Going Public With a Direct Placement Offering – Bruce E. Methven

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Many companies do not realize it, but it's possible to make a public offering and be listed on the over-the-counter market even though the company is small and not yet profitable.

When they hear "going public," most people think of initial public offerings (IPO's). These days an IPO requires that a company be profitable, takes perhaps two years to complete and costs a large amount of money. While an underwriter is involved with an IPO, for all but the hottest companies the underwriter will not guarantee the offering but only agree to use best efforts to sell it. Many best-efforts IPO's do not raise the minimum amount of money required for the offering.

There is an alternative: A federal direct placement offering or DPO. These do not involve an underwriter and are faster and less expensive than an IPO. While the stock in a DPO does not wind up on the New York Stock Exchange or NASDAQ (few companies can qualify for such listings anyway), a DPO can be set up so that the company's stock is listed on the over-the-counter (OTC) market and securities brokers can trade it for their clients. (The OTC markets have become more formalized over time.) This is a huge plus in that it a substantial amount of money can be raised and it gives investors a market so they can sell when they want.

Federal Form S-1 is used for the offering, which involves registration (rather than an exemption). This means that the form must be submitted to the SEC (along with exhibits and financials) and the offering cannot begin until the SEC has approved it. On the other hand, full public advertising is allowed and there can be an unlimited number of non-accredited investors.

With a DPO there is no underwriter involved. Instead, the offeror itself sells the stock or a consortium of stock brokers sells the stock, often to investors they already know. Even if the minimum amount of money necessary for the offering isn't reached, the offeror still has a publicly traded corporate shell that often can be sold for more than the cost of the offering.

Approval by the SEC of a DPO does not by itself list the securities on any over-the-counter platform. That requires the additional steps of filing an application with FINRA to obtain a trading symbol, getting approved for the electronic exchange that stock brokers use, and filing for listing on the over-the-counter markets. FINRA requires that a company have at least 35 investors to obtain a trading symbol.

To raise the money for the cost of a DPO – and to get at least 35 investors -- many small companies conduct a federal Rule 506 offering first.

A DPO is not for every company, but given its strengths and the fact that the requirements are substantially less than for an IPO, it is offering approach that companies should always keep in mind.

--Bruce E. Methven

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