CAPITAL MARKETS BRIEFING

The JOBS Act and IPOs: the view from Europe

The US Jumpstart Our Business Startups Act of 2012 (JOBS Act) was enacted in response to a declining number of initial public offerings (IPOs) in the US. It was intended to stimulate job creation and economic growth by removing some of the more onerous barriers to accessing the US capital markets. In particular, it introduced a number of key changes to facilitate US IPOs by companies that qualify as emerging growth companies (EGCs), including foreign private issuers (FPIs) (*see box "Emerging growth companies"*).

The benefits of the JOBS Act are easy to see and the vast majority of the changes have proven increasingly popular among non-US companies pursuing an IPO in the US. The relaxations for EGCs appear to have had a positive impact on the number of EGCs going public in the US in recent years. Although the first half of 2015 experienced a drop in the number of US IPOs compared to 2014, this is likely to be the result of larger market trends and not an indication that the tide has turned on the attractiveness of the JOBS Act changes or the US market more generally.

Emerging growth companies

An emerging growth company (EGC) is a company that had less than $1 billion (or the equivalent in other currencies) in total annual gross revenue during its most recently completed financial year before an initial public offering (IPO). An EGC will retain this status until the earlier of:

- The last day of the financial year during which it had total annual gross revenues of $1 billion or more.
- The last day of the financial year following the fifth anniversary of its IPO.
- The date on which the company has, during the previous three-year period, issued more than $1 billion in non-convertible debt.
- The date on which the company becomes a large accelerated filer, as defined under US securities laws.

Sample group study

We analysed a selected group of 18 US IPOs by European EGCs that: priced in 2014 and the first half of 2015; listed on a US stock exchange; and raised a minimum of $30 million in gross proceeds (the sample group). We defined European EGCs as companies incorporated in an EU member state and Switzerland or companies incorporated outside of the EU or Switzerland but with substantial operations in those countries. In the sample group, 14 IPOs priced in 2014 and four priced in the first half of 2015.

Since the enactment of the JOBS Act, the vast majority of IPO issuers have been EGCs. In 2014, 14 US IPOs of European companies were conducted by issuers that qualified and opted to be treated as EGCs and in the first half of 2015, European EGCs priced four IPOs. Of the companies in the sample group, 11 operate in the healthcare industry, three in the industrials industry, two in the transport industry, one in the energy industry and one in the financial services industry. The popularity of US IPOs by companies operating in the healthcare sector is consistent with past years and is an important trend in helping to understand what draws non-US companies to the US public markets.

Testing the waters

It is common practice in non-US IPOs to hold investor meetings with prospective sophisticated investors to gauge interest in a proposed offering. These anchor marketing, pilot-fishing or cornerstone meetings are designed to help companies better understand investor appetite for the company's shares and the acceptability of the proposed terms of the offering (*see feature articles "Pre-marketing: threading the needle", www.practicallaw.com/1-524-0551; and "Cornerstone investments in IPOs: the new normal for European markets?", this issue*). These meetings typically take place before the prospectus is finalised.

Before the JOBS Act, pre-marketing meetings in connection with a US Securities and Exchange Commission (SEC) registered offering raised issues about offers being made in violation of the US Securities Act of 1933 (the Securities Act), which would expose the company and underwriters to potential liability. The JOBS Act relieved those concerns by permitting an EGC to engage in oral and written communications with potential investors that are qualified institutional buyers or accredited investors without violating the restrictions on pre-filing communications under the Securities Act. The JOBS Act refers to EGC pre-marketing as "testing the waters".

EGCs are not required to file testing-the-waters materials. As a result, accurate data of the popularity of these meetings is unavailable. However, through informal research, we understand that testing-the-waters meetings have become a regular feature of EGC IPOs. In addition, the SEC often requests companies to submit copies of these materials. The SEC made this request of five companies in the sample group. Four of these companies responded affirmatively that they used testing-the-waters communications, while one company confirmed that it did not use these communications during its IPO process.

All available evidence suggests that the introduction into the EGC IPO market of pre-marketing has proven to be a popular procedure that appears to be helping to match the demands, expectations and needs of issuers, sophisticated investors and underwriters, and to bring the US IPO procedure closer to the process in other major markets, such as in Europe.

Financial information

Before the JOBS Act, IPO issuers were required to provide investors with three years

of audited financial statements and five years of selected financial information. For issuers that did not already prepare audited financial information, the three-year requirement was an onerous disclosure obligation both in terms of time and cost. Moreover, IPO issuers, which are often in a growth stage, frequently struggle with the requirement to produce five years of selected financial information. This is particularly true for companies that are not already listed on a non-US stock exchange or that otherwise do not already prepare audited financial statements.

The JOBS Act alleviated these burdens by allowing EGCs to present only two years of audited financial statements. In addition, EGCs do not need to present in a registration statement selected financial information for any period before the earliest audited period presented in its registration statement, effectively reducing the requirement from five to two years.

These relaxations have proven very popular with European companies seeking to undertake a US IPO. Of the 18 companies in the sample group, 13 elected to provide two years of audited financial statements. Moreover, 12 of the companies provided two years of selected financial information, five of the companies elected to include three years of selected financial information and one company provided five years of selected financial information.

Confidential submissions

Under generally applicable rules and procedures, the SEC review and comment process that precedes the approval of the IPO prospectus and registration statement is conducted in full view of investors and other market participants, as a company's filings appear in real time on the SEC website. The JOBS Act sought to render the IPO process less daunting for EGCs with a view to encouraging public market participation. Accordingly, an EGC is permitted to make confidential submissions to the SEC of its IPO registration statement instead of public, internet-based filings, provided that all submissions, including any amendments, are filed publicly on the SEC's electronic filing system (EDGAR) no later than 21 days before the start of the road show. This compromise is designed to ensure that IPOs that are filed with the SEC but do not make it to the market remain confidential, while those transactions that progress towards formal marketing and pricing are subjected to the SEC's generally applicable requirement to have all filings in the public domain.

While the SEC has historically allowed non-US companies to also submit their draft registration statements confidentially, it limited the availability of this option in December 2011 and again in May 2012, and has now sought to align the EGC and FPI procedures so that a non-US company that qualifies as an EGC cannot select the best aspects of both systems. Under the current regime, a non-US company that qualifies for confidential submission under both the EGC and FPI systems but that wishes to take advantage of the other EGC benefits under the JOBS Act is required to comply with the confidential submission requirements applicable to EGCs when submitting a registration statement confidentially. An FPI that does not take advantage of the benefits afforded to EGCs but is, or intends to be, listed on a non-US stock exchange, will be able to make confidential submissions under the SEC's policy on non-public submissions by FPIs.

The ability to submit confidentially draft registration statements to the SEC was, perhaps not surprisingly, a very welcome change for non-US EGCs. Out of the 18 companies in the sample group, 17 companies started the registration process with a confidential submission. This trend has gained popularity since 2012 and we expect EGCs to continue to take advantage of the relaxation going forward.

Sarbanes-Oxley Act

Section 404(b) of the US Sarbanes-Oxley Act of 2002 (section 404(b)) is perhaps the most unpopular requirement of that statute. It requires US reporting companies to include in certain of their periodic filings with the SEC an auditor's attestation to, and report on, the management's assessment of the company's internal controls over financial reporting. Section 404(b) has added significant cost and time to the US public reporting process and, anecdotally, has contributed to companies' decisions to choose a non-US listing venue.

The JOBS Act has sought to neutralise this costly and burdensome implication of a US listing by suspending the requirements of section 404(b) for EGCs for as long as they maintain their status as an EGC. In effect, this change provides up to five years of relief from the requirements of section 404(b). All 18 companies in the sample group took advantage of this accommodation by either disclosing an intention to use the extended phase-in or reserving the right to do so.

Research reports

The publication of pre-deal research is a common feature of European IPOs. Before the enactment of the JOBS Act, investment banks participating in a US IPO were prohibited from publishing pre-deal research and could not initiate post-deal research until 40 days following settlement of the IPO. The JOBS Act has changed this regime to permit research analysts to participate in additional communications with the management of an EGC in connection with an IPO. It also allows research reports relating to the EGC to be published or distributed by broker-dealers, including those participating in the offering, both before the proposed offering and following its completion, including during periods when this otherwise would have been prohibited.

Unlike the other relaxations for EGCs, companies do not appear to have adopted the pre-deal research relaxation. In our experience, most of the large multinational investment banks continue to prohibit pre-deal research as a result of their concerns about US securities law liability. With regard to post-deal research, the investment banks have largely continued to apply a waiting period, but have reduced it from 40 days to 25 days after the date of the EGC's IPO.

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