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Technical Advisory Firm

SEC Approves NYSE Proposal to Permit Primary Offerings at Time of Initial Direct Listing

by

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Executive Summary

On December 22, 2020, the SEC finalized its approval of proposed rule changes by the NYSE to modify the provisions related to direct listings. The rule change will allow a company that has not previously had its common equity shares registered under the Securities Exchange Act of 1934 to conduct an initial public offering of its common equity shares at the time of effectiveness of a registration statement as part of its initial direct listing without a firm commitment underwritten offering. In other words, a company can sell new shares directly through the exchange at the time of its initial direct listing without the use of an underwriter (referred to as a "Primary Direct Floor Listing"). The sale of common equity securities by existing shareholders in a direct listing was already permitted by NYSE rules, and may be combined with a Primary Direct Floor Listing.

The rule change provides private companies seeking to go public with another option to raise capital through a public share offering in addition to traditional IPOs and SPAC mergers.

Comparison with Traditional IPOs and SPAC Mergers

In a traditional IPO with a firm commitment, an underwriter enters into an agreement with the issuer in which it commits to purchase a specified number of shares at a negotiated discounted price. The underwriter then resells the shares to investors at the public offering price prior to the opening of trading. In a direct listing, there is no initial sale to the underwriter. Instead, the shares are sold directly to investors through the exchange, and the price is determined based on matching buy and sell orders in accordance with applicable listing rules.

In a SPAC merger, a company merges with an existing public shell company that was created (pre-funded by investors) to acquire a private operating company with attractive growth potential. The price of the merger is negotiated between the SPAC and the private operating company. Upon completion of the merger, the combined company is a public operating entity. In a SPAC merger, capital for the private operating company is typically raised through cash held in trust at the SPAC, and/or underwritten private investments in public equity ("PIPE offerings").

Requirements for a Primary Direct Floor Listing

To qualify for a primary offering through a direct listing on the NYSE, certain conditions must be met. For example, the shares sold through the offering must have a market value of at least $100 million,[1] the issuer must have at least 1.1 million publicly held shares outstanding at the time of initial listing, and the price per share maintained must be at least $4.00.

Additionally, the rule changes also introduced a new Issuer Direct Offering ("IDO") order, which is a limit order. The IDO order specifies the limit price, which is the lowest price of the price range established by the issuer in the prospectus in the effective registration statement. The IDO order must specify the quantity of shares offered by the issuer, as disclosed in the prospectus, cannot be canceled, or modified, and must be executed in full (or not at all).

[1] If the shares sold will have a lower market value, an alternative measure is available to determine eligibility. That is, the market value of the shares sold through the offering plus the publicly held shares immediately prior to the listing is at least $250 million, using the lowest price of the price range established by the issuer in its registration statement.

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A designated market maker ("DMM") would be responsible for executing the direct listing auction manually and determining the auction price and whether the order can be executed in full. If the order cannot be executed in full, the order would not be executed, and no trading would take place. The IDO order would be guaranteed to participate in the direct listing auction at the auction price.

Closing Thoughts

Private companies thinking about going public and raising capital through an initial public offering of common equity securities in the foreseeable future may want to explore this new option in addition to a traditional IPO or SPAC merger. A Primary Direct Floor Listing allows the issuer to save underwriting and related costs and streamline the process of an initial public offering. Another appealing benefit is that there would be no lockup period for investors to resell their shares.

A public offering through a NYSE initial direct listing still requires an effective registration statement to be filed with the SEC, including PCAOB audited financial statements in accordance with Regulation S-X and GAAP for PBEs. Additionally, companies that complete a direct listing are subject to the certification and internal control requirements for newly public companies. Companies should consult with legal counsel when considering a public offering through a NYSE initial direct listing.

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Founded in 2003, CNM is recognized as one of the premier technical advisory firms in Southern California with Big 4 experience that provides the responsive customer service of a boutique firm. And we're a dynamic team that enlists all our energy to help transform the way your company does business – carefully evaluating your needs, simplifying your financial processes, and passionately solving problems in the most cost-effective way.

Our extensive knowledge of US GAAP, ICFR and SEC reporting skills has given us the ability to assist our clients with transactions that are not only multifaceted, but the capability to implement new or complex accounting standards. We have over 130 partners and employees in our Los Angeles, Orange County, San Diego, and New York City offices. Many of our clients are developed from direct referrals from the Big 4 accounting firms, speaking to the level of quality services we provide.

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