ALTERNATIVES TO AN INITIAL PUBLIC OFFERING

An IPO that is registered with the SEC is only one means of financing your company.

Deciding whether this course of action is best for your company should only be made after carefully evaluating alternative means of financing. Some of these are not only ends in themselves, but also interim steps on the road to an IPO. The variety of financing techniques is limited only by the ingenuity of the financial community. Some of the possible alternatives are briefly described below. You should consider the advantages and drawbacks of each the effects they could have on your company.

Bank Loans

Bank loans are by far the most widely used means of financing. For mature companies, this type of funding is usually the most flexible and easiest to obtain. It also allows you to retain control over your company and to maintain substantial confidentiality of company information.

However, bank loans do not provide the long-term equity base your company may need as a foundation for growth since repayment of principal and interest will put pressure on future cash flow. Moreover, depending on your company's financial history and prospects, bankers may require substantial pledging of company assets; various operating restrictions, such as limitations on dividends, capital expenditures, and business acquisitions; maintenance of specific financial ratios; and, in many instances, your personal guarantee.

Regulation A Offerings

Regulation A, the small issues exemption, governs public offerings not exceeding $5 million. Although Regulation A is technically an exemption from registration under the 1933 Act. An offering statement, which is less extensive than most 1933 Act filings, still must be filed with and "qualified by" the SEC. In addition, an Offering Circular, which is an abbreviated version of a prospectus, is distributed to investors. Although financial statements are included in an Offering Circular, they are not required to be audited. However, underwriters or state securities laws may require audited financial statements or more detailed disclosures than would be required under Regulation-A.

In December 2013, the SEC proposed rule amendments required by Title IV of the JOBS Act. The proposed rule amends Regulation A to establish a streamlined process by which a private company could offer and sell up to $50 million of securities in a 12-month period if it complies with certain reporting requirements. The proposed amendments would create two tiers of offerings:

Tier 1 – A revised version of the current Regulation A, Tier 1 would permit offerings of up to $5 million in a 12-month period.

Tier 2 – This new tier would permit offerings of up to $50 million in a 12-month period. Investors in Tier 2 offerings would be limited to purchasing no more than 10% of the greater of their net worth or annual income.

State securities law requirements would be preempted for these offerings.

Private Placements

Private placements of debt or equity securities are exempt from registration if they are offered in small issues or to a limited number of specially defined investors. Regulation D provides a safe harbor; companies that meet its requirements have certainty that an offering is a private offering that is exempt from registration. The various underlying rules are complex and you should consult your independent accountants and attorneys in considering this financial alternative. A private placement is generally less expensive than an IPO and does not require as much disclosure or preparation time. It also does not require periodic reporting to regulatory agencies. However, there are restrictions on subsequent resale of the securities sold, so the proceeds will typically be at a lower value than in a registered offering.

Different levels of disclosures to investors are required by Regulation D, based on the size of the offering and the nature of the purchasers, as follows.

• **Rule 504:** relates to offerings not over $1 million in a 12-month period. No specific disclosures are required by the SEC, although they may be required by state law.

• **Rule 505:** relates to offerings up to $5 million in any 12-month period to an unlimited number of "accredited investors" (e.g., institutional investors, wealthy individuals) and no more than 35 other purchasers. Disclosures are generally the same as would be required in an IPO. However, if only accredited investors are involved, there are no SEC required disclosures; although, again, state laws may require certain information.

• **Rule 506:** permits offerings of an unlimited amount to no more than 35 purchasers meeting various financial "sophistication"standards, and an unlimited number of accredited investors. Disclosures generally would be similar to those in an IPO. However, if only accredited investors are involved, there are no SEC required disclosures; although, again, state laws may require certain information.

Venture Capital

For those companies seeking funds during their development stage, venture capital financing may be particularly appropriate. This is designed to give investors the possibility of significant appreciation in their investment, often in the form of an eventual IPO, in return for taking the high risk of investing in a new company. Venture capital can be expensive since it requires giving up a substantial part of your company's equity.

Furthermore, venture capital comes at the price of a certain amount of control, as venture capitalists will want an influential voice in the company's affairs. They usually require membership on the board of directors and will closely monitor the company's progress.

Intrastate Offerings

Rule 147 of the 1933 Act exempts from registration offerings restricted to residents of the state in which the company is organized and does business, provided:

(1) The company has at least 80% of its revenues and assets within the state; and
(2) at least 80% of the net proceeds of the offering are used within the state.

This exemption is available regardless of the size of the offering or the sophistication of the investors. There are no specific disclosure requirements in this type of offering. A substantial disadvantage of an intrastate offering is the risk of the entire sale being rescinded if the stock limitation on resales to nonresidents is violated.

Crowdfunding

In October 2013, the SEC proposed a rule required by Title IV of the JOBS Act that would permit "crowdfunding." Under the crowdfunding proposal, private companies conducting public offerings of $1 million per year or less would be exempt from the standard SEC registration process. The intent is to allow limited-size offerings, principally via the internet, to enable small amounts to be sold to a large number of investors.

Participating investors need not be accredited but would be subject to specific purchase limits. Companies interested in this type of offering should stay tuned to the SEC's website and rulemaking schedule for updates.

Other Possibilities

Other possible financing alternatives include: leasing, government loans (e.g., Small Business Administration), research and development partnerships, joint ventures, and convertible debt. In addition, the securities markets are becoming more global in nature, spawning new opportunities to obtain financing overseas. For example, an increasing number of U.S. companies have undergone IPOs in foreign countries.

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