Session 107 | Testing the Waters – Initial Public Offerings in the Age and Shadow of the Unicorn

Since January, over a dozen Unicorn companies have listed on the NASDAQ and NYSE, and have generated over $20 billion in IPO proceeds, with several more in 2019 expected. While this program may not focus on the magical, horned equine that occupy the pages of fairy tales and folklore, the Unicorns of 2019—that is, startup companies valued at or above $1 billion—have a mythos all their own and have been some of the most talked about IPOs in recent history. Spanning the country, some of the best-known ride sharing, social media, apparel, biotech, cyber security and e-commerce companies—companies whose products or services we use on a daily basis—are among the Unicorns that have gone public this year.

We will discuss the current IPO market, along with the legal, regulatory and business considerations for companies that wish to go public from the perspective of the various legal counsels involved in the IPO offering process. We will cover how these Unicorn IPOs have impacted both IPO and securities trends, as well as recent general developments in the field of public company securities law, from the new testing the waters marketing regulations to smaller reporting company and emerging growth company status.

**Moderator:**
Alice Hsu, Akin Gump Strauss Hauer & Feld LLP

**Speakers:**
W.S. Wilson Leung, Uber Technologies, Inc.
Osamu Watanabe, Moelis & Company
Dwight Yoo, Skadden, Arps, Slate, Meagher & Flom LLP
Testing the Waters – Initial Public Offerings in the Age and Shadow of the Unicorn

Friday, November 8, 2019

Alice Hsu, Partner, Akin Gump Strauss Hauer & Feld LLP

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What is a Unicorn?

A term used in the venture capital and investment banking industry, a unicorn refers to a startup company whose valuation is $1 billion or higher.
## Unicorn IPOs of 2019 (through August 2019)

<table>
<thead>
<tr>
<th>Company (Exchange: Ticker)</th>
<th>Shares of Offered in IPO</th>
<th>Price per Share</th>
<th>Aggregate IPO Value</th>
<th>Dual Class Stock</th>
<th>Primary, Secondary or Mixed Issuance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Adaptive Biotechnologies Corporation (Nasdaq: ADPT)</td>
<td>15,000,000</td>
<td>$20.00</td>
<td>$300,000,000</td>
<td>No</td>
<td>Primary</td>
</tr>
<tr>
<td>Alector, Inc. (Nasdaq: ALEC)</td>
<td>9,250,000</td>
<td>$19.00</td>
<td>$175,750,000</td>
<td>No</td>
<td>Primary</td>
</tr>
<tr>
<td>Beyond Meat, Inc. (Nasdaq: BYND)</td>
<td>9,625,000</td>
<td>$25.00</td>
<td>$240,625,000</td>
<td>No</td>
<td>Primary</td>
</tr>
<tr>
<td>BridgeBio Pharma, Inc. (Nasdaq: BBIO)</td>
<td>20,500,000</td>
<td>$17.00</td>
<td>$348,500,000</td>
<td>No</td>
<td>Primary</td>
</tr>
<tr>
<td>Chewy, Inc. (NYSE: CHWY)</td>
<td>46,500,000</td>
<td>$22.00</td>
<td>$1,023,000,000</td>
<td>Yes, Class B entitled to 10 votes</td>
<td>Mixed</td>
</tr>
<tr>
<td>CrowdStrike Holdings, Inc. (Nasdaq: CRWD)</td>
<td>18,000,000</td>
<td>$34.00</td>
<td>$612,000,000</td>
<td>Yes, Class B entitled to 10 votes</td>
<td>Primary</td>
</tr>
<tr>
<td>Gossamer Bio, Inc. (Nasdaq: GOSS)</td>
<td>17,250,000</td>
<td>$16.00</td>
<td>$276,000,000</td>
<td>No</td>
<td>Primary</td>
</tr>
<tr>
<td>Levi Strauss &amp; Co. (NYSE: LEVI)</td>
<td>36,666,667</td>
<td>$17.00</td>
<td>$623,333,339</td>
<td>Yes, Class B entitled to 10 votes</td>
<td>Mixed</td>
</tr>
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<tr>
<td>Lyft, Inc. (Nasdaq: LYFT)</td>
<td>32,500,000</td>
<td>$72.00</td>
<td>$2,340,000,000</td>
<td>Yes, Class B entitled to 20 votes</td>
<td>Primary</td>
</tr>
<tr>
<td>Medallia, Inc. (NYSE: MDLA)</td>
<td>15,500,000</td>
<td>$21.00</td>
<td>$325,500,000</td>
<td>No</td>
<td>Mixed</td>
</tr>
<tr>
<td>PagerDuty, Inc. (NYSE: PD)</td>
<td>9,070,000</td>
<td>$24.00</td>
<td>$217,680,000</td>
<td>No</td>
<td>Mixed</td>
</tr>
<tr>
<td>Pinterest, Inc. (NYSE: PINS)</td>
<td>75,000,000</td>
<td>$19.00</td>
<td>$1,425,000,000</td>
<td>Yes, Class B entitled to 20 votes</td>
<td>Primary</td>
</tr>
<tr>
<td>Revolve Group, Inc. (NYSE: RVLV)</td>
<td>11,764,706</td>
<td>$18.00</td>
<td>$211,764,708</td>
<td>Yes, Class B entitled to 10 votes</td>
<td>Mixed</td>
</tr>
<tr>
<td>Slack Technologies, Inc. (NYSE: WORK)</td>
<td>118,429,640</td>
<td>$26.00</td>
<td>$3,079,170,640</td>
<td>Yes, Class B entitled to 10 votes</td>
<td>Secondary</td>
</tr>
<tr>
<td>The RealReal, Inc. (Nasdaq: REAL)</td>
<td>15,000,000</td>
<td>$20.00</td>
<td>$300,000,000</td>
<td>No</td>
<td>Primary</td>
</tr>
<tr>
<td>Tradeweb Markets Inc. (Nasdaq: TW)</td>
<td>40,000,000</td>
<td>$27.00</td>
<td>$1,080,000,000</td>
<td>Yes, Class B and D entitled to 10 votes</td>
<td>Primary</td>
</tr>
<tr>
<td>Uber Technologies, Inc. (NYSE: UBER)</td>
<td>180,000,000</td>
<td>$45.00</td>
<td>$8,100,000,000</td>
<td>No</td>
<td>Mixed</td>
</tr>
<tr>
<td>Zoom Video Communications, Inc. (Nasdaq: ZM)</td>
<td>20,869,565</td>
<td>$36.00</td>
<td>$751,304,340</td>
<td>Yes, Class B entitled to 10 votes</td>
<td>Mixed</td>
</tr>
</tbody>
</table>
Anticipated Unicorn IPOs

- Airbnb, Inc.
- Casper Sleep Inc.
- Cloudflare, Inc.
- Palantir Technologies
- Peloton Interactive, Inc.
- Postmates Inc.
- Robinhood Markets Inc.
- Rubrik
- The We Company (formerly known as WeWork)*

* The We Company filed an initial registration statement on Form S-1 on August 8, 2019, registering up to $1,000,000,000 in shares of common stock.
Parties Involved in an IPO

• **Company/Issuer**
  – Board of Directors
  – Management: CEO, CFO, in-house legal, investor relations

• **Existing Stockholders**

• **Underwriter(s)/Investment Bank**
  – In-house legal team

• **Outside Legal Counsel**
  – Issuer’s counsel
  – Selling stockholders (if offer includes secondary component)
  – Underwriter’s counsel

• **Accountant/Auditor**

• **Transfer Agent, Registrar and Custodian**
In-house Advice for Companies Going Public

• Pick one or two important battles
  – The company will go to market with one set of terms, not all of which will be hard-fought negotiating points
  – Because so few of these terms will be negotiating points, management should pick one or two matters that are most important to the company and negotiate those points aggressively. The rest of the terms will be market.
  – For Moelis & Company, that battle was super-voting power for its founder.

• Go public early
  – For purposes of determining equity rewards for founders and management versus equity meant for the general public, it is helpful if the same group that initially started the company take the company public. The longer the period before the IPO, the less likely that the founders of the company will be involved, and the more difficult it will be to balance the initial equity distribution.

• There is no turning back
  – Once a company goes to market, it needs to accept the pricing offered by the underwriters. Underwriters have an interest in balancing the pricing between issuers and investors, so the company might always be happy with the result.

• Plan ahead
  – General counsel should plan ahead when it comes to things like equity plans, documenting and reporting related party transactions, changes to the charter, bylaws and the codes of conduct and ethics. Everything becomes more difficult when the company goes public.
Issuer Compliance & Regulatory Focus: Stock Exchange Listing

- Nasdaq and the New York Stock Exchange (NYSE)
  - This is among the most visible aspects of the IPO process. Companies will celebrate as their stock begins to trade on a national exchange. However, making it to that point is a long, involved process.
  - While the SEC reviews a company’s registration statement, the company should begin to decide which stock exchange it will list its securities after the completion of the IPO.
  - The two major US stock exchanges, the Nasdaq and NYSE, each have their own unique sets of quantitative listing requirements and corporate governance standards that companies must meet before being allowed to list their securities.
  - Both exchanges also maintain continued listing standards which require companies to meet certain requirements related to stockholder communication, annual meetings, proper ongoing disclosure and certain trading dollar thresholds that securities must meet.
  - If a company fails to meet these continued listing standards, the exchanges will begin the delisting process, which can eventually lead to a company’s securities being removed from the exchange if compliance is not regained within a certain time period.

- A Registration Statement on Form 8-A registers an entire class of securities with the SEC, as opposed to a certain number of a class of securities. A Form 8-A must be completed before a company’s securities can be traded on Nasdaq or NYSE.
Uber Technologies, Inc. Celebrates its IPO and Listing on NYSE by Ringing Opening Bell
Lyft, Inc. Celebrates its IPO and Listing on Nasdaq by Ringing Opening Bell
Timeline of an IPO

Day 1
- Organizational Meeting
- First Confidential Submission to SEC

Day 60
- Second Confidential Submission to SEC

Day 100
- First Public Filing with SEC

Day 130
- Second Public Filing with SEC

Day 160
- SEC Declares Form S-1 Effective and Pricing Occurs

Day 165
- Begin Road Show

Day 176
- Trading Begins

Day 177
- Close IPO

Day 180
Issuer Compliance & Regulatory Focus: SEC Process, IPO Structure and Post-IPO Governance

• The U.S. Securities and Exchange Commission

  – The SEC is the federal agency tasked with administering the U.S. Securities Act of 1933 (the Securities Act) and the U.S. Securities Exchange Act of 1934 (the Exchange Act), the two statutes that provide the framework of U.S. securities laws.

  – The Securities Act generally governs the initial offering and sale of securities, whereas the Exchange Act regulates the post-issuance conduct of an issuer, including disclosure and trading.

  – The SEC has promulgated a body of rules under both the Securities Act and the Exchange Act with which companies must comply.

  – It falls on the SEC to review and comment on the initial filing or submission of a company’s registration statement, whether it be confidential or not. After submitting the initial registration statement, the SEC has 30 days to provide comments to the company, which may ask for additional clarification, disclosure or materials. After the comment process, if the SEC is satisfied with the company’s registration statement, it will declare the registration statement “effective,” at which point the company may begin marketing its newly registered securities.

  – The SEC is also the regulatory agency responsible for prosecuting the violation of the securities laws which they administer.
Emerging Growth Companies

- Defined in Section 2(a)(19) of the Securities Act.

- A company qualifies as an emerging growth company if it has total annual gross revenues of less than $1.07 billion during its most recently completed fiscal year and, as of December 8, 2011, had not sold common equity securities under a registration statement.

- An EGC maintains its status as such for the first five fiscal years after it completes its IPO unless one of the following occurs:
  - its total annual gross revenues are $1.07 billion or more
  - it has issued more than $1 billion in non-convertible debt in the past three years or
  - It becomes a large accelerated filer as defined in Rule 12b-2 of the Exchange Act.

- Emerging growth companies are permitted:
  - to include less extensive narrative disclosure than required of other reporting companies, particularly in the description of executive compensation
  - to provide audited financial statements for two fiscal years, in contrast to other reporting companies, which must provide audited financial statements for three fiscal years
  - not to provide an auditor attestation of internal control over financial reporting under Sarbanes-Oxley Act Section 404(b)
  - to defer complying with certain changes in accounting standards and
  - to use test-the-waters communications with qualified institutional buyers and institutional accredited investors.
Smaller Reporting Companies

- Defined in Item 10(f)(1) of Regulation S-K.

- A company qualifies as a smaller reporting company (SRC) if:
  - it has public float of less than $250 million or
  - it has less than $100 million in annual revenues and
    - no public float or
    - public float of less than $700 million.

- For purposes of determining SRC status, public float is calculated by multiplying the number of the company’s common shares held by non-affiliates by the market price and, in the case of an IPO, adding to that number the product obtained by multiplying the common shares covered by the registration statement by their estimated public offering price.

- SRCs are subject to scaled disclosure requirements which include:
  - less extensive narrative disclosure than that required of other reporting companies, particularly in the description of executive compensation and
  - to provide audited financial statements for two fiscal years, in contrast to other reporting companies, which must provide audited financial statements for three fiscal years.
Testing the Waters

In April 2012, Congress signed the Jumpstart Our Business Startups (JOBS) Act into law. Under the JOBS Act, certain companies with limited annual revenue may qualify as an Emerging Growth Company (EGCs).

Under the JOBS Act, companies that qualify as an EGC are authorized to approach large investors that are deemed qualified institutional buyers (QIBs) or institutional accredited investors (IAIs) to discuss a possible initial public offering and gauge interest. These communications can be either written or oral and can occur before or after the confidential submission or public filing of a registration statement. Such communications would otherwise be considered “gun-jumping,” a violation of the Securities Act of 1933 (the Securities Act).

In February of 2019, the Securities and Exchange Commission (SEC) proposed a rule that would allow all issuers, regardless of EGC status, to conduct Testing the Waters meetings with potentially interested QIBs and IAIs. The public comment period expired on April 29, 2019 and the final rule has yet to be published.
Offering Terms

• Class of Stock
  – In their IPOs, companies can offer one or more classes of stock. These classes may differ in the rights they afford shareholders.

• Number of Shares Offered
  – The 424 Prospectus will detail the exact number of shares to be offered in the IPO.

• Price Range and Midpoint

• Primary and Secondary Offerings
  – Primary: Shares are being issued directly from the company to the public
  – Secondary: Shares that are held by existing shareholders of the company are offered to the public.
  – Mixed: IPOs can involve a mix of stock, some issued from the company and some sold by existing shareholders.

• Use of Proceeds
  – Companies must disclose how they intend to use the proceeds generated by their IPO. General corporate purposes is a common, if vague, explanation.
Unicorn IPOs with a Single Class of Stock
Unicorn IPOs with Dual Class Stock

Chewy

Chewy Inc.

Unicorn IPOs with Dual Class Stock

Lyft

Lyft Inc.

Pinterest

Pinterest Inc.

Akin Gump Strauss Hauer & Feld LLP

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Governance: Voting Rights and Dual Class Structure

- What are dual class shares?
  - Dual class refers to the increasingly popular approach (up 44% between 2005 and 2015 according to the SEC) of issuing two or more classes of stock in an IPO or other offering. The two classes of stock will have different dividend payment rights, voting rights or other terms.
  - A common use of dual class structured offerings will be to consolidate or reserve power to direct the company in the hands of insiders.
  - For example, a company going public might register both Class A and Class B shares:
    - The Class A shares will be offered to the general public during the IPO and will entitle the holder of each share one vote per share in corporate matters.
    - Class B shares, which will be issued to insiders or existing investors, may entitle the holder of each share ten or twenty votes per share in corporate matters, effectively guaranteeing that control is maintained by the existing insiders. This
    - Dual class structure is not free from controversy, with some industry groups coming out against the practice for its circumvention of the “one share, one vote” principle.
Governance: Committees and Public Company Reporting

• Public companies are required to maintain certain board committee, made up of members from the company’s board of directors. Common committees include the following:
  – Audit Committee
  – Compensation Committee
  – Nominating and Corporate Governance Committee

• Once a company becomes a registered public company, the Exchange Act require the company to keep the market up to date using certain periodic disclosure documents. These documents are filed with the SEC and include:
  – Annual Report on Form 10-K: an annual report that must be filed by a public company describing the results of operations for the company’s last completed fiscal year
  – Quarterly Report on Form 10-Q: quarterly reports that must be filed following the completion of each fiscal quarter
  – Current Report on Form 8-K: a report that must be filed with the SEC within four business days after certain specified events occur.

• A company must also file a Proxy Statement on Schedule 14A with the SEC ahead of the company’s annual meeting of shareholders. The proxy statement details the matters that will be voted upon at the annual meeting and often discloses certain corporate information, such as employee compensation plans.
Underwriter Compliance & Regulatory Focus: FINRA

- The Financial Industry Regulatory Authority (FINRA)
  - FINRA is a self-regulatory organization (SRO) that is authorized by Congress to regulate the broker-dealer industry.
  - FINRA promulgates rules that securities brokers, such as underwriters, must follow. Notable rules include:
    - FINRA Rule 5110 – “corporate financing rule”
      - Underwriters cannot participate in offering unless underwriting terms and compensation are “fair and reasonable”
      - FINRA review required in all US public offerings (primary and secondary) unless exemption applies, e.g., “seasoned issuer” exemption:
        - Shelf offerings on S-3 / F-3 under (more stringent) pre-October 1992 eligibility standards
        - Reporting company for 3+ years and minimum public float (new Well-known seasoned issuers may not qualify)
      - May require filing fee
    - FINRA Rule 5121 – conflicts of interest
      - Qualified independent underwriter (QIU) and specified prospectus disclosure if there is an underwriter conflict
      - If QIU required, Rule 5110 exemptions are not available
The Underwriting Agreement

- The underwriting agreement is the operative document in an IPO.

- Parties to the underwriting agreement include the issuer, the underwriter or underwriters if there are more than one and any selling shareholders that might be participating in the securities offering. Underwriters will often form a syndicate that will be led by a representative, or lead underwriter. This arrangement helps divide the burden of marketing the new securities.

- The underwriting agreement contains the terms of the transaction, including the underwriter's commitment to purchase the new securities, the agreed-upon price, the initial resale price, the settlement date and the allocation of liability.

- The terms of underwriting agreements can differ:
  - Firm commitment underwriting agreements require the underwriter to purchase all of the securities of the issuance, regardless of whether they sell.
  - Alternatively, in a best-efforts underwriting agreement, the underwriter will use its best efforts to sell the securities, but is not obligated to purchase unsold shares for their own account.
Lock-up Agreements

- For specified period, prohibits sales, pledges and other transfers by insiders of additional shares (or convertibles into such shares):
  - Often 180 days for IPOs.
- Lock-up provisions may be included in the underwriting agreement itself or in separate agreement, which is usually included as an exhibit.
- Underwriters will seek to lock-up issuer, directors and officers and may also seek to lock-up all or major stockholders (e.g., >5% shareholders).
- Lock-up agreements avoid market perception that insiders are eager to sell.
- Lock-ups are typically in place before launch.
- Underwriters will request permitted transferees to be bound by lock-up.
- Lead manager(s) typically can consent to release lock-up in certain situations and lock-up agreements will often have carve outs for certain categories of transfer (e.g. bona fide gift).
- Lock-ups are disclosed in Shares Eligible for Future Sale section of prospectus.
The 424 Prospectus

- The 424 Prospectus is a disclosure document prepared and filed with the SEC by the issuer that discloses specific information that pertains to the offering, including:
  - Number of shares to be sold
  - Price at which those shares are to be sold
  - Underwriting arrangement and any discounts or commissions
  - Risk factors inherent in an investment in the company’s securities.

- Corresponds with a previously filed registration statement, such as a registration statement on Form S-1.

- The 424 Prospectus is often used as a marketing document as well, sharing growth projections, financial statements, market share percentages and business segment details with potential investors.
Underwriting Compliance & Regulatory Focus: FinCEN

- New customer due diligence rule became effective May 11, 2018

- Covered financial institutions (including brokers or dealers in securities) must identify, and verify the identity of, beneficial owners of legal entity customers when new accounts are opened, with limited exceptions (including Exchange Act filers and NYSE or Nasdaq-listed non-bank entities)

- Two prongs of “beneficial owner” definition:
  - Ownership prong: each individual (if any) owning 25% or more of equity interests (but not required to look through pooled investment vehicles according to FinCEN FAQs)
  - Control prong: single individual with significant responsibility to control, manage or direct (such as an executive officer, senior manager or, in the case of a pooled investment vehicle, a portfolio manager)

- Covered financial institutions must identify each individual (e.g., by obtaining a completed FinCEN certification form) and verify a copy of identity document (e.g., driver’s license or passport).