A QUICK GUIDE TO COMMON PUBLIC OFFERING TERMS

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Registration Statement. The “registration statement” is the principal disclosure document that is filed with the SEC. It contains a cover page, the “Part II” information (information regarding expenses, securities sold in reliance of private placement exemptions, and indemnification of directors and officers, a list of exhibits and financial schedules and undertakings by the issuer) and the prospectus.

Preliminary Prospectus (Red Herring). The “preliminary prospectus” is the disclosure / marketing document that is distributed to prospective investors. It contains (or incorporates by reference) all information about the issuer and the offering that is material to a prospective investor. The preliminary prospectus also is referred to as the “red herring” because of the language in red type along the top and left margin of the cover page of the preliminary prospectus that cautions that the prospectus is not complete and that the securities may not be sold until the registration statement has been declared effective.

Final Prospectus. The “final prospectus” is very similar to the preliminary prospectus, but with a few key differences: it has updated disclosure, either due to new events or SEC comments since the date of the preliminary prospectus; the offering price, the underwriters’ fee (the “gross spread” as discussed below) and the completed list of underwriters participating in the offering are included; and the red herring language is removed from the cover. The final prospectus is circulated to investors when confirmations of their purchases are sent after the effectiveness of the registration statement.

Road Show. The “road show” is a series of informational meetings organized by the underwriters at which management of the issuer makes presentations about the issuer, its business and strategy to institutional investors and other prospective purchasers of the issuer’s stock. These meetings are set up at selected cities across the United States (and frequently in Europe as well) and typically include presentations to large audiences of potential investors, followed by one-on-one meetings.

Due Diligence. “Due diligence” is the term used to describe the process undertaken by issuers, underwriters and their respective counsel to verify the accuracy of information contained in the prospectus, to determine whether additional information should be disclosed or whether issues or risks exist that need to be addressed or disclosed and to conduct the legal “audit” of the issuer’s corporate records.

Primary Offering. A “primary offering” is an offering in which the issuer is offering and selling its own shares.

Secondary Offering. A “secondary offering” is an offering in which the existing shareholders of an issuer are offering and selling shares owned by them. Sometimes, people refer to an offering that is not the IPO as a secondary offering. However, if the offering does not involve selling shareholders, the more accurate term is a “follow-on offering.”
**Follow-on Offering.** A “follow-on offering” is an offering that is not the IPO. In other words, it is the second, third, fourth, etc. offering by an issuer. A follow-on offering may be a primary offering, a secondary offering or both.

**Immediate Offering.** An “immediate offering” occurs when the issuer and / or selling shareholders register securities and propose to offer and sell all such securities immediately following the effectiveness of the registration statement.

**Delayed Offering.** A “delayed offering” occurs when the issuer and / or selling shareholders register securities but do not propose to offer and sell all such securities immediately following the effectiveness of the registration statement. Rather, the securities are offered and sold over an extended period of time. This is typically accomplished by filing a “shelf registration statement,” which allows the issuer and / or selling shareholders to periodically “take securities off the shelf” and offer and sell the securities to the public.

**Continuous Offering.** A “continuous offering” occurs when the issuer proposes to offer and sell securities pursuant to the registration statement at any time or from time to time following the effectiveness of the registration statement. The most common example of a continuous offering is the offer and sale of securities pursuant to an employee benefits plan under a Form S-8 registration statement.

**Lead Managing Underwriter (Lead Manager).** The “lead managing underwriter” is identified in that its name is furthest to the left of the investment banks listed on the cover of the prospectus. The other investment banks listed on the cover are the “co-managing underwriters” or the “co-managers.” The lead managing underwriter coordinates the efforts of the co-managing underwriters and typically is responsible for the selling effort, including putting together the underwriting syndicate, managing the aggregation of orders and allocation of shares in the offering (otherwise known as “running the books”) and organizing the road show and marketing meetings. Because the lead manager and the co-managers use the preliminary prospectus as marketing materials to market the offering, and because they may have liability for the disclosure in the prospectus, they assist in the drafting process. The lead manager and the co-managers are sometimes collectively referred to as the “lead managers” or the “managing underwriters.”

**Underwriters.** The investment banks and other broker-dealers that are participating in the offer and sale of the securities and, as a result, are undertaking potential liability with respect to the offering.

**Selling Group of Underwriters (Underwriting Syndicate).** The chart in the underwriting section of the final prospectus lists the “selling group of underwriters” or “underwriting syndicate.” The number of shares listed in the chart opposite the name of a given underwriter is used to determine the amount of the deal on which they are taking underwriting risk, not the number of shares that they are actually selling. The syndicate members, together with the managing underwriters, solicit indications of interest from prospective purchasers.

**Selected Dealers.** Sometimes the underwriters may not, by themselves, be able to locate purchasers for all of the securities they are underwriting. The underwriters may wish to bring into the transaction various market professionals who can effectively facilitate the distribution, but who
could not be, or who did not wish to be, underwriters, to encourage broad interest in the issuer and the offering. These market professionals are known as the “selected dealers.” The underwriting syndicate sells a portion of the securities to selected dealers who do not participate as underwriters in the offering. Selected dealers purchase the securities for their own account or for resale either to retail customers or to other securities professionals. Selected dealers do not assume the risk of underwriters.

**Firm Commitment Underwriting.** A “firm commitment underwriting” is the most common type of underwriting. It occurs when the underwriters purchase all of the securities in the offering from the issuer and/or selling shareholders at a discount and then resell them to the public. Typically, the underwriters will line-up buyers for the securities prior to the time that the underwriters purchase the securities from the issuer and/or selling shareholders. Thus, the period during which the underwriters have “market risk” (i.e., face risk that the market price for the securities they have just purchased will decline prior to the time that the underwriters can resell such securities) is almost non-existent.

**Best Efforts Underwriting.** A “best efforts underwriting” occurs when the underwriters assist in the sale by the issuer and/or selling shareholders and receive a commission on the sale.

**Bought Deal.** A “bought deal” occurs when an underwriter agrees to purchase the securities from the issuer prior to marketing the deal to investors. Because the underwriters have not lined-up buyers for the securities in advance, the underwriters may face considerable market risk.

**Overalloting.** In a firm commitment underwriting, underwriters typically line-up buyers for, and actually sell, more shares than are being offered in the offering. This process, called “overalloting,” accomplishes the following:

- It gives the underwriters comfort that they will not end up holding unsold shares in the event some of the buyers decide not to purchase shares.
- Underwriters often support the market for the shares that they are underwriting for a certain period of time following the offering. This “after-market support” requires the underwriters to purchase shares in the open market. Thus, the underwriters sell more shares than are available to them in the offering, creating a “short” position, that they then “cover” as they purchase shares in their after-market support activities.

**Overallotment Option (Green Shoe).** The issuer and/or selling shareholders typically grant the underwriters an option to purchase additional securities at the public offering price beyond those offered and sold in the offering. This option, known as the “overallotment option,” the “green shoe” or simply the “shoe,” usually covers up to an additional 15% of the securities originally offered and sold in the offering and usually must be exercised within 30 days of the closing of the offering. As discussed above, underwriters often overallot, creating a short position. The overallotment option allows the underwriters to purchase additional securities to cover any short position that continues to exist at the time that the overallotment option would otherwise expire.
Firm Commitment Underwriting Compensation.

The Gross Spread. The “gross spread” is the difference between the public offering price and the price at which the underwriters purchase the offered securities from the issuer and/or selling shareholders. In IPOs, the gross spread is typically 7%. The gross spread is typically comprised of the following:

1. Management Fee. The “management fee” is usually about 20% of the gross spread and is split among the lead and co-managing underwriters as negotiated. This fee is paid to compensate the managing underwriters for originating and processing the transaction.

2. Underwriting Fee. The “underwriting fee” is usually about 20% of the gross spread. The underwriting fee is paid to the members of the underwriting syndicate on the basis of their underwriting commitment to compensate them for taking the underwriting risk. Costs of the deal are charged against the underwriting fee, and the costs typically exceed this amount. However, by being in the underwriting syndicate, the underwriter will receive more shares to sell to investors and thus will receive more fees in the form of the selling concession.

3. Selling Concession (Sales Commission). The “selling concession” or “sales commission” is usually about 60% of the gross spread. The selling concession is paid to the underwriters that actually sell the shares based on the number of shares sold (as distinguished from each underwriter’s underwriting commitment or its allocation).

Retention. “Retention” is the number of shares that a particular underwriter actually gets to sell, as distinguished from the number of shares such underwriter is underwriting. The retention is typically about 20% of the number of shares underwritten. The bulk of the shares are sold by the lead and co-managers in what is known as the “pot.”

Reallowing Shares (Realowance). In a process called “reallowing shares,” an underwriter sell shares to another dealer on a wholesale basis, and the dealer then resells the shares to the public. The underwriter and the dealer share the selling concession. The portion of the selling concession received by the dealer is called the “reallowance.”