Orrick Technology IPO Insights

Q4 2014

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Table of Contents

Orrick Technology IPO Insights
Q4 2014

Welcome to the Q4 2014 issue of Orrick Technology IPO Insights, a quarterly publication highlighting trends in U.S. information technology company IPOs. We isolate technology companies in order to analyze and present concerns specific to them in the IPO process – we believe that lumping technology companies together with companies in other industries can muddy the water and lead to misguided conclusions about the issues that technology companies face.

Each issue of *Orrick Technology IPO Insights* features commentary on a specific aspect of tech IPOs by one of Orrick's partners, as well as data on the technology company IPOs for the most recent quarter and for the overall period since the 2008 Financial Crisis.

In this issue, **Christopher Austin**, a recognized leader in capital markets work with extensive experience advising technology companies and leading tech-focused investment banks on IPOs, highlights key considerations that companies should be mindful of when drafting MD&A. In particular, he urges careful consideration of the company's business model and key metrics, as this disclosure can set the terms upon which the company's performance will be judged for years to come.

We hope you find these observations useful. If you have any questions or comments, please do not hesitate to contact us.

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Preparing for an IPO: Good Disclosure Requires Careful Consideration of How You Present the Drivers of Your Business

BY CHRISTOPHER AUSTIN

The IPO market continues to be very active, particularly in the technology and the life sciences areas. Elsewhere in this report, you'll find performance data for Q4 2014 and its footing against historical trends. This note, however, is about a much earlier stage in the IPO process, and a frequently neglected area of disclosure — the first five to ten pages of management's discussion and analysis, also known as "MD&A."

In preparing for an initial public offering, the first six to eight drafting sessions are often focused on the description of the company's business — its markets, its offerings and its competitive strengths. While important messaging points to solidify, these discussions are often at the expense of careful consideration of the company's key financial and business drivers, as well as known trends and risks. Since these additional elements contained in MD&A are crucial to an investor's understanding of the company and its prospects, we'll highlight certain considerations one should contemplate while preparing MD&A.

A key insight to keep in mind while drafting MD&A comes from the guidance statement issued by the SEC in 2003, where it stated that:

> "MD&A should be a discussion and analysis of a company's business as seen through the eyes of those who manage that business. Management has a unique perspective on its business that only it can present."

MD&A continues to be a significant focus of the SEC staff, and is often an area that regularly causes the company and its underwriters, auditors and attorneys to tear their hair out while trying to respond to SEC comments. The staff has proved quite adept in recent years in finding weaknesses in disclosure and areas where, shall we say, companies would prefer to allow a bit of ambiguity in the description of their businesses.

Key Business Drivers

I generally tell management teams sitting down to prepare MD&A that they need to think first about what levers they pull to drive business results. How do they evaluate their business? How do they report to their board about their results? It is NOT a discussion of revenue recognition or accounting policies. Consider the overview along the lines of a review you would give to a new director to explain your business. It should be your reporting dashboard explained in text. A discussion of those key operating levers evolves into the overview of MD&A.

KEY BUSINESS OPERATING LEVERS: QUESTIONS TO REFLECT ON

- **How do we make money?** Do we sell to lots of consumers? Sell ads? Sell to large enterprises?
- **How do we drive growth?** More products? More sales people? Is “land and expand” a key part of our strategy? (in other words “We generally sell a small subset of our solution to customers, and then focus on selling more modules over time.”) Do we have to do a lot of marketing to lay a foundation, or is our focus more on targeted sales?
- **What are the risks that we are worried about?** Is it a crowded market? Or is it the opposite — are we so new that people don’t know how to think about us yet? Do we have interest rate risk? Are we susceptible to overall economic downturns? How have we mitigated those risks (hedging, R&D spend)?
- **Do we drive results by buying new products or technologies, or are we all about organic growth?**

Known Trends and Uncertainties

Disclosure of known trends and uncertainties, which is expected to be addressed in MD&A overview, is another area on which the SEC has focused much attention. The goal here is to think “What are the macro trends that keep me awake at night, and how are we thinking about them or organizing our business to combat them?” These are things that need to be pondered and carefully discussed. If, for instance, a company is selling computers, there might be a known trend that costs continue to decline, putting pressure on margins. Or, there might be a known trend that Best Buy and Circuit City are in trouble or gone, and that online retailers are controlling more of the market. In software, similar trends could affect sales of on premise solutions because of the growth of mobile and cloud computing. Any significant trend or uncertainty that management is closely monitoring, has identified in risk factors or discussed with the board should be evaluated for disclosure.

Key Metrics

Finally, it’s important to consider how investors evaluate the company. The way most companies provide information to investors about their business or financial model is with “Key Metrics” or “Key Performance Indicators,” which provides a description of important data, such as operating or financial metrics, that might not be immediately apparent from financial statements. Key Metrics disclosure has taken on greater importance in the last five years, as many important insights about your company come in this discussion. The Key Metrics are critical in helping analysts build their valuation models. Often the Key Metrics are things management is focused on already — Adjusted EBITDA, or some variant of Monthly Recurring Revenue, user growth or other volume metrics.

There are sometimes measures that investors want to focus on, which the private company management team hasn’t calculated or thought about with rigor. For instance, in SaaS companies, one measure of customer retention, often titled “monthly recurring revenue retention rate,” is used by management to help show the visibility management has into future results. But, there are many ways the retention rate can be calculated, so it can be hard to know if this retention rate gives a valid picture of the company’s business. What if it’s distorted during hyper-growth? Or what if it overstates the downside in a time of slowing growth? Is there another measure like backlog that works better?

It’s important to be cautious and evaluate the implications of including certain measures, to ensure the company does not disclose sensitive information. There are certain important measures that management teams use internally, which could provide TOO much information to competitors because they make it too easy to reverse engineer pricing or margins. It’s beneficial for the group to consider how metrics are perceived and whether there are comparable metrics that could help investors evaluate the business without potentially harming the company competitively.

Another important consideration when setting up Key Metrics is whether you are comfortable updating them quarterly. Once the investors have been provided the data, they will expect to continue receiving it regularly.

Conclusion

All of these disclosure discussions take time, data and careful thought. To ensure your MD&A is well drafted and provides a solid reflection of your company, it is important to have the discussion early with the underwriters about how to present the company's business drivers and Key Metrics, and to carefully consider the risks and benefits of disclosing them. Putting some time and thought up front into MD&A will help in many ways, including encouraging the team to think early about the model you'll have to build for the analysts, as well as framing the discussions you'll have on the roadshow and in earnings calls. The overview and key metrics discussion is your opportunity to help set the terms upon which the company's performance will be judged for years to come.

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Christopher Austin, a partner at Orrick, Herrington & Sutcliffe in the New York and Silicon Valley offices, is a member of the firm's Technology Company Group and Capital Markets Practice. He focuses on IPOs, follow-ons and other financing transactions for technology companies, with extensive experience in securities law compliance, mergers and acquisitions, and venture capital transactions.

Christopher is a recognized leader in capital markets work for technology companies and for leading technology-focused investment banks, including Bank of America Merrill Lynch, Barclays, Credit Suisse, Deutsche Bank, Goldman Sachs, J.P. Morgan and Morgan Stanley. He also has worked for leading venture capital firms in connection with their investments in technology, biotech and medical device companies. His recent transactions include the initial public offerings of OnDeck, Inc., Eloqua, Inc., Benefitfocus, Inc. and Paylocity, Inc., multiple public offerings of Intercept Pharmaceuticals stock, the sale of Mashery, Inc., to Intel and many companies receiving venture capital investments by leading VC funds.

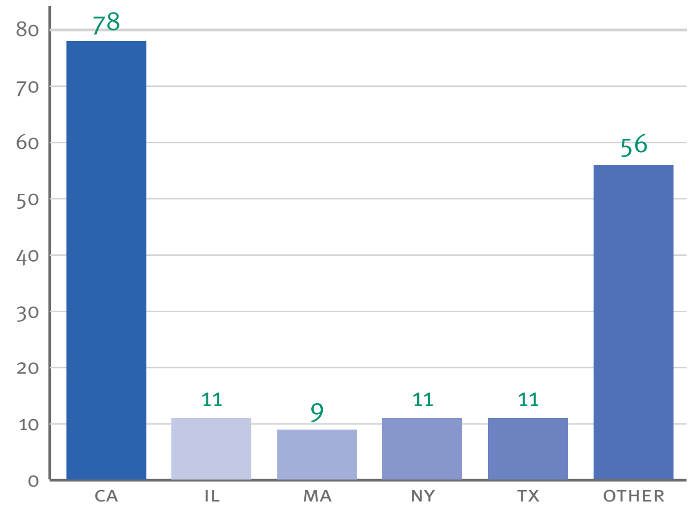
State of Headquarters
Q4 2014 vs. Historical (2009 – 2014)

Of the eleven technology companies going public in Q4, Workiva, Connecture and Zayo Group Holdings were headquartered outside of the states ranked within the top five states of headquarter from our historical data.

Q4 2014

COMPANY	VC-BACKED
OnDeck	NY
Workiva	IA
New Relic	CA
Connecture	WI
Hortonworks	CA
Lending Club	CA
Upland Software	TX
Zayo Group Holdings	CO
Hubspot	MA
Yodlee	CA
Wayfair	MA

Historical (2009 – 2014)



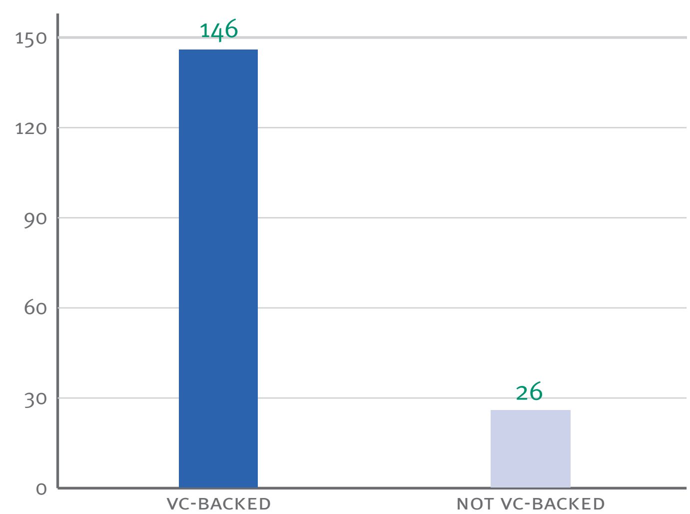
VC-Backed
Q4 2014 vs. Historical (2009 – 2014)

Consistent with the overall trend since the 2008 Financial Crisis, all technology companies going public in Q4 were venture-backed companies. More than half of those listed priced above range, while two priced below range.

Q4 2014

COMPANY	VC-BACKED (3)
OnDeck	Yes
Workiva	Yes
New Relic	Yes
Connecture	Yes
Hortonworks	Yes
Lending Club	Yes
Upland Software	Yes
Zayo Group Holdings	Yes
Hubspot	Yes
Yodlee	Yes
Wayfair	Yes

Historical (2009 – 2014)



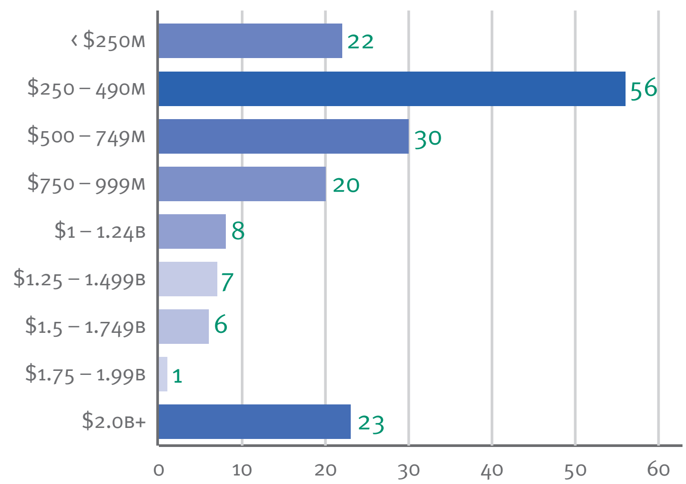
Post-Money IPO Valuation
Q4 2014 vs. Historical (2009 – 2014)

Only one of the Q4 IPO transactions fell within the historical survey's sweet spot for post-money valuations, which is between $250 million and $499 million. Upland Software, provider of cloud-based enterprise work management software, had a post-money valuation at the lowest end of our range at $172 million. LendingClub, provider of online peer-lending service, came in with a post-money valuation far above the range at $5.42 billion.

Q4 2014

COMPANY	POST-MONEY IPO VALUATIONS ($ IN MILLIONS)
OnDeck	$1,323.2
Workiva	$533.3
New Relic	$1,059.1
Connecture	$173.4
Hortonworks	$665.9
Lending Club	$5,421.1
Upland Software	$172.0
Zayo Group Holdings	$4,541.2
Hubspot	$759.0
Yodlee	$339.8
Wayfair	$2,400.0

Historical (2009 – 2014)



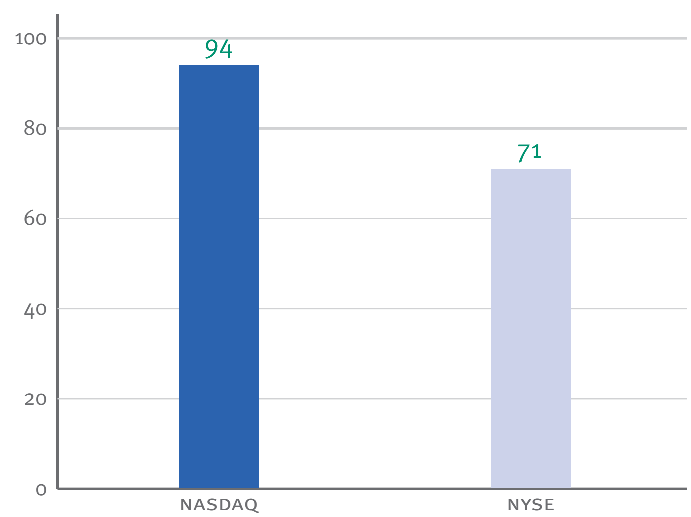
Selection of Exchange
Q4 2014 vs. Historical (2009 – 2014)

More than half of the technology companies priced in Q4 flouted the historical preference for listing on NASDAQ and priced instead on NYSE. Historically, 54.7% of all technology companies tracked in our data priced on NASDAQ while the remaining 45.3% priced on the New York Stock Exchange.

Q4 2014

COMPANY	EXCHANGE
OnDeck	NYSE
Workiva	NYSE
New Relic	NYSE
Connecture	NASDAQ
Hortonworks	NASDAQ
Lending Club	NYSE
Upland Software	NASDAQ
Zayo Group Holdings	NYSE
Hubspot	NYSE
Yodlee	NASDAQ
Wayfair	NYSE

Historical (2009 – 2014)



Confidential Filings
Q4 2014 vs. Historical (2009 – 2014)

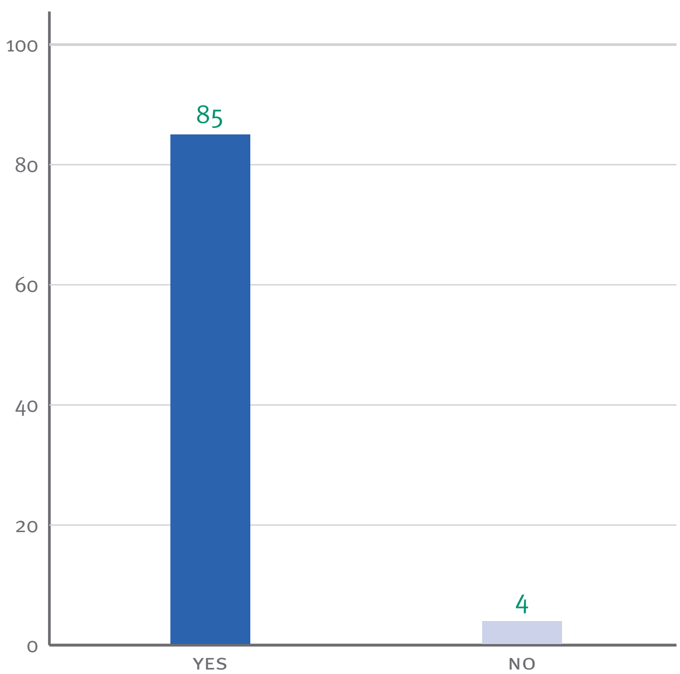
Since the JOBS Act was enacted in April 2012, 70 of the technology companies that qualified as Emerging Growth Companies (EGCs) have elected to make confidential filings, representing 79% of the total. In Q4, two technology companies going public, LendingClub and Zayo Group Holdings, did not qualify as EGCs and did not file confidentially, while the remaining nine that qualified as EGCs did file confidentially.

Q4 2014

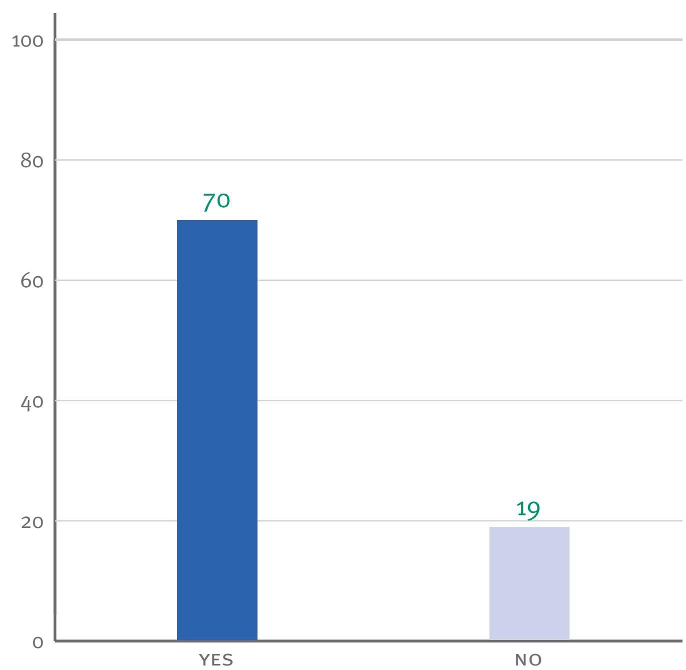
COMPANY	EGC/JOBS ACT	CONFIDENTIAL FILING
OnDeck	Yes	Yes
Workiva	Yes	Yes
New Relic	Yes	Yes
Connecture	Yes	Yes
Hortonworks	Yes	Yes
Lending Club	No	No
Upland Software	Yes	Yes
Zayo Group Holdings	No	No
Hubspot	Yes	Yes
Yodlee	Yes	Yes
Wayfair	Yes	Yes

Historical (2009 – 2014)

OF COMPANIES QUALIFIED FOR EGC STATUS



OF EGCS MAKING CONFIDENTIAL FILINGS



Length of IPO Process

Q4 2014 vs. Historical (2009 – 2014)

The prevalence of confidential filings since the enactment of the JOBS Act skews the historical data on days between the filing of the S-1 and effectiveness, significantly increasing the number of deals that are completed in the 30-90 day range. Within our survey, the historical median for the number of days between the filing of the S-1 and effectiveness prior to the enactment of the JOBS Act was 123.5 days. The overall median has now declined to 52 days.

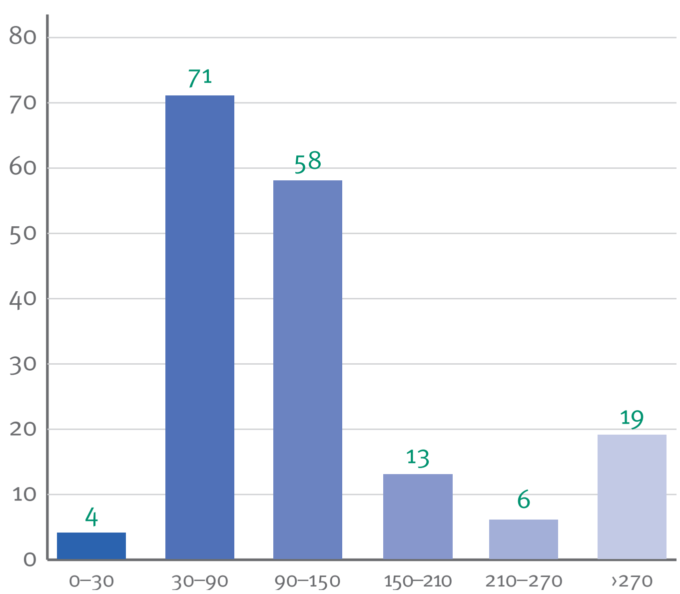
We note, however, that for EGCs filing confidentially under the JOBS Act, the median length of time between the filing of the draft registration statement (DRS) and effectiveness is 105 days. In Q4, Workiva and Connecture were the only companies that had lengths between filing of DRS and effectiveness that were near historical ranges, while the remaining companies reached well beyond historical ranges with the median for all companies being 147 days.

Q4 2014

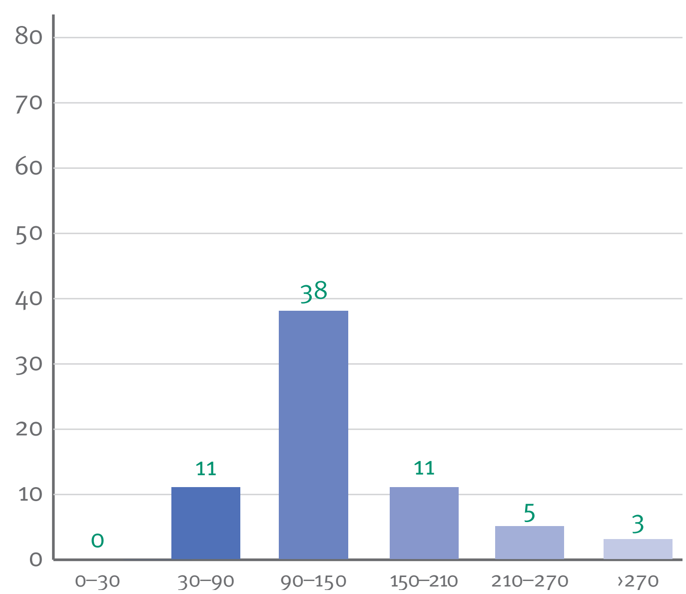
COMPANY	DAYS BETWEEN FIRST PUBLIC FILING AND EFFECTIVENESS	DAYS BETWEEN JOBS CONFIDENTIAL FILING OF S-1 AND EFFECTIVENESS
OnDeck	36	117
Workiva	55	99
New Relic	31	231
Connecture	52	104
Hortonworks	31	167
Lending Club	105	—
Upland Software	62	176
Zayo Group Holdings	106	—
Hubspot	44	194
Yodlee	94	195
Wayfair	47	147
Median	**52**	**147**

Historical (2009 – 2014)

DAYS BETWEEN FILING OF S-1 AND EFFECTIVENESS



DAYS BETWEEN JOBS CONFIDENTIAL FILING OF S-1 AND EFFECTIVENESS



Number of Lead Left Transactions
Q4 2014 vs. Historical (2009 – 2014)

Morgan Stanley led the group with seven lead left transactions, followed by Goldman Sachs, and William Blair in Q4. The top five leaders for our historical data set remain the same, with Morgan Stanley leading the pack.

Q4 2014

UNDERWRITER	NUMBER
Morgan Stanley	7
Goldman Sachs	3
William Blair & Comapny	1

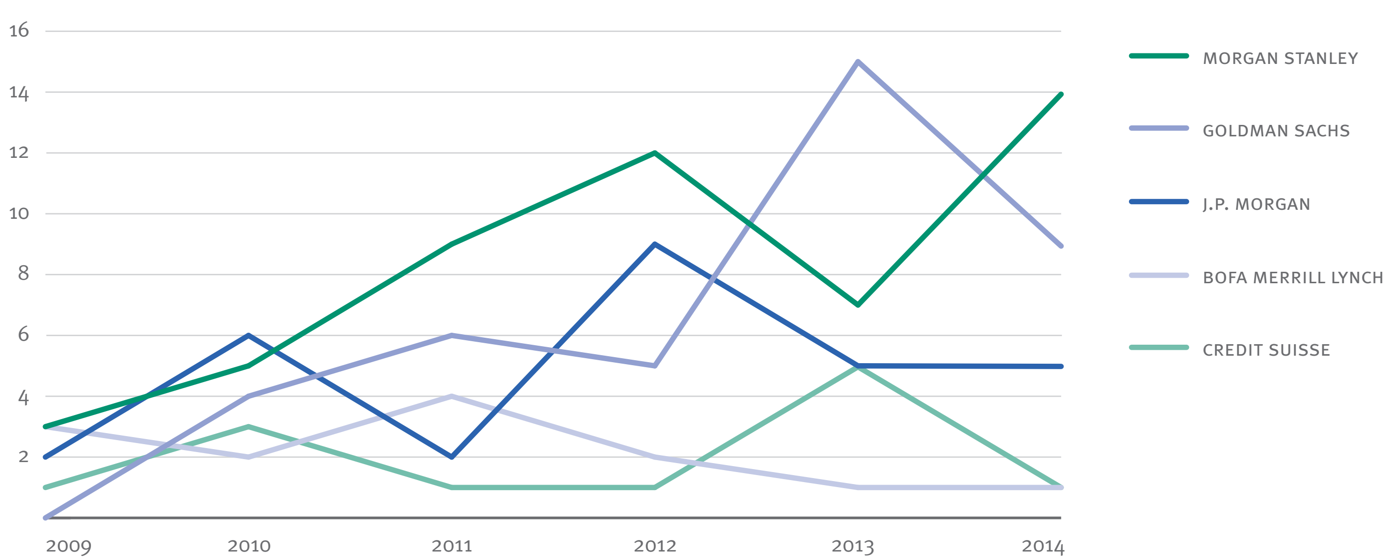
Historical (2009 – 2014)

LEAD LEFT UNDERWRITER IN U.S.-BASED TECH COMPANY IPOS

Includes only NASDAQ Global Market and NYSE-listed companies

UNDERWRITER	TOTAL	2009	2010	2011	2012	2013	2014
Morgan Stanley	51	3	5	9	12	7	14
Goldman Sachs	39	—	4	6	5	15	9
J.P. Morgan	29	2	6	2	9	5	5
BofA Merrill Lynch	13	3	2	4	2	1	1
Credit Suisse	12	1	3	1	1	5	1
Citigroup	5	1	—	1	1	1	1
Barclays	4	—	—	1	1	1	1
Deutsche Bank	5	—	—	1	1	1	2
Stifel	3	—	1	—	1	—	1
Thomas Weisel	2	—	2	—	—	—	—
Raymond James	1	—	—	—	—	1	—
Sandler O'Neill & Partners	1	—	—	—	—	1	—
FBR	1	—	—	—	—	1	—
UBS	1	—	—	1	—	—	—
Imperial Capital	1	—	—	1	—	—	—
Lazard	1	—	—	1	—	—	—
SunTrust Robinson Humphrey	1	—	1	—	—	—	—
Piper Jaffray	1	—	1	—	—	—	—
Jefferies	1	1	—	—	—	—	—

Historical (2009 – 2014)



Pricing Relative to Initial Range

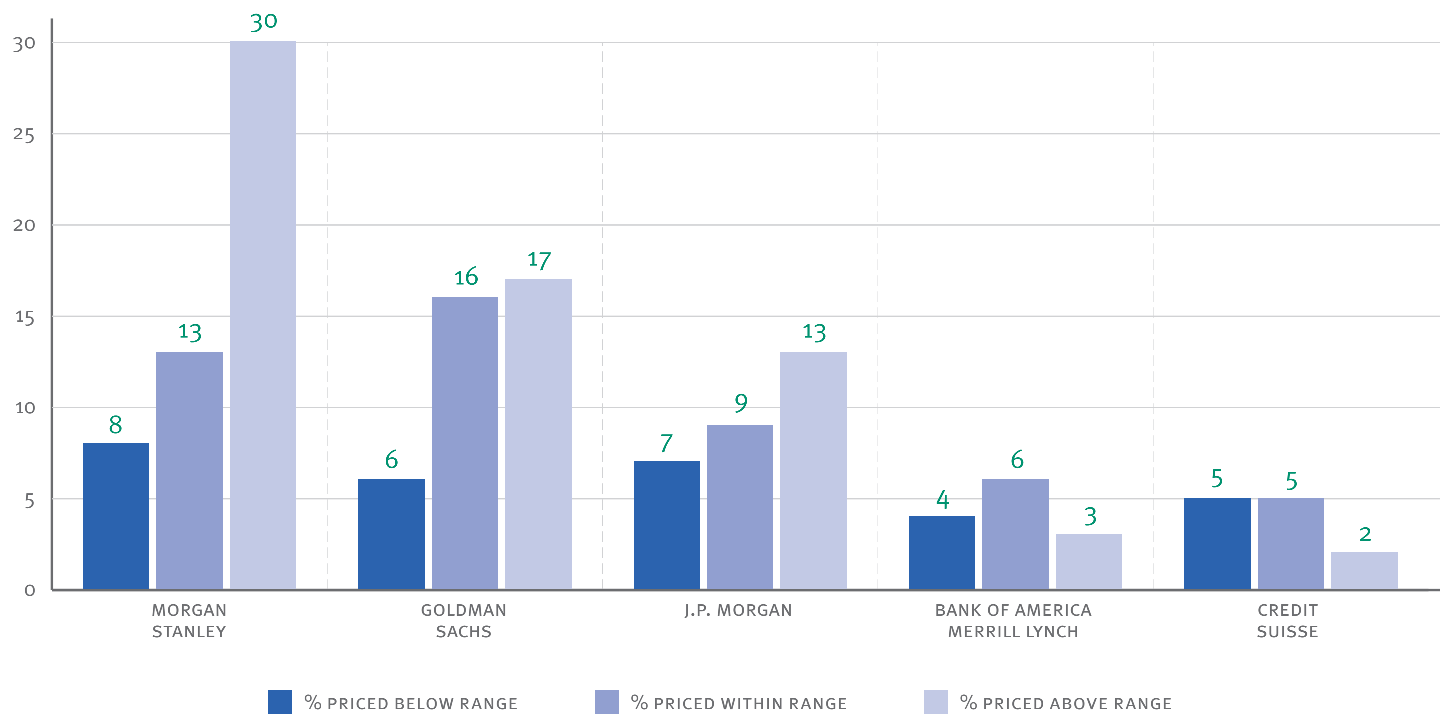
Q4 2014 vs. Historical (2009 – 2014)

The majority of the Q4 deals priced above the range initially specified in the red herring prospectus. Morgan Stanley priced the greatest number of deals above or within range in Q4 and remains the leader for historical number of pricings above the range.

Q4 2014

UNDERWRITER	BELOW RANGE	WITHIN RANGE	ABOVE RANGE	TOTAL
Morgan Stanley	2	1	4	7
Goldman Sachs	—	1	2	3
William Blair & Company	—	1	—	1

Historical (2009 – 2014)



Size of Directed Share Offerings

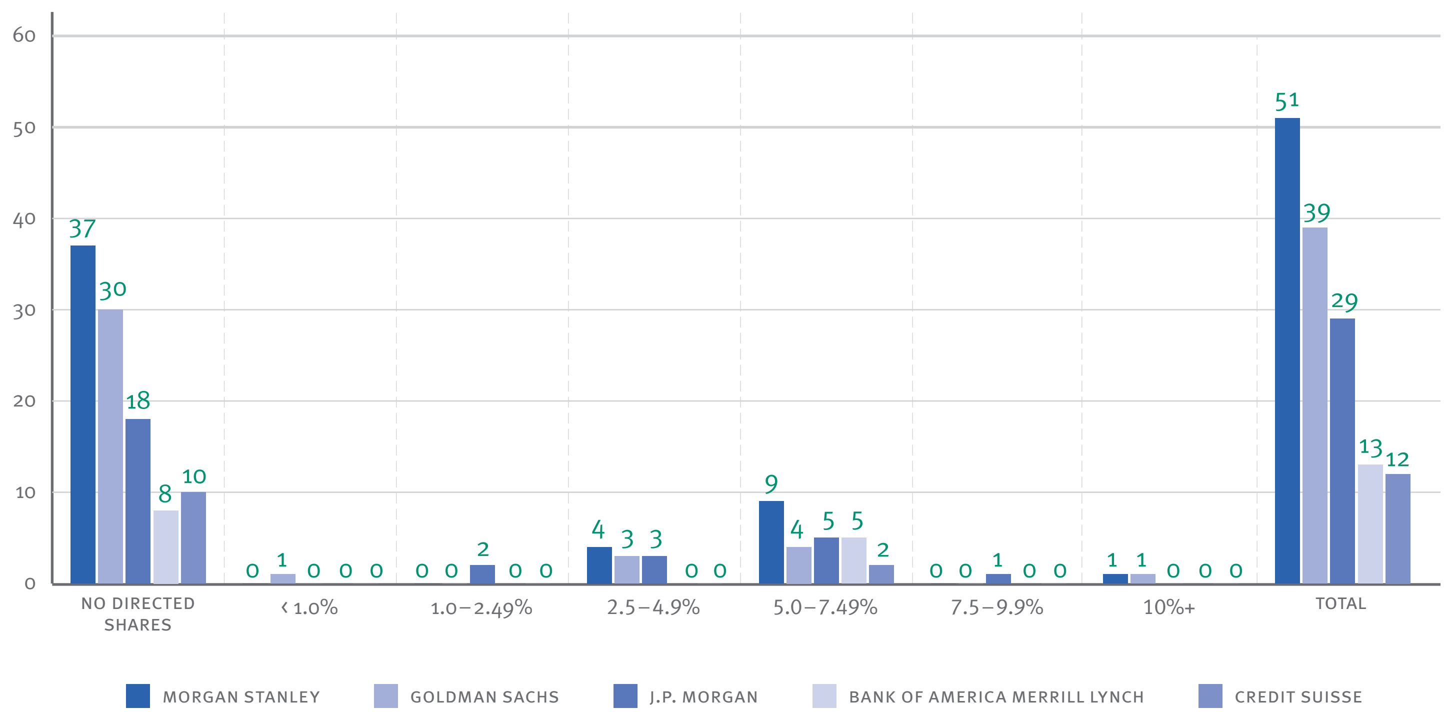
Q4 2014 vs. Historical (2009 – 2014)

While 70.8% of historical technology company offerings included no directed shares program, those offerings that did include a program most commonly featured ones within the range of 2.5%-7.49%. In Q4, three of the eleven offerings included a directed shares program, which goes against the historical trend. Of those three, LendingClub fell outside of the most common historical range at 10%.

Q4 2014

UNDERWRITER	NO DIRECTED SHARES	‹1.0%	1% – 2.49%	2.5% – 4.9%	5.0% – 7.49%	7.5% – 9.9%	10%+	TOTAL
Morgan Stanley	5	—	—	1	—	—	1	7
Goldman Sachs	2	—	—	—	1	—	—	3
William Blair & Company	1	—	—	1	—	—	—	1

Historical (2009 – 2014)



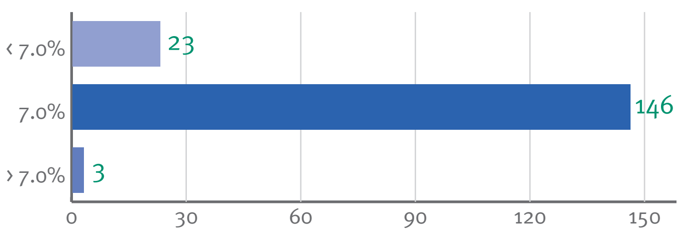
Underwriter's Discount
Q4 2014 vs. Historical (2009 – 2014)

Over the historical period, 84.9% of offerings (146 of 172) had an underwriting discount (the difference between the price an underwriter pays an issuer and the price at which it sells the offering to the public) of 7%. All but three Q4 offerings followed this trend. LendingClub, Zayo Group Holdings and Wayfair all had discounts below the 7% historical trend. The table below details the gross proceeds for the offering in the historical period in which the issuers were able to negotiate a discount below 7%. In the majority of cases, these were possible in large offerings – the median offering was $575.00 million, and the mean was $1.490 billion.

Q4 2014

UNDERWRITER	‹7.0%	7.0%	›7.0%
Morgan Stanley	2	5	—
Goldman Sachs	1	2	—
William Blair & Company	—	1	—

Historical (2009 – 2014)



Gross Proceeds for Exceptions (<7.0%)

COMPANY	PROCEEDS ($ IN MILLIONS)
Facebook (1.1%)	$18,407.91
Verisk Analytics (4.0%)	$2,155.91
Twitter (3.25%)	$2,093.00
Zynga (3.25%)	$1,000.00
Groupon (6.0%)	$700.00
Workday (6.0%)	$637.00
Sabre (5.25%)	$627.20
CommScope Holding Co., Inc. (5.25%)	$576.92
Vantiv (5.5%)	$575.00
EVERTEC (5.5%)	$505.26
CDW (5.5%)	$454.54
GoPro (6.0%)	$427.20
West (5.7%)	$425.50
Bankrate (6.0%)	$300.00
Zulily (6.5%)	$290.95
Aeroflex (6.25%)	$267.15
Endurance Int'l Grp Holdings (5.0%)	$252.61
Arista Networks (6.0%)	$225.75
STR Holdings (6.5%)	$139.95
SunEdison Semiconductor (6.75%)	$93.60
LendingClub (5.8%)	$1,000.50
Zayo Group Holdings (5.4%)	$95.00
Wayfair (6.0%)	$597.40
Median	**$575.00**
Mean	**$1,490.00**

Antitakeover Defenses
Q4 2014 vs. Historical (2009 – 2014)

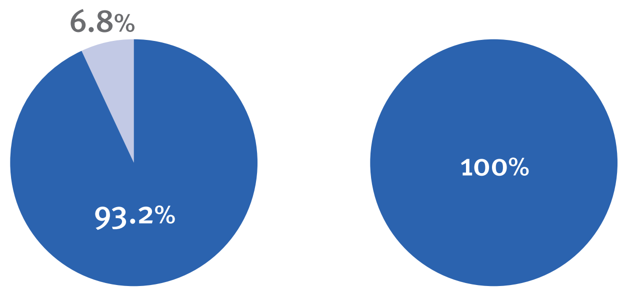
Below are the Q4 and historical percentages of adoption of various antitakeover defenses. A slight majority of the Q4 results mirror the historical norms.

BLANK CHECK PREFERRED STOCK

Q3 2014 | Historical (2009 – 2014)

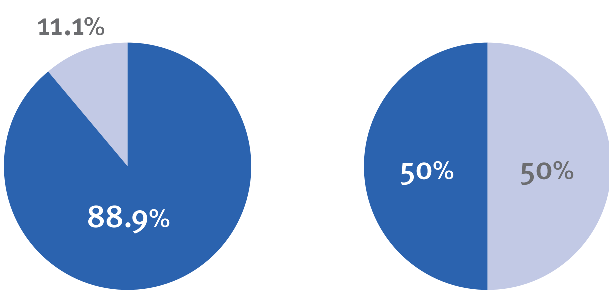
ELIMINATE S-H ACTION BY WRITTEN CONSENT

Q3 2014 | Historical (2009 – 2014)



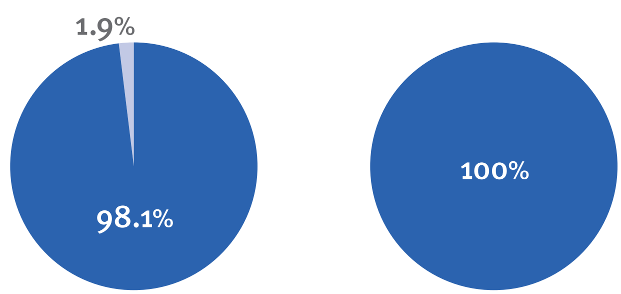
CLASSIFIED BOARD

Q3 2014 | Historical (2009 – 2014)



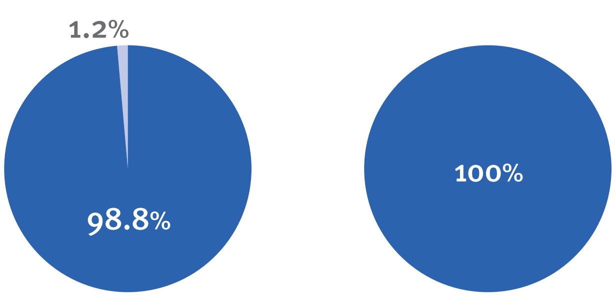
ELIMINATE CUMULATIVE VOTING

Q3 2014 | Historical (2009 – 2014)



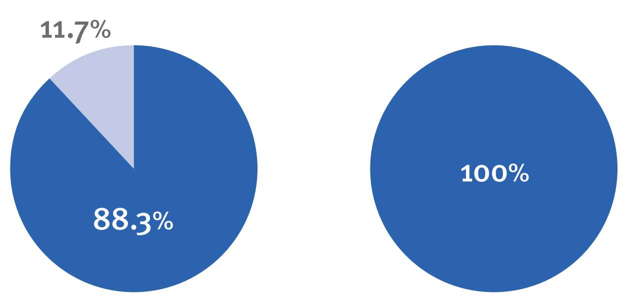
REQUIRE ADVANCE NOTICE OF S-H PROPOSAL

Q3 2014 | Historical (2009 – 2014)



SUPERMAJORITY TO AMEND CHARTER

Q3 2014 | Historical (2009 – 2014)



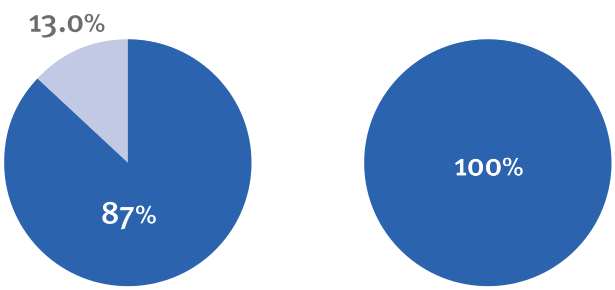
Antitakeover Defenses

Q4 2014 vs. Historical (2009 – 2014) cont'd

Below are the Q4 and historical percentages of adoption of various antitakeover defenses. A slight majority of the Q4 results mirror the historical norms.

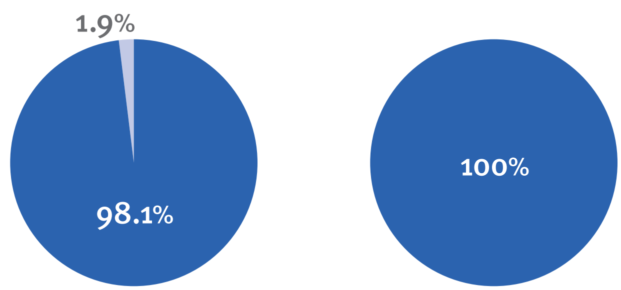
LIMITATION ON REMOVING DIRECTOR WITHOUT CAUSE

Q3 2014 | Historical (2009 – 2014)



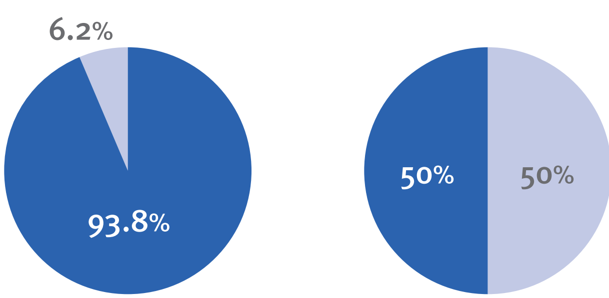
LIMITATION ON WHO CAN CALL S-H MEETING

Q3 2014 | Historical (2009 – 2014)



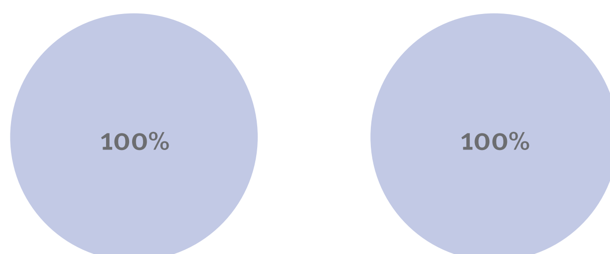
BOARD VACANCIES FILLED BY BOARD VOTE

Q3 2014 | Historical (2009 – 2014)



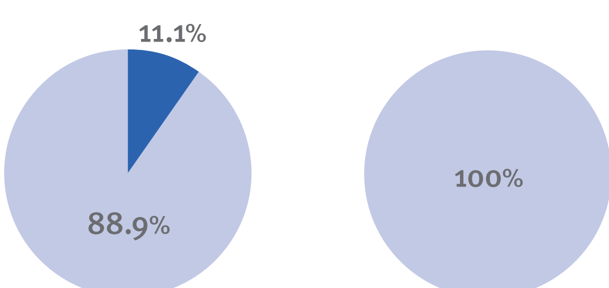
OTHER DEFENSES (POISON PILLS, ETC.)

Q3 2014 | Historical (2009 – 2014)



DUAL CLASS STOCK STRUCTURE

Q3 2014 | Historical (2009 – 2014)



Methodology

METHODOLOGY

Data included in the Orrick Technology IPO Insights report includes U.S. technology companies with principal executive offices in the U.S. and an effective date on or after April 15, 2009, and is gathered leveraging public resources such as the U.S. Securities and Exchange Commission web site, press articles found via Google search and market information via Google Finance. All transaction details are derived from SEC documentation, while details regarding use of the over-allotment option are gathered through SEC documentation and press reports.

The companies considered in our report's data include the following:

2U
A10 Networks
Active Network (ACQUIRED)
Aeroflex Holding Corp.
Aerohive Networks
Ambarella
Amber Road
Ancestry.com (ACQUIRED)
Angie's List
Applied Optoelectronics
Archipelago Learning (ACQUIRED)
Arista Networks
Audience
Bankrate
Barracuda Networks
Bazaarvoice
Benefitfocus
Boingo Wireless
Borderfree
Brightcove
BroadSoft
CafePress
Calix
Carbonite
Castlight Health
CDW
ChannelAdvisor
Chegg
CommScope Holding Company, Inc.
Connecture
Control4
Convio (ACQUIRED)
Cornerstone OnDemand
Coupons.com
Covisint
Cvent
Cyan
Demand Media
Demandware
DynaVox (DELISTED)
E2open
Ellie Mae
Eloqua (ACQUIRED)
Endurance International Group Holdings
Envestnet
Envivio
EPAM Systems
Epocrates (ACQUIRED)
EVERTEC
Everyday Health
Exa Corporation
ExactTarget (ACQUIRED)
ExOne
Facebook
Financial Engines
FireEye
Five9
Fortinet
FriendFinder Networks (ACQUIRED)
Fusion-io
Gigamon
Global Geophysical Services (DELISTED)
GoGo
GoPro
Groupon
GrubHub
Guidewire Software
Health Insurance Innovations
HealthEquity
HomeAway
Hortonworks
Hubspot
Imperva
Infoblox
Inphi Corporation
Intermolecular
IntraLinks Holdings
InvenSense
Jive Software
Kayak Software (ACQUIRED)
KEYW Holding Corporation
LendingClub
LifeLock
LinkedIn
Liquid Holdings Group
LogMeIn
M/A-COM Technology Solutions
Marin Software
Marketo
Mavenir Systems
MaxLinear
MediaMind Technologies (ACQUIRED)
Medidata Solutions
MedQuist Holdings (DELISTED)
Meru Networks
Millennial Media
MobileIron
Model N
Motricity
NeoPhotonics
New Relic
Nimble Storage
OnDeck
OpenTable
Opower
Palo Alto Networks
Pandora Media
Paycom
Paylocity Holding Corp.
Peregrine Semiconductor
Proofpoint
Q3 Holdings
Qlik Technologies
Qualys
QuinStreet
Rally Software
ReachLocal
RealD
RealPage
Responsys (ACQUIRED)
RetailMeNot
RingCentral
Rocket Fuel
Rosetta Stone
RPX Corp.
Rubicon Project
Ruckus Wireless
Sabre
SciQuest
SemiLEDs
ServiceNow
ServiceSource International
Shutterstock
Silver Spring Networks
SolarWinds
Splunk
SPS Commerce
SS&C Technologies
STR Holdings
SunEdison Semiconductor
Synacor
Tableau Software
Tangoe
TeleNav
Textura
Tremor Video
TrueCar
Trulia
TubeMogul
Twitter
Ubiquiti Networks
Upland Software
Vantiv
Varonis Systems
Veeva Systems
Verisk Analytics
Violin Memory
Vitacost
Vocera Communications
Wayfair
West
Workday
Workiva
Xoom
Yelp
Yodlee
YuMe
Zayo Group Holdings
Zendesk
Zillow
zulily
Zynga