Stradling
Attorneys at Law

A First Look at Equity Crowdfunding in the US: Q1 & Q2 2017

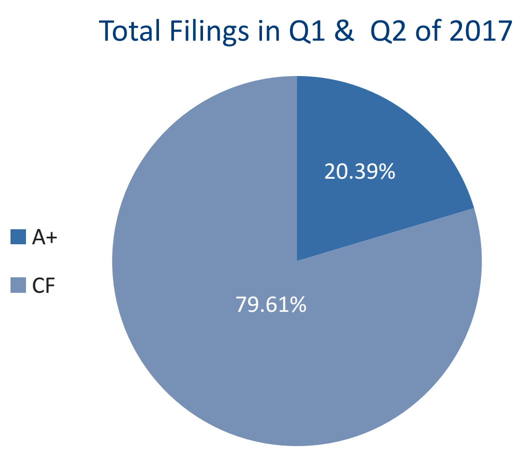
A First Look at Equity Crowdfunding in the US: Q1 & Q2 2017

Stradling
Attorneys at Law

Overview of Results

The 2012 Jumpstart Our Business Startups (JOBS) Act established provisions that allow early-stage businesses to offer and sell securities to the public with relatively light regulation. Both Regulation A+ and Regulation Crowdfunding help startups crowdfund equity investments from unaccredited and accredited investors.

- Between January and June 2017, 309 companies filed forms to conduct new offerings under Regulation A+ or Regulation Crowdfunding. The latter was the more widely used, with 80 percent of those issuers conducting a Regulation Crowdfunding offering.



- Approximately 44 percent of the companies that submitted initial filings under Regulation Crowdfunding were incorporated in the state of Delaware. In contrast, just more than 60 percent of the issuers to conduct a Regulation A+ were incorporated in that state.

- Common stock and debt each accounted for 31 percent of the offerings under Regulation Crowdfunding, while Simple Agreements for Future Equity (SAFEs) were issued in just less than 24 percent of the offerings. Common stock was issued in 81 percent of Regulation A+ offerings, which makes sense since Regulation A+ allows companies to conduct mini initial public offerings (IPOs) and virtually all IPOs are common stock issuances.

Regulation CF

Regulation CF allows private companies to offer and sell up to $1 million of securities to accredited and unaccredited investors through crowdfunding offerings over a 12-month period, under certain conditions. The issuer is required to conduct its offering through an online platform operated by an intermediary that is registered with the SEC either as a broker-dealer or as a funding portal.

In the first six months of 2017, there were 214 initial Form C filings submitted with the SEC to conduct a Regulation CF offering. The level of activity in 2Q17 was markedly higher than 1Q17, bolstered by the months of April and May when there were 46 and 49 initial filings, respectively. The volume of Regulation CF activity in 2017 has outpaced a comparable time period in 2016. The SEC has reported that there were 163 unique offerings between May 16, 2016, when the regulation took effect, and December 31, 2016. This represents a 31 percent increase in activity in the first half of 2017.

Because the issuer must raise at least the target amount to receive funds, the typical offering sets both a target and a maximum amount, increasing the likelihood of raising at least some funding while preserving the flexibility to raise up to a higher limit. The average minimum amount sought to be raised by the companies that submitted initial filings in 2017 was approximately $92,300. The average maximum amount targeted was just under $618,300.

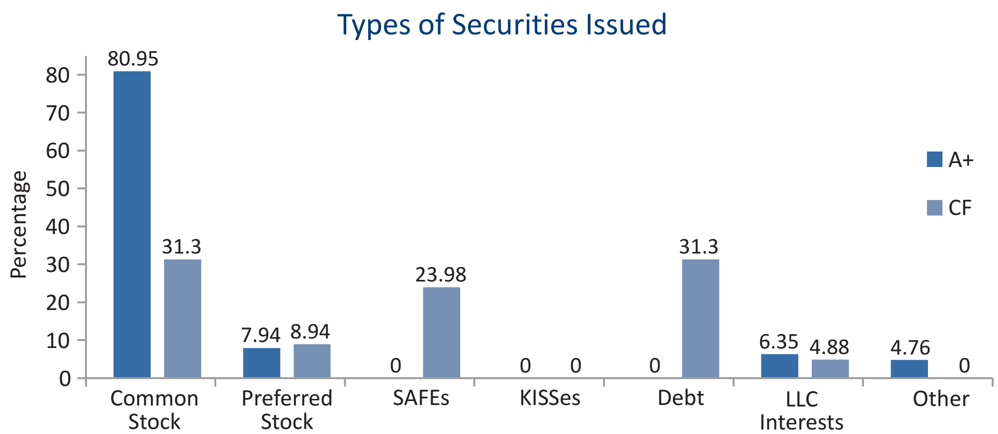
Amounts Requested and Raised

Of those companies that submitted initial filings, 34 reported the amount raised through Form C-U, which is required upon completion of the offering. In total, these companies raised more than $8.1 million. The average amount raised per company was approximately $240,400. The maximum amount raised by any one issuer during that period was $1 million; the minimum was $14,400.

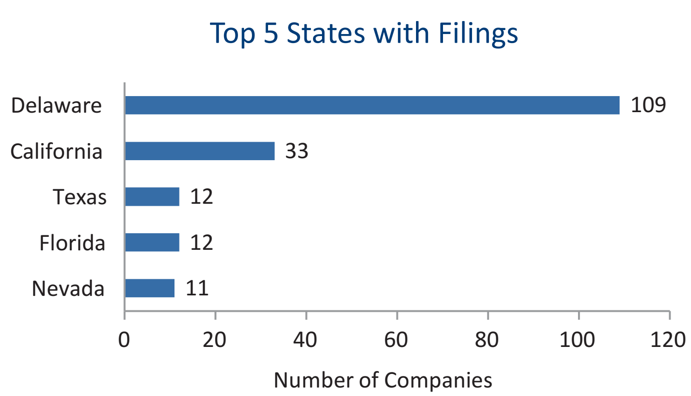
Intermediaries

More than 97 percent of all offerings involved funding portals, with the remainder using broker-dealers. Although more than two dozen portals participated in Regulation Crowdfunding, the five largest portals based on the number of offerings accounted for 68 percent of the initiated offerings. Wefunder Portal LLC was by far the most-widely used, having taken part in 68 offerings. StartEngine Capital LLC and SI Securities rounded out the top three, used by 37 and 34 companies, respectively.

Types of Security



The most popular type of security was equity, either in the form of common stock or preferred stock. Common stock was issued in 31 percent of the offerings, while preferred stock was issued in approximately nine percent of the offerings. Convertible debt was the second most widely-used, at 31 percent. SAFEs, a popular investing tool used as an alternative to convertible debt, accounted for almost 24 percent of offerings. This is comparable to the Regulation Crowdfunding activity in 2016, as reported by the SEC, though debt has surpassed SAFEs in popularity in 2017.



State of Incorporation

To be eligible to use the Regulation Crowdfunding exemption, companies must be based in the United States. The most common state of incorporation for companies that submitted initial filings was Delaware. Companies from that state were responsible for 109 filings. California was a distant second with 33, followed by Texas and Florida, which each had 12. While 33 of the 50 states were represented, the top five states accounted for almost 72 percent of the filings.

Regulation A+

Regulation A+, also known as Title IV of the JOBS Act, allows companies to raise up to $50 million in a 12-month period from both accredited and unaccredited investors. This regulation is similar to a traditional IPO, but with more limited disclosure requirements than a full-fledged IPO. Regulation A+, which only took effect in June 2015, provides for two tiers of offerings: Tier 1 for offerings of securities up to $20 million; and Tier 2 for offerings of up to $50 million.

Much like an IPO, Regulation A+ offerings must be qualified by the SEC before issuers may sell securities. In 1Q17 and 2Q17, there were 63 qualified Regulation A+ offerings filed by prospective issuers. Tier 2 offerings comprised approximately 71 percent of the qualified offerings. The total number of qualified offerings was relatively consistent between 1Q17 and 2Q17, with 33 and 30 filings, respectively.

The number of qualified offerings are on pace to surpass those in the months after Regulation A+ took effect in 2015. According to the Commission, approximately 81 qualified offerings were filed in the 16 months between when the regulation became effective and October 31, 2016.

Types of Security

Common stock was issued in just more than 80 percent of the offerings, while preferred stock was issued in approximately eight percent. LLC Units and other forms of securities accounted for the remainder of the securities issued. This is in line with numbers reported by the SEC capturing the period between June 2015 and October 2016, in which equity accounted for 87 percent of securities issued in all offering statements.

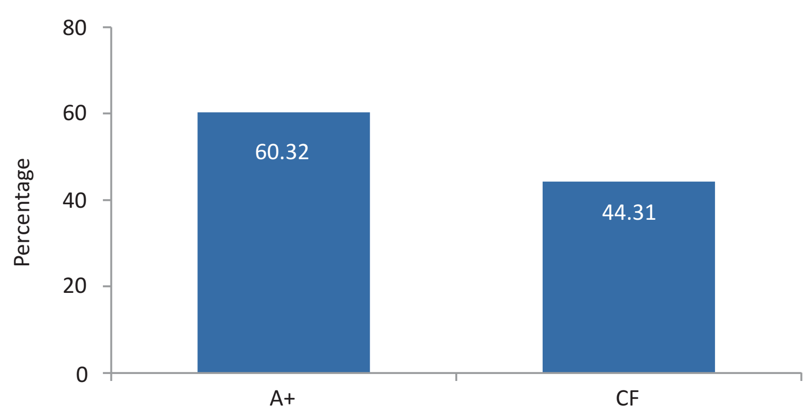
Amount Raised

Of those companies that filed statements for qualified offerings, four reported the amount raised through a Form 1-U. In total, these companies raised more than $28.8 million. The average amount raised per company was approximately $7.2 million. The maximum amount raised by any one issuer during that period was $18 million; the minimum was $174,862.

State of Incorporation

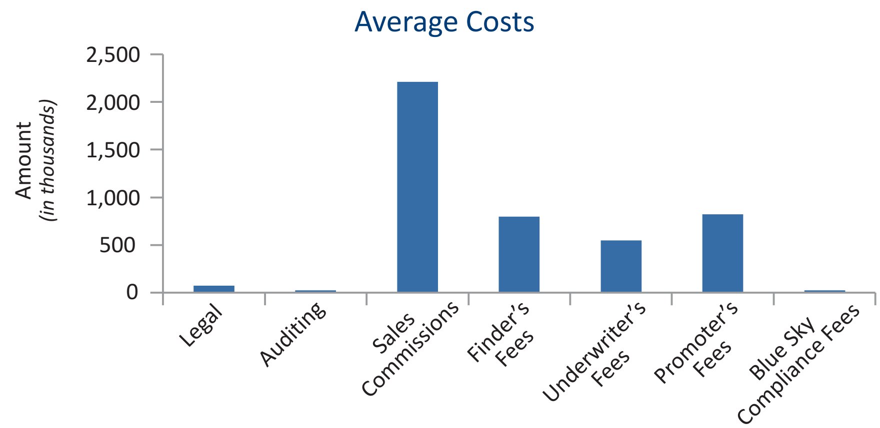
Delaware was the state of incorporation for 38 companies that submitted filings under Regulation A+, accounting for 60 percent of the filings. No other state had more than four filings.

Companies Incorporated in Delaware
Reg A+ vs. Reg CF



Offering Costs

The average company that reported costs associated with a Regulation A+ offering spent just less than $77,000 in legal fees. The average audit cost was reported as approximately $26,400. Significantly fewer companies reported costs associated with the remaining fees. From the limited data available, the average costs were as follows: sales commissions, $2.2 million; finders' fees, $800,000; underwriters' fees, $550,000; promoters' fees, $822,750; and Blue Sky compliance fees, $24,565.



Summary

Attached is a chart that includes our research for this paper. In recent years, crowdfunding websites like Kickstarter and GoFundMe have become a popular way for people to solicit charitable contributions or raise money for projects. Now, companies can use crowdfunding for a whole new purpose: to offer and sell securities to the investing public. Anyone has the ability to invest in these companies, something that has traditionally been reserved for the elite few. For startups, it provides another fundraising avenue, a benefit particularly for those unable to obtain seed financing from angel or venture capital investors. Though the numbers here are very small compared with the funds received through IPOs and even traditional private offerings, as companies and their attorneys acclimate to the new regulatory environment, these relatively new regulations will likely play an outsize role in companies' future funding plans.

About the Author

Amit Singh is a shareholder in Stradling's corporate and securities law and technology transactions practice groups. He has practiced corporate law for more than 19 years and is a corporate governance and business transactions expert, with extensive experience in venture capital and private equity transactions, mergers and acquisitions, joint ventures, technology transactions and general corporate law. Amit counsels companies and investors in a broad range of industries, including life sciences, software, hardware, communications and networking, internet, manufacturing and distribution and medical devices. Special thanks to Peter Hong and Arash Lessantiz for their contributions.

Contact/Sign Up Information

For additional information about this report please contact Amit Singh at (858) 926-3012; asingh@sycr.com at Stradling.

To view the report online please visit: sycr.com/A-First-Look-At-Equity-Crowdfunding-in-the-US-Q1-Q2-2017.

To be placed on an email list for future editions of this report please email sfeuchter@sycr.com.

Disclaimer

The preparation of the information contained herein involves assumptions, compilations and analysis, and there can be no assurance that the information provided herein is error-free. Neither Stradling Yocca Carlson & Rauth, P.C. nor any of its partners, associates, staff or agents shall have any liability for any information contained herein, including any errors or incompleteness. The contents of this report are not intended, and should not be considered, as legal advice or opinion. To the extent that any views on equity crowfunding or other matters expressed in this report, they are the views of the author only, and not Stradling Yocca Carlson & Rauth, P.C.