



# Managing and Capitalizing on Growth

Smith Anderson Securities Breakfast Series



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# Agenda

- Changes in Filer/Issuer Status
- Loss of Controlled Company Status
- Enhanced Ability to Raise Capital
- Mergers and Acquisitions

# Changes in Filer/Issuer Status

# Changes to Filer/Issuer Status

- When are my reports due?
  - Filer status determined annually under Rule 12b-2
- Under what framework am I reporting?
  - More complex and depends on the context

# When Are My Reports Due?

- Filer status always **determined at fiscal year end** based on profile of the company on the last business day of the most recently completed second fiscal quarter
- Do I meet all of the following criteria?
  - Subject to 13(a) or 15(d) for at least 12 calendar months
  - Have filed at least one annual report; and
  - Do not qualify as a “smaller reporting company”

# When Are My Reports Due?

- If so, what is my public float?
  - Market value held by non-affiliates  $\geq$ \$75 million,  $<$ \$700 million = “accelerated filer”
  - Market value held by non-affiliates  $\geq$ \$700 million = “large accelerated filer”
- Quick notes on calculating public float:
  - Determine your universe of “affiliates” - usually directors, executive officers, 10%+ holders
  - Include only shares actually held (not which may be deemed held due to ability to acquire within 60 days)

# Filing Deadlines Determined By Filer Status Only

	Non-Accelerated	Accelerated	Large Accelerated
Form 10-K	90 days	75 days	60 days
Form 10-Q	45 days	40 days	40 days

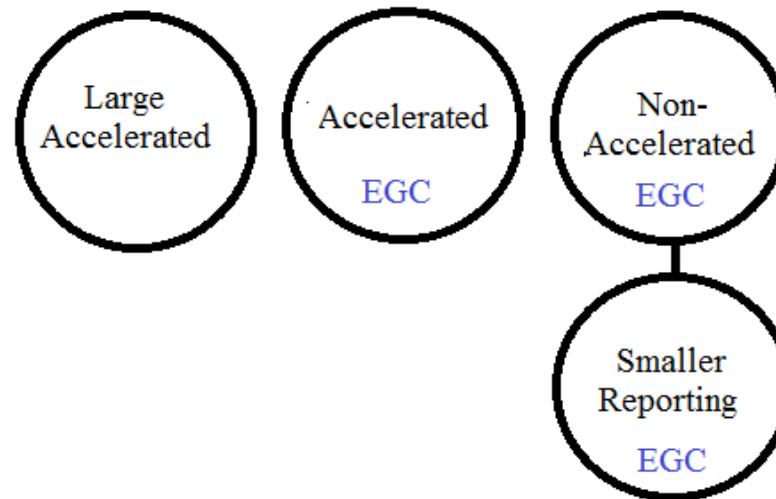
- It's unlikely to be implicated by raising capital, but do remember to check Rule 12b-2 on entering/exiting accelerated filer status:
  - Once an "accelerated filer," you only drop down to "non-accelerated" if public float goes below \$50 million (not \$75 million)
  - Once a "large accelerated filer," you only drop down to "accelerated" if public float goes below \$500 million (not \$700 million)

# If Filer Status Changes...

- You'll have six months lead time
- Prepare for accelerated filing deadlines:
  - Financial reporting/disclosure preparation
  - Board/committee calendars
  - Audit schedule

# But There Are Five Boxes on the Front of Form 10-K and Form 10-Q

- How do “smaller reporting company” and “emerging growth company” status fit in?
  - Dictates the applicable disclosure framework



# Under What Framework Am I Reporting?

- A few distinctions by filer status:
  - Large accelerated and accelerated (non-EGC): ICFR auditor attestation reports required
  - Large accelerated and accelerated: disclosure of unresolved Staff comments required
- The rest governed by issuer status:
  - Smaller reporting company
  - Emerging growth company

# Smaller Reporting Company

- Some disqualifiers:
  - Not an investment company
  - Not an asset-backed issuer
  - Not a majority-owned subsidiary of a parent that's not a SRC
- Parameters:
  - Initial determination within 30 days of first registration statement
  - Public float <\$75 million
  - Thereafter, public float <\$50 million (if you've previously failed to qualify as a SRC)

# Smaller Reporting Company

- After the initial determination, determined on an annual basis by looking back to the end of the most recently completed second fiscal quarter, just like filer status
- You're permitted to take advantage of reduced disclosure beginning with the period immediately following your Q2 determination

# SRC Disclosure Framework

- Less disclosure required for:
  - Business description (S-K 101)
  - MD&A (S-K 303)
    - No inflation impact
    - No contractual obligations table
  - Executive compensation (S-K 402)
    - No CD&A
    - Fewer NEOs
    - Significantly less disclosure
  - Related party (S-K 404) - but longer lookback

# SRC Disclosure Framework

- No disclosure required for:
  - Stock performance graph (S-K 201)
  - Selected financial data (S-K 301)
  - Market risk (S-K 305)
  - Compensation committee interlocks, Compensation Committee Report (S-K 407)
  - Pay ratio (S-K 402)

# SRC Disclosure Framework

- No disclosure required for:
  - Ratio of earnings to fixed charges (S-K 503)
  - Statements re: computation of ratios (S-K 601)
  - Risk factors (Form 10-K/10-Q)
    - Should be included anyways
  - Special circumstances: first post-IPO Form 10-K not required to disclose audit committee financial expert (S-K 407)

# SRC: Additional Considerations

- Compensation Committees - NYSE and Nasdaq:
  - Exempt from heightened independence requirements for compensation committee members
  - Exempt from responsibility to assess the independence of compensation committee advisers

# Exiting SRC Status

- **Scaled Reg. S-K disclosures:** Generally may continue to use scaled disclosures through its annual report on Form 10-K for that year
- **Pay Ratio (unless an EGC):** Required in the report for the first fiscal year commencing on or after the issuer ceases to be an SRC (effectively a one-year transition period)
- **404(b) (unless an EGC or still non-accelerated):** ICFR audit is required in the Form 10-K for that year

# Exiting SRC Status

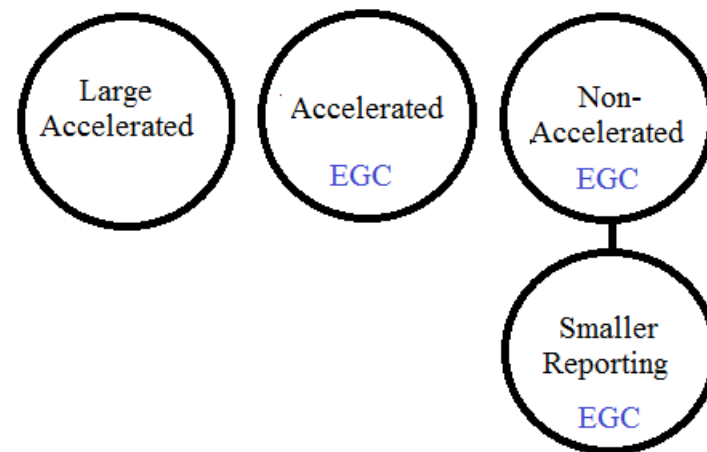
- **Compensation committee requirements:**
  - Must have one member that meets the enhanced independence requirements within 6 months following beginning of year following loss of SRC status; majority within 9 months; all within 12 months
  - NYSE-listed companies: Loss of SRC status triggers the filing of an interim written affirmation, and changes in board and committee composition will also trigger interim written affirmation filings
  - Nasdaq-listed companies: Must certify to Nasdaq of compliance with enhanced compensation committee standards within 6 months

# Losing SRC Status - Practical Guidance

- Compensation disclosures are the most significant change (unless also an EGC)
  - CD&A preparation:
    - Careful documentation of decisions by the compensation committee
    - Early drafting of the narrative
- Update compensation committee policies and procedures regarding independence and approval of advisors

# Emerging Growth Company

- A newly public company with revenues of less than \$1.07 billion will generally qualify as an EGC



## Remain an EGC Until the Earliest of:

- Gross Revenues: The last day of the fiscal year in which the issuer's total annual gross revenues are \$1.07 billion or more.
  - Example: A calendar year-end company whose total annual gross revenues exceed \$1.07 billion on October 31, 2018 would cease to be an EGC on December 31, 2018.

## Remain an EGC Until the Earliest of:

- Five Years Since IPO: The last day of the fiscal year following the fifth anniversary of the date of the first sale of common equity securities of the issuer under an effective Securities Act registration statement.
  - Example: A company that had an IPO in July 2017 would lose EGC status at the latest on December 31, 2022 (i.e., with respect to its 2022 Form 10-K).

## Remain an EGC Until the Earliest of:

- Non-convertible Debt: The date on which the issuer has issued more than \$1 billion in non-convertible debt in the previous three years
- Large accelerated filer status: Date on which the issuer becomes a large accelerated filer

# EGC Disclosure Framework

- ICFR Audit: Exempt
  - *Transition:* Required in first filing after issuer loses EGC status (unless a non-accelerated filer)
- Say-on-Pay/Say-on-Frequency Vote: Exempt
  - *Transition:* Generally required within one-year after losing EGC status
- Pay Ratio Disclosure: Exempt
  - *Transition:* Required in the report for the first fiscal year commencing on or after the issuer ceases to be an EGC (effectively a one-year transition period) (unless an SRC)

# EGC Disclosure Framework

- Golden Parachute Advisory Vote: Exempt
  - *Transition*: Golden parachute vote required at any shareholders' meeting after the issuer ceases to be an EGC where shareholders seek to approve a merger, etc.
- CD&A/Full Exec Comp Disclosure: Apply SRC executive compensation disclosure requirements
  - *Transition*: Non-SRC disclosures required in first filing after lose EGC status (unless an SRC) (Note: Quicker transition period than for loss of SRC status)

# EGC Disclosure Framework

- PCAOB Rules: Exempt from certain new PCAOB rules (none at this time)
  - *Transition*: Would be based on the particular PCAOB rule
- Compliance with New or Amended Accounting Standards: Can elect to utilize the private company transition timelines
  - *Transition*: Public company timelines appear to apply immediately

# EGC Disclosure Framework

- Presentation of Five Years of Selected Financial Data: Not required for any period prior to the earliest audited period in the issuer's initial registration statement
  - *Transition*: No real transition - Staff will not object if the issuer does not present selected financial data in its Form 10-K filings for periods prior to the earliest audited period presented in its initial registration statement
- Testing-the-Waters: Permitted to engage in limited testing-the-waters communications
  - *Transition*: Immediate

# Losing EGC Status - Practical Guidance

- Be prepared for immediate application of enhanced requirements, particularly ICFR audit and enhanced compensation disclosures
- Assess impact of acquisitions on revenue thresholds
- Position compensation policies for say-on-pay vote
  - Ensure compensation is performance-based
  - Consider adopting (if not already adopted) stock ownership guidelines, clawback policies and other risk mitigation policies
  - Reassess benchmarking practices
  - Run a preliminary ISS pay-for-performance report to evaluate compensation policies against ISS standards

# Loss of Controlled Company Status

# What is a Controlled Company?

- Company of which more than 50% of the voting power for the election of directors is held by an individual, a group or another company
  - Group must have filed a Schedule 13D/G stating its members are acting as a group
- Issuer must disclose
  - That it is relying on the controlled company exemption
  - The basis for the exemption
  - The corporate governance standards with which it does not apply

# Controlled Company Benefits

- Controlled company exemption for both the NYSE and Nasdaq provides relief from certain corporate governance requirements
  - Majority independent board
  - Independent compensation and nominating committees

# Loss of Controlled Company Status

- NYSE and Nasdaq provide transition periods for compliance:
  - Immediately: One member of the compensation and nominating committee must be independent; website posting of compensation and nominating committee charters
  - Within 90 days: Majority independent compensation and nominating committees
  - 1 year: Fully independent compensation and nominating committees and majority independent board
- NYSE-listed companies: interim written affirmation required

# Preparing for Loss of Controlled Company Status - Practical Advice

- Identify qualified independent director candidates
- Develop a transition plan, including appropriate messaging for potential departures of non-independent directors
- Review corporate governance and compensation programs
  - ISS/Glass Lewis will have greater influence as the company's shareholdings become more dispersed
  - Note: Even if not using the controlled company exemption, this becomes important as ownership by the founders/pre-IPO shareholders decreases
- Reassess takeover defenses

# Enhanced Ability to Raise Capital

# Capital Raising Landscape

- Lots of options for public issuers
- As a public company grows and matures, its options broaden
  - Typical public offering path
  - Variations for more mature, larger companies

# Form S-3 Eligibility

- Public for at least 12 calendar months
- Has timely filed all required reports for the prior 12 calendar months
- Have not:
  - Failed to pay dividends on preferred stock
  - Materially defaulted in the aggregate on installments for debt or rentals on one more long term leases

# Growth Can Simplify Capital Raising Using Form S-3

- Removal of “baby shelf” restrictions:
  - With public float below \$75 million, can only raise 1/3 of public float over a rolling 12 month period
  - If public float goes above \$75 million at any time, restrictions are removed
    - Will remain lifted until the issuer is below \$75 million at a regular update (usually filing of the 10-K)
- Qualifying as a well-known seasoned issuer (WKSI)

# Definition of a WKSI

- Size is principal determining factor: Within past 60 days (before filing or updating shelf registration statement), issuer has either:
  - Public float of \$700 million
  - Issued at least \$1 billion of non-convertible securities (other than common equity) in primary offerings for cash during the last 3 years

# Definition of a WKSI

- Other requirements:
  - Must be S-3 eligible
  - Must not be: asset-backed issuer, investment company or business development company
  - Must not meet any of the “ineligible issuer” conditions (three year lookback)
    - Examples: bankruptcy, registrations subject to stop orders, convictions of Exchange Act felonies or misdemeanors, violations of anti-fraud provisions

# Benefits of Being a WKSI

- **Shelf registration automatic:**
  - Form S-3s are automatically effective without SEC review (like a Form S-8)
- **Communications:**
  - Oral or written offers (other than by means of statutory prospectus) permissible (Securities Act Rule 163)
    - “Free writing prospectus” before registration statement filed
    - Broad rule

# Benefits of Being a WKSI

- **Flexibility for registration statements:**
  - Registration of unspecified amounts of securities
  - Omission of type of offering (primary, secondary or both)
  - Omission of detailed distribution plans
  - Initial omission of selling shareholders
  - Deferral of payment of filing fees until securities offered to the market (“pay as you go”)

# Benefits of Being a WKSI

- **Post-filing (post-effective amendments, automatically effective):**
  - Can register additional classes of securities
  - Can include majority-owned subsidiaries and additional registrants

# Transition periods: WKSI

- If you lose EGC status by virtue of becoming a “large accelerated filer,” could be both an EGC and a WKSI until your new filer status takes effect
  - Example for a calendar year company: Public float increases over \$700 million in March and is still over \$700 million at June 30 (end of Q2) → WKSI as of March (assuming other criteria satisfied), and also still an EGC until the following January (when large accelerated filer status kicks in)

# Mergers and Acquisitions

# Mergers and Acquisitions (M&A)

- **Background:** Generally will be discussing the acquisition by a public, exchange-listed issuer of a private, non-listed company in a transaction that does not result in a change of control of the public company

# M&A - Disclosure Obligations

- Letters of Intent
  - Generally not required to be disclosed unless they require the parties to complete the transaction
  - Binding exclusivity provisions are typically not material if reasonable in time
  - Parties should clearly state in the LOI that it is non-binding

# M&A - Potential Form 8-K triggers

- Item 1.01 - Material contracts: Upon signing, if the acquisition agreement is material
- Item 2.01 - Significant acquisitions: At closing, if the acquisition is “significant”
- Item 2.03 - Financing Obligations: At closing (generally) if borrowing money to fund the transaction
- Item 3.02 - Unregistered sales of equity securities: At signing, if issuing securities in a private placement in connection with the transaction

## M&A - Potential Form 8-K triggers

- Item 5.02 - Directors and executive officers: At closing, if appointing target personnel as key executive officers or directors
- Item 5.07 - Submission of matters to vote of security holders: Following special meeting to approve transaction/issuance of shares (if applicable)
- Item 7.01/Item 8.01 - Reg. FD disclosure/Other events: At signing or closing if appropriate and no other items would otherwise be triggered

# M&A - Material Contract Analysis

- When is an acquisition agreement “material”?
  - If the transaction is “significant” (discussed below)
  - If it is for the acquisition of any property, plant or equipment for a consideration exceeding 15% of the registrant’s fixed assets on a consolidated basis
  - If a director, officer or 5% or more beneficial owner is a party to the agreement
  - If the registrant otherwise determines it is material based on all of the facts and circumstances

# M&A - Significance Analysis

- When is an acquisition “significant”?
  - **Asset test:** Compare registrant’s share of acquired business’s total assets to registrant’s total assets
  - **Investment test:** Compare total GAAP purchase price of the acquired business (as adjusted) to the registrant’s consolidated total assets
  - **Income test:** Compare registrant’s income from continuing operations before taxes, extraordinary items and cumulative effect of a change in accounting principle to that of the target

# M&A - Significance Analysis

- If transaction is significant, pro forma financial statements are required, along with audited financial statements of the target depending on the level of significance
  - 20% but less than 40% significance: 1 year of audited target financial statements
  - 40% but less than 50% significance: 2 years of audited target financial statements
  - 50% or greater significance: 3 years of audited target financial statements

# M&A - Significance Analysis

- Audited financial statements filed on a Form 8-K/A within 71 days after due date of closing Form 8-K, along with applicable pro forma financial statements
  - Failure to file on time will result in loss of Form S-3 eligibility
- If significance at 50% or greater for a probable or completed transaction, financials generally must be filed before registrant can make offerings under registration statements or pursuant to Rule 506 of Regulation D

# M&A - Significance Analysis

- Practical advice:
  - Income test is often the test that can result in seemingly small acquisitions being significant, especially if the public company has had losses or has been operating at close to break even
  - Include provisions in the acquisition agreement to require support from the target in preparing these financial statements and coordinating with the target's auditor to provide consents in the Form 8-K
  - Don't underestimate the difficulty in completing these financial statements, especially if the target has never had an audit performed

# Using Stock as Currency

- If issuing shares, offering must either be registered or exempt from registration
  - Cannot start the offering as a public offering and switch to a private offering and vice versa
- General approaches:
  - Form S-4
  - Regulation D Rule 506
  - Fairness hearing

# Using Stock as Currency-Form S-4

- Not required to be S-3 eligible to use Form S-4, but S-3 eligibility can reduce disclosure obligations by permitting incorporation by reference
- Includes comprehensive information, including financial statements, of the issuer and the target company
  - Preparing the disclosure regarding the target company and its financial statements can be highly time consuming
- Target shareholders will receive freely tradable shares post-transaction (subject to limitations if any of them become affiliates of the issuer)

# Using Stock as Currency-Form S-4

- **Practical advice:**
  - Analyze and ensure agreement among all parties (including the auditors) on financial statement requirements ASAP
  - Do not obtain written consents from the target company shareholders—doing so will cause the offering to be a private offering and Form S-4 will be unable
    - See Securities Act Forms CDI 225.10
  - Build in sufficient time—several months—between signing and closing

# Using Stock as Currency-Regulation D

- If all target shareholders are accredited investors, may be able to use Regulation D exemption to issue the equity instead of Form S-4
  - Note: If any target shareholders are not accredited investors, additional steps will need to be taken to use Reg. D, and a Form S-4 will often be more appropriate
- **Advantage:** Can be much quicker, with more limited disclosure obligations
- **Disadvantage:** Target shareholders receive restricted securities and may demand registration rights

# Using Stock as Currency-Regulation D

- **Practical advice:**
  - Assess/confirm accredited investor status of all target shareholders as soon as possible
  - Obtain bad actor certifications from issuer and other applicable parties

# Using Stock as Currency-Fairness Hearing

- Fairness hearing is an alternative to a Form S-4 or Reg. D private placement
- State securities administrators who are authorized by state statute can conduct the fairness hearing to determine if the exchange of the public company's securities for the private company's securities is "fair"
  - Note: NC has a fairness hearing procedure for NC companies and those with sufficient ties to NC

# Using Stock as Currency-Fairness Hearing

- **Advantages:**
  - Generally quicker and less expensive than a Form S-4
  - Can be used effectively when there are unaccredited target shareholders
  - North Carolina's securities regulator has extensive experience with them
  - Issued shares will not be restricted securities (same as using a Form S-4)
- **Disadvantages:**
  - Not as commonly understood by parties in states that don't provide for them
  - No state level preemption, so if target shareholders are in multiple states must conduct a state-by-state blue sky analysis

# Using Stock as Currency-Fairness Hearing

- **Practical Advice:**
  - In general, assess the status of the target's shareholder base as soon as possible and ensure all parties are agreed on the securities law registration/exemption strategy at the outset

# Using Stock as Currency-Shareholder Approval

- Shareholder approval required (NYSE and Nasdaq) when issuing shares as acquisition currency in certain circumstances (among other potential triggers)
- **NYSE:**
  - Potential issuance equals 20% of shares/voting power outstanding
  - Potential issuance is to related parties (or a company in which related parties have a substantial interest) and exceeds 1% of the shares/voting power outstanding before the issuance
- **Nasdaq:**
  - Potential issuance equals 20% of shares/voting power outstanding
  - Insiders have an interest in the target entity and potential issuance equals 5% of the shares/voting power outstanding

# Using Stock as Currency-Shareholder Approval

- Practical advice

- Analyze potential shareholder approval requirements as early as possible in the transaction
- If necessary, consider building in share caps, etc. to allow for transaction closing subject to later shareholder approval
- Consider shareholder approval requirements in connection with applicable securities exemptions
- Can use a Shelf S-4, but not very common—must be put up when not in contemplation of an offering

# Additional Questions and Discussion

# Thank You

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