Underwriters and the Underwriting Process

Overview of Underwriting Process

The Underwriting Process: Driving Your IPO Success

- CORE ROLE: Investment banks help structure and execute the offering, conduct diligence, advise on valuation/marketing, and—depending on deal structure—either purchase the shares for resale (firm commitment) or act as agent to place the shares (best efforts/other structures).
- KEY STAGES
  - Select experienced underwriter(s).
  - Conduct thorough due diligence.
  - Draft the prospectus.
  - Determine valuation and offering price.
  - Market the IPO to investors.
  - Finalize pricing and close the IPO.

Role of Underwriters in an IPO

Role of Underwriters: Guiding Your IPO Journey

UNDERWRITERS DRIVE EVERY PHASE OF THE IPO:

- Advise on structuring (primary/secondary offerings, stock splits).
- Provide market insights for registration statement.
- Lead rigorous due diligence process.
- Facilitate "Testing the Waters" with institutional investors.
- Support Management’s Model/Analyst Day.
- Orchestrate roadshow, pricing, and closing.

Selecting Underwriters; Engagement Letters

Selecting Underwriters: Building Your IPO Team

Within the first month, choose underwriters, legal counsel, and an IPO-experienced auditor.

KEY FACTORS FOR SELECTING UNDERWRITERS:

- Strong reputation and high-quality research.
- Deep industry expertise.
- Proven track record via network connections.
- Cultural fit and compatibility.
- Capability to serve as lead or book-running manager.

Engagement Letters: Securing Underwriter Terms

- Engagement letters outline key provisions for IPO underwriters.

CRITICAL NEGOTIATED TERMS INCLUDE:

- **Reimbursement Clause**: Underwriters are typically reimbursed for reasonable out-of-pocket expenses (often subject to caps/approvals), including in some circumstances if the IPO is postponed or withdrawn.
- **Gross Spread/Underwriting Discount**: Sets the difference between the underwriter's purchase price and the public sale price.
- **Indemnification Provisions**: Defines obligations for losses or damages related to the IPO.

Underwriters’ Due Diligence Process

Section 11 of the Securities Act: Ensuring Accuracy

LIABILITY SCOPE

- Section 11(a) holds parties accountable for material misstatements or omissions in the registration statement at effectiveness.

COVERED PARTIES

  - Signatories of the registration statement.
  - Board members.
  - Experts (e.g., auditors) responsible for statement portions.
  - Participating underwriters.

CLAIMS

- Section 11 claims are generally brought by purchasers of securities issued under the registration statement (including certain aftermarket purchasers, depending on tracing). Government enforcement typically proceeds under other federal securities law provisions.

Section 11 Liability: Defenses

ISSUER LIABILITY

- Issuers face strict liability under Section 11 for material misstatements or omissions (no due diligence defense).

DEFENSES FOR NON-ISSUERS

- **Due Diligence Defense**: Prove reasonable investigation and belief that statements were true, with no material omissions.
- **Reliance Defense**: For non-experts on expertized sections, show no reasonable grounds to suspect, nor belief in, material misstatements or omissions.

Due Diligence Process: Ensuring IPO Integrity

Underwriters conduct rigorous due diligence to mitigate liability and protect reputation.

Begins with a comprehensive management presentation (usually at the organizational meeting).

Continues through all drafting sessions until IPO closing.

Underwriters' counsel requests evidence to "back-up" registration statement claims.

Due Diligence Activities

- Comprehensive document request list.
- Management calls and key employee meetings.
- Calls with customers, suppliers, and auditors.
- Industry expert consultations (select sectors).
- Regulatory compliance review.
- Evidence requests to validate prospectus statements.

Due Diligence Examples

EXTENSIVE DOCUMENT REQUEST LIST

- All material customer and supplier contracts (including software/tech agreements).
- Schedule of all intellectual property (with agreements).
- Schedule of all real property owned or leased (with agreements).
- Schedule of all insurance policies (with policies).
- Schedule of all employees (with employment contracts).

SOURCE/EVIDENCE REQUESTS

(FOR STATEMENTS MADE IN PROSPECTUS)

- The Company's current facilities have the capacity to manufacture 2,500 widgets per day.
- In pre-clinical trials, our product candidate has been well-tolerated by patients and shown promising results in combatting malaria.
- The coffee segment worldwide is projected to grow by 4.47% (2023-2025) resulting in a market volume of over $540 billion in 2025.

Underwriting Agreements

Underwriting Agreements

Underwriters, issuer, and selling stockholders sign an underwriting agreement for the IPO.

Defines terms for underwriters to purchase and distribute securities to the public.

Issuer and underwriters’ counsel negotiate key provisions to ensure clarity and compliance.

Underwriting Agreement: Where to Begin?

- Investment banks and law firms use tailored "form" underwriting agreements for IPOs.
- Agreements are customized to match the IPO's structure and terms.
- Underwriters' counsel reviews recent, comparable IPO agreements.
- Underwriters' counsel typically delivers the initial draft to issuer's counsel.

Underwriting Agreements: Key Negotiated Terms

CRITICAL PROVISIONS HEAVILY NEGOTIATED IN UNDERWRITING AGREEMENTS:

- **Representations and Warranties**: Scope, including “materiality” and “knowledge” qualifiers.
- **Material Adverse Change/Effect**: Definition and triggers.
- **Underwriter Information Carve-out**: Allocates responsibility for disclosure provided by the underwriters (e.g., underwriting section), carving that information out of the issuer’s representations/indemnities.
- **Indemnification and Termination**: Obligations and exit clauses.
- **Lock-ups**: Restrictions on share sales post-IPO.
- **Offering Expenses**: Allocation of costs.
- **Deliverables**: Required documents and certifications.

Marketing the IPO

Testing the Waters: Gauging Investor Interest

Issuers may engage institutional investors to assess interest in a potential offering.

“Testing the Waters” (TTW) meetings may occur before and/or after the initial SEC submission/filing, subject to securities law communications rules and counsel-approved materials

SEC may request copies of TTW materials used in these discussions (generally no pre-use review or filing requirement).

TTW meetings are optional, used selectively based on deal strategy.

Road Show: Pitching Your IPO Story

- Takes place during the “waiting period” (post-SEC filing, pre-registration effectiveness; if confidential submission used, you must publicly file 15 days before roadshow.
- Prepare the road show presentation alongside the registration statement.
- Craft a compelling 30-minute pitch to distill the issuer’s story.
- Central to marketing, road show slides attract significant attention.
- Underwriters build an order book of investor indications of interest.

Road Show Process: Engaging Investors

- Involves extensive travel for the issuer’s management team.
- Begins with a “teach-in” to educate lead underwriters’ sales forces.
- Features group lunches with buy-side institutional investors and one-on-one meetings with major investors.
- Roadshows are often conducted in a mix of in-person and electronic formats. Materials are typically distributed and tracked electronically through approved platforms; any retail/electronic roadshow access is handled in coordination with counsel and the underwriters.

Pricing and Closing

Pricing the IPO: Setting the Stage

The day before the IPO, underwriters and the issuer's board finalize the offering price.

Price reflects analysis of institutional investor offers, market conditions, demand strength, and investor mix.

Ensures the issuer knows exact funds raised, unaffected by post-trading fluctuations.

Board, often with a pricing committee, approves the final price.

Launching the Shares

- Institutional investor bids typically exceed available IPO shares.
- Underwriters allocate shares around pricing, balancing based on expected shareholder behavior.
- Price discovery starts at market open, though trading begins later.
- Stock exchange records open market buy/sell offers for the issuer’s shares.
- The exchange coordinates the opening process (e.g., NYSE DMM model; Nasdaq market maker framework). The underwriters and exchange work together to facilitate an orderly opening and initial trading.
- Major exchanges set an equilibrium opening price.

Trading Begins & Stabilization: Launching with Control

- Issuer’s stock starts trading on the open market once the opening price is set.
- First-day trading can be highly volatile.
- Stabilization is commonly supported through the syndicate’s over-allotment/short position, the over-allotment option (greenshoe), and syndicate covering transactions, consistent with securities law and exchange rules.
  - Underwriters may buy/sell up to 15% additional shares if demand exceeds supply.
  - If demand weakens and prices fall, underwriters can repurchase shares to support the stock price.

Closing the IPO: Finalizing the Transaction

Typically, T+1 (subject to deal-specific mechanics)

Underwriters transfer funds to Issuer, net of commission.

Shares delivered to Investors

