Case # 5-0022

TUCK SCHOOL OF BUSINESS AT DARTMOUTH
CENTER FOR PRIVATE EQUITY AND ENTREPRENEURSHIP

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Note on Exits

In the investment world, an "exit" is the process by which founders, management and investors in a startup or growth company successfully find public or corporate buyers for some or all of the company's shares. Through an exit, investors can realize returns while the company receives an infusion of capital and/or a new strategic direction from a corporate partner.

The most popular exit strategies are:

- A merger with another company, either public or private
- An acquisition by another company, either public or private
- An Initial Public Offering ("IPO") whereby a private company offers its shares to the general public through a registration process with the Securities and Exchange Commission ("SEC")
- A private placement, whereby the company sells its securities to accredited or institutional investors.

As shown in Exhibits 1 and 2, mergers and acquisitions are much more common in recent years than IPOs. Entrepreneurs that dream of an IPO and insist upon it when seeking an exit are vastly reducing their opportunities for successfully monetizing their shares.

The number and dollar value of exits declined significantly during the economic downturn of 2000. In 1999, equity underwritings in the technology, health care, and consumer segments totaled 665 but by 2002, the total was just 151 transactions. Mergers and acquisitions for the same sectors totaled 988 in 1999 and just 388 in

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This document was written by Adjunct Assistant Professor Fred Wainwright and Research Assistant Angela Groeninger, under the supervision of Professor Colin Blaydon as a basis for class discussion rather than to illustrate either effective or ineffective management.

2002.[1] Furthermore, many companies that did conduct IPOs during the bubble did not achieve success – almost 70% of companies that went public between 1997 and 2000 could not maintain a market capitalization above $200 million.[2]

More recently, statistics and market conditions indicate potential for a greater number and value of exits. Specifically within the private equity industry, given the increase in number of companies wanting to exit and the rising number of disenchanted limited partners wanting to see returns on their investments, there is an increased sense of urgency for portfolio companies to seek exits.

The exit market is beginning to show signs of life as 2003 annualized (Q3) activity in IPOs and M&A transactions well exceeds 2002 levels. See Table 1 below:

Table 1 – Equity Underwritings and M&A Activity in Select Years

	Peak Years		**Recession Periods**			
	1993	**1999**	**1991**	**2002**	**2003 Annualized**	**2003 v 2002 % change**
Equity Underwritings						
Technology	228	531	55	60	176	193%
Health Care	146	69	133	68	140	106%
Consumer	138	65	76	23	40	74%
Total	**512**	**665**	**264**	**151**	**356**	**136%**
M&A						
Technology	75	684	42	218	312	43%
Health Care	77	239	49	135	136	1%
Consumer	45	65	27	35	64	83%
Total	**197**	**988**	**118**	**388**	**512**	**32%**

Source: SDC /Thomson Financial and America's Growth Capital, "Emerging Growth Capital Markets Update, Third Quarter 2003"

[1] SDC/Thomson Financial and America's Growth Capital, "Emerging Growth Capital Markets Update, Third Quarter 2003"
[2] Liang, Jim and Florence, Tony, *Private Equity Exit Alternatives*, Morgan Stanley, November 2003

Early Exit Thinking and Strategic Considerations

As part of the Center's study of exit strategies, we interviewed approximately 25 general partners with venture and buyout firms, entrepreneurs, investment bankers, lawyers, and accountants. A recurring theme among nearly all of the GPs was that they only invest in a portfolio company if they have a clear sense at the beginning of what the exit will be. Several GPs indicated that they need to see at least three clear buyers at the outset to believe that an M&A exit approach is viable. It is important early on to explore the type of buyers that would be interested in the business. If a GP believes that an IPO is the exit vehicle of choice, he needs to evaluate the likelihood (early on) of the company being able to survive as a standalone entity.

When deciding whether to exit or remain independent, a company's management and board of directors should consider several strategic factors[3]:

- *How does an exit strategy fit with the company's original business plan objectives?* A company's ability to stand as an individual entity should not be compromised by its pursuit of an exit.

- *Is the company approaching an exit in a position of strength or one of weakness?* Has the marketplace dictated the need for a significantly larger scale that can be gained through an IPO or M&A or has the market deteriorated such that being acquired is a means of survival?

- *What are the financial motives behind the pursuit of an exit strategy?* A successful exit strategy balances the need for additional growth capital with the need to provide returns on capital to early investors who, after several years, often seek liquidity.

- *What is the risk/reward trade-off of conducting an exit strategy vs. remaining a stand-alone entity?* It is important to examine the pros and cons of exiting. Does the potential for expansion and access to additional capital outweigh potential dilution of ownership and the loss of job security?

- *Is the company able to manage itself throughout the process?* Execution of an exit strategy involves a significant amount of time and money, especially the IPO process. Does the company have sufficient funds to complete an exit strategy? Do the management team and board of directors have the ability and qualifications to lead the company through this process?

[3] Liang, Jim and Florence, Tony, *Private Equity Exit Alternatives*, Morgan Stanley, November 2003

- *What is the state of public markets?* Public markets are volatile, and a successful exit strategy largely depends on market timing. Many IPOs have been pulled at the last minute at a high cost due to unfavorable market conditions.

- *What is the state of the company's systems and controls?* Before conducting an exit strategy, a company will be subjected to a stringent due diligence process to ensure that all of the proper systems and controls are in place. Is the company ready for the intense scrutiny of its management and operations that accompanies the exit process?

- *What decision is in the best interest of shareholders?* Evaluate the timing of the exit – would it benefit shareholders to continue to strengthen the company as a standalone entity and fetch a higher valuation at a later time, or is now the optimal time to exit?

In addition to these strategic considerations, general partners that we interviewed also noted the following factors that impact their investment decisions and eventually the success of their exit strategies:

- Does the business solve a particular problem, and if so, is there a large market demanding that the problem be solved?
- How accessible is the target market?
- What kind of capital do you have/need to open access to these markets?
- What is the company's track record in meeting or achieving goals and performance measures?

Comparing IPOs and M&A

The following table details the pros and cons of conducting an IPO:

[see next page]

Table 2 – Pros and Cons of an IPO

Pros of Conducting an IPO	Cons of Conducting and IPO
Opportunity for Growth: An IPO exposes a company to a significant number of investors, giving it access to a larger pool of capital to use for growth purposes.	*Significant Time and Money:* Preparation of documents, the due diligence process, and lengthy meetings take up a significant amount of management's time. Furthermore, lawyers, accountants, underwriters and other counsel charge high fees to assist with the IPO process.
Increased Visibility: Due to the increased media and analyst coverage of public companies, an IPO results in increased visibility for both the company itself and startups in general.	*Increased Scrutiny:* When a company goes public, it must file numerous documents with the SEC and disclose information on its management and board of directors. With this increased visibility comes intense scrutiny of financial information and management behavior.
Profitability: If an IPO is successful in the long-run, founders and early investors can generate even greater returns.	*Ongoing Disclosure:* Public companies are required to disclose all events material to their business through press releases and 8K filings with the SEC. Annual reports, 10K's, 10Q's, and other financial documents must also be prepared and/or filed for public access.
Opportunity for Liquidity: An IPO creates an active market where investors can liquidate their shares for cash (following certain regulations). While early investors are usually subject to a lock-up period, they can often make a significant profit.	*Control Reduced:* Founders and/or early investors lose exclusive control of the company after conducting an IPO. Shareholder approval is required for certain activities such as issuing new stock, M&A activity, or instituting an employee stock purchase plan.
Attract Solid Personnel: IPO's offer the ability to entice quality personnel with various stock incentive plans.	*Reliance on Market Conditions:* Market conditions have a significant impact on the success or failure of an IPO.

The following table details the pros and cons of conducting a merger or acquisition:

Table 3 – Pros and Cons of an M&A Decision

Pros of M&A	Cons of M&A
Accessibility: A merger or acquisition usually gives the target company access to additional resources that it did not have as a standalone entity, thus giving it more opportunity for growth. For example, the acquiring/merging company might have more access to capital, larger distribution channels, or a wider customer base.	*Loss of Control:* Getting acquired or merging with another company often results in a loss of control. In a merger, the combined company might blend management teams together or dismiss current management, depending on the terms of the deal.
Liquidity: If a company is acquired or merges with another company, initial investors can usually liquidate their investment in a quick and timely fashion as compared to an IPO (but may fetch a lower valuation.)	*Closures or Job Losses:* After a merger or acquisition, the surviving entity attempts to achieve synergies resulting from the combination. These synergies are often attained by cutting back or downsizing in areas now deemed to be unnecessary, duplicated, or extravagant, which often results in facility closures and job losses.

The IPO Process

An Initial Public Offering ("IPO") occurs when a private company offers its shares to the general public after registering its issue with the Securities and Exchange Commission ("SEC"). The main purpose of an IPO is to raise additional capital from outside investors to fund the growth of the company. The offer and sale of securities are governed by the Securities Acts of 1933 and 1934 and enforced by the SEC on a federal level. On a state level, Blue Sky laws govern the IPO process. The purpose of these laws is to ensure adequate disclosure to investors and to prevent fraud. Under the Securities Act of 1933, companies intending to conduct an IPO must file a detailed registration statement with the SEC which includes in depth financial, management, and operational information.

Preparation for an IPO

There are a number of requirements a company must fulfill as well as steps it can take to better position itself for a potential IPO. Depending on the exchange where the securities will trade, the company will have to meet a minimum market valuation. The ability to raise a sufficient amount of capital in its offering and the achievement of a minimum growth rate are also keys to a successful IPO. [4]
The cost of taking a company public has increased substantially, largely as a result of the Sarbanes Oxley Act of 2002. Therefore, M&A has become the more popular exit strategy in recent years. However, if an IPO is conducted, popular opinion is that the minimum size for a company to go public has risen from $20-$30 M to $75-$100 M.

If a company is to conduct an IPO as its exit strategy, it needs to begin operating like a public company well beforehand. Some GPs note that it should be fully functional as a public company at least 2 quarters before the IPO. Even in an M&A deal, an acquirer will not want a company with sloppy controls, inaccurate financial statements, or other questionable practices. It is important to introduce accounting, financial, and legal internal controls early on in the lifecycle to create the perception that the company is ready for public scrutiny. Some actions a company can take prior to conducting an IPO include 1) cleaning up its financial records and ensuring they are free of material misstatements; 2) creating an investor relations department to prepare to deal with investors and analysts; and 3) establishing controls to ensure the timely and accurate preparation of the upcoming disclosures required of a public company.

A sound and qualified board of directors is also a necessity in completing a successful IPO, and its selection should be made well before the IPO process begins. Depending on the exchange, a public company must adhere to strict corporate governance standards. There are mandatory rules as to the number of directors that must be independent, and this requirement can prove difficult for many companies. Venture capitalists who serve on the boards of their portfolio companies will often be forced to resign as they do not meet the current independence standards. Furthermore, Sarbanes-Oxley has created even more rules for public companies, making it expensive and difficult to find qualified directors. For example, under this new act, five of a company's directors must be financially literate and at least two must have had a CPA license at one point.[5] These additional rules and standards emphasize the need for companies with prospects of

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[4] Gabor Garai and Susan Pravda, *How to Take Your Company Public the Right Way at the Right Time*, Epstein Becker & Green RC, May 1996
[5] American Institute of Certified Public Accountants (AICPA) Website

going public to find qualified board members early on, as it can be difficult to fulfill these requirements at the last minute.

Finally, many general partners have also noted that it is sometimes necessary to replace the management team of a portfolio company before it exits. Actually, it is common to replace management throughout the life of the business. In the venture capital sector, general partners may replace the entire management team two or three times as the business enters different phases. Different skill sets and teams are often needed to manage an early stage company versus a rapidly growing operation versus a public company. It is important to anticipate when these management changes are necessary rather than waiting until it is too late and a crisis develops. Although buyouts are almost certain to make some personnel changes, these will likely be confined to a handful of key people.

More on Sarbanes-Oxley

Sarbanes-Oxley has introduced meaningful costs to public companies, taking the form of internal compliance measures, external audits, and consulting expenses. The managing director of one accounting firm indicated that internal compliance costs are the largest costs related to being a public company, but also the hardest to quantify, and attributes them directly to Sarbanes-Oxley legislation.

The cost of the legislation is meaningful and often means that a company might conduct a trade sale in today's environment (versus an IPO pre Sarbanes Oxley). At a recent Tuck conference, one VC claimed that compliance costs shaved 4-5 cents/share from portfolio companies. A buyout firm viewed the costs for compliance to be on the order of $1-2MM a year in ongoing efforts, depending on the size of the company, and noted that the cost of D&O insurance has also risen dramatically.

The average shift in the minimum effective size for companies to go public is at least largely attributable to increased regulatory costs. Furthermore, since acquirers who are SEC registrants need to swiftly integrate acquisitions into their control systems, even portfolio companies exiting via trade sale will have to undertake compliance activities. The result is that VCs cannot avoid SO expenses by shunning the IPO route to liquidity.

Selection of an Underwriter

One of the first steps in conducting an IPO is the selection of an underwriting firm. An underwriting firm assists throughout the whole IPO process, from the preparation of the registration statement to setting a price for the company's securities. With its access to capital markets, the underwriting firm helps distribute the company's shares to institutional and retail clients. Where a private equity firm is involved, the general partners and Finance Committee often select the underwriter, as many firms try to limit the involvement of the management team in the whole process. Both the IPO and M&A processes can be very distracting to management and take up too much of their time if they are too involved. When evaluating an underwriter, it is important to consider the size and types of IPOs the firm has handled in the past as well as its client base. During our interviews with private equity firms, general partners noted that pricing, sell-side coverage, and company positioning are important factors to consider when choosing an investment bank. Other key questions include:

- Is the underwriting firm too large or too small to handle the size of the issuance?
- Does the underwriting firm have experience in the relevant industry sector?
- Does the underwriter have a wide client base and the ability to distribute shares to a range of institutional and individual customers?

When a company is planning to conduct an IPO, it will typically hire more than one underwriter to gain access to a larger pool of public investors. The group of underwriters working on the deal is called a syndicate. One firm is usually designated as the lead underwriter with heightened responsibilities, including setting the final price for a firm's securities before the IPO, entering into the underwriting agreement, and controlling advertising. In recent years, the formation of an underwriting syndicate has been common given the large size of many IPOs.

As a syndicate, more than one firm will put up the capital to purchase the securities, and the risk of not selling the securities to the public is spread among the investment banks. Once a company has selected an underwriter or underwriting syndicate, a non-binding letter of intent is drafted. The letter of intent includes a description of the security, the tentative number of shares to be issued, a tentative price range, underwriters' compensation, the type of underwriting (firm commitment or best efforts), and which expenses the company will be responsible for if the offering doesn't succeed.[6] The agreement does not become final until the

[6] Equity Analytics, Ltd. Website, *IPO Resource Center*

SEC approves the issue and all parties sign a contract, binding them to the letter of intent.

The underwriting syndicate is paid out of the spread, the difference between the price the issuing company receives from the lead underwriter and the offering price to the public. The spread is expressed as a percentage of the gross proceeds of the offering and is typically about 7%. The fee paid to the syndicate to compensate them for their expenses and risk is called the syndicate allowance. The lead underwriter also receives a percentage of every security sold, known as the manager's fee.

Types of Underwritings

The two main types of underwritings are "firm commitment" and "best efforts." "Firm commitment" underwritings are the most popular in the United States, where the underwriting firm purchases the new securities from the issuer at a stated price and assumes the risk of not being able to sell them to the public at a higher price. As mentioned above, the formation of a syndicate mitigates the risk of one firm being left with all the unsold shares. Furthermore, underwriters often wait until the last minute, hours before the registration statement is declared effective, to price the shares, limiting the amount of time between their purchase of the shares and the sale to investors. There are certain situations where an underwriter can get out of his "firm commitment" agreement, stated in a "market out" clause of the underwriting agreement. These situations are usually extreme, as a lenient "market out" clause would defeat the purpose of a firm commitment underwriting.

In a "best efforts" underwriting, the issuing company retains the risk of holding any remaining unsold shares. The underwriter uses its best efforts to sell the shares, but the underwriting firm never actually owns the securities, and it only makes a commission on the shares it sells. Any unsold shares belong to the issuing company. While best efforts underwritings are less common, they are options for companies conducting riskier IPOs.

The Pre-Filing Period

The preparation of the registration statement, usually the Form S-1, begins after the letter of intent has been signed. The time period before the filing of the registration statement is called the pre-filing period. The registration statement serves to fulfill the requirements of the Securities Act of 1933, providing full disclosure on the company intending to go public. The registration statement includes the prospectus, which is given to potential investors, along with additional information on the company. It provides investors with detailed information on the company, its management, its business, and its relevant risk factors to allow investors to make an informed decision. It also includes the company's financial statements. The registration statement is prepared by a group of attorneys, accountants, and underwriters, in collaboration with the issuer. For a more detailed description of the items included in the registration statement, see Exhibits 3 and 4. There is significant legal liability for any material misrepresentations in the document; therefore a lengthy due diligence investigation of the issuer is conducted. Due-diligence procedures entail reviews of the company and its management, including, but not limited to, visiting facility sites, reviewing significant agreements and contracts, financial statements, tax returns, board of directors and shareholders' meeting minutes, and performing various analyses of the company and the industry in which it operates by the attorneys and underwriters.[7]

During the pre-filing period, it is imperative that the issuing company makes no offers to sell its securities. Formal or veiled attempts at publicizing an offer to sell securities before the registration statement is filed, also known as "gun-jumping", is strictly prohibited as it could generate demand for the issuance with potentially misleading information. If the SEC finds a company guilty of inappropriate disclosure, it can impose fines or postpone the IPO.

The Waiting Period (or Cooling Off Period)

The waiting period is the time between the filing of the registration statement with the SEC and its effective date. During this period, oral offers to sell the issuer's securities can be made, but no actual sales can take place. There are specific regulations as to the type of written material that can be distributed during the waiting period (no brochures, television advertisements, articles, etc. about the issuer).

Company management and underwriters will also visit institutional investors who have interest in the IPO in a road show. The road show gives an indication of the demand for the new issue, but any indications of interest are non-binding. A red herring, or preliminary prospectus, can be given to potential investors. A red herring does not include any price-related information on the securities since the offering price is not set until the effective date, but it does include most of the other pertinent information that investors would use to make a decision. It must be stated in the document that it is not intended to be an offer to buy or sell securities.

A tombstone ad is also permitted during the waiting period to provide limited information on the IPO (although it is typically published after the effective date of

[7] PricewaterhouseCoopers Website, *The Going Public Process*

the registration statement). The ad can announce the offering and its dollar amount, identify certain members of the underwriting syndicate, and note where and from whom a copy of the company's prospectus can be obtained.[8]

After the registration statement is sent to the SEC, there is a review process whereby the SEC and the company intending to go public exchange edits. Typically, the SEC takes an average of 30 days to release its initial revisions in a comment letter. Each comment must be addressed; furthermore, amendments must be made to the registration statement for any interim developments between its filing date and the effective date. The offering is usually priced immediately before the underwriting agreement is signed and the day before the registration statement is effective. The underwriter prices the shares, with the approval of company management, based on the company's financial performance and growth prospects, the stock price of other companies in the sector, market conditions, and the amount of interest already generated in the issuance from the road show.

The Post-Effective Period

After the revisions have been made to the registration statement and approved by both the SEC and the company, the statement becomes effective with the SEC. During the post-effective period, offers to buy and sell may be made freely. Investors, management, and insiders owning pre-IPO shares in the issuing company are subject to a lock-up period, typically 180 days after the IPO is declared effective, where they are not allowed to sell their shares. If insiders were allowed to sell their shares immediately, it could cause a downward spike in the company's stock price, undermining the initial public offering price. Furthermore, pre-IPO shareholders are often limited in the amount of shares they can sell, as large sales might convey the perception to investors that early stakeholders lack confidence in the company's future.

After the IPO

After conducting an IPO, a company must abide by a new set of rules set forth by the SEC to regulate public companies. These new requirements often entail a significant amount of extra time and money as compared to the company's pre-IPO life. The most time-consuming changes to a newly public company are the increased reporting and disclosure requirements. At a minimum, public companies must file quarterly (10Q's) and annual (10K's) earnings reports with the SEC, as well as annual reports to shareholders and proxy solicitation materials. Furthermore, public companies have an obligation to report matters through press

[8] Ibid.

releases that could have a material impact on their business, such as earnings revisions, merger/acquisition activity, or management changes.

Along with the increased disclosure requirements comes increased scrutiny of company management and directors. Individuals involved with a public company are prohibited from taking certain actions. For example, insider trading, or trading securities based on non-public information, is strictly prohibited. Along those lines, Regulation Fair Disclosure (“Reg FD”) went into effect in October 2000. This rule bars companies from practicing “selective disclosure” of pertinent nonpublic information. It is especially applicable to the disclosure of information to analysts and institutional investors. If information is disclosed unintentionally, a subsequent press release must be issued 1) within 24 hours of the disclosure or 2) before the next market opening, whichever is later. There are also numerous other disclosure and corporate governance rules depending on the exchange on which the company trades.

Mergers and Acquisitions

The cost of conducting an IPO has significantly risen in recent years due to the passage of the Sarbanes-Oxley Act and an increase in regulations required by the SEC and the various exchanges. Combining this cost increase with the need for consolidation and improved performance by many companies, M&A is now the dominant exit strategy. Good companies will exit roughly 80% M&A and 20% IPO – many other companies will not find an exit.[9]

Some experts argue that a company should not exist with the sole intention to merge or be acquired but should first experience success as a stand-alone entity. The need to merge or be acquired should then come when the company is on a fast track and needs an infusion of capital to grow, access to facilities or distribution channels, or additional expertise that only another company could provide. Furthermore, M&A deals often yield the best terms for companies with strong growth prospects rather than a solid past performance. In other words, terms of a combination or acquisition are likely to be much more favorable for companies with a solid market share and the potential to improve margins.

[9] America’s Growth Capital, “Emerging Growth Capital Markets Update, Third Quarter 2003”

M&A Structures

The following table shows a sample of the most common M&A structures.

Table 4 – Common M&A Mechanisms

Type of Structure	**Description**
Forward Merger	Target merges into acquirer's company and target shareholders get acquirer's stock
Reverse Merger	Acquirer merges into target's company and acquiring shareholders get target company's stock (In some cases a private company uses a reverse merger with a public one as a way to go public at a lesser cost and with less stock dilution than through an IPO.)
Subsidiary Merger	An acquirer incorporates an acquisition subsidiary and merges it with the target company.
Triangular Merger	Target company's assets are conveyed to the acquirer's company in exchange for the acquirer's stock.
Stock Acquisition	The acquirer purchases all or substantially all of the common stock of the target company for a specified price. The buyer replaces the selling stockholders as the owner of the target company.
Asset Purchase	The buyer buys specific assets and perhaps some liabilities that are explicitly detailed. The tax and accounting basis of the assets, including any goodwill being purchased, is the purchase price.

Source: Nicholas J Jr Mastracchio and Victoria M Zunitch "Differences Between Mergers and Acquisitions," Journal of Accountancy, November 2002

M&A Preparation

There are a number of issues to take into account when considering merging with another company or getting acquired.

- *Who is the potential acquirer?* A company in the M&A market should take the time to identify its own strengths and weaknesses and then compare them to those of the potential combining/acquiring company. It is important to understand what the acquirer has to offer, how these attributes would benefit the target company, and the motive behind the desire to merge or acquire. Common motives behind the pursuit of a merger or acquisition include the following:

  - Strategic: the target company has a technology or service that the acquirer cannot or will not build or develop on its own.
  - Defensive: the target company offers too much competition or is stealing too much market share from the acquirer.
  - Financial: the purchasing entity needs the target company to strengthen its financial statements.
  - Growth: a financial conglomerate has the capital, a well-developed distribution network, and certain expertise to further develop an existing company.

- *What will be the impact on the target company's business?* When considering M&A activity, it is necessary to assess whether or not the combination will enhance the target company's core competencies. Will the acquirer provide the target with the best opportunity to expand and gain additional market share? Are the founders and initial shareholders ready to relinquish their leadership and control of the company if necessary?

- *What will be the impact on the management and employees?* Retention of key management and personnel can be critical. Furthermore, employees often become nervous upon hearing rumors of M&A activity within their own companies, especially since it can lead to downsizing and layoffs. In fact, studies found 'employee problems' as being responsible for between one-third to a half of all merger failures.[10] If downsizing must occur, it is important to conduct it in a sensitive manner as it will affect the morale and loyalty of existing employees.

- *How will a merger/acquisition impact investor returns?* M&A activity is the exit strategy of choice in today's economic environment, partially because it usually allows investors to exit faster than an IPO. However, competition among acquirers has declined in recent years, allowing buyers to shop around and negotiate cheaper deals, resulting in lower returns for early investors.

[10] Jennifer Jin, *The Ups and Downsizing of Mergers*, Business Weekly, 2002

Current Trends

Given today's volatile economy and the difficult IPO market, companies are finding it necessary to explore their exit options. Some companies elect to employ a "dual track" strategy whereby one team looks for potential acquirers while the other team prepares for an IPO. Under this strategy, the company tries to better position itself to take advantage of either exit vehicle should the opportunity arise.
Despite the weakness in exits over the past few years, there are signs of an up-tick in transactions. The following table details the current conditions that indicate a potential increase in IPO and M&A activity:

Table 5 – Recent IPO and M&A Trends

IPO	M&A
Increase in investor confidence and appetite for risk due to recent improved returns in financial markets.	Overcrowding in many sectors and maturing product lines are encouraging consolidation.
Private companies have gone a long time without new capital and liquidity.	Strong stock prices and improved operating performance have made both buyers and sellers more enthusiastic about M&A.
Private companies have had 3 years to mature and grow stronger. Companies that have emerged from the downturn at or near profitability are very strong IPO candidates.	Companies are poised to acquire after focusing on structure and cost containment, but active buyers are more sensitive to value, accretion, and potential shareholder reaction.
Emerging growth businesses are much healthier today and showing some growth with the economy.	Targets now have real traction and revenue growth.
Hedge funds have hundreds of billions of dollars to invest and are leading the way. They have also encouraged major investors to act more aggressively in this environment.	Large buyers have taken advantage of lower asset values.
Wall Street is ready to get back to business.	Going private transactions are beginning to gain momentum.

Source: America's Growth Capital, "Emerging Growth Capital Markets Update, Third Quarter 2003"

Dutch Auctions

Dutch auctions have recently been brought to the forefront given the highly publicized Google IPO. W.R. Hambrecht introduced the OpenIPO, a Dutch auction, in 1999. Since then a handful of companies have used the process to go public including Peets Coffee & Tea and Overstock.com.

In a Dutch auction, a company reveals the maximum amount of shares being sold and sometimes a potential price for those shares. Investors then state the number of shares they want and at what price. Once a minimum clearing price is determined, investors who bid at least that price are awarded shares. If there are more bids than shares available, allotment is on a pro-rata basis--awarding a percent of actual shares available based on the percent bid for--or a maximum basis, which fills the maximum amount of smaller bids by setting an allocation for the largest bids.[11]

It remains to be determined whether the Dutch auction method will become a popular alternative to the traditional IPO.

[11] IPO Dutch Auctions vs. Traditional Allocation, Ari Weinberg, Forbes.com

Exhibit 1 - Total Value in Millions of Dollars

Transaction Values	Q1 02	Q2 02	Q3 02	Q4 02	Q1 03	Q2 03	Q3 03
Technology							
M&A Transactions	$8693	$11,914	$9150	$8538	$6920	$13,458	$15,109
IPOs (a)	$125	$324	$0	$0	$0	$187	$1016
Health Care							
M&A Transactions (b)	$4,218	$11,028	$4,860	$7,463	$6,710	$9,210	$15,650
IPOs	$2,522	$1,126	$30	$522	$0	$0	$238
Consumer							
M&A Transactions	$3,507	$2,765	$1,500	$2,381	$1,088	$1,515	$2,011
IPOs	$691	$413	$155	$146	$0	$0	$0

Note: Includes US Transaction valued at or above $20 million.
(a) Excludes $870M IPO for Seagate Technology, Q4 02
(b) Excludes Pfizer Inc acquiring Pharmacia Corp on 7/15/02 for $59.5 B.

Source: America's Growth Capital, Emerging Growth Capital Markets Update, "Third Quarter 2003"

Exhibit 2 - Total M&A and IPO Volume

Transactions	Q1 02	Q2 02	Q3 02	Q4 02	Q1 03	Q2 03	Q3 03
Technology							
M&A Transactions	69	57	41	51	37	51	78
IPOs (a)	2	6	0	0	0	2	6
Health Care							
M&A Transactions (b)	42	38	20	35	26	24	34
IPOs	3	9	1	3	0	0	3
Consumer							
M&A Transactions	13	7	9	6	12	13	16
IPOs	2	3	2	2	0	0	0

Note: Includes US Transaction valued at or above $20 million.
(a) Excludes $870M IPO for Seagate Technology, Q4 02
(b) Excludes Pfizer Inc acquiring Pharmacia Corp on 7/15/02 for $59.5 B.

Source: America's Growth Capital, "Emerging Growth Capital Markets Update, Third Quarter 2003"

Exhibit 3 - Items Included in the Prospectus (Part I)

- A summary of the information presented in the prospectus.
- A discussion of risk factors
- A description of the company, including what business it is in, its corporate name and operating history.
- Information regarding management.
- Information regarding any promoters.
- Summary information on corporate earnings.
- A description of the company’s capital structure.
- A description of the stock being registered and other securities being registered.
- The plan of distribution.
- An explanation of how the proceeds are to be used.
- A list of sales being made for other than cash.
- A list of the principal holders of securities along with the number of shares owned by each principal holder.
- Disclosures of any interests management has in certain transactions.
- A statement setting for the compensation of officers and directors.
- Disclosure of any options to purchase securities, including the number of options outstanding and their exercise price.
- Disclosure of any pending legal proceedings.
- Any legal opinions of counsel.
- Management’s discussion and analysis of the company’s financial condition and results of operations.
- Financial Statements

Source: Heim, Robert G, Going Public in Good Times and Bad, 2002

Exhibit 4 - Items Included in Part II of the Registration Statement

- A list of expenses associated with the issuance and distribution of the securities.
- Disclosure of any relationship with experts named in the registration statement.
- Listing of sales to special parties.
- Disclosures of any recent sales of unregistered securities.
- Information about the registrant's subsidiaries.
- A discussion of the effect of any charter provision or bylaw under which an officer or director is indemnified against liability which he may incur in his capacity as such.
- Any exhibits, including any material contract not made in the ordinary course of business.
- Disclosures of certain undertakings that the issuer must perform after the conclusion of the offering.
- Signatures of the company's officers and directors to confirm that they have read and approved the registration statement.
- Consent of the certified public accountant to the use of its auditing reports in the registration statement.

Source: Heim, Robert G, Going Public in Good Times and Bad, 2002

Exhibit 5 - Estimated Cost of Going Public (NASDAQ Exchange)

Offering Value	**$25 million**	**$50 million**
Total shares outstanding	5,880,000 shares	5,880,000 shares
Item	**Estimated Fee**	**Estimated Fee**
SEC Fees	9,914 (2)	19,828 (2)
NASD Fees	3,375 (3)	6,250 (3)
Printing and Engraving	100,000 (1)	100,000 (1)
Accounting Fees & Expenses	160,000 (1)	160,000 (1)
Legal Fees & Expenses	200,000 (1)	200,000 (1)
Blue-Sky Fees (6)	25,000 (1)	25,000 (1)
Miscellaneous	34,200 (1)	34,200 (1)
Nasdaq Entry Fees	63,725 (4)	63,725 (4)
Nasdaq Annual Fees	11,960 (5)	11,960 (5)
Transfer Agent and Registrar Fees	5,000 (1)	5,000 (1)
Total	**$2,363,174**	**$4,125,963**

(1) Mean value; issuers should be aware that all aspects of the relationship, including underwriting, can be negotiated.
(2) 1/29 of 1 percent of the offering value, inclusive of over-allotment shares.
(3) $500 + .01 percent of the offering value, inclusive of over-allotment shares, not to exceed $30,500.
(4) Includes a $5,000 one-time company initial fee and a fee based on 5,880,000 total shares outstanding.
(5) Fee shown is a full year's fee. On Nasdaq, first year of annual fee will be prorated based on month listed.

Source: NASDAQ Website, Going Public Manual

Exhibit 6 - Initial Public Offering Schedule

This schedule applies to a fully syndicated, fixed price offering for both U.S. and non-U.S. companies. The time frames are merely illustrative.

	1-2 years before	1-6 months before	1-3 months before	1-4 weeks before
Company	Act like a public company	Select the team; execute letter of intent	Select printer & transfer agent	Executives present the road show
Company Law Firm		Perform housekeeping of company records; Draft S-1; file with the SEC; file Nasdaq listing application.	Prepare & file preliminary registration statement	Clear SEC comments
Company Accounting Firm		Clean up and restate balance sheet; prepare and review audited financial statements	Prepare draft comfort letter	Prepare updated financial statements, if necessary.
Investment Banker(s)		Assess market; make presentation to board.	Continue due diligence.	Orchestrate road show; solicit expressions of interest
Investment Banker's Counsel		Begin due diligence	Prepare NASDR filing; undertake blue-sky filings	Clear NASDR comments.
Financial Printer		Print preliminary registration statement/prospectus	Produce SEC & NASDR filing packages.	
SEC		Confer regarding problems, if necessary	Review preliminary registration statement; issue comfort letter	
NASDR		Request pre-filing advice, if necessary	Review preliminary registration statement; issue comment letter	Resolve comments.

	1-10 days before	1 day before	Day of IPO	3 days after	0-30 days after
Company	Issue press release.	Price the offering; execute underwriting agreement.	Trading of company's securities begins.	Provide certificates; collect proceeds	Provide additional certificates; collect additional proceeds.
Company Law Firm		Request acceleration; file final registration statement.		Deliver documents/ opinions	Update closing documents.
Company Accounting Firm	Deliver draft comfort letters	Deliver final comfort letter		Deliver bring-down comfort letter	Second bring-down comfort letter
Investment Banker(s)	Form syndicate; place tombstone ad.	Execute underwriting agreement		Provide net proceeds	Exercise over-allotment option; make determination about issuing research report.
Investment Banker's Counsel	Continue due diligence			Assist in closing	Assist in second closing
Financial Printer		Print final registration statement/ Prospectus			
SEC		Declare offering effective			
NASDR		Declare no objections.			

Source: NASDAQ Website, Going Public Manual

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