another company that has received payments of a certain level from the listed company



This list isn't exhaustive, and the absence of any of these specified relationships does not mean that a particular director is independent. Many other relationships (including business or social relationships between a director and a member of management outside the company) may impact a particular director's independence and should be considered by the Board in the course of making an independence determination. In particular, relationships that are close to the prohibited relationships (e.g., a director whose family member is employed by the company in a non-executive capacity) must be carefully scrutinized.

4. ENHANCED INDEPENDENCE STANDARDS

Audit Committee

Pursuant to SEC rules, a director is not eligible to serve on the Audit Committee in any year if the director receives any compensation from the company other than for Board service in that year. In addition, none of the Audit Committee members can be an "affiliate" of the company, defined as a person who controls, is controlled by, or is under common control with the company. Generally speaking, a director who owns less than 10% of the company's outstanding common stock, without any other relationships, will not be considered an "affiliate" for this purpose. A director with a higher level of stock ownership may serve on the Audit Committee only if the Board affirmatively determines that the director is not an "affiliate." This is often a difficult analysis for VCs who have a significant stock interest in the company – they may be independent in the colloquial sense, but not be able to serve on the audit committee.

Compensation Committee

In order to affirmatively determine the independence of any director who will serve on the Compensation Committee, the Board must also consider all factors that are relevant to determining whether a director has a relationship to the company that is material to that director's ability to be independent from management in connection with the duties of the Compensation Committee, including, but not limited to, the source of compensation of such director (including any consulting or other fee paid by the company) and whether that director is affiliated with the company or any of its subsidiaries or affiliates. When considering the sources of a director's compensation in determining his independence for purposes of Compensation Committee service, the Board should

consider whether the director receives compensation from any person or entity that would impair his or her ability to make independent judgments about the company's executive compensation. Similarly, when considering any affiliate relationship a director has with the company, a subsidiary of the company or an affiliate of a subsidiary of the company, in determining his independence for purposes of Compensation Committee service, the Board should consider whether the affiliate relationship places the director under the direct or indirect control of the listed company or its senior management, or creates a direct relationship between the director and members of senior management, in each case of a nature that would impair his or her ability to make independent judgments about the company's executive compensation.

5. PHASE-IN PERIOD FOR NEWLY-LISTED COMPANIES

Both the NYSE and NASDAQ currently permit companies listing in connection with an IPO to phase in compliance with the Board and committee independence rules. A listed company must have at least one independent director on each committee at the time of IPO effectiveness, a majority of independent directors on each committee within 90 days, and fully independent committees within one year. Furthermore, a company listing in connection with its IPO will have 12 months from the date of listing to comply with the requirement to have a majority independent board.

There are also limited exemptions to the independence rules for all NASDAQ-listed companies, whether or not they are listing in connection with an IPO. A committee with at least three members may include one non-employee director who is not independent under the NASDAQ listing rules. Directors sitting on a committee under this limited

NASDAQ exemption may not chair the committee and may not sit on the committee for more than two years. In addition, the company must disclose the fact that it is relying on the NASDAQ exemption in its annual meeting proxy statement. Note, however, that all Audit Committee members must still meet the SEC independence standards. In addition, the Compensation Committee members must still meet the Section 16 and Internal Revenue Code Section 162(m) standards to retain favorable treatment under those rules.

6. CONTROLLED COMPANY EXEMPTION

The NYSE and NASDAQ rules provide that if more than 50% of the voting power of a listed company is held by an individual, group or other company after the IPO, the company can qualify as a "controlled company." Under both listing standards, a controlled company is not required to have a Board comprised of a majority of independent directors and does not need an independent Compensation Committee or Nominating Committee. Many companies that could be controlled companies choose not to avail themselves of the exemption and choose to file the normal rules out of a desire to show their good governance practices. Others choose the greater flexibility and freedom from certain requirements provided to controlled companies.

When a company no longer qualifies as a controlled company, it may rely on the same phase-in periods available to companies completing an IPO, with the grace periods being calculated from the date the company's status changed. As indicated above, some controlled companies may nonetheless choose to comply with some or all of the exchange listing rules applicable to non-controlled companies, either for marketing optics or in an attempt to follow best corporate governance practices.

	At Time of IPO*	Within 90 Days of IPO*	Within 12 Months of IPO*
Board			Majority of independent members
Audit Committee**			
Compensation Committee	At least 1 independent member	Majority of independent members	Fully independent
Nominating Committee***			

* The phase-in periods for the Board, Compensation Committee and any nominating committee under the exchange listing standards are calculated from the company's listing date.

The grace periods for the Audit Committee are set by SEC rules and are calculated from the date of effectiveness of the company's registration statement.

** Under the NYSE listing standards, the company must have at least one Audit Committee member by the listing date, at least two members within 90 days of the listing date and at least three members within one year of the listing date.

*** Including any nominating committee formed by a NASDAQ-listed company.

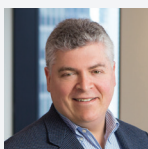
7. FOREIGN PRIVATE ISSUERS

Listed companies that are “foreign private issuers” (as defined under SEC rules) are permitted to follow home country practice in lieu of the exchange listing standards, although they must still meet the SEC rules applicable to the Audit Committee.

Following completion of its IPO, a foreign private issuer is required under SEC rules to test its status on an annual

basis as of the end of its most recently completed second fiscal quarter. If a company ceases to qualify as a foreign private issuer, it is given a phase-in period to comply with the exchange listing standards. The company will have to satisfy the majority independent Board requirement and exchange rules applicable to the committees (along with all other reporting requirements applicable to domestic public companies) beginning on the first day of the immediately following fiscal year.

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Brian Margolis, a partner at Orrick, Herrington & Sutcliffe in the New York office, is a member of the firm’s Capital Markets Group. Mr. Margolis has a broad background in corporate and securities law, with an emphasis on public offerings, private placements, mergers and acquisitions, corporate governance issues and general corporate counseling. Mr. Margolis’ practice focuses on the representation of both domestic and foreign issuers and underwriters in public offerings of equity securities. He has acted as counsel to issuers and underwriters in more than 50 public offerings, which have raised an aggregate amount in excess of \$5 billion. He has extensive experience representing companies and venture capital funds in connection with equity investments in private companies. His practice also focuses on representing Israeli companies accessing the U.S. public and private capital markets. Additionally, Mr. Margolis has advised numerous companies in mergers and acquisitions. He has experience representing special purpose acquisition companies (SPACs) in both initial public offerings and acquisition transactions. Mr. Margolis counsels public companies regarding disclosure, compliance and other securities law issues. His clients have included a wide variety of companies, from startups to established publicly traded companies, and they span various industry sectors, including biotech, consumer products, fintech, information technology, software, telecommunications and wireless communications.



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Mr. Ashley has represented companies covering many industries, including the information technology, software, media, telecommunications, retail, finance, biotechnology, life sciences, pharmaceuticals, energy, infrastructure, industrial, manufacturing and transportation sectors.

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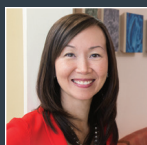
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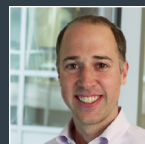
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