FAQ Direct Public Offerings

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What is a Direct Public Offering?

A Direct Public Offering (also called a DPO) is a type of offering that allows the selling of securities directly to the public without an underwriter or broker-dealer.

> **Note:** *While "Direct Public Offering (DPO)" is not an official term used by the Securities & Exchange Commission (SEC) or state regulators, it is used loosely to describe registered offerings such as SCOR, Reg A and S1's (see How many types of Direct Public Offerings are there).*

Direct Public Offerings as used on this page refer to registered offerings only. DPOs, once deemed effective, allow you to advertise directly to the public and sell to any number of non-accredited and accredited investors alike.

> **Note:** *A registered offering means that specific forms need to be filed with state regulatory agencies or the SEC depending on the type of DPO a company will pursue. In addition, companies are often required to file audited financials and provide quarterly and annual reports for DPOs at the national level (such as Reg A and S1). The agencies use the term "deemed effective" to mean a company may pursue their offerings.*

> **Note:** *This is in contrast to private placements (Reg D offerings) that do not allow you to advertise and restrict the sales of securities to no more than 35 unaccredited investors. (see Terms and definition)*

If a company raises money through a Direct Public Offering does that mean they are a public company?

No. Completing a Direct Public Offering does not mean you are a publicly trading company once you've completed the fundraising. It simply means once your offering has been deemed effective you can sell securities directly to the public-at-large. However, a DPO can be used as a slow IPO or staged IPO in that they give you the option of becoming a publicly traded company with two or three incremental steps at your discretion and timing.

A DPO allows a company the option of becoming a publicly traded company on an exchange at some point in the future, far quicker and at a fraction of the cost of a traditional IPO. (This public option is a powerful capability that few companies understand or avail themselves of.)

> **Note:** *Direct Public Offerings are not reverse mergers.*

How many types of Direct Public Offerings are there?

There are four different types of Direct Public Offerings, each having their own unique benefits:

1. SCOR offerings (Small Corporation Registration Offerings)
2. Rule 147 offerings (Intrastate Offering Exemption)
3. Reg A offering (Regulation A Registration Statement)

4. S-1 Offering (S-1 Registration Statement)

The common denominator of all Direct Public Offerings is that you are allowed to solicit investors through advertising or the use of free writing and you can sell an unlimited number of unaccredited investors. This opens up an enormous world of the investors.
(see **High Value Investors**)

SCOR Offering. This type of securities offering allows you to sell your offering within a specific state.* You do not have to file or get approval from the SEC, you only need approval from the state you are selling securities in.

You file a simple question and answer form to the state, which reviews it and generally approves it within 30 to 45 days. The form is called a U-7

SCOR offerings allow you to raise up to $1 million within a 12 month period of time.

As mentioned, with all DPOs you can advertise directly to the public and there is no limitations on the number of unaccredited investors you can sell to.

48 states allow some form of the SCOR offering.

> ***Note:*** *You need 2 years of either reviewed or audited financials to accompany your U-7 filing.*

> ****Note:*** *There is also something known as a regional score that in theory allows you to sell within a select group of States—this is seldom used however because it requires multiple states reviews and coordination which makes it extremely difficult to get all states to agree.*

Rule 147 Offering. This type of securities offering is also restricted to sales of securities within the state your company is registered in. This means if your corporation is registered in another state different from where your headquarters is located,* in order to use this exemption you will need to refile your corporate papers in the state that the corporation resides in.

> ****Note:*** *An example of this is many businesses register their corporations in Nevada or Delaware because there are certain advantages in doing so, this does not however prohibit you from refilling in the state in which are located.*

The Rule 147 Direct Public Offering allows you to raise upwards of $2.5 million to $5 million in most states that allow this offering or its equivalent. In some states there is no limit on the amount you can raise.

This Rule 147 exemption also requires either the majority of the company's products or services to be sold within the state of the company's main residency—of course if you're selling across state lines it still counts as a sale within your state as long as you are paying sales taxes within your state.

The Rule 147 requires the filing of a simplified prospectus to the state which reviews it and generally approves it within 30 to 45 days.

> ***Note:*** *You need 2 years of either reviewed or audited financials to accompany your rule 147 filing*

Reg A Offering. This is the first of two national registrations that allow you to sell your securities nationally. As it currently stands, a Reg A offering allows you to raise up to $5 million within a 12 month period of time. In addition, you have to register a Reg A with the SEC and within the each of the states you're going to sell your securities in. This makes a Reg A somewhat impractical and very few are done because of these state and SEC coordination issues.

Recently, the Obama administration passed new legislation called "The Jobs Act". This new legislation takes the negative elements out of the Reg A offering and gives it a new name "the 3(b)(2) Exemption" (not an elegant name for sure). This new exemption is quite useful in that it allows one filing with the SEC and none to the states. It also raises the ceiling of funds that can be raised to $50 million in one year.

It is expected to be approved for use by the SEC in the last quarter of 2013.

> ***Note:*** *You need 2 years of audited financials for the 3(b)(2) Exemption*

S-1 Offering. This is the most versatile national Direct Public Offering method. It's an SEC registration that allows you to raise anywhere from $50,000 or $100,000 to a Google-type multi-billion dollar offering. An S-1 registration statement is filled out and filed with the SEC with typical approval time in less than 100 days.

As mentioned with all DPOs, you can advertise directly to the public and there are no limitations on the number of unaccredited investors you can sell to. With an S-1 offering you may use a type of advertising referred to as "free writing".

> ***Note:*** *You need 2 years of audited financials to accompany an S-1 Registration statement*

Why Use a Direct Public Offering?

> *"For every idea and every company, no matter how unusual, there are a sizable number of investors who will want to invest in it."*
>
> — Michael Bissonnette

One could easily say the fundraising rules and regulations in place for small businesses until recently have placed insurmountable burdens on companies trying to raise money.

Two converging trends, both gaining momentum, have collectively and powerfully changed the capacity for small businesses to raise capital:

The continual deregulation of the fundraising rules allowing small businesses equal access to the public markets including eliminating the need for accredited investors and allowing advertising to the general public.

The rise of the internet and the SEC's acceptance of it as a marketing and communications medium, allowing small businesses the ability to access over 30 million new investors for pennies on the dollar, and giving entrepreneurs a simple, direct and economical way to find, pitch and close investors.

Two Game Changers that Rocked the Fundraising World

Over the last number of years two game changing events have opened up enormous new avenues and opportunities that entrepreneurs can use to raise money—offering the option of reaching out to a new category of investors totaling over 30 million virgin investors.

THE GAME CHANGER #1

> **SEC and state regulators agree on new exemptions companies can now rely upon to advertise their stock offerings to potential investors.**

Congress, realizing small businesses create the vast majority of new jobs and recognizing the need for legislation that makes it easier for small businesses to raise money, passed the Small Business Investment Act (SBIA). This instructed the SEC to give small private companies, for the first time in history, the ability to raise money from the public markets.

With the SEC leading the way, they worked in concert with state regulators to stimulate more investments in small companies. Three special small business exemptions were passed: the SCOR Act (Small Corporation Offering Registration), Rule 147, and Reg A (soon to be called the 3(b)(2) exemption). There is a fourth way to do a Direct Public Offering which is a federal registration known as an S-1. These new offering methods clearly and decisively gave small businesses full and equal access to the public markets in the same way that Broker Dealers and Investment Bankers had for raising money without the same level of legal filings or accounting regulations.

Now, small business are allowed to legally advertise and sell stock directly to the general public, either in their home state (SCOR & Rule 147) or nationwide with a Reg A or S-1 offering.

To further open up investment opportunities for both small companies and investors alike, the SEC also eliminated the net-worth requirements and the need for accredited investors for companies that raised money using Direct Public Offerings. This offered significant benefits to both companies raising money and investors as well.

> **Company Benefits:** The combination of lifting the requirement for accredited investors, in addition to allowing companies to advertise their offerings to the general public, has opened a vast pool of over 30 million new potential investors — and like a virgin trout stream that has never been fished, the potential investor receptivity is quite high for exciting investment opportunities with high upside potential.
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> **Investor Benefits:** Unaccredited investors, or the public at large, have never been invited to participate in road shows for evaluating private companies' investments. This had been the privilege of the investment banking community accredited investors.

Now virtually all interested investors will have both access to private companies' one-on-one presentations and group road shows, plus the right to invest in companies of their choice doing Direct Public Offerings.

GAME CHANGER #2

> **The rise of the Internet and subsequent approval by the SEC allowing nationwide investor outreach over the Web**

Never in the history of fundraising have entrepreneurs had the capacity to reach out and tell their story to a nationwide pool of investors.

When the SEC accepted the Internet as a medium for advertising offerings, distributing investor prospectuses, and delivering investment documents, they dramatically decreased the cost to find, pitch and close investors.

> **Finding Investors:** Companies can use various low-cost web marketing tactics, including social media outreach (e.g. LinkedIn, Facebook, Twitter), e-mail blasts to investor lists, banner ads on investor websites, Google Ad Words, and many other creative ways to target investors. In addition many other solid proven direct marketing methods have proven to work consistently over the years including direct mail, postcard mailings, newspaper ads and many other methods.
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> **Pitching Investors:** In addition to one-on-one and group face-to-face presentations, companies can use the Internet for statewide or nationwide teleseminars and webinars as virtual road shows to present to investors, thus eliminating the need for time consuming and expensive travel and set up for companies, and allowing investors to experience various opportunities without ever leaving their home or office.
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> **Closing investors:** All investment and closing documents can now be transmitted by e-mail eliminating potentially tens of thousands of dollars in printing, handling, and mailing of prospectuses and other investor communication.
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> ***Note:*** *Before the arrival of the Internet and the SEC's acceptance of the Internet as a marketing and communication channel for investors, all marketing outreach efforts to investors had to be by mail and accompanied by a prospectus. To reach out to 5,000 investors to invite them to an investor meeting would have cost in excess of $20,000 compared to a few hundred dollars for a similar marketing campaign today using targeted e-mail for affinity investors with a web link to the company prospectus.*

Lastly, choosing to do a Direct Public Offering allows you the option to take your company public either now, or at a time in the future, at an extremely low cost (pennies on the dollar in contrast with a typical big company IPO) and list your shares for sale on an exchange with all the resulting liquidity and other benefits of being a public company.

Is a Direct Public Offering the same as a Private Placement or Reg D?

No. A common misconception is that a Direct Public Offering (DPO) is a type of private placement. While there are some similarities, they are quite different.

Both private placements and DPOs are vehicles businesses can use to raise money by selling securities or equity in their companies. However, a private placement restricts a company by allowing sales to people who already have a relationship with or connection to the company and only to a limited number of unaccredited investors. A private placement is often used early in the fundraising process in what is referred to as a "friends and family" round. Also, a company cannot advertise for investors when raising money in a private placement.

On the other hand, a DPO has perceived advantages over a private placement because companies can advertise to the general public and companies are able to sell to an unlimited number of unaccredited investors.

Another difference between a private placement and a DPO is how simply and quickly a private placement can be put into effect. Private placements are very common and can be put together with minimal legal and accounting work.

In most cases, a company only needs an offering document (prospectus) and an unaudited balance sheet and P& L followed by filing a Form D with the state and SEC to begin selling shares to the general public

While timelines vary, some companies can complete a private placement and be selling the offering within as little as 15 days and in many cases 30 to 45 days.

With a DPO, a company is required to file and have its offering document reviewed with either the state or the SEC depending on the type of DPO (see FAQ "**How many types of DPOs are there?**").

State approval can often get approved in as little as within 30-45 days. SEC approval generally takes from 60to120 days after filing.

Details of Regulation D offerings follow.

To facilitate investments in small businesses, the Securities and Exchange Commission (SEC) adopted Regulation D (Reg D), also commonly referred to as a Private Placement, which allowed companies a “safe harbor” to bypass the sometime costly and time-intensive requirement to register and seek approval* with the SEC before being able to sell stock to investors.

Note: *The rules (exemptions) that allowed companies to bypass registration requirements were Rules 504, 505 and 506.*The SEC doesn’t actually approve a registration, the technical term is the offering is deemed effective.*

TWO HUGE ADVANTAGES TO COMPANIES ARE:

1. **No Broker Dealers or Investment Bankers Required**

   Before Reg D, companies had to use third party intermediaries (investment bankers and broker dealers) to work through the morass of SEC regulations and registration requirements to sell an offering. The Reg D exemption breaks this stranglehold and allows companies to sell their own offering directly to investors. This has eliminated commissions, fees, loads and third party sales charges in these types of offerings.

2. **No SEC Review or Approval Process; Raise Money Quickly**

   Before the Reg D exemption, stock offerings required SEC approval. This process took many months* and cost tens of thousands of dollars in legal, accounting and audit fees.

   Companies can now with non legal help and a template and a few actual examples can create their own Private Placement Memorandum (PPM) without audited financials or extensive legal fees. Their PPM requires no review, comments, or evaluation by regulators. Companies often can choose to use an attorney for a simple review or to write their complete document.

   The net result is that companies can now be on the street selling to investors in a few weeks. (Some of our clients have received their first investor checks in less than 30 days.)

   **A Reg D is the quickest pathway to have funds come in the door.*

TWO LIMITATIONS TO COMPANIES ARE:

1. **Companies Cannot Advertise Their Offering**

   As significant as this milestone was, companies using a Private Placement are still unable to advertise or sell their offering to the general public. They are limited to selling their offerings to individuals with whom they have a pre-existing relationship*. This means entrepreneurs can only sell to a limited universe of family, friends and professional relationships, such as angel investors, lawyers, accountants, consultants, suppliers, customers, employees, etc.

2. **Requirements For High Net Worth Investors**

   The second limitation of Reg D is a requirement known as Rule 501 that requires investors to be high net-worth individuals or sophisticated investors. This severely limits the pool of investors that companies can sell to. Rule 501 created a definition for a high net-worth individual, now known as an “accredited investor,” that requires individual investors to have a $250K/year income or $1M in net-worth (excluding home and cars.)

   Note: *The one redeeming quality of this restriction is that you can sell up to, but no more than, 35 unaccredited investors (not high-worth individuals.)*

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