

Facebook IPO Now Likely in 2012

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Facebook has dominated the headlines today with the news that it has raised \$500 million from Goldman Sachs and Digital Sky Technologies at a \$50 billion valuation.

In addition, the social network intends to raise another \$1.5 billion through a “special purpose vehicle” that Goldman Sachs will be setting up to allow some of its clients to indirectly invest in Facebook.

There have been a lot of questions about the Goldman Sachs “special purpose vehicle” since the news broke. The key questions: Why is Facebook choosing to raise more money through Goldman Sachs? Will the SEC allow this move, or will it force Facebook to start disclosing its financial results to the public? And when will Facebook finally have an IPO?

SEC regulations and the nuances of private investment are complicated subjects, so we thought we’d try to clarify some of the issues surrounding the Facebook-Goldman Sachs deal, including figuring out the likely date of the Facebook IPO.

1. Why Are Facebook and Goldman Sachs Creating a “Special Purpose Vehicle”?

There is an SEC regulation, set by The Securities Exchange Act of 1934, that requires companies with 500 or more shareholders to disclose their earnings to the SEC. The SEC then publishes this financial information, making it public knowledge.

Facebook doesn’t want that headache at all. It doesn’t want to go through the audits, create the reports, or let its competitors know the details of its earnings and expenditures. However, the social network still wants \$2 billion in fresh resources, so Goldman Sachs has come up with a very clever workaround; instead of having thousands of individual investors, Goldman Sachs will represent them all and invest on their behalf.

This is essentially what most brokers do on behalf of their clients, the shareholders. Instead of making a person an investor of record in Google, Goldman Sachs will invest money on that individual's behalf, making him or her a benefitting investor

The New York Times' Steven Davidoff provides a stellar overview of the SEC regulations in question, but it essentially boils down to this: Goldman Sachs is helping Facebook circumvent the system so it doesn't have to report earnings or raise money via an IPO.

2. Will the SEC Allow It?

The SEC isn't stupid; it knew that brokerage firms would try these types of workarounds. *The New York Times* dug up the SEC's definition of a record holder, which includes a provision that says if a company creates a vessel for holding securities of record primarily to circumvent The 1934 Securities Exchange Act, then it will deem beneficial owners as record owners.

In other words, the SEC could deem that Goldman Sachs is circumventing its regulations with its "special purpose vehicle" and thus consider all of the investors within it "record owners" of Facebook. That would mean that the social network would be required to report its earnings.

We think it's likely that the SEC will intervene. The SEC is already investigating the private secondary markets for potentially violating the same 500 shareholder regulation. It wouldn't be much of a jump for the SEC to tell Facebook that its investment vehicle doesn't preclude it from publicly disclosing its financial information. In fact, it's likely to tell Facebook the opposite.

3. So, When Will Facebook IPO?



Now here's where it gets interesting. Facebook and Goldman Sachs are setting up this "special purpose vehicle" to raise a ton of cash for the social networking company. They're absolutely aware that the SEC will not be happy with their arrangement, and they also know that the SEC will likely step in and tell Facebook to disclose its earnings to the public due to the existence of the Goldman Sachs vehicle.

So why would Facebook go through all this trouble when the SEC is going to shoot them down anyway?

The answer is that this move buys Facebook more time to grow and prepare itself for an IPO. The SEC regulation wouldn't take effect until May 2012 because the SEC only requires private companies to start reporting its financial information within four months after the end of its current fiscal year. So if Facebook violates the 500 shareholder rule this year, then it won't have to start reporting its earnings until May 2012, 120 days after December 31, 2011.

That's more than enough time for Facebook to prepare for its IPO. When the day comes that Facebook is required to release its financial information to the public, it will probably decide to just go all-in and become a public company, raising even more money in the process.

Essentially, Facebook has set the clock for its IPO to occur on May 2012 or earlier. Part of the reason we predicted no Facebook IPO in 2011 is because 2012 is the year most of our sources say the Facebook IPO is likely to occur. It all fits.

Mark your calendars and set your watches, everyone: The Facebook IPO is likely coming in 12 to 16 months.