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## Locke Lord QuickStudy: Tier 2 Regulation A Offerings – Is Your Company Ready for a Mini-IPO??

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The amount of capital that companies can raise in a Regulation A (also known as a "Reg A+") offering increased to \$75 million annually, effective as of March 15, 2021. With the new offering limit, Tier 2 Reg A+ offerings, often called mini-IPOs, can boost an issuer's capital and simultaneously raise market awareness of its brand and products. By increasing the offering limit, issuers may better absorb fixed offering costs, as they would represent a smaller percentage of the total capital raised. The new limit also incentivizes bigger players to enter the market, giving this type of offering more visibility, credibility, and institutional backing. We believe one key to a successful Reg A+ offering, in addition to a solid business plan and hard-working management team, is an effective marketing plan that attracts both institutional and retail investors.

Following is a short summary of Reg A+ and why we believe now is the time for mid-market and smaller issuers to consider raising capital through Reg A+ offerings. Prior to the Jumpstart Our Business Startups Act of 2012 (the "JOBS Act"), issuers shied away from Regulation A because of low offering limits and the requirement to comply with blue sky laws in all 50 states, which was time-consuming and cost-prohibitive. The JOBS Act reforms increased the Reg A+ offering limits and eliminated state-by-state blue sky compliance, subject to satisfactory completion of SEC review of the offering materials. The amendments effective March 15, 2021 raised the annual cap to \$75 million and added the ability for an issuer to conduct a continuous offering. While larger (Tier 2) Reg A+ offerings are available to both institutional and retail investors, individual "non-accredited" investors cannot invest more than 10% of the greater of their annual income or net worth (excluding the value of the person's primary residence and any loans secured by the residence (up to the value of the residence)), if the issuer's securities are not concurrently listed on a national securities exchange.

The COVID-19 pandemic and the recent surge in SPAC offerings and direct listings by tech companies has driven significant interest in public markets and the accumulation of a lot of dry powder to invest in innovative companies. Most retail investors and even some institutional investors have been left out of the new SPAC offerings. With the proper marketing program and professional advice, there is a significant untapped source of capital for enterprising companies. Reg A+ may be an effective means for companies to raise a modest amount of capital and gain the media and marketing attention that come along as a welcome bonus.

Generally speaking, a Reg A+ offering:

- will cost less and require less management attention than a traditional IPO;
- shares can be listed on a national securities exchange;
- can be marketed to retail investors who are not "accredited investors";

- will get "free press" for the company and its products through the public marketing process; and
- can be an efficient, and long-term capital access vehicle for growing companies.

To get started, issuers should have some capital and management capacity available to invest in the offering. While Reg A+ does allow issuers to use capital raise proceeds to pay offering costs, we recommend that the issuer have a sufficient war chest to kick-start the marketing and professional service teams. While the amount of starting capital can vary for each issuer, we believe several hundred thousand dollars may be required to get the offering out of the gate.

Below are some of the factors to consider to determine if a Tier 2 offering is right for your company.

<u>Timeline</u>. A fair estimate of the time from commencement to completion of a Reg A+ offering is about 4-6 months. Timing might be quicker if (i) the issuer has audited financials and (ii) some of the processes can run concurrently or overlap. Broken down, an issuer should consider the following elements and allocate an appropriate resources for each:

- 1-2 weeks to prepare materials and develop a list of potential investors to test the waters;
- 2-4 weeks for the "road show" to solicit indications of interest;
- 3-4 weeks to prepare and file an offering statement on Form 1-A. Some issuers who are committed to the process begin preparation of the offering statement concurrently with the road show;
- 6-10 weeks for coordination with the SEC staff to receive, review and respond to staff comments. This period
  could be longer or shorter depending on the complexity of the offering materials, whether or not the filing is
  made confidentially or publicly, and the coordination with the professionals who prepare the disclosures and
  financial statements;
- 1 week to coordinate sales under the qualified offering statement and for the marketer to file a Form 211 Application. As discussed below, depending on the amount of subscriptions and whether or not the issuer plans to list on a national exchange, the offering may be conducted on a continuous basis over a period of six to twelve months (subject to the annual offering limit). During this period, the issuer will apply for a stock ticker and other listing requirements; and
- 3-4 weeks to apply for listing on the OTCQX / OTCQX premier and to engage a Designated Advisor for Disclosure ("DAD") as required by the exchange.

Marketing. Unlike IPOs, there is no "quiet period" for Reg A+ offerings; see "Testing the Waters" below. Issuers can test the waters before or after filing the Offering Circular with the SEC. A good marketing program will introduce potential investors to the company, its brand, its products and market potential. A good marketing program also keeps potential investors involved and interested in the company's future and follows the company's progress towards stated goals, but remains unobtrusive. Each communication to potential investors must be carefully crafted to provide value so that the prospect feels like they are being educated about why your company deserves the prospect's interest, support and precious capital. Having a great public relationship firm, investment banker and/or client relationship management ("CRM") system is key to marketing of your Reg A+ offering. After investing in developing your investor pool, it is important to stay in regular and efficient contact, via email, webinars, and social media, so those dollars are not squandered. The focus, frequency and modes of

contact for your marketing program will depend on your target audience and differing sales channels.

Testing the Waters. Reg A+ allows an issuer to "test the waters" for interest in its offering before making a substantial investment in in the process. This allows investors to provide indications of interest in an offering before the company can actually accept the investment. Despite indications of interest, however, issuers cannot rely on those subscriptions until the effective date of the offering and the investors can rescind or modify their indications up until closing; issuers refer to those indications as "soft circled" investments. To test the waters, the issuer and its representatives usually meet with potential investors on a road show (in person or more often virtually) to ask them how much if at all they would invest if the issuer completes the offering.

Exchange or Platform Trading. Companies that successfully complete a Tier 2 offering may list their securities on the NYSE or Nasdaq, if they otherwise meet the exchange's listing standards. Listing on an exchange, however, does come at an increased cost due to exchange listing and maintenance fees, as well as the cost to comply with the exchange's increased disclosure requirements. Like an IPO, Reg A+ shares that are listed on an exchange are not subject to a lock-up period so investors can trade the securities immediately after purchase.

Offering Circular. Issuers in Reg A+ offerings file Form 1-A (containing the Offering Circular) with the SEC. The Offering Circular contains information about the issuer's financial results and business, among other details. The Offering Circular can be filed and amended confidentially to gain SEC feedback before releasing it to the public. The final Offering Circular then must be filed with the SEC and released publicly at least 21 calendar days before qualification.

Continuous Offerings. Reg A+ permits a continuous offering where not all the stock offered is sold upon qualification. To maintain a continuous offering, the issuer must keep its annual and semiannual reporting current throughout the offering period. In addition to new issue securities, an issuer can also include in the continuous offering: (i) securities offered by selling shareholders (up to an annual cap); (ii) securities offered under an employee benefit plan; (iii) securities issued under outstanding options, warrants, or rights, or for securities issued upon conversion of other outstanding securities; and (iv) securities pledged as collateral to lenders, if reasonably expected to be offered and sold within two years from the initial qualification date. Note that issuers in a continuous offering cannot sell stock into the market in an "at the market offering." "At the market" means selling securities at the current trading price as if the issuer were an ordinary shareholder holding free trading stock. All sales in a continuous offering must be negotiated and closed off market.

Zero Dollar Minimums. Under Reg A+, an issuer may set a zero capital raise minimum. This way, the issuer may still close on subscriptions even if it does not meet applicable exchange minimum listing capital or investor count requirements. Issuers should be aware, however, that several Reg A+ offerings have failed because investors, particularly institutional investors, conditioned their subscription on the issuer's listing. Furthermore, if an issuer discloses that it intends to list on an exchange at the conclusion of an offering and does not do so, it may need to release any subscriptions and provide updated offering materials to reflect the change in expected liquidity of its securities.

<u>Form 1-A Compared to Form S-1</u>. Reg A+ provides a limited-offering exemption from registration under the Securities Act of 1933, as amended (the "1933 Act") and the Securities Exchange Act of 1934, as amended (the "1934 Act"). Like a traditional IPO on Form S-1, Reg A+ issuers are required to provide audited financials and on-

going financial and business disclosure. Reg A+ securities are also unrestricted, freely tradeable and can be quoted over-the-counter or listed on exchanges. Traditional IPOs can be expensive and time-consuming but allow for an unlimited capital raise. Reg A+ offerings are less expensive and easier, but are limited to \$75 million in a 12-month period.

Lessened disclosure requirements under the 1933 Act and 1934 Act limited-offering exemptions generally lead to lower fees for legal and audit professionals. The SEC's review of a registration statement on Form S-1 is typically fulsome and subject to several rounds of comment and responses. The SEC review process for a Reg A+ offering will be generally shorter and less onerous assuming that the issuer has provided all required information. Additionally, these lessened disclosure requirements may result in lower management distraction.

Reg A+ Fee Estimates. Generally, an issuer will employ the following professionals to assist with the preparation and closing of a Reg A+ offering and budget accordingly. Most professional fees are "pay as you go," potentially with a retainer up front. Therefore the issuer should work closely with the professional service providers to make sure that funds are available as needed to avoid delays in the listing process. As noted above, an issuer should have access to around \$200,000 at the beginning of the process and expect all-in cost to be between \$275,000 to \$450,000, excluding sales commissions. We note, however, that every deal is different and may include complications that cause fee increases.

- Investment bankers will usually charge an engagement fee, a percentage of the capital raised, and include a
  budget for out of pocket expenses. Engagement fees generally run between \$25,000 to \$50,000 and expense
  budgets run from \$10,000 to \$25,000, or more if the road show is in-person rather than virtual. Sales
  commissions generally run between 6% to 10% of the raise the smaller the raise, usually the greater the
  commission percentage;
- Legal fees will usually range between \$100,000 to \$250,000, which includes securities and tax advice. If the issuer's strategy includes acquisitions or other transactions, legal fees will be higher;
- Securities compliance advice to navigate the listing process generally ranges from \$40,000 to \$60,000. Annual securities compliance maintenance costs average between \$35,000 to \$50,000;
- Audit fees and financial statement preparation for the Form 1-A usually fall in the \$35,000 to \$45,000 range for US dollar based companies. If digital assets or non-US currency review is required, the audit fees will increase – in some cases by 50% or more;
- Issuers should budget printer costs at between \$10,000 to \$20,000 for initial filings, several thousand for each revision, and \$5,000 to \$10,000 per year thereafter; and
- Exchange listing, DTC fees and DAD should be budgeted at \$50,000 to list, and \$50,000 per year for maintenance fees.

Please reach out to the authors on any questions related to these topics. As we have in the past, we will ?continue to monitor these issues and will provide future client updates.

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