

EQUITY OFFERINGS 101

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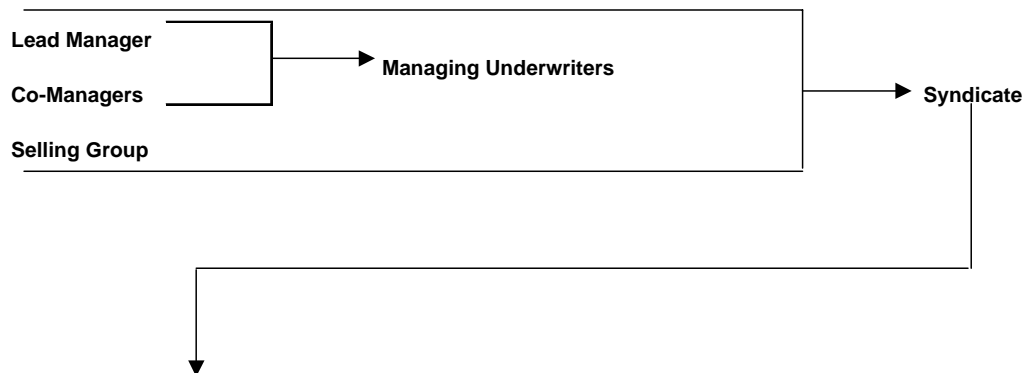
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Types of Equity Offerings

- **Primary/Secondary Offering** – Proceeds go to issuing Company
- **Split Offerings** – Combination of a primary and secondary offering
- **Shelf Offering** (under SEC Rule 415) – allows the issuer to sell securities over a two-year period as the funds are needed.
- **Private Placement** – Proceeds go to a major stockholder who is sell his/her part of equity in the corporation. Direct sale of an issue of securities to large institutional investors and large private investors. There is no public offering.

Types of Underwriting Tiers



- **Syndicate**
 - The group of underwriters that will participate in selling the issue
 - Why have a syndicate?
 - To ensure a broad base of institutional and individual investors and geographical presence
 - To diversify customer base so that it reduces the number of speculators holding the stock for short-term gains
- **Lead Manager** - This is the underwriter who has ultimate control of the offering. The lead manager controls all aspects of the offering, including how many shares of stock the co-managers get to sell, the timing of the road show, and the ultimate pricing of the deal.
- **Co-Manager / Underwriting Group** – Chosen by the Lead Manager or Issuer and has less work to do, but still remains responsible for its amount of shares to be sold.
- **Selling Group** – allocated shares to sell and do not receive underwriting fee, but receive selling concession

LEGAL PROCESS

- All Parties in the offering must sign three letters on intent:
 - **Agreement Among Underwriters (“AAU”)**
 - Designates syndicate manager who:
 - Determines price of offering
 - Enters into underwriting agreement
 - Responds to letters from SEC
 - Determines underwriters allotment
 - Drafts Underwriting Agreement
 - **Underwriting Agreement (“UA”)**
 - Establishes relationship between corporate issuer and the underwriters in the syndicate
 - Is executed based on the authority by the AAU
 - **Dealer Agreement (Selling Agreement) – See Reallowance**
 - Agreement in which securities dealers, which ARE NOT part of the syndicate are contracted to purchase some of the securities from the issue.
 - Another distribution channel
 - Help move the product to the public

Offering Methods (2 Types)

- **Firm Commitment Offering** – the underwriter agrees to purchase the entire issue from the Company and then re-offer them to the general public. (TYPICAL)
- **Best Efforts Offering** – the underwriter is only an agent on behalf of the Company

Gross Spread Breakdown

Historically, for transactions less than \$10 million, the gross spread is 7-9% and for transactions above \$100 million, the gross spread is 5.5-6.2%

Management Fee

- This fee is virtually always **20% of the total gross spread**
- **Used to compensate the “Managing Underwriter” (lead managers and co-managers) for their “management” of the offering:**
 - Preparation of documentation
 - Roadshow preparation and organization
 - Overall Strategy
- This fee is split up:
 - amongst the managers on a fixed basis and is determined prior to pricing

Underwriting Fee

- This fee is virtually always **20% of the total gross spread**
- **Used to compensate ALL underwriters (lead managers, co-managers, and syndicate members, if any) for underwriting the offering, or agreeing to purchase shares from the company at a specified price.** Expenses for the underwriting group are typically charged against the underwriting fee.
- This fee is split up:
 - on the basis of underwriting commitments, which are determined prior to pricing.

Selling Concession

- This fee is approximately **50-60% of the total gross spread**
- **Used to compensate the managing underwriters and syndicate for sales of shares**
- This fee is split up:
 - from the outset as fixed, or a combination of fixed and competitive splits can be used.

Selling Concession (con't)

- For shares sold institutionally, or the “institutional pot”, this fee is usually split up on a competitive or “jump ball” basis
 - In a jump ball, institutions who receive allocations designate the underwriter or underwriters whom they wish to receive this fee. This is an attractive arrangement to institutions as it allows them to reward underwriters for research, trading support, etc.
 - **Lead Managers** are usually capped to avoid a disproportionate distribution of this fee
 - **Co-Managers** typically compete for the balance of the fee outside the cap
- For shares sold to retail accounts, allocations of stock are usually negotiated between the lead managers and the issuer on the basis of quantity and quality of demand generated by underwriters’ retail systems
 - Underwriters receiving retail allocation are entitled to the entire selling concession for such shares, irrespective of pre-arranged splits from the institutional pot, if any.

Re-allowance

- Fee paid to securities firms which contacts one of the members of the syndicate to purchase part of the issue to fill its own customer orders
 - Because the firm has incurred no-risk and made no effort in the underwriting, this is the smallest fee earned by any firm

Over-allotment

- **Greenshoe (“over-allotment option”)** (15% of total offering size)
 - used by the underwriter to fill overflow orders taken during a fast moving offering
 - underwriters must purchase the shares at the pro-rata percentage to the initial commitment

An EXAMPLE of the “fee structure” can be found at the end of this report

Getting into the offering?

- To become a lead underwriter or member of the syndicate you must have a strong combination of the following:
 - **Good Reputation** – because the underwriter is legally liable and will be dealing with the customers to whom he sells shares
 - **Ability to Finding Investors** – The underwriter first puts together a syndicate of other underwriters to distribute the shares
 - Will the new investors be institutional or private?
 - Will there be long-term investors, aftermarket support?
 - **Overall Experience** – knowing the details of the process (familiar with the structure)
 - **Solid Aftermarket Support** – for 30 days after the offering, the underwriter provides price stabilization (makes offering more attractive)
 - **Future Services** – RESEARCH coverage and market making services

- Other less conventional ways to enter the syndicate are as follows:
 - **Leverage Firm Relationships** – If ANY member of the underwriting group is a customer of ours, or vice versa, the probability of being included is increased.
 - **(Example)** During the Federated Investor IPO in 1999, they had Edward Jones included as a co-manager because they were their Midwest mutual fund distribution channel. Subsequently, two other firms who had relationships with Edward Jones and were also included in the selling group.
 - **(Example)** If Merrill Lynch or Salomon Smith Barney are the Managing Underwriters in an offering we would like to take part in, leverage could be used as we may have hired them in the past for other capital market related transactions.
 - **Start Research Coverage and Interaction Early** – For inclusion in the syndicate, it may prove beneficial to issue research on private companies; establishing the relationship prior to an (IPO) offering. Alternatively, the hosting of various conferences can lead to future offerings.
 - **Personal Relationships** – Sometimes it comes down to ‘who you know’.
 - **Establish a Dialogue with Capital Market Desks on the Street** – Persistence overcomes resistance

Example

Shares sold	8,500,000 shares	
	Per Share	Total
Public Offering Price	\$12.00	\$102,000,000
Underwriting Discount - 7% <i>(typically called the "gross spread")</i>	0.84	7,140,000
Proceeds to Company	\$11.16	\$94,860,000

PUBLISHED IN PROSPECTUS

Underwriter	Role	Shares Agreed to Purchase	20% of Spread		60% of Spread
			Mgmt. Fee (1)	Underwriting Fee (2)	Selling Concession (3)
Lehman Brothers	Lead Manager	3,775,000	\$714,000	\$634,200	\$1,812,000
Dain Rauscher Wessels	Co-Manager	1,887,500	357,000	317,100	906,000
Thomas Weisel Partners	Co-Manager	1,887,500	357,000	317,100	906,000
Bear, Stearns & Co.	Underwriting Group	100,000		16,800	48,000
Donaldson, Lufkin, Jenrette	Underwriting Group	100,000		16,800	48,000
Goldman, Sachs & Company	Underwriting Group	100,000	Major Bracket	16,800	48,000
J.P. Morgan	Underwriting Group	100,000		16,800	48,000
Salomon Smith Barney	Underwriting Group	100,000		16,800	48,000
SG Cowen Securities	Underwriting Group	100,000		16,800	48,000
Prudential Securities	Underwriting Group	100,000		16,800	48,000
Advest, Inc.	Underwriting Group	50,000		8,400	24,000
Adams, Harkness & Hill	Underwriting Group	50,000	Regional Bracket	8,400	24,000
Robert Baird	Underwriting Group	50,000		8,400	24,000
JC Bradford & Co.	Underwriting Group	50,000		8,400	24,000
Hanifen, Imhoff	Underwriting Group	50,000		8,400	24,000
Legg Mason Wood Walker	Underwriting Group	50,000		8,400	24,000
SunTrust Equitable	Underwriting Group	50,000		8,400	24,000
TOTAL		8,500,000	\$1,428,000	\$1,428,000	\$4,128,000

Footnotes:

- (1) Management Fee is 20% of the Total Gross Spread
- (2) Underwriting Fee is 20% of the Total Gross Spread (based on commitments)
- (3) Selling Concession is 60% of the Total Gross Spread and cannot be in charge in excess of \$0.48 per share (based on what is sold)

BEHIND THE SCENES

REALLOWANCE: Fee paid to securities firms which contacts any member of the Underwriter Group to purchase part of the issue to fill its own customer orders. The fee is generally the lowest earned by any firm since there is no risk incurred.

Hypothetical Example:

If JP Morgan cannot sell all 100,000 shares allotted to them, they can hire and broker dealer (including other underwriters) on the Street to sell their shares not in excess of \$0.10 minus the selling concession = \$0.38 (\$0.48 - 0.10)

	<u>Firm Name</u>	<u>Shares Sold</u>	<u>Fee Received</u>
1	Everen Sec.	10,000	\$3,800
2	BancAmerica	10,000	3,800