



Chapman, Spira & Carson, LLC

Memo from the Chairman, Bob A. Spira

CHAPMAN SPIRA & CARSON, L.L.C.

Investment Banking Consultants

(November , 1998)

This recital and the accompanying "Overview" are provided by way of introduction to Chapman Spira & Carson, LLC, (an investment banking organization headquartered at 110 Wall Street in New York City. Chapman specializes in a broad range of financial services, which are enumerated in detail below. Along with the typical investment banking functions such as mergers, acquisitions, corporate finance, consulting, and marketing, we also act for our own account, and in conjunction with others, providing early stage capital to promising new companies, while, conversely, representing well established old line major businesses. Our transactions are not limited to the United States, and much of our business is consummated offshore.

Overseas, Chapman is convinced that regions brimming with resources are entombed in the genie's bottle for all time unless someone with a magic "opener" arrives to release them. We inaugurate an offshore assignment by achieving a thorough understanding of the laws, customs, mores and ethos of the region, while analyzing potential future trends and their possible effect on our client's projected transaction. We exhaustively identify marketable domestic resources and local industries that have the capacity to readily adapt to the rigorous competitive demands of the world market. The adaptation must inherently occur within the economic constraints of quality production at competitive prices with an indigenous, highly motivated labor force that is capable of absorbing new technologies as changes occur. This methodology allows us to recognize regional patterns and economic anomalies, thus giving us the ability to predict the shifting of industrial strength from one region to another. The latter, in turn, guides Chapman when matching local businesses with technology-donor corporations. Only those candidates that comply with our intensive search criteria are selected.

We regard ourselves as extremely proficient apropos the nuances of the Pacific Rim, the Eastern Block, South America and Africa. These operations are complimentary to our ongoing domestic investment banking business. Our associates are very familiar with ramifications of offshore transactions in these regions. Among our team of professionals are some of the country's most talented accountants, attorneys and economists, each specializing in a distinct component of global economics. They have been hand picked based on their knowledge of local custom and law, their personal integrity, and, ultimately, their ability to get the job done for our clients.

The Chapman team is equipped to optimize the client's transactional requirements in numerous financial disciplines. By positioning our firm exclusively as an independent financial advisor, we bring to bear substantial resources. This permits Chapman's staff to clearly convey our client's goals to firms that we have identified as logical strategic financial partners. Even in the area of financing we are careful to evaluate synergistical relationships well suited for the task of providing substantive results within *contractually* discernible time parameters.

One of the most sophisticated resources in the Chapman arsenal is the algorithm based regression analysis model created by MCC. This is a highly complex mechanism, which takes advantage of advanced mathematical and electronic principles, which allow the establishment of concentric simultaneous database structures. The database is created synthetically through the use of highly refined electronic "agents". As a result, we are able to reach conclusions quickly. Although the database has

philosophical problems dealing with aesthetic anomalies, it is still able to encompass multiple platforms containing unlimited data and information. The system is also self qualifying and internally correcting, permitting the firm to assume a very high level of accuracy.

Once the candidate's data has been thoroughly reviewed for accuracy, our economists are positioned to propose a variety of functional investment banking services. These run the gamut of: strategic planning and partnering, reverse mergers, acquisitions and financings. The firm's financing capabilities include bridge loans, private placements and initial and secondary public offerings. If the determination has been reached that "go it alone" financing is the optimal approach, the profile driven system is able to identify which variation will generate the foremost long-term benefits for the client. The system is also capable of assessing which currency translations will best support "risk averse" financing.

Barter, which is generally disregarded as a financial tool in the United States, is routinely evaluated when we are addressing the optimum design of our proposed strategy. A joint venture with the largest barter firm in North America opens up a nearly insatiable market for competitively priced quality products produced in the target region. Through a complex system of cost analysis, profit margins are established for marginal excess production that usually cannot be disposed of locally. In most export transactions, even after taking into consideration, tariffs, shipping, insurance and other incidentals, we are usually able to substantially increase profitability.

Chapman also uses barter as a supplemental form of credit enhancement which, under certain circumstances, can be used when other more established methods are either unavailable or prohibitively expensive. Our economists are convinced that on-line electronic commerce will eventually replace the use of money as we know it today. The eventual demonitization of cross-border transactions will remove the necessity of currency hedging. A nation's financial strength will be measured in terms of the quality and quantity of their resources, goods and services. Electronic "Country Credits", payable in whatever surplus resources that nation has available, will become "the coin of the realm". We predict a world with few middlemen in which strategically located warehouses will replace showrooms. A transaction of the future may contain thousands of links if no "one-on-one" transaction is possible. There will be infinite range of goods and services changing hands among geographically diverse groups of companies scattered around the world. Barter credits not spent will be stored in massive electronic databases awaiting a needed commodity. Predictably, these electronic credits will replace currency and create an environment requiring an ever-evolving level of knowledge to succeed. Chapman believes that it is well positioned to assist its clients in their efforts to keep pace with this coming economic revolution.

EQUITY ADVISORY

We are equally attentive in other areas as well. As an example: there are numerous well-established foreign companies that want to become United States traded public companies. Their motivations are varied, and include liquidity, credibility, wealth creation, stock and or cash acquisitions, and raising capital. The major investment banking houses have abdicated this niche market. Chapman is convinced that it is filling an economic void, and has geared up its staff to handle all facets of these sophisticated transactions.

With regard to reverse mergers, Chapman provides an efficient and comprehensive "system" for client corporations that desire to go public to augment their options while enhancing their visibility in the financial community. Each client's goals are analyzed and an individualized program is created from Chapman's "menu" of services to optimally effect the desired results.

Chapman's investment banking group has a diverse background that is well suited to accomplishing client objectives. It includes experience in the international sphere, management of public companies, and high level experience in the legal, accounting, financial, investment banking, money management, marketing and sales, and advertising and public relations areas. Chapman, thus, has the ability to call upon the people with the specific skills needed to make a company's transition from private to public ownership a successful one, and or achieve visibility for the company within the investment community.

The four senior managing directors of Chapman have substantially more than a century on the "Street", having served in almost every arena constituting the global financial marketplace. We provide clients access to the New York financial community, including, brokerage firms, banks, consultants, venture capitalists, as well as lawyers and accountants, all uniquely positioned to provide backup to the client's particular needs. Chapman's primary goal is to establish long-term relationships with those who seek guidance.

Chapman's combination of experience, competence and personalized service, when viewed in tandem with the unusual niche in which it operates, may indeed, provide the difference between success and failure for client companies. From underwriting to reorganization, our years of experience have taught us how to get the job done efficiently, while diligently adhering to the parameters laid out by the client. Over the years, members of Chapman's senior management have served on distinguished Wall Street Committees, and have held numerous memberships on the New York and other Exchanges. Further, our services in the areas of securities regulation, arbitration and new products development on the New York, American and Boston Stock Exchanges along with the National Association of Securities Dealers, has afforded us enviable personal relationships with managing partners at many of Wall Street's most venerable firms. One of our associates is the Managing General Partner of a group of seven of the most prestigious financial organizations in the United States: , Bankers Trust, Solomon Brothers, Goldman Sachs, and other well known organizations. A senior partner was an early member of the elite group first certified as a C.I.R.A. by the prestigious "Association of Insolvency Accountants" (A.I.A) "Certified Insolvency Reorganization Accountants" (C.I.R.A), which counts as its members the leading bankruptcy and reorganization practitioners in the Country. These connections remove much of the guesswork when it comes to the bottom line: *"getting the job done"*.

We are confident that we have addressed many, if not all, of the critical issues relative to financial structuring, credit enhancements, currency fluctuations, arbitrage, barter, and trade credits within our database. The firm has worked with the Export-Import Bank, the World Bank, the World Health Organization, the United Nations, the Department of State, the FDA, New York State, as well as congressional committees and individual members of Congress. We have been invited to work with many state and foreign development associations, and have consulted and/or testified on behalf of various government organizations, including congressional committees, the U. S. Treasury, the Federal Reserve Bank, the General Accounting Office, the U.S. Trustee, the Securities and Exchange Commission and the United Nations. We have been quoted in Forbes, The Institutional Investor, The Wall Street Journal, Chief Executive, and Business Week, among others.

We have concluded transactions in the fields of banking, pharmaceutical, electronics, software, computes, Internet, intellectual property, learning, leisure, mail-order, mining, real estate, financing, designer clothing, energy, publishing, fabrication, oil and even in sophisticated surveillance equipment, among many others. (our client list is available upon request). We have concluded these transactions as principals, as brokers and as combinations of the above and are also receptive to client's requests to supervise negotiations in particular facets of transactions in which they had no familiarity.

We invite your company to make use of our resources. An important caveat is the fact that our fees tend to be success-oriented; as a result, we are extremely circumspect when reviewing a potential client's business objective. Chapman must be satisfied that the goals set forth are logical, achievable and legal. Furthermore, it is important to us that our transactional input benefit all involved parties and that additional resources can be optimally utilized by present management. All of our associates are individually responsible for assuring the successful culmination of each project.

APPENDIX

A REPRESENTATIVE LIST OF INVESTMENT BANKING AND SHAREHOLDER RELATIONS SERVICES AVAILABLE THROUGH Chapman SOURCES.

1. Preparation of a comprehensive business plan, which details a client company's history, current operations, financial condition, and future plans and prospects, supported by financial forecasts and other associated documents. The "Plan" is a company's primary document for introducing itself to the financial community. Additionally, it provides the business and technical information that the professional advisors and attorneys will require to prepare the various legal documents.
2. Preparing pro-forma financial projections designed to be utilized by the investment community and potential individual investors as a means of evaluating the potential of the company's securities and their suitability as an investment.
3. Making capital structure recommendations, which reflect the realities of the financial marketplace and the needs of shareholders, broker dealers, investment bankers and the financial media. Usually a company desiring financing will be offered what is called a "cap rate" for its shares (the offering price multiplied by the total number of shares to be issued and outstanding on the completion of the offering).
4. Arranging for the placement of a company's securities, through an initial public offering, secondary, private placement, and bridge or mezzanine financing. This is much more sophisticated than commonly believed by lay people.

5. Providing a publicly trading "shell" or "pool" under advantageous terms. The choice would be predicated on the client's particular needs and the availability of a suitable vehicle.

6. Recommending legal and accounting services, which reflect a client's specific requirements. For example, one client might require sophisticated representation in the intellectual property arena, while another could well have international accounting or legal concerns. Preparing and coordinating regulatory filings, notices and applications, including those required by federal and state agencies, shareholder notifications, stock exchange listings and credit rating bureau applications. Procedures can be set up to ensure that ongoing filings are made in a timely fashion and that record keeping is properly maintained. While this is normally handled by in-house professionals, economics may play a critical role in determining whether these functions will be handled by outside firms. The weight of these additional reporting requirements are sometimes forgotten during the heat of assembling a public underwriting document. There are many service organizations that can perform various parts of the responsibility, both professionally and at a reasonable cost but, if you don't know how to contact them or worse, lack the knowledge that they even exist, you may wind up spending substantial dollars and not even gain first rate treatment.

8. Arranging representation for clients in the unpleasant event that they are required to appear before various federal and state agencies under adverse circumstances. As we have noted before, the fact that you are able to afford big dollars to bring high priced assistance before these forums can be a doubly costly mistake. Just in the practice of security law, there are specialists that we work with in most regulatory arenas. As part of our services, consultation with any of our associates will be provided, should it be necessary, so that our client can best evaluate his alternatives in a timely fashion.

9. Identification of logical acquisition candidates. Almost all fledgling companies have a burning desire to become bigger, whether by internal growth or by acquisition. The nuances of acquiring another company when you are public are too complicated to go into in detail in this short synopsis. Suffice to say, our access to substantive databases, which can be filtered to address the profile presented by our client, are readily available and can determine within a short time what companies, if any, are available to be acquired. Again, this is only the beginning. Many vital companies have been turned into ashes by not dotting the i's and crossing the t's when entering into a merger. We have available for our clientele, a checklist that provides, at least a valuable start in attempting to "cover all of the bases".

10. Advise on how to maximize return on corporate cash balances, while adhering strictly to SEC guidelines. One of our associates has spent, literally, his entire life in this field. He has been a consultant to many of the largest banks in this Country. One of his specialties is cash management and at the level of his expertise we have generally found that he is able to create a higher return on cash balances. This again is what we believe to be a unique service of Chapman.

Function as a client's "Investor Relations Department". This includes keeping in close contact with key investment banking institutions and others in the financial community and supervising the preparation and distribution of materials, such as annual reports, 10-K's and proxy statements to shareholders, the media, the brokerage community, and all other interested parties.

Establish strong financial public relations with market makers, retail brokers, the media, etc. This is accomplished by working closely with the appropriate members of the financial community who can assist the company to gain broad based exposure, recognition and stock distribution, both domestically and internationally. Only the highest visibility companies are able to attract investors attention in a vacuum (We are not sure that this is true either). The fact that a company is public is not enough to garner investors' interest. The company may be sanguine about the price of their stock, "because we are not going to sell it anyway", but as we have described in the footnote of Item 11, things in life are not that simple. The price of the stock becomes of great consequence when a merger involving the company's shares is contemplated and the shares drop under the original offering price, or at the time that management wants to sell a portion of their stock to raise money for taxes and there is no liquidity. Planning for these exigencies, at times, is as important as the strategic planning that goes into determining the company's overall business direction.

13. Coordination of corporate and/or product promotion campaigns to enhance company visibility to the financial community and commercial marketplace. Any company is a by-product of all of its facets and a successful face creates an image of success, thus indirectly causing demand for its products and, potentially, enabling management to increase profits.. When higher stock prices are thrown into the brew, the resultant mixture can act as a marvelous sleeping aid for management.

14. Develop programs to introduce a non-domestic company and its products to the United States domestic market; these programs could include introduction to potential strategic domestic partners and/or distribution networks, product placements and the coordination of trade show activities. This may be more of a problem for the offshore company that is not fully familiar with the American distribution and media system. Because they have evolved into such a mature combination, very often a successful product launch can become more of an issue of public relations than advertising. Our society is more interested in

who else is driving a certain car or using a type of exercise equipment. If Michael Jordan told the world that he owed his basketball success to eating a nourishing bowl of "preserved turnips", each morning, every grocery store in the country will have arranged extra shelf space for the inevitable run-on turnips within hours. There is a critical balance between the use of these type of media, which we believe is somewhat unique to this country. There are professionals available to our clientele that specialize in developing sophisticated marketing techniques for "off-the-shelf" as well as unique offshore products seeking penetration of geographically specific locales. We would certainly recommend that, before a client embarks on an expensive promotional campaign, it would make strategic sense to permit our experts to evaluate the situation and determine the best course of action. This, as with the services addressed previously, carries no obligation on the part of our client and, if nothing else, serves as a sounding board for the company to use, when needed.

15. Planning and administering of annual and due diligence meetings. This is usually the function of the brokerage firm designated to raise money for the company, but often, they become cavalier when addressing the issue of conducting a high-level meeting which would top producers from the "right" broker-dealers. We have had substantial experience coordinating these meetings and / or helping others plan the event so as to best show off the Company's wares. Naturally, we would be pleased to augment the Broker-Dealer's invitations with our proprietary list, which contains many of the critical Wall Street names.

16. Serve on the company's board of directors. Occasionally we serve on various corporate boards, if so-requested by our clients. It is our feeling that if we can arrange for strategically placed, highly visible people, with tangible name recognition, to serve in our stead, it creates a type of public relations that money can't buy. Many of our clients have requested that we arrange advisory boards of illustrious individuals in the company's field and have done so in the past with great success. As to directors, it is possible to create "blue ribbon boards" but there are elements that make this more difficult. If the company is in a high risk business such as pharmaceuticals or medical instruments, where there may be substantial personal litigation risk to the officer's and director's for any number of reasons, Directors and Officers liability insurance is practically mandatory. Many of the insurance companies we are acquainted with write this type of policy and, under certain circumstances, the cost does not have to be prohibitive. If management desires this service, usually all of its aspects can be handled in-house.

The next page on the web:

- *Coping With Changing Environments*
- Maximization of Your Results, Staying Within Your Abilities and Not Stubbing Your Toes.
- In an innovative approach, Chapman Spira and Carson has established an offsite evaluation and systems department for small to mid-sized companies. The purpose of this division is to provide management with all of the necessary tools to facilitate decision making in our ever-evolving business scene. The day of the local cabinetmaker who only had to concern himself with where to buy the best wood to build his product are over. We are overwhelmed with innovation, which allows today's business the ability of expanding beyond anything before dreamed possible or in the alternative falling prey to competitors that are not even visible.
- Technological innovations such as the Internet have changed the way products are marketed. No longer is your only competition the guy next door. Today he can be across the continent and tomorrow he may reside half a globe away.
- Banking has also altered its face as the era of dropping by the local office and refinancing the business over lunch has gone the way of the dinosaur. The financial business has become institutionalized and loans are made more by being a candidate that the computer recognizes as a good risk than a good dining companion. Dealing with the banking community now requires new expertise totally contrary to the requirements of the past.
- American industry has learned well from the Japanese, and we have taken their "*just in time*" inventory methodology and lowered the average amount of time that the product is kept on the shelf from a two month supply to that of one month. This has caused suppliers to look for less expensive and more exact ways of shipping product, more centralized manufacturing facilities and alternative raw material suppliers.
- The minimum wage has been raised recently and payroll expenses continue to climb. Unemployment has reached almost at historic lows while immigration has been cut off. Green cards are no longer issued by the Passport and Emigration Service upon request and the union movement has regained strength. Insurance costs have risen unmercifully and social security rates continue to climb. It would take a Ph.D. just to follow what is happening on a daily basis. It is not conceivable that a small business's can do this and grow their business, the number of hours in a day has remained at a constant twenty-four.
- The rules and perceptions regarding corporate reorganizations have changed dramatically over the last several years and the stigma of using the regulations covering these actions has literally evaporated. Many of the practices that historically were considered immoral are in today's climate considered "*good business*". All business has good and bad times. There are alternatives to cover the rough spots that were not viable just a few short years ago.

- During the Republican years, many of the government agencies that were charged with aiding businesses had much of their funding diminished severely. *The Clinton Administration* has taken a 180-degree turn and resurrected many of the old programs while simultaneously aiding new ones. There are programs geared to assist all businesses, not just minorities. It is only a matter of knowing what they are and how to go about utilizing them. The states have also installed economic development programs that can be of great value to the entrepreneur if you just know where to find them.
 - Roll-ups have become the new Wall Street fad. A roll-up is simply the combination of a large number of small businesses within the same general business category for the purpose of saving money through greater purchasing power, sharing general and administrative expense, keeping up with government regulations, analyzing current business trends and creating solid marketing plans to cope with the ever changing marketplace, and ultimately to go public at a combined price earning ratio far higher than the local business would ever have received by itself. Car agencies, doctor's practices, franchised food takeout stores, hardware stores and funeral parlors are just a few of the recent "roll ups" that have "worked" for owners and investors alike.
 - The only way for many to survive would be the acquisition on other competitors so that you can receive the benefits of quantity discounts in materials and shipping. Centralized manufacturing, low tax and available labor areas are also important consideration. The quest for financing, location and acquisition is time consuming and an art form that takes a lifetime of experience.
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- These are some of the areas that our management experts cover. Let our people come in and make recommendations on everything from the ground up. We will also individualize management assistance on an ongoing basis for as long as it may be required under a number of unique plans because they don't know whether it will ever be worth anything. For the most part this is a pretty hard sell. However, there are some exceptions. You can use what is called the "Bill Gates Anecdote" about the guy that knew Bill from school, who went to work for him and faithfully took his entire salary in Microsoft Stock. The loyal employee in question now owns two major-league sports teams and is one of the richest people in the United States.
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- Raising Money in the Public Marketplace. The Terms, The Tricks and the Essence.
 - This memorandum has been an attempt by Chapman Spira and Carson LLC to put in rational prospective the process of going public. We have attempted to make the reading of a most difficult subject enjoyable and have added a few stories of our own to illustrate what we believe to be important points. We are not underwriters, or even brokers for that matter so this is a primarily public interest document, but if there are questions that arise when perusing the material presented, please free to call or e-mail us and we will do our best to get back to you with a response. If you have a deal that should happen, let us find you a firm on the "Street" that best suits your criteria.
 - What do we do first?
 - Before you raise money publicly (or any other way) you should consult your lawyer and accountant and ask them about the advantages of incorporation. It is generally more suitable to use a corporate structure because personal liability is diminished and, for practical purposes, it is the only entity that is acceptable for public offering purposes. The risk of raising money in our own name is that if things do not go as well as expected you could find yourself either in bankruptcy court or paying creditors off for a long time to come. Incorporation is a relatively painless process and can be accomplished literally overnight in most jurisdictions. Legally, you are allowed to incorporate wherever you desire, and substantial competition exists among the states in the form of incentives to induce corporations to chose their locale. These incentives include lower tax rates and protection of officers and directors from certain types of litigation under specific statutes. The state in which you ultimately incorporate has no bearing on where your business is located. Your lawyer and accountant will give you advice concerning the best jurisdiction and the best corporate form to fit your long-term goals.
 - SECTION ONE
 - Corporation- must apply for a charter "Articles of Incorporation." Or "Certificate of Incorporation". Before incorporating you will have to know:
 - What name you want to give the corporation
 - Where you want to incorporate
 - How many shares you want to be able to issue
 - How much money the corporation can or should borrow
 - What each of the officers should be able to do
 - Who the original directors of the corporation will be and where they live
 - This stuff is all pretty basic although certainly important. Of the checklist above, the name is most important and should be considered carefully. Changing it down the road can be both confusing and expensive. The name should relate to the company's business and send a message that tells people that see it what you are about. General

Motors obviously sells cars, Mary Carter Paint Company didn't sell paint at all but would you believe owned Resorts Casino.

- Board of Directors
 - The Board of Directors is elected by the stockholders. On day one, the original incorporator who probably owns most if not all of the stock calls a meeting and names the board. If you are attempting to raise money, you should add some strength and maturity on the board with you. This means the wife and kids may not be your best choices as Board members. As a general rule we would also eliminate from consideration, hardened criminals, defrocked clergy, and disbarred lawyers. Investors generally like to feel that the people guiding the ship have been through the treacherous waters of business before, and can react constructively to any problems that may arise.
 - When you are talking to people about raising money, you may need to know the meaning of some key words:
 - Capitalization
 - Webster's defines capitalization as: "The total capital funds of a corporation represented by stocks, bonds, undivided profits, surplus, etc."
 - Capitalization is composed of debt and equity. Stocks are commonly referred to as equity securities. Bonds are commonly referred to as debt securities.
 - It pays to get your lawyer's and accountant's best thinking on the initial capital structure. After the initial capital structure is in place, any capitalization change must be approved by the stockholders, who can get to be a pain. It is best to have an unlisted telephone number at home, if you intend to have a lot of shareholders.
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- There are different kinds of shares of stock and the number of possibilities are as great as the human mind has the ability of thinking things up. We have simple things like voting and non-voting common. We have participating and non-participating shares; you may ask participating in what and I would answer, participating in anything, dividends, votes or conversion, take your choice. We have war-like classifications such as exploding common and preferred and more down to earth items such as founders shares. There are shares with warrants attached and shares that have rights to more shares and there are shares that have shares. Drexel Burnham during the Millikin years probably did more for exponentially expanding our equity universe with new creations than had been accomplished in total since man first walked upon the earth. In spite of the above we will go into some of the classifications that you will run across in the ordinary course of affairs.
 - Authorized Shares
 - The authorized shares are the total number of shares issued and in the hands of stockholders along with those that may be issued at some later date by a vote of the Board of Directors of the corporation. Our corporation could have 500 authorized shares of which you own 300 and other shareholders hold 100. Another 100 is in the treasury and can be issued on Board authorization for any legitimate corporate use. It may be better to issue more shares than you currently need in order to avoid having to beg the shareholders down the road to approve more if something good comes down the pike.
 - Hypothetically, the competition could be in a situation where it would be in the family's best interest to get their estate planning in order and exchange their shares for those in a publicly traded company. The head of the company is very ill and the lawyers want to make a quick deal to avoid extensive probate problems. The easiest deal to make quickly is usually one in which the negotiators are familiar with each other. You, as their primary competition, fall into that category and when their lawyers reach out to you, it becomes quickly obvious that this would be a terrific fit for all concerned. An agreement is quickly reached on the number of shares to be exchanged. However when your corporate secretary checks he finds that there are not enough shares authorized to accomplish the transaction within the timeframe required.
 - The by-laws require that certain notice must be given to shareholders regarding the issuance of additional shares. In spite of the fact that it is a foregone conclusion that the transaction would have ultimately been approved; the insiders that negotiated the merger also control 50% of the company's shares, but yet there is no realistic waiver to the required notice period. The condition of the competition's president becomes grave, his lawyers determine that although you are the best deal for all concerned, they just cannot take the time to wait for the shareholders to agree to the issuance of additional shares.
 - The company is quickly sold for less money to someone else. The new purchaser turns out to be in a much stronger financial condition and dedicates his substantial resources to his newly acquired line of business. The result becomes a disaster, you were not fortunate enough to acquire a major competitor and that have forfeited the benefits of increased volume and the savings of lower unit costs. Worse, you are now confronted with a competitor far more formidable than before only because someone had fumbled the ball and had not taken the simple precaution to have additional authorized shares on the shelf in case something like this happened.
 - One of the most canny guys we know jokingly asks his lawyers whether their malpractice insurance is fully paid up when they are setting up new corporations. Although incorporation itself is one of the most painless tasks in

business, the price for even the smallest mistakes can cause problems that will effect your business for a long time to come. Make sure that it is done right the first time.

- Issued shares
- Public stock is useful for more than just corporate acquisitions. You can exchange authorized shares for services necessary in getting the business started such as accounting fees, office rent, furniture and fixtures, fees for board members and executives and employee salaries. In many cases, until the company has gone public most people are reluctant to accept stock because they don't know whether it will ever be worth anything. For the most part this is a pretty hard sell. However, there are some exceptions. You can use what is called the "Bill Gates Anecdote" about the guy that knew Bill from school, who went to work for him and faithfully took his entire salary in Microsoft Stock. The loyal employee in question now owns two major-league sports teams and is one of the richest people in the United States.
- Treasury stock
- These are shares that were authorized but not issued, or were issued and repurchased by the issuing company. Treasury stock has no voting rights. As we have just explained, these shares just sit in a "bank" waiting for someone to draw them out. Once all the shares have been issued, the company will have to go back to the stockholders and ask them to allow the issuance of additional shares.
- Private Placement
- All offerings of stock to investors are covered by securities laws and even though sales of shares to relatives and friends seems reasonably harmless, this is not always the case. Any exchanges of cash for stock should be discussed with legal counsel. Money is commonly raised for non-public companies though private placements.
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- Generally, this is an offering of stock to investors in which the group of investors is larger than just friends and family. It may include wealthy individuals who have "been around the block" and have assets over a limit set by federal securities laws. The line between a private placement and a public offering is clear, but the rules are many and very technical. When you are deciding between the two, you need to have a good securities lawyer on board.
- So, the Blodget family incorporated the company and started up the business. They set up a small production line in the barn behind the tavern and before you knew it, they were actually producing an item, that at a meeting of the family was named, "the Blodget" after themselves. These gadgets were literally amazing, no one had any idea of how they worked and some of the stores on Main Street started carrying them. Would you believe it, people actually began buying them, some even bought more than one so that the kids could use it during the day!
- The Blodget family went to the well and raised money from the old gang in a private placement offering and used the money to retire bank debt and to hire a marketing team. Business is exploding and they now need some real money but everyone says our capital base is too small. They think we ought to go public. Out of the blue, one of the local brokers who had bought one of the Blodgets and really freaked out came back and bought them for the rest of his family. He then asked if they wanted to go public. Before you knew it a 'letter of intent' is signed with the brokerage firm next to the barber shop and they tell me that it won't be long before we will be on small cap NASDAQ, whatever that is."
- At this stage of the process you need to be familiar with some other terms:
- New Issue or "IPO" ("initial public offering")
- An Initial Public Offering is the first issue of securities by a company that has previously not been public.
- Assume for a moment that you have been through the initial public offering stage and business opportunities are continuing to come your way. The scenario could go something like this:
- So time has really flown by, someone by the name of Clinton is President and Russia has become our friend, Blodget has now been public for several years. Business has remained good and the customer baser base has been extended into the Far East and Europe. They just couldn't get the stuff out the door fast enough in the small plant in Blogetville so the Blodgets's talked to their consultants and the conclusion was that manufacturing facilities should be setup in the Pacific Rim. A partner was identified and a joint venture arranged with a Korean Company but it was required that Blodget put up its share of the joint venture expenses. The company's bank lines are at the limit creating a short term crunch and additional debt would screw up the balance sheet. Touché' recommended that we sell more stock. What is a secondary?
- The local guy that took the company public thinks that Blodget has outgrown his financial resources and came up with some suggestions as to people in New York that could raise the kind of money we're talking about. So the Blodget's's flew to New York and visited with Goldman and Solomon and Morgan and Bear Stearns. The family went to all the sport events and the nice restaurants. Cousin Franklin was so overwhelmed that he muttered, "I think they all really liked us."
- The price of poker is rising here. We think that it is time that you become familiar with some more serious words:
- Securities and Exchange Commission ("SEC") - The SEC enforces a group of federal laws that prevent fraud in the sale of securities. When your company sells securities they must be registered and must provide purchasers with a prospectus that states that in spite of the fact that the SEC has spent substantial time going over and over and over and over the offering statement, it is not making any representations regarding the adequacy or accuracy of information.

- Your accounting and legal advisors should be aware of these acts, and you should be able to trust them – I have heard something like the following a little too often from prospective clients:
- "I told the lawyers that in advertising we call it 'puffing' and it's perfectly ok. I mean, where would the automobile and cosmetic companies be if they didn't lie a little bit about the product. I told the lawyers that they are working for me, not the other way around, and that I call the shots. All I asked them to do was to carry my stamp collection as an asset on the books. It would make us look better; we'd be eligible for National NASDAQ, whatever that is, and I don't look at the collection too much any more."
- They said that I couldn't do it because of GAAP (generally accepted accounting practices) and if I tried it, I would be breaking both the '33 and '34 acts. Well I don't know much about acts, and I'm the boss, so I told them to do it anyway. They left and said something about not wanting to go to jail over my stamp collection. I'm not sure I know what to do next."
- If you want to sound smart when you talk to any of your advisors, you need to know some more about the key events and terms surrounding registration with the SEC:
 - Filing date
 - Blodget, Inc.'s filing date is their day their registration statement is received by the SEC.
 - Blodget, Inc. will have to provide at least the following information to the lawyer who prepares its registration statement:
 - Blodget, Inc. will have to describe its business and disclose the shareholdings of senior officers, directors and underwriters. It must identify people who hold at least 10% of the company's securities. The purpose of the exercise is to make sure that the public is told just who is in control of the company. Theoretically you could be John Dillinger and they would have to approve the registration if it is factually correct. On the other hand, if you were incarcerated at the time of the offering, you would have to disclose that fact as well, which might cause investors to have second thoughts about investing.
 - Blodget will have to provide the biographies of officers and directors. The SEC wants to make sure the public is aware of the skills and experience of the people who run the company. Investors want to know that the folks handling their money are not going to put it in a bag and leave the country. It is wise not to choose travel agents, airline personnel or people in the passport bureau as board members, because investors tend to think the worst.
 - Blodget will have to disclose the Company's capitalization - how funds are brought in - through stock and bond offerings. It will also be necessary to describe how Blodget made money and raised money, how it spent money and paid taxes. All those things seem to wind up on the liability side of the balance sheet and magically they are supposed to make everything come out even. Actually, I think that the accountants are cheating a little bit, I mean if it isn't exactly in balance, you can take little for over here and put it over there. It doesn't make any sense that they find every nickel and account of it. I'm sure that that is what really happens.
 - Specific uses of the proceeds. Investors want to know exactly how their money will be spent. I've heard the following a little too often:
 - "We really need the money for this joint venture in Korea, but my Shirley's car is starting to show some wear, so we will make her an officer of Blodget and let her run a division called "area evaluation" and get her a new car so the company will pay for it. After all, the kids are already running sales and marketing. The little woman should be on the old gravy train as well. The accountants say that this is all right as long as the car is used exclusively for business and that she is really working at her job. Well, I told them that this was the case, but Shirley's never been down here and doesn't even know what a Blodget is, let alone how to "area evaluate". We're going ahead and hoping for the best."
 - Blodget will have to provide certified financial statements. Unbelievably, some of the smartest entrepreneurs I've met have reacted this way to the duty of providing certified financials:
 - "So this guy that I never saw before comes in. Someone says that he is the outside accountant and that Blodget will have to certify it's books. The whole thing doesn't make much sense. If he is working outside, how can he know what happening inside? Well maybe, with the way we are running things it's all for the best and he shouldn't come in. Anyway, our regular accountants, Touché Anderson and Ross, say we have to give this fella access to all of the records. I'm not letting him see my proctoscopic x-rays though."
 - The Securities and Exchange Commission Act of 1933 is designed to provide purchasers of new issues of securities with information regarding the company and to prevent fraud in their sale. In the event the SEC sees a deficiency or misrepresentation, it can postpone the effective date of the issue or issue a stop order -- which prohibits the sale of securities.
 - Investors can sue officers, directors, principal stockholders and underwriters if a registration statement has material omissions, errors, or misrepresentation of facts. They also can sue officers, directors, principal stockholders and underwriters for anything else they want to sue them for as well. As a matter of fact, so many stockholders filed so many lawsuits against public companies that two things happened. The first was that lawyers became very rich. The second was that the price of Director's and Officer's Insurance (D & O) went to the moon. D & O insurance is the type of policy that officers and directors buy so that they can screw things up as badly as they like and not have to take the money out of their own pockets when stockholders sue them for mismanaging the company.

- In the last couple of decades, the price of D&O insurance increased faster than the Dow Jones Averages, until a recent change in the law. The important people on Wall Street became concerned when even brokerage firms became parties to the lawsuits filed against corporations. It seems that the public, for some strange reason, felt that brokerage firms should check to see that all of the things being stated by the company are true. The SEC requires that all brokerage houses involved in the money raising process make sure that everything is on the up and up before weaving their wondrous stories espousing the company's attributes to their customers. While this approach made a lot of sense to the Securities and Exchange Commission, some brokers and securities lawyers took offense at the notion that they should have known their client that well before siphoning money out of client's accounts. The general feeling among this group was that lawsuits are bad for the country, bad for motherhood and bad for members of the New York Stock Exchange. Congress agreed with the important people on Wall Street and passed new laws that were not helpful to the investing public or class action attorneys.
- Congress's law in essence states that you can't file frivolous securities-oriented lawsuits; I mean, you had better have these guys red handed or you will be looking at rule eleven charge. Lawyers who do not understand the term frivolous have taken the high road and have gone into other lines of practice. Seeing this mass exodus of litigating attorneys from the Street, insurance companies determined that they could again afford to drop their rates on Directors and Officers Insurance (DO) coverage. With the rates becoming more affordable and litigation no longer hanging over the heads of management. Wall Street has regained the more relaxed approach to funding new companies that it normally has during periods of when the government has a more *laissez faire* toward the securities business. Although it will not work out to well for the investing public, we are again seeing smiling faces on the Street, which has become a more pleasant place to work.
- Cooling off period: a time, usually measured from the day a proposed registration arrives at the SEC for its review and the day the SEC indicates it has had enough and the underwriting is a go.
- During the cooling off period, a preliminary prospectus or "red herring" is prepared by the corporation.. The document is dubbed a "red herring" because the prospectus has a cover page with a red border that advises potential investors that a registration statement has been filed, but isn't yet effective. During the McCarthy era, the word "red" had very negative overtones. Perhaps this is what the commission had in mind when they created the red stripe down the side of the offering memorandum.
- Some people that are in the know say that in King Arthur's time, when people were being chased by the hounds, if a "red herring" was dragged across the path of the hard charging dogs, the dogs senses were total screwed up by the strange smell and they lost all track of the quarry. The dictionary elucidates on this by stating that a red herring is something used to divert attention from the basic issue. We couldn't agree more.
- The "red herring" is a tentative document that will resemble the ultimately approved copy. It is used primarily by lawyers to as a draft, but occasionally brokers will share its message with their clients. For the most part neither the "red herring" nor its ultimate successor, the approved registration statement, will have anything good to say about anything or anybody. You could tell anyone within hearing distance all of the negatives, the "risk factors", but making any unqualified positive statement, particularly if it predicted the success of the company in some way, has historically been treated as a crime against nature, punishable by a long visit to a government facility at their expense.
- Problems arise during the cooling off period (also known as the quiet period for unknown reasons) when a product release occurs simultaneously and the marketing people and the legal staff become confrontational. Management steps in when this happens, the company's marketing, public relations/advertising agency and the securities lawyers meet for hours trying to reinterpret the SEC regulation so that they can hype the product and still collect the much needed funding.
- The SEC, speaking out of both sides of its mouth says in one breath that if the incident is material, the company has an affirmative obligation to publicize the event in order to keep stockholders informed as to what has happened. If the SEC believes that the event was not material, and that an announcement is made only to "hype" the securities issue, the perpetrators can be censured, fined or even imprisoned. The meaning of "material" is elusive. The SEC has indicated that they are not in the dictionary business, and added that if they told everyone what they were going to do and when they were going to do it, then everyone would know what was going on and would lose respect for their mission. Additionally there was some feeling among "the staff" (anybody that works for the SEC including the janitor) that this would probably cause people to comprehend what steps had to be taken to avoid these penalties, thus income from fines would drop causing some career people at the Commission to become unnecessary.
- One staffer was quoted saying that, "It was best for everyone if we leave definitions to Webster and just concentrate on our mission of putting people that break the rules in jail." One of the solutions that Doctor Bob came up with to avoid this problem was that companies should time product releases so that they are not released when the company needs money. Someone said to Doctor Bob that this would in effect stop the company from performing its profit making function. Doctor Bob indicated that he understood.
- Also during cooling off period, the issuer will "Blue Sky" or register the issue in the states where the underwriter plans to market the IPO. A state may approve or disapprove the sale of securities within its borders based on its own

regulations. State's regulations may contain provisions that are diametrically opposed to those in the SEC code. For many years the Securities and Exchange commission has been attempting to create a set of regulations that could be accepted by all of the states but this has been viewed as a ploy by many to eliminate regulatory competition.

- The fact that there is no compromise in sight continues to create a lot of legal business for lawyers. Surprisingly, the American Bar Association has been strongly supportive of states' rights. A sage once said that to be "Blue Skied" in all fifty states, the company must have sales of over \$100 million, no debt, no officers of questionable background, no advertising and, preferably, no product. They can have no litigation against them and the officers and directors must be regular churchgoers. Each state has its own prejudices. Some states like California and New York are liberal on taxation issues, yet conservative when it comes to certain environmental issues and straddle the road on others.
- Immediately prior to the issuance of the final prospectus, a due diligence meeting is held. The purpose of the meeting is to review various aspects of the planned underwriting, specifically the issuer's and underwriter's exercise of "due diligence" in meeting federal and state laws and examining the subject company that is a candidate for an IPO. The forum is arranged to accept questions from the audience, but usually the bar is opened for some time before the question and answer session is scheduled to begin. The objective is to encourage the audience to be receptive to the company's own version of its story. A succession of speakers then proceeds to make a series of increasingly outlandish statements intended to stampede the audience into buying the shares. The outlandish statements assume substantially greater credibility as the evening wears on. It isn't until the next day that attendees try to figure out how many shares they had committed for the previous evening. Many frantic calls are exchanged between the attendees and the syndicate manager.
- To recap, the following steps are usually taken in laying the groundwork for bringing an issue public:
- File registration statement with Securities and Exchange Commission
- Blue Sky the Issue
- Issue Preliminary Prospectus
- Due Diligence Meeting
- Issue Final Prospectus.
- Earlier we discussed in detail the steps leading up to the issuance of the final prospectus so we felt that it would be *apropos* to address the most difficult aspect of the process independently. This can be very painful for all of the people involved because no one is quite sure what the rules really are. We have been told that the SEC gives all of its examiners a secret book that details exactly what the final prospectus should contain but we have never met anybody that has actually seen it. Supposedly, each of the SEC representatives carries this book about him wherever he goes.
- Some have said it is biblical in nature and the agent is to read it at all hours that he is not on the job. This book is a roadmap advising the agent on how to best make the issuer totally miserable. When exciting new methods of torturing companies new to the process are discovered, a new edition of the book is immediately published containing this important information so that it can be shared by the field staff. Some embittered issuers have stated that the SEC must be rewarding examiners who create new impediments with substantial bonuses.
- The final prospectus must be promptly distributed to prospective buyers of the issue after the effective issue's date. Once the purchaser of the shares in the offering has had time to peruse the final document, he has the right to rescind his purchase literally for any reason whatsoever. In practice this occurs only when there are substantial differences between statements made by the broker and the facts that appear in the prospectus. Even if every client purchasing stock in the IPO, if it were a firm deal, were to rescind it would not effect the company in that they received good funds from the underwriter at the time the deal became effective.
- Many people can't tell whether they have been told the truth or not by reading the prospectus because it is written in a language which at best is must be considered most unusual. Knowledgeable people have said that it is a cross between Sanskrit and Esperanto which we are told, the SEC believes is the language of the future. Having qualified interpreters available to determine what was meant in these languages has not been too successful in court. The next hurdle the is the most difficult,
- Exempt Securities
- These are securities that are not subject to the registration requirements of the 1933 Securities Act. Exempt securities also include securities that do not have to follow certain provisions of the Securities Exchange Act of 1934 in terms of margin, registration of deals, certain reporting requirements, and the identity of market makers.
- U.S. Government and U.S. Government. Agency Securities
- Municipal Securities
- Securities issued by non-profit organizations
- Bank Securities
- They may be exempt, but we are not sure what that means. It may have something to do with registration the fact that they can be freely offered without a regulatory authority passing on them. In the particular case of Government securities, we think that the term exempt means that the government is not going to lie in an offering memorandum regarding the placement of their securities and a buyer shouldn't worry too much. In other words, if you can't trust Uncle Sam, who can you trust?

- At the same time, salesmen recommending government securities have several problems. First, there is not much profit in these instruments for the broker. Second, it is hard to get a customer once invested in governments to switch into a penny stock on which the broker makes a lot of money. Therefore, when all is said and done, the U. S. Government has taken the position that you can call its securities whatever you want, but don't call them late for dinner.
- For some period of time firms that dealt exclusively in the U. S. government arena didn't even have to be registered as a broker. Some people, such as the more prestigious brokers and banks, abused their privileges and did bad things in the government market, treating it more as their territory than the Government's. The Government became upset at losing turf and was forced to punish some of them severely. They made the government look bad. These are institutions you do business with everyday.
- The government said, even though our securities are exempt, you cannot go around breaking securities laws whenever you want. After all, the public is still protected by the anti-fraud provisions in the act aren't they? Well the bad guys said, awe come-on, when you needed your merchandise moved you didn't mind our rigging the market now and then, now that you don't need help any more you're becoming sassy. What the bad guys said is mostly true.
- Now municipal bonds are something else. They are almost universal free from Federal Taxation. Because of all the rights granted the states in the constitution, states and their subdivisions could independently do their own financing and not have to worry about paying assessments to the federal government. Because of this quirk, the states, cities, municipalities and taxing districts were able to pass along this benefit to the buyers of their bonds. Municipal bonds of an equivalent rating with that of the U. S. Government would sell at a price equal to the current federal income tax rate deducted from the equivalent government bond. In other words you have to compare apples with apples and not with oranges. A 20-year Virginia general obligation compared with a 20-year Treasury bond.
- In any event, the non-federal taxing authorities found a good idea. They would raise a lot of money by telling people that they were going to do something or other and then they wouldn't do it. (After all the bonds were exempt, weren't they?). Instead, they would buy U. S. Government paper with the proceeds, thus making a profit on the difference between their interest cost on debt and the rate they received from Uncle Sam. This caused taxpayers in states that weren't smart enough to do illegal things to ship money into states that were engaged in these activities. Luckily, I always lived in a state that knew how to do this. The fact that they lied as to what they were going to do with the money seemed to be OK because they were the government. I guess that seems all right, but I'm really not sure.
- Another thing that the non-federal tax accessing bodies can do that seems strange is that they can sell bonds that represent financing for private industrial concerns. These strange bonds are called industrial revenues. States and other taxing authorities interesting in attracting industry can give companies showing interest in their location various benefits. These could include tax abatements, free land, plant and machinery, a cash bounty for each employee they hire along with a never ending list of additional goodies if the facility will ultimately hire enough residents, produce enough taxes and become a good enough citizen. The package given to various Japanese auto companies by various states to set up manufacturing literally went on for pages and pages. I have often wondered why no American company ever qualified for something like that but Doctor Bob said it has something to do with the CIA and it is best not to pry.
- To most company's, the most singly beneficial part of the offering package is the ability to get Industrial Revenue Status. This allows the company to issue a tax-free bond and rates under those of the competition that is only paid back from the particular revenue of the project being financed. Often startup or companies with poor credit can raise money through this method that would be unavailable under any other scenario.
- Primarily, because of these strange characteristics, many people have lost their savings in these investments. Vietnam veterans and old people have been particular targets of inventive financiers who create companies as fast as nefarious brokerage houses can move the paper that they generate. To some degree a damper has been put on this activity after everyone's money was lost so I guess I shouldn't even have brought it up but I still feel sorry for some of those people.
- Charities that qualify for tax exempt status, are able to raise money with reasonable latitude. Recently one organization offered investors the opportunity of donating to a fund that would match whatever they put up dollar for dollar. Thus, the potential patrons were told they would receive a double deduction from the internal revenue service. With taxes (including federal income taxes) approaching 50% in some states, money could be given to charity and when the tax benefits were added in, there literally would be no cost to the donor and he would be held in great esteem in his community. Many important people donated to this cause because they wanted to be held in greater esteem than they already were. When the whole thing turned out to be a fraud, they became liable for unpaid taxes, and lost whatever esteem they had previously garnered and probably a little more for being such idiots to believe in being able to get something for nothing. The guy who ran the charity is going to be in jail for a long time but that won't help everybody who got screwed.
- Most of the money we donate to charity is never used for the purpose the donor intended. By far the largest percentage as a rule goes for general and administrative expenses, so that the people running the charity can have nice homes, big cars and send their kids to college so that they can become legitimate when they graduate. I guess that's why charities are exempt. If we knew that none of the money was going where we intended, we probably wouldn't be so generous and these kids couldn't go to college. We think that continued exemptions for charities is probably a good idea, Uncle Louie runs a not-for-profit and maybe someday I'll need a good job.

- Bank Securities are also exempt. This may be because most of the crash of 1929 was blamed on the banks and when the securities laws were written in 1933 and 1934 it was thought best to stay totally clear of anything remotely connected with banking because it would give the brokerage industry a bad name. Brokers have gotten a bad name on their own and many of the exemptions in the 1933 and 1934 acts are no longer required.
- It was also felt that banks needed more latitude in telling their stories so that they could raise money. If banks had to disclose everything, the SEC felt that no one would ever put money into that kind of security. They felt it best to allow the banks to make up whatever story they wanted for the good of making the industry health again. The banks became very adept at making up stories and raised substantial sums of money.
- Regulation D
- The Securities and Exchange Regulation D exempts registration for private placements of Securities and Exchange Commission if:
 - Issuer believes buyer is a sophisticated investor- I think this is one of the more important definitions that we will deal with. Notice that the discretion as to the buyers sophistication is left to the Issuer. This seems a little like having the fox guard the chicken coupe. I can just picture the president of Blodget Widgets, a company that is down to its last \$20 in the bank, saying to an investor holding a check for \$ 1 million, "I don't believe that you are sophisticated enough to invest in my company". It is possible that this has occurred in the distant past, but it was not the action of a company officer that caused the event; it was more likely the corporate counsel that was afraid to lose his license to practice. You can make book on the fact that the attorney never did any work for Blodget again.
 - Another confusing aspect of this regulation is the fact that the going definition of an accredited person is one who earned \$200,000 during the previous two years and has a net worth of \$1 million. I'm not sure that this is a good definition of a sophisticated investor. Doctor Bob is probably worth a whole lot more than that and he certainly earns more than \$200 thousand a year, but I have never seen anybody worse with money.
 - I mean this guy puts his money into every hair-brained investment that comes down the pike. You may remember that he was the guy that said buy comic books; comic books are going through the roof. That was just before they collapsed. Next he started buying something called commemorative plates that were also going to make him a lot of money. The plate market fell apart when the moving people were moving them into the warehouse, the guy dropped them on the pavement. Then he invested in a company that looked for sunken treasure, and they actual found the stuff, but the state impounded it. Doctor Bob still visits his treasure in the state nautical museum though and thinks of what might have been.
 - Ultimately, things got so bad that they had to appoint a conservator for Doctor Bob so he wouldn't keep messing up. Well, in spite of the fact that the court won't let him sign his own name to a check for anything but groceries, Doctor Bob can still fill out private placement memorandums and qualify as a sophisticated investor in the eyes of the securities laws of the U. S. Government. Things keep going from bad to worse for him. Yesterday the fella in the white jacket said that Doctor Bob couldn't write with anything that had a sharp point anymore. How is he going to write complicated prescriptions?
- Buyer must have financial information in memorandum form. This too is extremely important. It makes a lot of sense that they get all of this information, except for one thing, the financials are not necessarily done by an accountant. As a matter of fact for the most part, they are created by highly imaginative people that could have found more successful careers writing science fiction. They weave stories that would make the characters in Alice in Wonderland stand up and take notice.
- Almost all private placement memoranda show a series of projections that have no basis in fact in the real world; they predict that the issuing company will have a profit somewhat in excess of the combined gross national products of the European Community by the year 2004. Many people with great intellect (among them Doctor Bob) place a lot of faith in these projections. It was once estimated that if you added all of the projected after-tax income to be generated by companies doing private placements in 1996, they would show earnings of more than the estimated gross domestic product of China, The United States and Japan in 2050. These kind of statistics make a person less than sanguine when approaching financials that appear in many of the private placement memoranda.
- Issuer is assured buyer does not intend to make a quick sale of the securities. This one is a real corker. The private placement memorandum contains a statement that the buyer is not going to turn around and sell the offering immediately. We don't understand why that is of any consequence, other than as a subliminal message by the government saying, "your odds of ever seeing a nickel on this investment are next to zilch. Don't get any ideas that you're going to be able to turn this thing around for a quick profit." We would ask the government a more germane question. To whom would I sell this thing if I could sell it at all? Maybe the government knows people that are buying up all of these gems and they are subversive or something. Doctor Bob would certainly like to meet them.
- Exit Strategies
- Things tend to get so bad in these deals that for the most part we won't do them at all unless there is an exit strategy. What this means is that I have no interest in becoming a permanent minority stockholder in a company run by a bunch of people I know nothing about. If it is successful I don't want management filtering all of the profits out of the company in large salaries and expenses accounts. I am not interested in helping put their children through school by having the corporation pay interest on classes of stock I don't own and I am not interested in having to go through

extensive litigation to get what I was promised in the first place. What we insist upon is management's agreement to a definitive exit program, in writing, before we even think of making the investment.

- There are many ways that it can be done such as guaranteeing to do a public offering in which your shares are freed up as part of the registration process. For legal purposes, these intentions should be spelled out, chapter and verse within the private placement itself. This will not help a lot, because if the deal is a bummer anyway, nothing is going to save you from losing your money. One major American brokerage firm admittedly sold its customers over a billion dollars worth of questionable securities and is now after getting caught is trying to figure out how much they have to give back. An exit strategy only protects you from losing all of your money if the deal is a success and even then your odds are poor.
- Securities may not be sold to more than 35 non-accredited investors. Sometimes this statement is true and sometimes it isn't. In the deals that you are likely to run across it is probably true. In actuality, this is not what the SEC means and it is somewhat strange that it has become so convoluted over time. While it is true that most transactions cannot be sold to more than 35 non-accredited investors, it is also the fact that it cannot be shown to more than 35 non-accredited investors. Doctor Bob was telling me about a Temperance League meeting he went at which they were pushing a Monaco gold mining investment.
- Doctor Bob was saying that this guy got up at the League meeting and started talking about all the gold laying all over the place and that everyone could be rich and we could spread the word on alcoholism to the far corners of the earth with all the money we would make. Doctor Bob got a warm and fuzzy feeling from the excitement and indicated that he had a large tax loss carry-forward and would be using his gains to offset his substantial losses of past years.
- The rest of the audience was mostly elderly women who were living on social security pensions. Usually there are over a hundred at any given meeting and with an opportunity like this you can bet that at least that many were present. Many of them saw the last of their cash go down the drain on Monaco Gold and yet, the transaction was totally illegal relative to the Securities Act. It would also have been illegal under the "Blue Sky" laws of the state in which the offering was made. Once a general solicitation was made to over thirty-five people they had closed the books on taking any money at all from unaccredited investors. We are fairly certain that the intent of this regulation is bent out of shape on a regular basis.
- Relevant Regulation
- Rule 147- Intrastate-offering exemption for securities sold within borders of one state.
- Small Issue exemption -- Regulation A- a new issue of \$5 million or less during a 12 month period and is exempt under the Act (Rule 147). Issuer must file an offering statement with the Securities and Exchange Commission.
- Rule 144 -- exempts persons from the definition of underwriter. Actually, Rule 144 frees up the stock that you got in that private placement issue. As you remember, we signed essentially a lock-up agreement when we purchased the private placement by agreeing to hold the securities. Even if we had not agreed to that, companies have to file registration statements governing their securities' ability to be bought and sold in the marketplace. Historically these rules allowed sales after the securities were held for a period of two years if the company was a filing company. If the company was not a filing company, the securities had to be held for three years or longer.
- In spite of the fact that you may well, own a security that you bought in a private placement 20 years ago you can negotiate away the shares' fungibility. For example, management negotiates an IPO with an underwriter who as a precondition for the deal has management agree to "lock up" all of the potentially free trading securities in the company. The lock up is a contractual agreement stating that although you have the right under securities laws to sell your stock whenever you want to, you are waiving that right and for the purpose of interesting us in doing your IPO and you must agree to hold it for another 18 months.
- Often your alternative to not signing the lockup is either sitting around for another twenty years waiting for the next offer, which if you are lucky will be pretty much under the same terms and conditions as what you are not agreeing to now. That probably won't be something to worry about, without the public offering the company will not have enough money to survive and go out of business. This happened regularly to Doctor Bob.
- The underwriters position is that I am not going to do two underwritings, the first of which is the sale of the shares of your company to my clients and then after that is finished, also find a home for all of the selling shareholders of your company in the open market. If you don't like this approach and your shareholders are unwilling to hold their stock just a little longer to insure the company's success, why the hell should I.
- Insiders
- There are certain people that can hold on to their stock forever and yet without a registration statement will be restricted to some degree as long as they own the shares and are affiliated with the company. These are shares owned by officers, directors and affiliated persons of the company, as well as holders of 10% or more of the corporation's shares. These folks are insiders. For the most part they may not sell more than 1% of the outstanding shares in the company every quarter.
- This may not seem like a lot, but to guys like Bill Gates, who files to sell every quarter, you are not talking about chum change. Gates' quarterly sales amount to hundreds of millions of dollars, the number of hundreds of millions depends on what price the stock is selling at when his quarterly prerogative comes due. For the foreseeable future we believe that Bill Gates will be able to sell over \$1 billion per year of Microsoft shares per year and not materially effect the price of the stock or his percentage ownership in the company.

- Investment Banking --
- Object of investment banking is to raise capital. Sometimes, proceeds represent new funds, which others are refinancing their capital structure. Investment Bankers is at term of art yet nobody had aptly defined to our satisfaction. Because it sounds respectable, some brokers call themselves Investment Bankers, but that term is usually left to those people on the street that have a little money to invest for themselves and know where a lot more is buried. We think of it as a term of endearment for the many years most of us toiled as executives and floor brokers for broker dealers. Investment Bankers are for the most part, people with some money searching potentially rewarding transactions for themselves and their associates. This field if it were located in England would probably be known more as Merchant Banking.
- Underwriter, i.e. a banker, assumes risk by buying the new issue from the corporation and reselling it to the public. There are two basic types of underwriting, one is called a "best efforts" and other is called a "firm commitment". Neither is a guaranteed contract that anything is going to happen and when one friend of our attempted to borrow on his brokers firm commitment contract his banker called the police. These contracts have so many holes in them that they make limburger cheese seem solid. These are agreements that are as good as the people that are involved in them, thus, some firms on the street, anything they give is not worth the paper it is written on while with others nothing in writing is really critical.
- A best effort type of financing usually consists of the underwriter taking the client out to dinner, asking for a \$50,000 retainer and having him agree that he will try really hard to get the deal done. To some underwriters, "really hard" consists of discussing the deal's merits with their mistresses, in others it may be just a case of waiting for a sign.
- Usually the client has to pay for a road show, accountant and legal, all of which can amount to a substantial amount of money if the deal never happens. This occurs more often than the "street" would care to admit and usually the reasons are earth shattering, the most common heard on the street is the fact that the stars were not lined up in proper sequence and concluding the fund raising under those circumstances would have probably resulted an a global catastrophe. "It is best for us all to forget that we have ever heard of this deal", is the common pronouncement of horoscope driven underwriters. It is best to ask if you are in sink with the underwriter before giving him the money.
- Another all too often heard response to an underwriter's failure is the fact that the market is not acting well. It can be going up or down to conform to this anomaly. We have learned that if the market is going down, it may make sense to use this as an excuse for pocketing \$50,000 and not doing anything for it but when it is going up it become a more serious situation. An underwriter cornered by someone asking these types of questions will answer on of the following depending upon what business the Subject Company is in:
 - Only the cyclical are performing well
 - Only the non-cyclical are performing well
 - Only the blue chips are seeing any buying interest and it looks better than it is.
 - Only the non-blue chips are seeing any buying and your company is considered a blue chip.
 - The high-Tec's are hot and the cyclical aren't going anywhere.
 - Your company is terrific but it just doesn't have enough sex appeal in this market.
 - Your company has a lot of sex appeal but the guys in your industry did so many deals in the last couple of months that the market became saturated.
 - Interest rates are so high; people are buying bonds not equities.
 - Interest rates are so low; people are buying proven companies with dividends and not speculating.
 - People are waiting to see if the new capital gains tax reduction takes place.
 - When I took your money, I didn't tell you that it was going to done in this decade.
 - Therefore, the deal didn't get done and the money is down the drain. However, the underwriter didn't really promise you anything either. All he said was that he would use his best efforts; I am sure he did. The guy you picked has been using his best efforts for the last 20 years and it hasn't been good enough to get a deal done yet.
 - Then we have the sure thing, the "firm commitment" underwriting that is issued by only the most blue nose, high quality brokerage firms in the country. I mean their firm commitment means they are on that day putting their capital at risk by buying the entire underwriting for their own account and redistributing to their clients and other broker dealers. You say that in retrospect when Goldman Sachs offered to give you a firm commitment you took the Best Effort of Ajax Concrete and Broker Dealer Services instead? You thought that best efforts meant that they would try harder. While Goldman probably would have completed the deal even at a loss in a bad market, many of the "better firms" on the street would look to their "out" clauses instead. Can't you see in the fine print's fine print where it says we will only do the deal if the principal of the client's firm is caught in a tornado in a telephone booth on the day the deal is effective or at our discretion? Another "out" clause that is common besides the old tornado in the telephone booth excuse is old the "subject to market conditions" ploy. Every IPO has that clause in the body of the agreement and as we have seen, for the guy wanting to wiggle out of deal, it is the perfect excuse.
- "You mean to tell me that a high grade firm doing a firm commitment deal would use the same flimsy excuse as the firm that was only doing a 'best efforts' deal?"
- "You bet your bonnet he would bunkie! You think the guys on this street were born yesterday?"
- "Every Rube thinks he can come to town and the street for a ride, but tell you what we're going to do. You sit here and start calling every friend and relative and customer you have. Get them to buy seventy-five percent of the deal

and we'll still do the rest of because we have a lot of confidence in your deal. Bunkie, you can even use my desk, but don't take long, now."

- Several takeoffs on the "best efforts" form of deal are the "mini – maxi" and the "all or none". These apocryphal sounding visions are Wall Street works of art. The "mini – maxi" means, "I can't raise less than this or more than that." In many cases the accounting, legal, printing, and underwriting fees are included in the "less than this". Thus, all of the shareholders participating in the transactions have made many friends in the legal and accounting professions with their charity but they have not been left with much of a company. It would be wise not to invest in too many "mini-maxi's" or you could wind up keeping Doctor Bob company at the funny farm.
- The "all or none" is a much kinder type of underwriting to shareholders, but it usually acts as a depth charge hitting a submarine amidst as far as the target company is concerned. It has been estimated by the SEC that accounting, legal, and other costs run over \$300,000 in the average offering. Obviously the company wouldn't trying to go public if it didn't need the financing, so the principals begged, borrowed and stole the necessary \$50,000 non-refundable deposit for the underwriter. The underwriter had them hire a Big Six accounting firm that his son was apprenticing at, mind you not because his son is there but because it would look good on the title page. The law firm that the underwriter said was necessary to get the deal done asked for \$100,000 retainer and assigned the job to a \$400 an hour partner. "We need a firm that is reliable and can get the work out on time,"
- Usually, about the same time that the principal at the brokerage firm announces that he can't do the whole deal and that you have to bring in the customers, he will have available in his handy, dandy pocket legal reference guide the names of attorneys that specialize in bankruptcy reorganizations, plans for victims of failed IPO's. I really believe that some firms on the street are paid for as many deals that they don't do as they complete.
- Selling Group
- A selling group is a group of broker dealers who help distribute the stock – they are graciously invited to participate in this process by the managing underwriter, who in dulcet tones says: "You take all of my deals or none of them. If you don't like that setup get the hell out of my office."
- In the underwriting business you are only as good as your last deal. You can have twenty straight underwritings that go to the moon, but come up with one bad apple your firm becomes *persona non grata* on Wall Street.
- Formerly, Wall Street underwriters created successful issues by carefully placing the stock in the hands of brokers who bought it as an investment rather than as a source of quick profits. In the old days, the guys that would really hold onto stuff were the institutions. Today, in an intensely competitive market, five minutes can be long term for the new breed peripatetic institution.
- Another strange characteristic of an underwriting is that there must be enough shareholders when it is all over for the company to qualify for one of the exchanges or NASDAQ. (seven hundred is kind of minimum) Even if the institutions were willing to hold the stock until hell froze over, it wouldn't do the shareholders any good if it wasn't traded anywhere. Therefore, there has to be a mix between institutional and retail underwriters of the stock.
- Wall Street brokers also seek out broker/dealers who are regionally orientated within close proximity of the Target Company. If the company is located in Iowa, often finding the top regional Iowa broker-dealer to come into the deal will add buying power and credibility to the transaction. People that are familiar with the company on a day to day basis make better long-term players than traders having no ongoing interest in its affairs. Nobody, including Wall Street underwriters, discounts the home court advantage.
- The more focused Wall Street underwriters, if it isn't a wire house (the term originated from all the branches being connected by telephone or telegraph wire) such as Merrill or Smith Barney is extremely specialized in their approach to the IPO business. Their deals tend to share common characteristics, and the group of firms that they tend to allow into their underwritings historically remains intact over the years. These firms are called "selling group" members. These people have no particular axe to grind.
- They have no financial interest in bringing out the deal other than the commissions that they receive and the good will, which is generated if the deal goes to a premium. They receive a much-diminished commission because they are taking on a reduced risk. Selling groups receive none of the glory that comes with a successful underwriting but share none of the shame if it goes bad. They are the mules of the underwriting business. As long as they continue to be good lads and bring more buyers than sellers to the table, the managing underwriter continues to abide them. When the managing underwriter is "hot" every member of its selling group makes money. When the managing underwriter is not "hot" the loyal group soon dissolves and looks for a new fearless leader type.
- In firm underwritings, the underwriter's capital is at risk on of the effective date. The underwriter buys the shares of the company that is going public at the cost of the shares less his underwriter's commission based on the terms of the letter of intent. At this time more often than not for the purposes of being in the securities business, he goes "out of ratio". This means that in the complex formula used to compete whether brokers are healthy or not, this guy has just become critically ill. His penalty for this affliction is either promptly raising more money or getting rid of some of the risk.
- For this reason, underwriters form "syndicates" which operate somewhat akin to the Mafia. Syndicate members are placed in "brackets" which define their hierarchy in the organization just as the Mafia places "made men" on top, the most important members, next come the "captains" or "capos" who are important but not in the inner circle and bringing up the rear are the "soldiers" who if need be a dispensable. When the Tombstone is appears in print you have the managing underwriter or underwriters appearing over everyone else, kind of floating above the lower ranking members. The next group appears alphabetically for several lines and then the alphabet start over. This is

the point when we enter the second tier underwriters, and then a third and a fourth and even a fifth depending on the transaction's size. If you want to get a better idea of how the firm you do business with is perceived by the Street, find a tombstone bearing their name and see what group they are in. Remember, some guys aren't there are all, and these are the selling group members or those not even qualified for that.

- In order for underwriting members to become more important to the organization (syndicate) they must perform outstanding things such as being perceived by institutions as being bigger than life. This is an extremely hard thing to do and usually people remain in the same niche during the life of the syndicate.
- Usually, the only way to break out of this rut is to buy out your higher-ranking competition, which catapults you ahead of other members into the "bracket" of the firm you acquired, subject to approval of the loftiest members, usually consummated at a sit-down. This effectuates three things at once, you are allowed to lose or make more money in each transaction, your name appears ahead of your peers in the newspaper whenever the "syndicate" transacts business making you appear magisterial in the public's eyes and least important you have eliminated substantive competition, increased your profitability and added to your management base.
- The organizer of the syndicate, you know, the fellow whose firm didn't have enough in the bank to finance the deal, still runs the show as "syndicate manager" the "Don" of the underwriting world, he determines who will make up his syndicate and what each one's participation in the profits will be. This is usually determined by how well the member performed in his last assignment. (Performance is usually determined by how many shares of the deal his customers purchased in the market after the underwriting books were closed. ("After market"). You do not stay in the organization very long without showing results.
- For all of his organizational skills and more importantly his convincing the target company that they should sign with him, the managing underwriter receives an override of all of the spoils before the profits are divvied up among the participants. Although these groups remain together without changes for long periods of time, from time to time certain unforeseen circumstances arise and specialists must be brought in to help the syndicate in nuances of the transaction. (Similar needing an expert safecracker when committing in a bank robbery, usually these people are brought in from out of town just for the one deal).
- At the successful culmination of the underwriting, the syndicate proudly displays the members of the group and their respective position in the hierarchy in the press. Substantial outlays of money are expended to proclaim the members, their roles, the subject of the transaction that they put together and how much money was involved. Members that appear at the bottom of the list usually do not feel ashamed because they, for some reason, are proud to be in the company of such an esteemed company. These newspaper announcements are for some reason called "tombstones", and the only reason that we know of for that name, is that by comparing the current "tombstone" with its predecessor you can determine which firms have ceased business or have committed an unnatural act since the previous deal.
- Often firms stop appearing in a "Tombstone" when they have gone out of business or committed a violation of the syndicate's code. This information is not part of the tombstone and the public often is unaware that a grave sin has been committed by the former member. Often when people see this handsome advertisement they become interested in purchasing stock in the underwriting. When they call their broker there are informed that if they had read the "fine print" in the ad, they would have seen that this was not an offering of securities, it was just a matter of record of a transaction that had been completed.
- It has been said that tombstone advertising is the most costly form of advertising, it offers nothing and says little. It is historic in nature, requires no comment, and contains no redeeming characteristics other than giving members self-gratification. We could have told the tombstone reader that the stock had been allocated among favored clients of the various firms that participated in the deal. The reason is that these people gave great amounts of business to the firms and are rewarded for their loyalty if it was known in advance that the deal was going to go to a premium. If it were expected that the price would diminish, you can rest assured that the caller that came in late would have somehow been offered the ability to participate in the transaction.
- Sales of Hot Issues
- Hot Issue -- New Issue of stock that is in great demand and is oversubscribed.
- Firms are restricted in the sale to:
 - A Broker Dealer's proprietary acct.
 - Accounts of officers, directors, partners, employers of Company
 - Senior officers of a bank, insurance company, or any employee involved in a securities department.
- General speaking the price at which an IPO will come to market and where it will then trade are uncomplicated to figure out, but that is only if you are on the inside. An underwriter is in the inexplicable position of representing both the buyer and seller as principal. This in terms of law is an extremely tenuous position to be placed and can result in substantial legal problems. Strangely brokers are not apprehensive of being put into this strange legal position because it is such a profitable place to be. On one hand, he has the legal obligation as a fiduciary to always try to get his client the best possible price when executing an order. On the other hand, his obligation to the company going public is to get them the maximum amount of money he can. Historically making a decision between the two has been a no-brainer for the broker. His client is in the market everyday and represent the brokers bread and butter, so that if there is latitude in the pricing of the underwriting, and there is, the broker will price it so that it will go to a

premium immediately upon becoming effective. Thus demonstrating to the world that the company was shortchanged. This makes all of the brokers friends who were on his "A" list happy campers. The broker also is made contented because everyone will see in the tombstone that he was the underwriter and recognize he had a winner. It will probably make the company that went public sad to know that the underwriter could have gotten them much more for their property and literally sold them down the river. They probably will never know that the how much it really was. When asked by company officials the syndicate manager usually replies that they have no control over public demand for an issue and therefore do the best they can when pricing the deal. If you believe that then we have a bridge here in New York that can be purchased from Chapman Spira and a bargain price. how do they know what the price will be.

- Sounds good in principal, but they know almost to the nickel what the price is going to be. The managing underwriter keeps the books, he knows exactly how many shares are desired by other brokers, he knows how many shares his firm wants, he also knows how many he is going to give them. So in the interest of simplicity, let us say that there are requests for three times as much stock as are going to be underwritten, a certain number of those people will purchase the shares at a higher price in the market, a number represents an historic percentage that varies somewhat based on the degree of premium. (difference between the effective price and the price the share are selling at in the marketplace). In brokerage parlance, running the books in a syndicate is like betting on a horse a week after the race is over.
- Some brokers make it mandatory that if you are assigned share at the original price, more shares must be purchased at higher prices.. (this is illegal but common) There are many people that think this is a good idea, those are the same people that fought so hard to get the deck shares on the Titanic. This causes the stock to rise even higher and friends and nominees of the broker are the only ones allowed to sell. When the smoke has cleared, often the deal is in shambles and the money has found its way into the underwriters pocket. Luckily most firms do not specialize in this business, but the unsuspecting can ferret them out without to much trouble. Doctor Bob has dealt with almost every one and look where he is. After a number of years, the owners of the brokerage firm become philanthropists and are looked upon as public-spirited citizens who promote import projects in the community. The securities industry is not the only one in which people turn legitimate only after they retire.
- There are more sophisticated ways that new issues can be used to help the broker become very rich. Some money managers are very greedy people, others have little or no conscience. These people have many friends in the brokerage community. In exchange for shares having been allocated to the money managers personal account, the manager agrees to place substantial of the funds under his management (belonging to other people) at the disposal of the broker. Thus the broker has provided himself with source of funding for his pet projects. Many people that have entered into these types of transactions are now in jail, but not enough. Many of the people that have entered into these types of transactions are still on the Street and highly regarded in their profession. They will probably never be caught.
- A more important way for a broker to profit from his own underwritings is to open an offshore account domiciled in a country where there are laws keeping depositors identities secret. This account becomes a retirement nest egg and if set up in the right place totally avoids all taxation. Often brokers find it convenient to have money stowed away somewhere else when they are required to leave the country very abruptly. These are forward thinking people who probably did well in college.
- Fairness Opinions
- Often when an underwriting is being contemplated the brokerage firm that has been chosen for the job has conflicts of interest that may prevent them from being totally objective about the deal. These conflicts can assume various forms but the most common is the instance where the brokerage firm or its principals are also large shareholders in the issue. The National Association of Securities Dealers (NASD) does not find a problem with a brokerage firm selling the stock in a firm that is controlled by the managing underwriter, they don't even have a problem with the fact that it is the brokerage house negotiating all sides of the transaction, the price at which the issue will be brought public, the percent interest the public will receive, the amounts spent on professional fees, corporate salaries and management's stock options.
- What the NASD says is required for the brokerage firm to get away with murder is simply that they must hiring another broker has been in the business for a reasonable amount of time and has had a good record to participate in the evaluation of the deal's pricing to determine the fairness in the pricing of the proposed transaction. They do not tell you that you can't hire your college roommate who still owes you six big ones that you lent him when his girlfriend got pregnant. This is the same character that the last time this guy did an underwriting was the historic instance of the president of the company fleeing the country with the proceeds of the deal just ahead of his parole officer and the tobacco and firearms people. The deal's selling group members that lost their shirt when the president skipped were so mad that rumor has it, a hit was put on the underwriter. In spite of all of that, his name will appear in the prospectus along with his charitable statements regarding the deal's pricing. Even Doctor Bob said that he thought something was wrong with this.

- Green shoe – the broker has other ways of controlling his own income and the price of the underwritten security. Most agreements call for the use of a "green shoe" at the underwriters discretion. A green shoe is one in which the brokerage syndicate is allowed to expand the size of the offering by up to 10% at the last minute solely at the underwriters discretion. This is done for several reasons, it increases the money that the broker makes, it increases the money going to the company and it allows more participation in the deal. The additional shares also have a tendency of holding the price down a bit.
- The background for the name green shoe is somewhat obscure, but an influential Wall Street person once told me that green is the color of money and shoes are what you can buy with the additional profits generated from the extra stock. I think he must have been thinking about the expression from crap games where the shooter hollers something about his baby needing a new pair of green shoes. Some ninny once said that there was a company by the name of Green Shoe Company in which the term was first applied. We don't see any reason why anyone would want to name a company Green Shoe. This is probably just an old wives tale.
- Free riding and withholding -- member firms may not withhold securities that are part of a new issue if they have unfilled public orders. The underwriter has the deck totally stacked in his favor because they know how many shares there are to buy and sell coming into the market, they are usually making the market in the securities and are able to field all the inquires from the straight relative to the issue, they have the pent-up demand of people obligated to buy additional shares and they have a magic time stamp machine.
- The time stamp is an integral part of a brokerage operation. Every order that is entered on the books of the broker-dealer must be stamped at that time. When the trade is executed another time stamp is made on the order so that a complete record is made of when the order went into the system and when it came out. This is an excellent method of determining who is right when a customer complains that his price should have been different than what was reported to him.
- The name of the contra-party (the other side of the trade, all transactions of another side) is listed on the same ticket as the time stamp, thus in the case of a dispute reference can be made to the contra-parties time stamp as well. If that isn't enough, the transaction was reported and this too is stamped. Thus a pretty good case can be made at all times, what the stock was selling for in the market when the order was executed. As a matter of fact the system seems almost foolproof.
- When a firm commitment underwriting is completed the stock is taken down in one piece by the brokerage firm and then reassigned to customers. These transactions can be of record in the places indicated above. However, Doctor Bob was telling us a funny story about that. He was sitting in the broker's office and there was this guy with a timestamp putting the time on hundreds of tickets, Doctor Bob introduced himself to timestamp Harry and asked what was going on. Harry said that there was this big offering coming out and he was getting ready for it by stamping the tickets. "How do you know how many to stamp?" asked Doctor Bob, "I don't see you keeping an account." "Well". Harry said, " they don't tell me, because maybe they are going to need extras" You see they wait to see how well the deal does, how much of premium it goes to. If it goes way up they take the tickets that are stamped and are in blank and put their own names on them. If it doesn't do so well, they give it to customers that have discretionary accounts with the firm. When I'm done stamping I have to have enough to two sets of tickets, it's a more exact job than you think. Time stamping is really complicated you know and I report only to the boss because I do such a good job. He told me that we were really working together and I shouldn't discuss this with anyone else, but I've seen you around and know that you're OK."
- Bob wasn't sure what Harry meant, but since he never heard of anyone doing nothing but time stamping things all day he thought that it was worth repeating. Bob wondered whether this was something that you could go to school to learn.
- Doctor Bob said that he became very nervous around timestamp Harry when he Harry informed him that he was the one in the company responsible for reporting to Edgar. He mentioned that everything anyone in the firm did was Edgar's affair and that Edgar was expecting to update shortly on the final elements of the deal he was time stamping. This sounded really scary, Doctor Bob thought the top guy was working right here, in the big office down the hall. It now seemed to Doctor Bob that he was really a figurehead and someone much bigger was running the show.
- Bob became really concerned because he had a lot of money sitting at the firm and he called the SEC and told them that the brokerage firm he was dealing with was reporting everything to Edgar. The fella Doctor bob was talking said that this was good and hung up. Believing he had discovered a massive securities plot where even the SEC had become involved Bob left no stone unturned in his efforts to find out what was really going on.
- Ultimately, the U. S. Attorney asked Doctor Bob to put his problem in writing and when they got back to Bob they explained that it wasn't a guy named Edgar but a computer program called EDGAR (Electronic Data Gathering Analysis and Retrieval).It seems that this computer system was created and is operated by the SEC to eliminate unnecessary paper work and speed the securities processes along. Relieved, Doctor Bob and Timestamp Harry became fast friends and would often lunch together after Harry had finished his work.
- Stabilization -- form of price manipulation permitted by the Securities and Exchange Commission. If the underwriter didn't possess enough tools, the SEC itself allows him to stabilize the deal. In other words, the SEC doesn't want this

thing trading all over the place where nobody can keep up with what's going on. They're interested in a "fair and orderly" market being maintained in the issue and appoint the underwriter as their representative with the power to manipulate the market so that trading becomes non-chaotic.

- Dishonest brokers can use this to their advantage. Whereas the rules state that the stabilization should take place at the deal's offering price, they do not address the price at which the securities in question can be sold. The underwriter then legitimately issues the shares to his clientele and the stock goes nowhere. Becoming disenchanted with the deal the clients sell the stock, which under the regulations can be purchased by the dealer. When he has accumulated a large enough amount of the float and there are no sellers left, the issue suddenly sprouts wings and becomes a success. The underwriter did not make many friends among his customers with this tactic but he did make a lot of money and felt that this was good.
- Lawyer – Someone who went to law school and passed the bar exam in at least one state. This person instead of becoming a legitimate member of his community began practicing securities law. This is a good field for someone with a computer because having once completed an offering, you can use the same documents over and over again by just making minor changes in the name, amount of money being raised and the name of the underwriter. Although lawyers in securities work complain of long hours and grueling work, we think it is mostly for effect. As long as the word processor is in good order, lawyers are capable of making a good living.

Underwriter's counsel – A lawyer that represents the underwriter and passes on the legal merits of the deal for the brokerage house.

* Issuer's counsel – A lawyer that represents the issuer, how in many cases is picked by the underwriter because he has all of this stuff on his word processor and for other high sounding reasons. Underwriter's counsel and issuer's counsel often are good friends after hours, which makes the negotiations go much faster. Both lawyers are paid substantial amounts of money, much of which comes from the proceeds of the transaction. It is in both of their interests under the deal that the underwriter stays healthy, at least until the deal is completed. They try to arrange that underwriter does not have to lose his temper and get his blood pressure up in his dealings with the parties involved. Because of the substantial concern that these good people maintain for the underwriter's health, most arguments are quickly settled in his favor.

- The Process of Registration
- The process is much more complex, expensive and harrowing than can possibly be envisioned by a few short paragraphs in a memorandum such as this. You will be entering a battlefield that will require all of your guile to transverse all of the obstacles that have been placed between you and your objective. Critically important is not to make the process even more difficult than it already is. This requires teamwork between your accountants, lawyers and broker. You as the field marshal must make certain that they are constantly coordinating their efforts so that all required documents are submitted not only on a timely basis but that they are submitted in the form required by the Securities and Exchange Commission.
- The process begins when a proper preliminary prospectus is filed with the SEC. This gets you into the queue, but it isn't the type of line that you had at the movies in high school. In this line, each time you strike out the teacher sends you to the back and makes you do it over again until you can get it right. So until the first step is done correctly the queue doesn't even accept you, it is only when your submission is considered acceptable that you are allowed to be in line.
- This is extraordinarily important because your underwriter has created a calendar of IPOs and has scheduled them based on when he is best able to bring them to market and more important when he has room in his stable for another issue. If an issue is delayed by Washington for an unreasonably long period of time, for any number of reasons, the issuer may suffer two simultaneously adverse events. The first is that the SEC queue line has begun without him. The other event that could make it a really bad hair day is that the offeree's place in line with the underwriter now runs the risk of becoming usurped by another IPO because of scheduling problems. There may not be any recovery from this problem because as the longer the clock fails to tick, the more the risk that the submissions have become "stale" (outdated) and the SEC, like Mother Nature does not abide stale offerings.
- With each tick of the clock, the substantial costs of registration run like a runaway whirling dervish. Pity the poor issuer that had deficient advice to begin with, the lawyers and accounting fees may soon make up an unacceptably high percentage of the deal's "use of proceeds" and both the SEC and the underwriter could determine that they are no longer interested in a public offering, the proceeds of which are primarily dedicated to paying off the professionals. Sage advice would have mandated that the professionals agree in advance to a set fee in taking the deal all the way through to completion. Many Wall Street accountants and lawyers would agree in advance to a lessor fee, or hopefully no charge at all, if the deal aborts because of uncontrollable developments such as very poor market conditions and problems in the issuer's industry that did not antedate the filing.
- One of the pet peeves of the SEC in reviewing a registration statement is that of inferior readability. In other words, the lawyers are really trying to strut their stuff and draft the registration in legalese rather than readable English. The SEC would view that as not being able to be read by the average investor and would send it back to the issuer to start again.

- There are times when underwriting are popular and other times when you couldn't give one away. The staff that works on these things at the SEC remains fairly constant during both periods so that as a generally rule delays in busy periods produce a wait in back of a longer line than one when things are quiet. Actually, the person assigned to walking your project through the commission will have much more time to be of assistance during quiet periods.
- The use of EDGAR and other electronic filing devices have improved turnaround time, but in spite of that, more deals than ever are being perused by the commission and very often it is liking trying to go cross town in Mexico City during the rush hour. On the other hand, if when making the original submission, a well written transmittal letter is furnished the commission with all material matters discussed in workmanlike manner the commission would also attempt to live with a realistic underwriting timetable if it is possible. Remember that coming out of the SEC to early and you underwriter might not be ready for you and the data you have in your registration statement may have to be updated, the market could collapse in the meantime or even worse the broker could go out of business. I mean it has been known to happen.
- Competent lawyers are well aware of the preceding but sometimes local attorneys attempt to practice on their client because it doesn't so hard to do and I've got something similar in the word processor. Down deep in my heart, I believe that the SEC looks a lot closer at stuff submitted by lawyers that have not practiced before the commission previously. Kind of an initiation to the big leagues. Man, if it were my deal, I wouldn't want an hazing taking place at my expense. Additionally, the pro knows how to work with the underwriter and they have undoubtedly had other deals in the past together. The natty young graduate who is just spreading his wings and attempting to impress his client will antagonize the commission, not get the cooperation of the accountants and give the underwriter "agita. Although we know some reasonably intelligent young lawyers, they are intelligent because they are aware that they have much to learn about the system and are also in a queue of sorts, a learning one. But, alas, for a little less money you can wind up with a wet faced kid who will get you into more trouble than you can shake a stick at.
- Contact us at your convenience.