Ready for Action: the Pre-IPO Health Check
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Agenda

- Pre-IPO Health Check overview and process
- Assessing:
  - Compensation program and levels
  - Equity plan readiness
  - Employment agreements
- Governance items
Pre-IPO Health Check – What is it?

- IPO “readiness assessment” across four broad dimensions:
  - Executive compensation
  - Equity compensation plans and practices
  - Employment arrangements
  - Compensation governance

- Ideal timeframe:
  - 9-18 months prior to IPO/transaction

Why is it important?

- Identify gaps and key issues
  - Where do we look similar to other public companies?
  - Where are we different and why?

- Prioritize activities and outline path forward
  - Pre-IPO
  - Post-filing

- Identify potential deal-breakers and plan for resolving

Avoid “horror stories”
Health Check – Process Steps

- Gather information
- Assess and codify compensation programs
- Review equity plan, practices and allocations
- Harmonize employment arrangements
- Review governance procedures

Gather Information

- Materials regarding company strategy, organization charts, financials, cap table
- Compensation information/data
  - Base salary
  - Annual incentives/bonuses – target bonuses, actual payouts, plan documents/descriptions
  - Equity grants – current holdings, recent grants, dates, exercise price(s)
- Equity plan document; award agreements
- Employment letters and agreements
Assess Executive Compensation Program

- Form, mix and levels of compensation vary by industry and stage (pre- vs. post-IPO)
  - Pre-IPO: lower cash; higher equity opportunity
  - Public: higher base and bonus; less equity

- Appendix - PM&P analysis re: evolution of compensation pre- and post-IPO

Equity Opportunity (as a % of fully diluted shares)*

- Software companies provide larger grants pre-IPO (within ~18 months of IPO), and significantly smaller awards post-IPO
- Life Sciences companies have been more conservative with their pre-IPO awards

*Data from PM&P analysis of recent IPOs; see appendix for details
Review Equity Plan

- Capitalization table
  - Stock ledger rules
  - Data quality/cleanup
- Management equity plan
  - Plan document and grant agreements
  - Participation and allocations

Capitalization Table - Example
Stock Ledger Rules

- Accurate list of all equity outstanding
- Scanned documents
- Plan Reserve Information
- Historical information on splits, transfers, ASC 718 audits, cost basis
- Vesting of founders' and restricted stock
- Current contact info for all stakeholders
- Correct SSN and Tax ID Numbers
- Correct and identifying information for trusts and other entity stakeholders

Get Organized Now

1. Work with your law firm
2. Research and find missing documents
3. Scan copies of your documents and store them for ready reference
4. Validate and reconcile your ledger against your documents
5. Contact stakeholders to update their information
6. Document and review the process
Reconciliation Items

1. Confirm Ownership Type Authorizations and Reserves
2. Cross-reference Board resolutions for option grants and stock certificates
3. Review and verify transaction data
4. Backfill any information you are missing
5. Review your Option Plan Information

Equity Plan

- Review terms and conditions of equity plan document
  - Initial # of shares
  - evergreen provisions
  - Types of awards
    - options (ISOs/NSOs)
    - restricted stock/RSUs
    - performance-based
Equity Plan

- Review terms and conditions of equity plan document
  - Potentially fungible share counting
  - Individual grant maximum
  - Potential performance measures
  - Change-in-Control (CIC) definitions and provisions
  - Flexibility?

Equity Plan (cont’d.)

- Grant agreements – terms and conditions
  - Vesting schedule
    - Service (time) vesting or performance-based
  - Exercise provisions
  - Performance conditions
  - Treatment at termination of employment
  - Other items
    - “Cause” definition
    - CIC provisions
    - Non-compete/non-solicit provisions
    - Market stand-off
**Equity Plan (cont’d.)**

- Overall share allocation and usage
  - Comparison to peers/recent IPOs can provide a frame of reference

<table>
<thead>
<tr>
<th>Company (IPO)</th>
<th>Year End</th>
<th>Weighted Avg. Shares (Thousands)</th>
<th>New Share Allocation</th>
<th>Share Allocation Distribution</th>
<th>Annual Share Initiation</th>
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<tbody>
<tr>
<td>Americas Inc</td>
<td>12/31/12</td>
<td>28,000,000</td>
<td>2.0 %</td>
<td>1.5 %</td>
<td>1.5 %</td>
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<td>BioMed Inc</td>
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<td>Alphacore Holdings Inc</td>
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<td>2.0 %</td>
<td>2.0 %</td>
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<tr>
<td>AllCure Inc</td>
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<td>Green Imaging Ltd</td>
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<td>HeartWare International Inc</td>
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<tr>
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<td></td>
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<td><strong>25th Percentile</strong></td>
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**Equity Plan (cont’d.)**

- Overall share allocation and usage - evergreens

<table>
<thead>
<tr>
<th>Company (IPO)</th>
<th>Evergreen</th>
<th>% of Control Share</th>
<th>Amount ($)</th>
<th>Description</th>
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<tbody>
<tr>
<td>Americas Inc</td>
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<tr>
<td>BioMed Inc</td>
<td>No</td>
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<td>--</td>
<td>--</td>
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<tr>
<td>Algo Technology Inc</td>
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<td>--</td>
</tr>
<tr>
<td>Alphacore Holdings Inc</td>
<td>Yes</td>
<td>5.0%</td>
<td>1,600,000</td>
<td>N</td>
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<tr>
<td>AllCure Inc</td>
<td>Yes</td>
<td>3.25%</td>
<td>820,000</td>
<td>Y</td>
</tr>
<tr>
<td>Cardiovascular Systems Inc</td>
<td>Yes</td>
<td>5.0%</td>
<td>970,000</td>
<td>y</td>
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<tr>
<td>Caelus Inc</td>
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<td>200,000</td>
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<tr>
<td>DaCor Inc</td>
<td>Yes</td>
<td>3.25%</td>
<td>820,000</td>
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<tr>
<td>Endalis Inc</td>
<td>Yes</td>
<td>5.0%</td>
<td>1,600,000</td>
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<tr>
<td>Green Imaging Ltd</td>
<td>No</td>
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<tr>
<td>K = 16</td>
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**25th Percentile**

- Median
  - 2.5%

- Average (25)
  - 2.5%
Employment Agreements

- Review offer letters and employment agreements
  - Arrangements are often disparate, with differences depending on hire date/situation
  - Evaluate compliance with existing terms
  - Consider disclosure requirements
  - Evaluate how to harmonize arrangements

Areas of focus:
- Initial term and renewal provisions
- Ongoing compensation; participation in incentive plans; benefits; perquisites (if applicable)
- **Severance and post-termination benefits**
- Restrictive covenants – non-compete; non-solicit; non-disparagement; etc.
- CIC provisions
Governance

- Board of Directors – issues and planning points
  - Board composition
    - Continuing directors post-IPO
    - Recruiting needs – new independent members
  - Committee structure; charters
    - Audit
    - Compensation
    - Nominating/Governance

Governance

- Compensation Issues
  - Board retainer; meeting fees
  - Specialized roles – non-executive Chairman; Lead Director
  - Committee compensation – Chair retainers; meeting fees
  - Equity awards
    - Initial/on-boarding awards
    - Annual grants
      - including form, level and timing
Health Check - Key Takeaways

- Get started early – 9-18 months before IPO
  - Data gathering is time-consuming; checklists can help
- Establish an external frame of reference
  - Peer groups/comparables for compensation and program comparisons
- Ask for help – use your advisors
  - External viewpoints and experience are often helpful
- Identify gaps, issues and a game plan for resolving

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PM&P analysis regarding the evolution of compensation pre- and post-IPO
- Analysis covered 66 Software and Life Sciences companies with IPOs since 2011 (software) or 2010 (life sciences)
  - Excludes companies with revenue > $5 billion
- CEO and CFO positions
- Cash compensation and equity pre- and post-IPO
- Employment agreements – severance basis and multiples
**Base Salary**

- Life Sciences base salaries are higher than Software both pre- and post-IPO

**Target bonus**

- CEO target bonus % is significantly higher post-IPO
- Notably higher target % in Software
**Target Total Cash**

- Post-IPO target total cash virtually equivalent for Software and Life Sciences
  - Higher target bonuses for Software make up for lower base salaries

![Median Target Total Cash Chart](chart1.png)

**Equity Opportunity (as a % of fully diluted shares)**

- Software companies provide larger grants pre-IPO (within ~18 months of IPO), and significantly smaller awards post-IPO
- Life Sciences companies have been more conservative with their pre-IPO awards

![Median Grant Opportunity Chart](chart2.png)
Severance Basis & Multiples – Absent CIC

- CEOs generally receive a 1x severance multiple (absent CIC) and CFOs receive either 0.5x or 1x
- Severance multiple is usually based on base salary only rather than base + bonus

Severance Basis & Multiples – Following CIC

- Generally severance multiple is higher following CIC, or basis includes bonus