Capitalization Plan, Bikini Sports Company

The decision having been made by the Board of Directors, Bikini Sports Company, to capitalize the company through issuance of public shares, a survey was undertaken to determine the avenue capitalization most appropriate to the needs of Bikini Sports, an auction system through the NYSE or a dealer system through the NASDAQ Exchange. This report summarizes the findings and makes a recommendation to the board on behalf of the undersigned, H. G. Williams, CFO, Bikini Sports Company.

The report will survey topics pertinent to the decision including listing requirements, initial and ongoing fees related to the financial intermediary, liquidity issues associated with the two markets, and issues associated with the NYSE specialist and the NASDAQ dealer. The report briefly examines the SEC Rule 144 and how it may be applied to the initial public offering of Bikini Sports Company. Finally, a conclusion is drawn as to the best market capitalization vehicle to meet the short and long term needs of Bikini Sports.

The framework of the report is set around the plan set forth by the board to reach $1.5 billion in market capitalization. The below table outlines the issuance schedule from IPO to long term goal.

Ultimate Market Capitalization	$1,500,000,000
Estimated Price Per Share	$30
Shares to be Issued	50,000,000

Initial Stock Offering: 10% of Ultimate Capitalizaion	
Shares to Issue at IPO	5,000,000
Expected Share Price at IPO	$50
Market Capitalization After IPO	$250,000,000

Listing Requirements

In this section the listing requirements of each exchange are outlined. The information presented is relevant only to the market position and capitalization plans of Bikini Sports as outlined in the table above.

NYSE

As put by the NYSE themselves, "A New York Stock Exchange listing is a globally recognized signal of strength and leadership. The Exchange's listing standards ensure the quality and integrity of the NYSE list." From the NYSE Listed Company Manual section 102.00 a listed company must have at least 2000 holders of at least 100 shares or more a unit of trading (shares) and have at least 1.1 million publicly held shares. Further, a Company must demonstrate an aggregate market value of publicly-held shares of $60,000,000 for companies that list either at the time of their initial public offerings. The company must show earnings in accordance with the following schedule: pre-tax earnings from continuing operations and after minority interest, amortization and equity in the earnings or losses of investees, adjusted for items specified in (2)(a) through (2)(i) (not shown) below must total at least $10,000,000 in the aggregate for the last three fiscal years together with a minimum of $2,000,000 in each of the two most recent fiscal years, and positive amounts in all three years.

The exchange will reevaluate the applicant companies listing status if at any time following the Exchange's initial determination that a company meets the Exchange's original listing criteria, the company restates its financial statements due to a change from an unacceptable to an acceptable accounting principle or a correction of errors, and the restatement encompasses financial statements included in its SEC filings at the time of application for listing on the Exchange.

Finally, in the event that a company has less than three years of operating history and is acquiring (either completed or committed) an entity with the requisite operating history, the Exchange will consider the combined operating history of the aquiror and acquiree for the preceding period(s) in conducting its financial eligibility review.

The requirements for continued listing on the NYSE specify a minimum standard. When a company falls below the specified criteria the exchange will review the appropriateness of continued listing.

For companies that listed under the Pure Valuation standard average global market capitalization over a consecutive 30 trading-day period is less than $375 million and total revenues for the most recent fiscal year are less than $15 million or average global market capitalization over a consecutive 30 trading-day period is less than $100 million.

NASDAQ

Companies applying to file on the NASDAQ exchange under the new company listing rules must meet three liquidity requirements, or the applicable alternatives, in their specific category for initial inclusion on The NASDAQ Global Select Market. Again, the requirements listed are only those pertinent to the filing plan of Bikini Sports Company.

Beneficial shareholders numbering at least 2200 with at least 1.25 million publicly held shares valued at a minimum of $70 million.

Continued listing on the NASDAQ Global Select Market must meet all of the requirements under at least one of the standards for continued inclusion.
Global Select Market must meet all of the requirements under at least one of the standards for continued inclusion.

NASDAQ Global Select Market Financial Requirements

Requirements	Standard 1 Marketplace Rule 4450(a)	Standard 2 Marketplace Rule 4450(b)
Stockholders' equity	$10 million	N/A
Market value of listed securities or Total assets and total revenue	N/A	$50 million or $50 million and $50 million
Publicly held shares[1]	750,000	1.1 million
Market value of publicly held shares	$5 million	$15 million
Bid price	$1	$1
Shareholders (round lot holders)[2]	400	400
Market makers[3]	2	4
Corporate governance[4]	Yes	Yes

[1] Publicly held shares is defined as total shares outstanding, less any shares held by officers, directors or beneficial owners of 10% or more.

[2] Round lot holders are shareholders of 100 shares or more.

[3] An electronic communications network (ECN) is not considered a market maker for the purpose of these rules.

[4] Marketplace Rules 4350, 4351 and 4360.

Listing Requirement Comparison

In either case, NYSE or NASDAQ, the fiscal standing, ongoing revenue stream, and corporate history of the Bikini Sports Company easily meet the requirements for listing. In neither case is the requirement close enough to the standing of our company to warrant concern.

Initial & Ongoing Fees

In this section the fees structure of each exchange is outlined. The information presented is relevant only to the market position and capitalization plans of Bikini Sports as outlined in the table on page 1.

NYSE

The NYSE Listed Company Manual, subsection 902.00 Fees for Listed Securities outlines the fee structure: "Generally, when an issuer lists a new class of equity securities, a structured product or a short-term security, Listing Fees are calculated according to Listing Fee schedules that set a per share rate based on the number of shares issued and outstanding. When a closed-end fund, however, first lists on the Exchange, Listing Fees are not calculated at a per share rate but are, instead, based on a range of fixed Listing Fees set according to the total number of shares issued and outstanding at the time of listing."

In regard to ongoing fees: "For all listed securities, Listing Fees for subsequent listings of additional shares are calculated starting at the rate applicable to the number of shares already listed and outstanding (including treasury stock and restricted stock). Listing Fees for additional issuances are calculated according to the applicable Listing Fee schedule on a per share rate, subject to a minimum application fee."

Specific values for the Listing Fees were not available and are assumed settled in negotiations. There is an Annual Fees requirement calculated on a per share basis subject to a minimum fee. The Annual Fee is equal to the greater of the minimum fee and the fee calculated on a per share basis. The Listed Company Manual goes on to say: "In order to calculate a U.S. issuer's Annual Fees for each class of security listed, the Exchange will include all issued and outstanding shares of that class as of December 31 of the previous year. The Exchange obtains information on the number of securities issued and outstanding from each issuer's transfer agent."

Finally, a maximum fee per year is established as follows: The total fees that may be billed to an issuer in a calendar year are capped at $500,000. The fee cap includes most Listing Fees and Annual Fees. The fee cap, however, does not include the following fees:

- Listing Fees and Annual Fees for Investment Company Units;
- Listing Fees and Annual Fees for closed-end funds;
- Listing Fees for structured products; and
- Annual Fees for structured products other than retail debt securities.

NASDAQ

NASDAQ claims it's fees are lower than NYSE for initial listing, annual fees, and fees for listing additional shares. They claim that larger companies, like Bikini Sports, can see up to an 85% reduction from the NYSE fees. The NASDAQ Gobal Select fee structure can be outline as follows: there is a $5,000 application fee, and by rule the total fees shall not exceed $150,000 which represents a listing of 50 million shares or more, in line with the ultimate capitalization plan of Bikini Sports. Annual fees for the 50 to 75 million share range come to $45,500.

Fee Structure Comparison

The scales are decidedly tipped in favor of the NASDAQ fee structure. While the specific numbers associated with the NYSE fees were not available, the cap of $500,000 is much higher than NASDAQ. Further investigation is necessary but it may be that the NYSE is attempting to still cash in on it's brand even as it faces massive changes in the market and how even it's own business model.

Liquidity

An examination of how liquid each market is and the implications for the Bikini Sports Company.

NYSE

"Liquidity, after all, is the NYSE's main advantage" (quote from the NYSE web site). A recent article in The Economist London [1] sheds a little light on the workings of liquidity at the NYYSE. The article points out that some 90% of order blocks of 10,000 or more go through the big board, suggesting a very deep market. The article points out a study by Plexu which found that this type of volume may allow lower commission fees on NYSE than on NASDAQ, though there is debate over this finding. The article speculates that the NYSE may be so liduid only because it is the biggest market but goes on to say that some of it's member companies are so big that only a few leaving to an alternative market could "do serious damage to the big boards liquidity." It is also noted that the NYSE specialist is often needed to put his own money down in order to provide liquidity.

NASDAQ

By contrast the NASDAQ model seems to embrace liquidity. A recent Rice University paper [2] "examines the growth of electronic communication networks (ECNs) and their impact on the liquidity of Nasdaq stocks. I find that the recent growth of trading through ECNs has resulted in tighter bid-ask spreads, greater depths, and less concentrated markets. Overall, our results support the hypothesis that electronic communication networks have improved Nasdaq liquidity."

Market Maker

NYSE, Specialist

All orders on the NYSE pass through the stocks specialist. With this information the specialist can gage the depth of the market and account for the spread. When volatility enter the market the specialist is charged by the exchange to step forward and eithr buy or sell from his own inventory to quell the tide. Some take an altruistic view of the NYSE specialist as in a recent Business Week article by Peter Coy [3] where he "By stepping in to buy when others won't, 'liquidity providers' can quell panic that makes it impossible to sell at any price." And goes on to say "NYSE specialists are obligated to maintain orderly markets when prices are falling by buying shares with their own money."

But a recent Wall Street Journal article by John Bogle [4] paces the specialist function in a little better perspective: "But while the NYSE grants specialists a privileged position in order to maintain a "fair and orderly market" (which, curiously, is nowhere defined), the specialist is also permitted to simultaneously trade for his own account -- an obvious conflict of interest."

The article goes on to point out "We need not worry about the specialist abusing his privileged position, we are assured, because the NYSE's cardinal principle is that the investor's interest is always served first. But it's easy to get around this tenet. Even though there is no imbalance between supply and demand, the specialist simply trumps the price of investor orders. If a specialist is holding investor orders to buy IBM for $10.00, he cannot buy at $10 until all investor orders at $10.00 are executed. But he can buy at $10.01. With his informational advantage over everybody else concerning the likely direction of a stock's price, the specialist will outbid investors only at the most advantageous moments."

NASDAQ, Dealer

Again from the Peter Coy Business week article [3], "NASDAQ market makers are also supposed to post bids as well as offers for the shares they trade at all times, although their obligations are less stringent." But a 1995 statement by the Financial Economists Roundtable [5] points out "The NASDAQ Stock Market has recently come under intense scrutiny because of charges that some of its dealers have colluded to inflate the bid-ask spreads of NASDAQ-listed stocks. These charges of collusion were largely precipitated by a study by Professors William Christie and Paul Schultz, which was first reported in the press on May 26, 1994 and ultimately published in the December 1994 Journal of Finance. Subsequent to this study, both the Department of Justice and the Securities and Exchange Commission began broad investigations of NASDAQ." The article presents a theorey by one researcher of how the dealers may have entered into collusive agreements but the theory is knocked down by the economist as not substantiated or meeting the requirements for collusion, small number of firms and significant barrier to entry. The point is that no entity is completely immune to unethical behavior but the NASDAQ dealer system seems to make it more unlikely.

SEC Rule 144

Of interest to the board will be the disposition of it's holding after the IPO as prescribed by law. Taken from Post-IPO Restricted Stock Sales and Listing Choices, Anderson, Lehigh University, and Dyl, University of Arizona, is a brief outline of SEC Rule 144's requirements:

SEC's Rule 144: SEC Rule 144 promulgates specific restrictions as to when, and how many shares of, restricted stock can be sold. Restricted stock is unregistered shares acquired directly or indirectly from the issuer in a transaction that is not a public offering. Usually only about 20-30% of total shares outstanding are sold in the initial public offering. Typical holders of the remaining 70-80% of the shares—which are unregistered, and therefore restricted, shares—are the firm's early stage investors, including company founders, employees, venture capitalists, and mezzanine investors.

The article goes on to say that (paraphrasing) "investors who hold the firm's stock before an IPO select NASDAQ instead of NYSE to minimize the post-IPO selling limitations imposed by SEC Rule 144." And in fact between 1993 and 2003 of 729 firms eligible to list on the NYSE that went public 246 chose to list their stock on NASDAQ.

Why? The passage goes on to point out "The choice of exchange listing is relevant because in applying Rule 144 the SEC uses the trading volume reported for the stock by the exchange. Trading volume is reported differently at NASDAQ, a dealer market, than at the NYSE, an auction market. In a dealer market, a market maker is generally the counterparty in every transaction. For example, an investor sells 100 shares of a stock to a dealer, who reports the trade of 100 shares; another investor subsequently buys the shares from the dealer, who then reports another 100-share transaction. One hundred shares have changed hands, but a trading volume of 200 shares has been reported. Inter-dealer trading further increases the amount of trading volume reported in a dealer market. In an auction market, however, most transactions occur directly between buyers and sellers, so when a trade of 100 shares is reported it generally means that 100 shares changed hands between two investors."

The greater volume reported under the NASDAQ market method will allow the current (pre-IPO) owners to realize greater benefits through the stock issuance.

AGENCY

Agency problem include:

Spinning. Securities firms involved in initial public offerings may allocate shares to officers or directors of client firms on the understanding of obtaining future business, creating a transfer of wealth to those individuals at the expense of other investors.

Self-dealing. A multifunctional financial firm may act as trading counterparty for its own fiduciary clients, as when the firm's asset management unit sells or buys securities for a fiduciary client while its affiliated broker-dealer is on the other side of the trade.

> A recent article by Garvey and Swan [7] points out: We find strong evidence of a positive relationship between stock market liquidity and incentive compensation using a sample of over 1,500 publicly traded US corporations and 45,000 executive years covering the period 1992-1999. The shares of these firms are quite liquid overall in that the average annual volume of trade exceeds the firm's market capitalization. More importantly for our purposes, the annual turnover rate ranges from just less than 3% to over 2700% of market capitalization. We find that this variation in liquidity is strongly associated with the use of stock-based pay, and find

similar results for liquidity as measured by a narrow bid-ask spread and for a new measure of stock price informative.

Conclusion

There are no points in favor of the NYSE offering. It is known the NYSE is facing pressure from it's members to change in the face of the changing trading environment. Indeed they are trying to adapt with the acquisition of the large Archipelago Exchange. But NASDAQ is already in the ENC marketplace and is proven time and again by the success of some of the world's most successful companies. NASDAQ will offer Bikini Sports larger availability to potential shareholders.

[1] Stock exchanges: The battle for efficient markets
Anonymous. The Economist London:Jun 17, 2000. Vol. 355, Iss. 8175, p. 69-71 (3 pp.)

[2] Electronic Communication Networks and Liquidity on the Nasdaq**,** JAMES WESTON, Rice University - Jesse H. Jones Graduate School of Management

[3] The Ups and Downs Of Market Liquidity And the different ways both specialists and electronic exchanges affect it, Peter Coy in New York. Business Week New York:Nov 3, 2003. Iss. 3856, p. 104

[4] SpecialistMan, John C. Bogle. Wall Street Journal (Eastern Edition). New York, N.Y.:Sep 19, 2003. p. A.10

[5] Financial Economists Roundtable, Statement on The Structure of the Nasdaq Stock Market, September 18, 1995

[6] Post-IPO Restricted Stock Sales and Listing Choices, Anne M. Anderson, Lehigh University, Edward A. Dyl, University of Arizona, September 9, 2005

[7] Agency Problems are Ameliorated by Stock Market Liquidity: Monitoring, Information and the Use of Stock-Based Compensation , Version February 12, 2002