Update on Emerging Growth Companies and the JOBS Act

An increasing number of companies are adopting the private company timeline
Foreword

Six years in, how did we get here...

The Jumpstart Our Business Startups Act ("JOBS Act") was enacted on April 5, 2012. The principal goal of the JOBS Act was to encourage private companies to raise capital through an IPO. The Act was initially contemplated in March 2011 when it was determined that a long-term decline in US IPOs could result in a loss of up to 22 million American jobs.

The two main objectives of the JOBS Act are:

• To create an “IPO on-ramp” which reduces the filing and disclosure burdens associated with undertaking an IPO.

• To provide companies easier and broader access to the capital markets.

The FAST Act was enacted on December 4, 2015. While the primary objective of the law was to ensure funding for US transportation and infrastructure improvements, the FAST Act also included a number of securities-related provisions, including changes to the requirements of the JOBS Act.

In August 2017, the Division of Corporation Finance further clarified the policy changes through the release of Compliance and Disclosure Interpretations ("C&DIs"). These clarifications expanded on accommodations available to companies regarding omission of certain financial information in confidential pre-effective submissions.

Did it accomplish its goal?

1. Since enactment, we have seen an uptick in the number of IPOs of nearly 25%*;

2. More than 80% of all US IPO pricings since enactment have been by entities that qualify as EGCs;

3. An increasing number of EGC filers are taking advantage of the accommodations and exemptions available under the JOBS Act.

While certain key accommodations and exemptions are available to qualifying EGCs, not all companies that qualify as an EGC take advantage of the available accommodations and exemptions.

* Calculated as total IPOs in the six year period since enactment over total IPOs in the six year period prior to enactment (refer to page 7).
Although most companies filing as an EGC chose not to take the relief for the extended timeline to adopt new accounting standards, the trend took a notable turn in 2017

As an EGC filer, a company can elect to comply with new accounting standards in the same timeframe for a private company, i.e. opt in.

Since enactment, approximately 84% of companies filing as an EGC have opted out of the accommodation to defer adopting new or revised accounting standards until they are effective for private companies. Not deferring the adoption makes financial statements more comparable to other public companies and is generally favored by analysts and investors as it facilitates better comparisons to other public companies.

The Financial Services sector had the highest rate of election of the private company adoption timeline ('opt in'). Conversely, Pharma & Life Sciences companies had the highest rates of adopting public company timelines ('opt out'). This is consistent with companies assessment of the level of effort required to adopt the new revenue recognition standard (ASC 606). The majority of Pharma & Life Sciences IPOs were biotech startups that are pre-revenue and have minimal/no revenue. Conversely, Financial Services companies began to experience challenges in the practical application of the new standard which has required more time to resolve.

The number of EGCs choosing not to elect the private company timeline increased every year and peaked in 2016 before declining precipitously to its lowest level in 2017, with about 70% of EGCs ‘opting out’ of the accommodation. The decrease coincides with the public company effective date of ASC 606, Revenue from contracts with customers (Dec. 15, 2017). Adoption and implementation of ASC 606 has been onerous and more time consuming for many companies than originally anticipated. Accordingly, we’ve seen a significant uptick in the percentage of companies electing the private company adoption timeline. However, even if a company chooses to adopt the private company timeline, they can still choose to over-disclose.

Election of the private company adoption timeline
All EGC filings since Enactment

Source: SEC Filings and PwC Analysis

Although most companies filing as an EGC chose not to take the relief for the extended timeline to adopt new accounting standards, the trend took a notable turn in 2017.
Nearly 75% of companies filing as an EGC presented two years of financial statement information in their registration statements

As an EGC filer, a company may present two years of audited financial statements rather than the three required of non-EGC filers.

The percentage of EGC filers presenting two years of financial statement information has been steadily increasing since the JOBS Act was introduced.

The number of EGCs presenting two years of financial information increased from 26% to nearly 75% from 2012 to 2017. The upward trend would indicate growing investor acceptance of the provisions of the JOBS Act.

Companies in the Pharma & Life Sciences sector presented two years of financial statement information at the highest percentage. This is likely due to EGC companies in Pharma & Life Sciences typically having operated for fewer periods, and having little/no historical revenues to present to potential investors.

Conversely, Technology, Media & Telecom companies presented two years of financial statement information at the lowest percentage with approximately two-thirds of companies still filing with three years of financial statement information. This is likely due to companies having more than the minimum two years of information and wanting to show more periods to support the fast growth equity story within the registration statement.
More EGCs are choosing to present less than five years of selected financial information

As an EGC, a company may omit certain periods for selected financial information presentation within the registration statement. Companies need only to include the periods reflected in the audited financial statements.

Since enactment, the number of EGC’s disclosing only two years of selected financial information has increased from 21% to 70%. The trend is consistent with that of audited financial statements as companies generally include only the same number of periods in the selected financial information as reflected in the audited financial statements.

Companies in the Pharma & Life Sciences and Energy, Utilities & Mining sectors presented two years of selected financial information in more than 70% of filings. This exceeded all other sectors by a margin of more than 20%. Conversely, Technology, Media & Telecom, Health Services, and Consumer Markets companies presented three to five years of selected financial information in more than 70% of their filings.

This trend is likely due to EGC companies in Pharma & Life Sciences typically having operated for fewer periods, and having little or no historical revenues to present to potential investors. Conversely, Technology Media & Telecom companies that have operated for more periods want to disclose their fast growing revenues that are part of the equity story within the registration statement.

Years of summary and selected financial information presented
2012–2017

Source: SEC Filings and PwC Analysis

Years of selected financial information presented by sector
All EGC filings since Enactment, by sector

Source: SEC Filings and PwC Analysis
Most companies filing as an EGC disclosed compensation for less than 5 named executives

As an EGC filer, a company may present compensation disclosure for three instead of five named executives. This includes a company’s principal executive officer (PEO), principal financial officer (PFO), and the most highly compensated executive not a PEO or PFO.

Over 80% of companies filing as an EGC presented compensation disclosures for three or four named executives. This category covers EGCs that elected relief and also may have had a change in executives (e.g. CEO and/or CFO) and presented multiple people for the same role. A small percentage of companies disclosed only one or two named executives. These companies were largely from the Pharma & Life Sciences sector which typically includes smaller companies with fewer executives, e.g. biotech startups.

There is a consistent trend across all sectors since enactment, of companies disclosing compensation information for less than the required five named executive officers and other reduced disclosure requirements related to compensation. This is likely due to the level of time and effort to prepare Compensation & Discussion Analyses within the registration statement.

**Executive officers compensation disclosure**

All EGC filings since Enactment

<table>
<thead>
<tr>
<th>Number of Executives</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>1–2 Executives</td>
<td>82%</td>
</tr>
<tr>
<td>3–4 Executives</td>
<td>6%</td>
</tr>
<tr>
<td>5–6 Executives</td>
<td>12%</td>
</tr>
</tbody>
</table>

Source: SEC Filings and PwC Analysis

**Number of named executive officers**

By sector

<table>
<thead>
<tr>
<th>Sector</th>
<th>1–2 Executives</th>
<th>3–4 Executives</th>
<th>5+ Executives</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tech &amp; Media</td>
<td>1%</td>
<td>83%</td>
<td>16%</td>
</tr>
<tr>
<td>Pharma &amp; Life Sciences</td>
<td>9%</td>
<td>84%</td>
<td>7%</td>
</tr>
<tr>
<td>Industrial Products</td>
<td>6%</td>
<td>91%</td>
<td>3%</td>
</tr>
<tr>
<td>Health Services</td>
<td>3%</td>
<td>100%</td>
<td></td>
</tr>
<tr>
<td>Financial Services</td>
<td>3%</td>
<td>79%</td>
<td>18%</td>
</tr>
<tr>
<td>Energy, Utilities &amp; Mining</td>
<td>14%</td>
<td>73%</td>
<td>14%</td>
</tr>
<tr>
<td>Consumer Markets</td>
<td>3%</td>
<td>76%</td>
<td>21%</td>
</tr>
</tbody>
</table>

Source: SEC Filings and PwC Analysis

Note: The data summarized in the charts above excludes Foreign Private Issuers (FPIs). FPIs are not required to disclose executive compensation if the disclosure is not required in the company’s home country and is not otherwise publicly disclosed by the company.
In the six years leading up to the introduction of the JOBS Act there were 762 IPOs compared to 994 in the six years following its introduction.
**Definition of an Emerging Growth Company (EGCs) under the JOBS Act**

A company may be considered an EGC if it had total annual gross revenues of less than $1.07 billion* during its most recently completed fiscal year. An issuer that is an EGC as of the first day of that fiscal year may continue to be deemed an EGC until the earliest of:

- The last day of the fiscal year of the issuer during which it had total annual gross revenues of $1.07 billion or more;
- The last day of the fiscal year of the issuer following the fifth anniversary of the date of the first sale of common equity securities of the issuer pursuant to an effective registration statement under this title;
- The date on which such issuer has, during the previous three-year period, issued more than $1 billion in non-convertible debt; or
- The date on which such issuer is deemed to be a large accelerated filer (generally an issuer with worldwide public float greater than $700 million).

*Note that this number is updated periodically based on inflation.

**Additional accommodations/exemptions under the JOBS Act**

In addition to the reliefs discussed in the previous pages, the Act also allows for the following accommodations/exemptions:

**Accommodations:**

- Submit certain registration statements for initial SEC staff review on a confidential basis;
- Omit financial information (including audited financial statements) if that financial information relates to periods that are not reasonably expected to be required at the time of the offering;
- Publicly file registration statements 15 days before the start of their IPO roadshow, down from 21 days.

**Other key exemptions:**

- The internal control audit requirements of Section 404(b) of the Sarbanes-Oxley Act (deferred for up to five years as long as the filer remains an EGC);
- Various current and future executive compensation-related disclosures (e.g., “say-on-pay,” “say-on-golden parachute,” “pay vs. performance,” and “CEO pay ratio”).

**SEC Staff extends certain accommodations to all IPO filers**

On June 29, 2017, the SEC’s Division of Corporation Finance issued guidance further extending accommodations to companies going public. Under the new guidance, ALL issuers, including non-EGCs are permitted to file confidentially and may omit financial information (including audited financial statements) if that financial information relates to periods that are not reasonably expected to be required at the time of the offering.
Companies have shown strong support for the JOBS Act since its enactment six years ago, and have elected to take advantage of the accommodations granted through the Act at an increasing rate.

Any initial apprehension of electing to take the accommodations available under the Act has slowly faded, as the market has been open to scaled back disclosures/financial data.

Companies are not bound to the scaled back disclosures/financial data throughout the period that they qualify as an EGC and may present financial information in accordance with non-EGC requirements/public company adoption timelines if deemed beneficial.

These trends are expected to continue, and the Chairman of the SEC, Jay Clayton, has indicated that he believes there should more IPOs and public companies in the US. The SEC has continued to support this objective through the issuance of guidance in June 29, 2017 further extending accommodations to companies going public.

Companies considering IPOs that qualify as EGCs should pay close attention to the broader market and industry specific trends for election of accommodation/exemptions under the JOBS Act. Adequate evaluation and election of the available accommodations/exemptions can help to defray the costs and decrease the time it takes to go public.
Let’s talk
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