Direct Public Offering
Compassionate Capitalist Podcast Narrative and Research

By Karen Rands

Hello, welcome to the compassionate capitalist radio show. I am Karen Rands your host and today we are going to cover a very interesting topic> Direct Public Offering.   As a result of the legalization of general solicitation or more commonly known in the market as crowd funding, starting in 2012, the little known provision for raising capital directly from the public without being a registered public offering moved out of the shadows and became an alternate label for ‘crowd funding’.
Years later, there still exists a great deal of confusion in the marketplace about raising capital and general solicitation or public offerings. I first did a podcast on this topic before the JOBS Act was passed and was curious about how the dust has settled since 2012 and how Direct Public Offerings or DPOs, Crowd Funding, and even Secondary Private Stock Exchange impact investors and entrepreneurs seeking to create wealth as Compassionate Capitalists --- Remember a Compassionate Capitalist creates wealth by investing resources, time, money into bringing innovation to the market, that leads to jobs and thriving profitable companies which ultimately deliver a return on investment. No guest today, but I believe you will find this topic informative and interesting. So lets get at it.

With all the changes in securities rules on when you can solicit to the General public, or more commonly referred to as General Solicitation. It's very confusing. It's confusing to entrepreneurs. It's confusing to investors that have been in the market as Angel Investors and it's confusing to the new people that are coming into the market to try to figure out how to get started investing in private companies. Of course, my best selling finance education book, Inside Secrets to Angel Investing goes into great detail on all aspects of the risk vs reward of investing in private companies.   When people by my book on Amazon or any bookstore, or get a signed copy from my website, KarenRands.co, they also get access to a portal of information and tools for investing in private companies.

It is important for the my listeners, whether you are an investor or an entrepreneur… this term “angel investor’ is really just a man or woman that has figured out that the second greatest source of wealth creation is investing in private companies before they go public or are bought --- first being the entrepreneur founder his or herself.   They create a portfolio that is diversified with private equity startup, early stage, or growth stage companies, along with real estate and traditional stock market assets.   Entrepreneurs most often get money from such individuals after they have contributed their own savings and their friends and family’s investment and is really the greatest contributor to economic growth because even with SBA guarantees, banks simply don’t loan much money to companies that aren’t yet profitable yet or have vast assets to back the loan.   It is important to understand, over 3 Trillion is invested by individuals under the SEC Regulation D exemption into private companies.   That is what the SEC knows about. They have tracked over 37,000 Reg D offerings from Form D filings with the SEC, the step a company takes to declare they are qualified on the exemption. The irony is that still the majority of that capital raise is still under the traditional Reg D 506 (b).

As a quick refresher for my listeners: Reg D is the exemption that was offered by the SEC, the Securities Exchange Commission, since the Securities act of 1933 that allowed the sale of equity or debt Securities to Accredited Investors through a private transaction. In response to the Great Recession, the Jumpstart Our Business Startups Act of 2012 (“JOBS Act”) – fundamentally changed the landscape of companies raising capital and removed the restriction for soliciting to the general public as a private company. I’ve

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done many shows on the evolution of crowdfunding and the economic impact for both entrepreneurs and investors and ultimately the community, therefore I encourage you to seek those shows out and listen to those so we can get into the meat of our topic today. But for the record> REG D 506 was split into 506B, the traditional method used with angel investors that are in groups or have prior knowledge of the company founders, and through most Broker Dealers, and the new Rule 506(c) exemption which became effective in September 2013 and allows general solicitation and general advertising, changing almost 80 years of regulatory practice. The SEC also amended Regulation A into two camps, The standard version and Reg A+ which also allows for general solicitation and is not restricted to accredited investors, became effective June 19, 2015. And you have the new Regulation Crowdfunding, or REG CF, and is also not restricted to accredited investors but has some limits on what can be advertised and how the transactions are monitored. It became effective May 16, 2016.
The old REG D 504, which was the basis for the original genesis of Direct Public Offerings, was amended so that states could use it for Intrastate Solicitation Exemption and companies in that state can advertise to investors, accredited and unaccredited, to raise up to $5M.
For the record, accredited is not a test or a certification, it is based on the amount of household income and assets held by the investor. If you make hundreds of thousands of dollars, have a fat 401K or Self-Directed IRA, and assets greater than $1M not including your primary residents, you are an accredited investor.

Now you have the foundation we can build upon….

Let’s begin with DPO. Before there was the JOBS ACT and all these methods for raising capital from the public without being an public company there was Direct Public Offerings. Investopedia defines it
A direct public offering (DPO) is a type of offering in which a company offers its securities directly to the public to raise capital. ... Cutting out the intermediaries from a public offering substantially lowers the cost of capital of a DPO.

With the changes to general solicitation rules, it's the same the same song but to a different tune because people have started using that term “direct public offering” and applying it to the new general solicitation rules under the 506c.

As it turns out, direct public offering as a term; “Direct Public Offering” or DPO was used in a couple of different ways. It's used by public companies when they want offer new Securities into the market they can go through a direct public offering and offer them directly to the public versus the normal stock exchange of simply reselling ones that are already out there in the market. I recorded a podcast on this topic about a decade ago before all the provisions and exemptions of the jobs act were known.

IF you go back to 1999, you’ll find few people with knowledge and know how to use the 504 reg D exemption to offer Securities to the public . Most people, including securities attorneys and broker dealer really didn't understand this it could be because of the complexities associated with offering a public offering under a regulation and most likely because of the restrictions placed on Brokers to not solicit to the public by their regulatory body of FINRA. So even though the Company could solicit, the experts in raising capital, broker dealers, would not solicit. Therefore, I theorize the ability to do this back a decade ago, was buried under the fear uncertainty and doubt put out there by FINRA and the Brokers not wanting to get in the crosshairs of FINRA to fine them when they step out of the lines.

REG D 504 provided an exemption for the offering for sell up to a million dollars insecurities in a 12-month period after which, they must wait a month to sell more securities. This was how the states like

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GA and Kansas could start their Intrastate Exemption prior to the JOBS Act being passed, or the REG CF being available. To get the exemption, entrepreneurs would file with their state and prepare a disclosure document, then they were good to go to sell in the state.

EXAMPLE of the trucking direct public offering, for local investor to directly invest in the ownership of a delivery truck, almost like a franchise, and share in the revenue as the investment ROI.

Keep in mind, they are limited to investors in that state where have operations, in some cases 90% of their revenue had to be within the state. Each state has their own state laws, regulations, restrictions so you need to be sure prior to starting the offering to make sure you are within the guidelines.

This goes for investors too, to makes sure the company has filed all the proper paperwork

Some of the research I found on Direct public offerings is the expense for companies only raising a million dollars. It could cost them just in filing fees $ 20,000 to 50,000 dollars. Compared to an IPO that could cost $200,000 to Half a Million, it's a deal, but of course there is the limit on geography and the amount, but at that time, other than IPO, there wasn't a way to raise capital outside of the narrow gauntlet of angel investor networks. That is why nobody ever really did a direct public offering under the 504 exemption even then and it has been allowed for many decades. BUT now all the buzz people about crowdfunding, and people use these terms interchangeably – Crowd Funding can refer REG CF that has significant more restrictions on it for general solicitation that the REG D offerings under 504 and 506c and the Reg A +

Bottom line on all 4 of the equity based Crowd sourced funding, the risks that they have in common for investors to understand deal with illiquidity of the stock and transparency of current status---keeping in mind public companies naturally are affirmative in their liquidity and transparency, and as private companies are not required in the same way, but not doing it can bring dire consequences:

- they are restricted Securities meaning they cannot go and resell those Securities until some formal public offering has been made or some registration with the SEC as the made that a permits their the sale of them for as a public offering or to resell them and that comes under a another filing.
- Most often exit for angel invested companies is 7 years which impacts your personal cashflow and creates greater chance for the company to not reach its' milestones to set up to be a flat midling company.
- This applies to all the REG D exemptions, including intrastateREG A+ has a provision for the company shareholders to sell at the same time at the price offered by the company, but even then, as I discussed in my podcast with esteemed lawyer David Feldman, REG A+ offerings are best suited for companies with a reasonable operating history and key plan for growth with the funding. https://www.blogtalkradio.com/karen-rands/2019/07/16/changes-to-reg-a-on-the-horizon-with-industry-expert-david-feldman
- Of course this kind of capital strategy is a service we offer companies. IT also has a provision to move on into the public markets when they complete their paperwork. They can also 'test the waters' to see if investors will respond in the market before filing paperwork. But they cannot take funds from investors until the SEC approves their financial filings.

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- There are some forms such as Form 3 and Form 4 and Form 144 that have to do with selling of a shareholders illiquid stock to another shareholder outside of the Public Offering market. If you are an employee of a company that has been around a while and you got a bunch of stock options, this is the way you can sell them on the secondary market. Here is a podcast where I interview a savvy private investor and we discuss in more detail about diversifying an angel investor portfolio to include later stage PRE IPO along with the longer play of traditional angel investment. https://www.blogtalkradio.com/karen-rands/2019/10/15/strategies-for-angel-investors-to-invest-like-a-venture-capitalist

Let me summarize the comparison and why it is matters to both entrepreneurs and investors.

Kinds of Equity Offerings on Internet-Based Platforms					
	Online Launch	Max Raise Year 1	Investor Status	Investment Limit	Intermediary Required
Reg A+ Tier 1	2015	$20 M	Any/All	No Limit	No
Reg A+ Tier 2	2015	$50 M	Any/All	Depends on income/worth	No
Reg D Rule 506 b	2011	No limit	Accredited, allows for 35 Un-Accredited	No Limit	No
Reg D Rule 506 c	2013	No limit	Accredited, must certify	No Limit	No
Intrastate Equity Crowdfunding	2012 GA & KS 1st, now all states	Varies by State, $1M to $5M	Any/All	Depends on income/worth	Varies by State
Reg CF (JOBS Act Type iii)	2016	$1M rolling 12 mo	Any/All	Depends on income/worth	Yes Registered Online Portals

506b: You can sell the 35 non-accredited investors. We must make the legal standing of having sufficient knowledge like they're sophisticated investors. So, you know, they're Savvy and whatever way that they're Savvy and they basically sign off that they are sophisticated, even if they aren't accredited. You still have to give all your non-accredited investors the same disclosure documents that you would give an accredited investor. One caveat, if you raise capital under a REG D 506c you cannot go back and raise it under 506 b.

Quickly on the topic of transparency and note I have made numerous videos available on my youtube channel and as part of the Compassionate Capitalist Coffee break you can sign up for at html://KarenRands.co/contact. Here is a recent revamped talk on transparency from the Compassionate Capitalist Podcast Series: https://www.blogtalkradio.com/karen-rands/2019/08/27/difference-between-public-and-private-companies--transparency

Transparency is extremely important in all of these types of Direct Public Offerings. Entrepreneurs must be transparent to the investor the risks of failure, most of that information is disclosed in a Private Placement Memorandum or PPM. It contains these statements to establish the illiquid status and risks so as to almost discourage investors from investing. Also, entrepreneurs should be able to provide a report, and investors should look for information on the methods used to raise your prior money, including the commissions paid and any filings for that type of raise. Your cap table of investors and the price paid and if there are outstanding convertible or safe notes. The company's financial status – balance sheet showing debt and cash flow statement, and forecast are imperative for investors to make

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an informed decision.   In every one of the descriptions of these direct public offerings, the SEC makes a point of the anti-fraud provisions to assure there is no " bad actor" which is someone who has raised money illegally soliciting to the public without the proper filings, paid commissions on their capital raise from someone not licensed as in a broker dealer, did not disclose material information to the investor, and they were charged with fraud. IF you don't disclose and particularly if you take money from someone unsophisticated, then it could be construed as fraud. There are civil penalties and criminal penalties – if found guilty and SEC investigators lean toward protecting investors more than the companies, best case the company has to return all the money raised, effectively putting them out of business, worst case the founders go to jail and will forever be labeled a 'bad actor'. That is bad news for all involved.   and all it takes is one investor filing a complaint for an investigation to be opened. That is one of the reasons for REG CF is managed by portals that have been authorized and monitored by FINRA, to protect the unsophisticated unaccredited investors from investing in a company that had not intention or no likelihood of even getting to market. Accredited investors have full authority to report potential incidents of fraud too because lack of transparency affects how even a sophisticated accredited investor makes their investment decisions.

On the topic of illiquidity that Investors need to understand and appreciate before moving forward with the company to invest.

- It's very important that entrepreneurs and investors understand that these stocks are illiquid, meaning there is not market for them until the company goes public, whether as a traditional IPO, REG A+ or Reverse. There is an exception to this rule but is only available to a small percentage of the private shareholders, a topic we discussed on how investors sell their stock in a Pre IPO company on secondary exchanges that are gaining in popularity for those investors that want to invest in pre-ipo companies as they diversify their portfolio of private companies: https://www.blogtalkradio.com/karen-rands/2019/10/15/strategies-for-angel-investors-to-invest-like-a-venture-capitalist

As a side note to emphasize; I want to highly discourage entrepreneurs going on to the public exchanges with a reverse merger.   A Reverse Merger doesn't go any faster or cost less than a REG A+, it is harder to raise the capital and you are starting in the ditch to start.

I talk about in my book, Insides secrets to Angel Investing, recommending investors understand the management of funds that have come in and the strategies the company will use to get the remaining capital they need. Therefore, entrepreneurs need to know how to utilize these different methods to gain all the capital they need to succeed, and investors need to understand the entrepreneur has enough money and strategy to reach the milestones. Because if the company doesn't get all the capital it needs to succeed it will either fail in short order or become one of those 'payroll exit' companies.   You may not have heard that term.   My friend Hall Martin coined it and gave me permission to use it.   You know you have heard that 1 in 10 equity invested companies hit to make up for the outright losses of 3 of the companies and the flat growth of the 6 or 7 in between.   Hall called them payroll exits because the founders just keep going to the board for more payroll with no plan in site to raise capital to become the $20-50M or even Unicorn company that can get bought or go public.

As I Wrap up this podcast, and hope you have learned something new today about the best practices for direct public offerings and clarification on the positioning of each.   This is a topic I have found in the 7

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years since the JOBS Act was first passed, the vast majority of entrepreneurs are not aware of the best practices for raising capital when traditional angel groups and VCs pass. Keep in mind… according to the SEC, 37,000 private companies received money from angel investor groups…. That isn't even a quarter of the new businesses that get started every year according the SBA. Crowdfunding is a new way to break down the barriers between entrepreneurs and investors, but it isn't a simple scratch and win like a lotto card. Every method for raising capital takes a carefully thought out strategy and a LOT of work. They all take time and money, so the best strategies understand this and plan accordingly.

In my upcoming Book SCALE --- insides secrets to getting the capital you need to scale your business 10X, deals with these issues and how to combine these different approaches for raising capital from Rewards based for prototyping and market validation, to local companies expanding under REG D 504, to small companies getting going under REG CF, combined with a national roll out under a REG D 506C and Reg A+ …. Sign up at KarenRands.co and subscribe to this podcast so you will get updates on when that book will be released.

Thank you for joining in to the Compassionate Capitalist Podcast and hope you will return next week. Please comment your thoughts and questions and tell others. Help me spread the word about compassionate capitalism and grow this movement because every savvy investor needs to believe entrepreneurs are worth investing in to make money as a capitalist, but also to help change the world with innovation coming to market and grow the economy with new well paying jobs.

Until next week …. Onward and Upward.

Karen Rands, The Host of the Compassionate Capitalist Podcast

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