Top 10 PPM Mistakes

Growthink’s ‘Top 10 Private Placement Memorandum Mistakes’ provides advice on how – and how not – to approach the process of raising capital via a Regulation D private placement offering.
About the Report

Growthink is an investment bank that specializes in working with privately-held emerging and middle market companies.

We are a FINRA-registered broker dealer in all 50 states and we provide the following services:

- Raising Debt and Equity Capital
- Providing Company Valuations
- Mergers and Acquisitions Advisory
- Private Placement Memorandum (PPM) Services

We created the “Top 10 Private Placement Memorandum Mistakes” report based on our experience advising more than 1,500 emerging growth businesses on their capital formation strategies. Since 1999, Growthink clients have raised more than $1 billion in growth capital.

If you are seeking assistance with a private placement offering, please do not hesitate to contact us at 800-506-5728, and/or write us at info@growthink.com.
Top 10 Private Placement Memorandum Mistakes

Mistake #10: Believing That You Don’t Need a PPM to Raise Capital

If you are raising capital from an individual, as opposed to an institutional (a bank, or venture capital or a private equity fund), then to comply with SEC and state securities laws, a PPM may be required. But even if not, you need one for legal protection. A business plan is a component of a PPM, but in and of itself does not provide sufficient risk disclosures.

Mistake #9: Assuming That a PPM is ALL You Need to Raise Capital

The old joke on Wall Street is that a prospectus (another name for a PPM), is actually Latin for "that which is not read." A PPM, because of its somewhat ominous structure and exhaustive risk disclaimers, is in many ways a document that highlights everything that can go wrong. As such, it needs to be supplemented by more promotionally-focused materials, such as an executive summary, a PowerPoint, and/or multi-media including a website and/or a video presentation of the investment opportunity.
Mistake #8: Providing Insufficient Disclosures

Poorly prepared PPMs often have only "templated" risk factors such as disclosures regarding liquidity, dilution, management dependence, the need to raise more capital, etc. While these somewhat formulaic risk factors are included in all PPMs, they must be supplemented with more directly relevant and material risk factors for the specific business raising capital. These can include disclosure of matters such as the outstanding debts of the enterprise, the specific competitive threats to business success and investment return, and the to-be-met technological/implementation roadblocks the firm faces.

Note: Often over-looked by filers are the required disclosure and investigation requirements of the Patriot Acts and Anti-Terrorism Acts of 2001. While most issuers consider these tangential concerns, it is an area that regulatory agencies have paid far closer attention in the last few years, and have fined issuers significant sums for insufficient disclosures/safeguards.

Mistake #7: Not Filing Notice of the PPM with the Appropriate Regulatory Agencies

All Regulation D private placement offerings need to be filed with the Securities and Exchange Commission and in any state where the offering is made. It is
important to both properly fill out the various regulatory disclosure documents as well as to meet the time filing requirements for the various states.

Mistake #6: Publicly Advertising a Private Offering to Potential Investors

Your success in raising a private placement round – in terms of fundraising as well as legal liability – is not only affected by how you create the PPM, but also by how you market your opportunity.

Under the Securities Act of 1933, any offer to sell securities must either be registered with the SEC or meet an exemption. The most common vehicle is Regulation D, which is a limited offer and sale of a company’s stock or securities without registration under the 1933 Act.

Regulation D contains three rules providing exemptions from the registration requirements: 504, 505, and 506. Two of these rules – Rules 505 and 506 – of Regulation D specifically prohibit general solicitation or advertising to sell the securities. If you advertise your opportunity, you may turn your private offering into a public one, which then defeats the exemption and may require registration and/or return of investors’ money.

This means that you cannot advertise your offering in the newspaper, TV, or radio. Instead of generally advertising an investment opportunity, issuers are
required to limit the marketing of their opportunity to people with whom they have a pre-existing business relationship.

If an issuer does not have a pre-existing network of prospective investors, the company can demonstrate such a relationship through a “finder” that is acting on behalf of the issuer.

**Mistake #5: Using Unregistered “Finders” to Market Your Offering**

In order to broaden their network of potential investors, issuers will often use “finders” or intermediaries to help promote their offering.

Whether or not these finders are compensated, they are technically acting broker-dealers, and problems arise when such intermediaries are unregistered with the Financial Industry Regulatory Authority (FINRA). It is unlawful for an individual and/or firm to conduct business as a broker-dealer without holding a license and this activity can result in criminal and civil penalties.

More importantly, the company who hires an unlicensed broker puts its private placement in jeopardy. The company faces a significant risk of rescission of the transaction by the purchaser, whereby the purchaser may “cancel” the sale and have its funds returned by the seller.
In order to avoid the risk of rescission and the accompanying litigation, the safest course is to work exclusively with registered broker-dealers.

**Mistake #4: Selling Securities to Unaccredited Investors**

The various rules under SEC Regulation D proscribe very specifically regarding the investor accreditation requirements for various types of offerings. Depending on if it is a 504, 505, or 506 offering, either the offering has to be made to only accredited investors, or to no more than a specifically prescribed number of unaccredited investors.

What is an “accredited” investor?

When marketing to individual private equity investors (e.g. “angel” investors), the following two definitions of accredited investor apply:

1. A person who has individual net worth, or joint net worth with the person’s spouse, that exceeds $1 million at the time of the purchase; or,

2. A person with income exceeding $200,000 in each of the two most recent years or joint income with a spouse exceeding $300,000 for those years and a reasonable expectation of the same income level in the current year; or

By restricting your private offering to accredited investors, you help ensure that you retain your exemption status.
Limiting your offering to accredited investors is beneficial both from a fundraising and legal liability perspective. Accredited investors are capable of investing larger sums, they tend to be more familiar with the risk and illiquidity associated with private equity investments, and they are a better financial position to withstand a potential loss of investment.

**Mistake #3: Assuming Only Attorneys Can Prepare PPMs**

While there is much to be said for higher-end securities law understanding and perspective when preparing a PPM, it is wrong (and extremely costly) to assume that only securities lawyers can prepare PPMs. As advised above, the core aspects of the PPM are as much business challenges as legal ones - and it is the rare attorney with fluency in both. And for the resource-constrained entrepreneur, those types of attorneys are extremely expensive - with hourly billing rates in excess of $500/hour. It is not unusual for a high-end securities law firm to charge $75,000+ for a full PPM package. There are very good options out there at significant fractions of this price.
Mistake #2: Thinking That the PPM is "Just a Template"

While some aspects of a PPM are “templatized,” its core, material aspects – the proposed capital structure and terms of investment, the business plan and financial projections, and the risk disclosures – are completely customized and unique to each offering. True "entrepreneurial finance" skill sets and experience are necessary to fully assemble a PPM that conveys an attractive investment story.

Mistake #1: Assuming That a PPM is "Locked" and Not to Be Edited

Probably the #1 mistake we see in PPMs for operating companies is their lack of updating. Especially in these markets, where fund-raising time lines are extremely elongated, it is not unusual for an investment offering to take 6 months (or sometimes much longer) to complete. The business updates that occur during this offering time need to be disclosed to both the existing and prospective subscribers to the offering via circulating amendments to the original document.