RESEARCH ABSTRACT

The Acceleration of Online Private Placements in 2015

What it Means for Issuers and Investors

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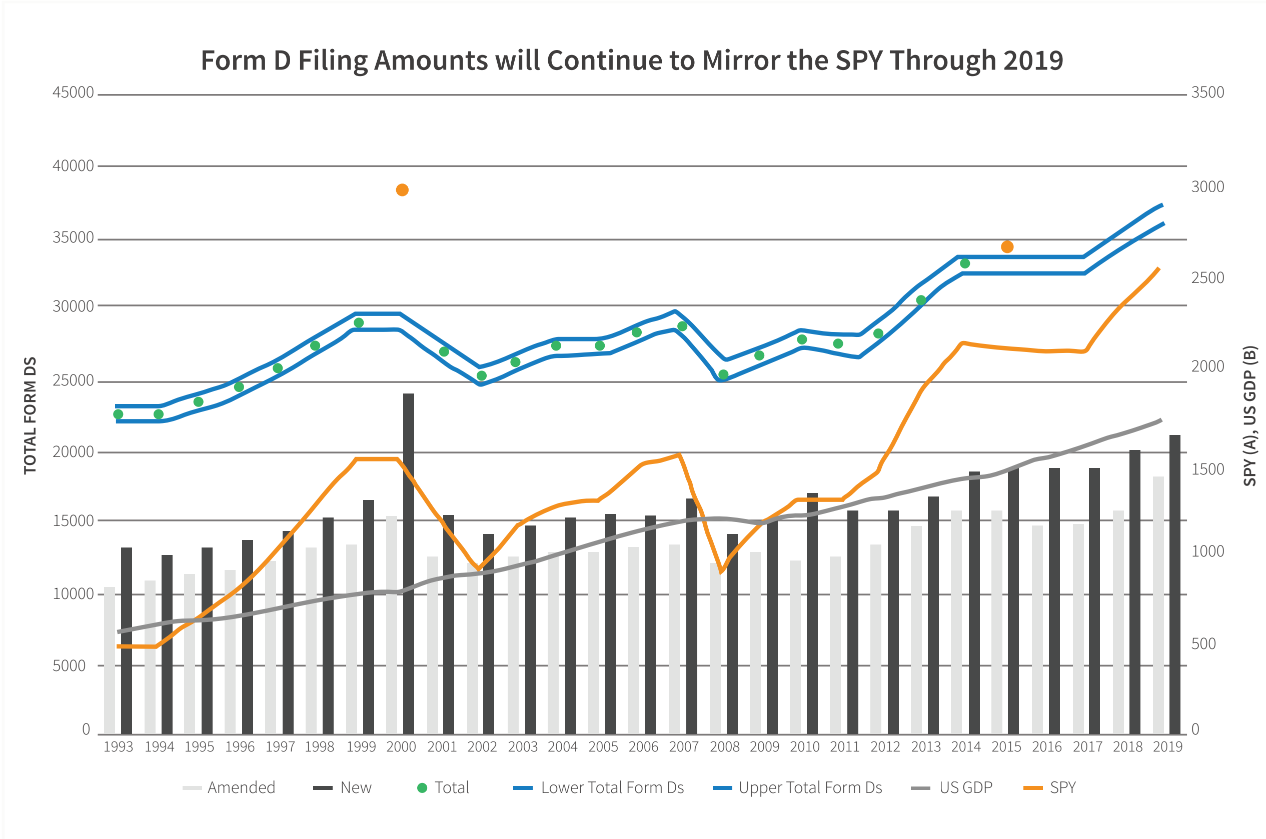
Private placements seeing historical growth

The private placement industry experienced abnormally high growth in 2015, deviating from a 24 year historical trend. As a leading technology innovator and broker-dealer for private capital markets, we were interested in learning what could have made companies shift to completing more private capital raises. Specifically, we wanted to see if there was proof that technology and new regulation has helped issuers find capital that they otherwise would have been unable to raise.

2015 was the first year since 2000 that the total amount of private placement deals deviated from our 24 year multi-variable regression.

Figure 1



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Most Active Broker-Dealers in Private Placements

As a financial intermediary ourselves, the first place we looked was at which groups were the most active broker-dealers in private placements in 2015. If there were significantly more deals completed through online private placement broker-dealers, this would be the first piece of evidence to show that technology helps accelerate deal completion and the private placement market in general.

Of the 33,392 forms filed in 2015, 2,959 (8.86%) of them had an associated broker-dealer. WealthForge was recorded as the broker-dealer of record on 107 different transactions and was the fourth most active broker-dealer in US private placements last year. In total, new portal deals associated with a broker-dealer accounted for just under 13% of all new deals with an associated broker-dealer, which is considerable for a subsector that is just over 2 years old.

As you can see in the table to the right, WealthForge conducted more private placements than several well-known banks including J.P. Morgan, Morgan Stanley, Citigroup, Barclays, UBS and Credit Suisse. As a relatively new competitor in the private placement space, this speaks volumes about the ease and speed of online access portals, especially for individual accredited investors.

Accredited investors are likely attracted to online portals because, in many ways, the portals serve a similar function to angel groups while offering many benefits that most angel groups currently do not, including fewer, if any, fees, less physical time-commitment, narrower company selection, autonomy of choice, expedience of deal completion, and higher likelihood of broker-dealer involvement. These factors all provide autonomy to accredited investors, giving them more control over the costs and the direction of each investment.

Figure 2

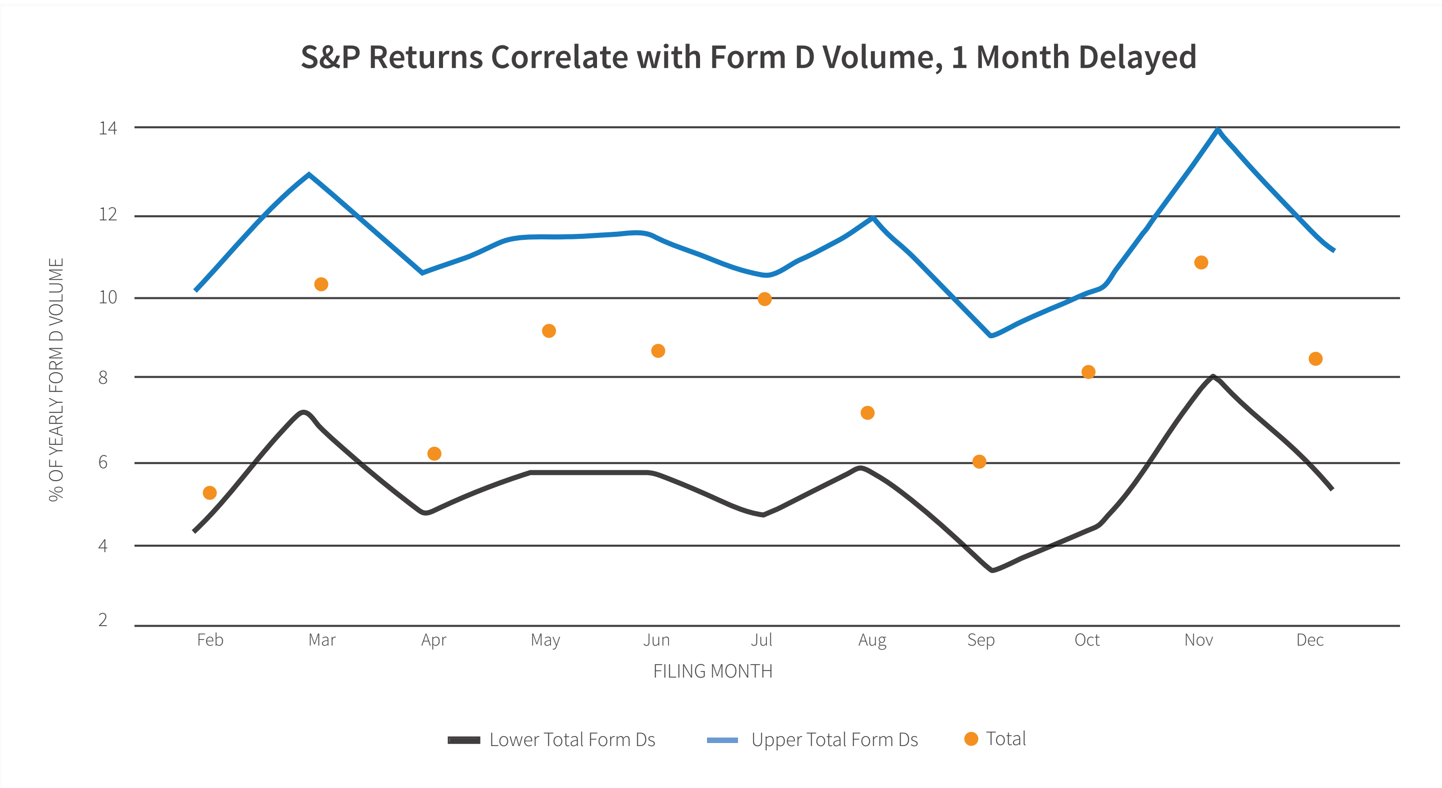
Broker-Dealer	Initial Number of Private Placements Filed
H&L Equities, LLC	192
Newport Group Securities Inc.	140
M Holding Securities Inc.	138
WealthForge Securities, LLC	**107**
J.P. Morgan Securities	94
Morgan Stanley Smith Barney, LLC	89
Concorde Investment Services, LLC	88
Sandlapper Securities, LLC	86
Newport Coast Securities Inc.	74
Cambridge Investment Research Inc.	70
McDermott Investment Services	69
NFP Securities	63
Commonwealth Financial Network	62
Citigroup Global Markets	58
Barclays Capital	56
UBS Financial Services	56
Stifel Nicolaus & Company	53
Altegris Investments	48
Credit Suisse Securities	48
Triad Advisors	47

Still, accredited investors do not make up the majority of capital flows in the private placement market and there are still significant strides to be made in shifting volume to the online portion of the private placement market, as the volume of those 107 deals ($63M) is much smaller than all of the competitors on the list, and as a percentage of broker-dealer commissions, WealthForge still is a small fraction of the almost $6B in commissions reported in 2015.

The data in figure 2 indicates that online portals are beginning to make a significant impact on total forms filed. As larger issuers begin to look into breaking from tradition and tapping into general solicitation, we would anticipate that both the total number and volume of deals will continue to increase through WealthForge and other associated broker-dealers conducting online private placements.

While studying the distribution and effects of Form Ds, we found two additional correlations. We already knew about a broader public/private market correlation demonstrated in our regression in figure 1. However, a single-variable regression on data from 2015 also let us see that not only are years correlated, but there is also a one-month delayed correlation between form volumes and S&P returns. That is, if the S&P does well in one month, there is more volume the next month, and vice versa.

Figure 3



For the year of 2015, there was a significant correlation between monthly S&P returns and the volume filed in the Form D marketplace.

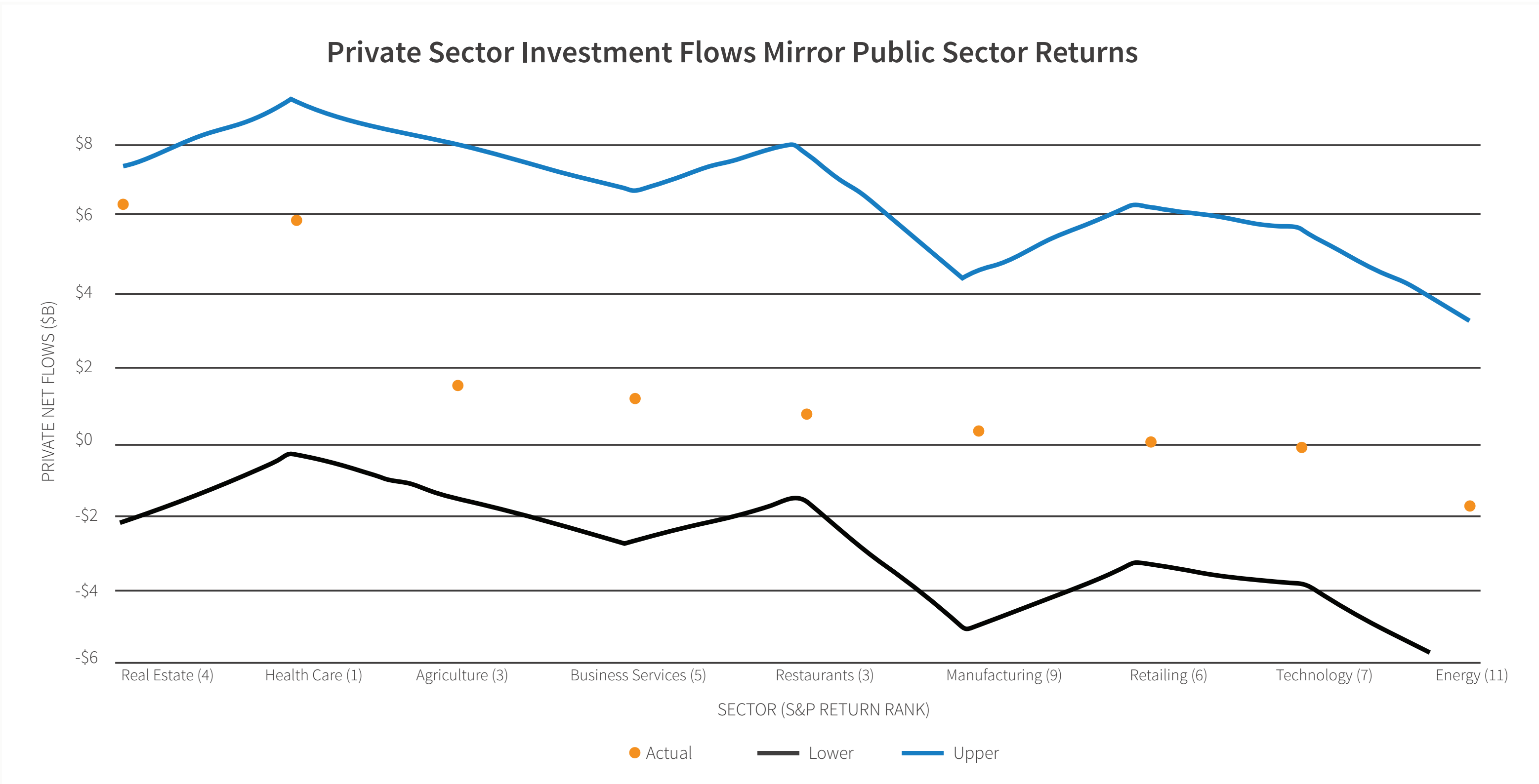
Private market volume reflecting public markets is not incredibly surprising, considering strong public markets likely give investors either additional capital or additional confidence with which to make private investments. However, a more surprising correlation was that returns on specific sectors correlated with net inflows to private sectors. As seen in Figure 4 below, we ran a regression that tested the correlation of year-over-year sector flows, e.g., the amount of additional new money into a specific sector on Form D, with the ranking of returns on the indices that included that specific sector.

This regression was significant and leads us to believe that investors do consider current market trends when deciding which sector to invest in for the private placement market.

When thinking about private capital markets, this is counterintuitive. Private placements are meant to be long-term investments, with mandated holding periods greater than a year. Additionally, they are highly illiquid, meaning that once an investor buys equity in this market, it is unlikely they will be able to resell the equity. Therefore, private placement markets should focus increasingly on value rather than speculation.

Public sector investments are becoming increasingly short-term focused. This makes public sector industry trends tend to not hold up in the long-run. It would seem that private market investors would attempt to avoid using these trends, but as the data shows, investors are not acting accordingly.

Figure 4



One possible explanation is that private placement investors tend to use public based metrics for valuation purposes. Therefore, if a certain sector is hot, the companies will be able to demand a higher valuation on their equity. Still, it seems that, given the additional liquidity risk that an investor takes on in a private market, there could be a potential mispricing if companies and investors are trying to use these fleeting valuation metrics to create long-term, illiquid deals. Essentially, the deviation from expected investor behavior is likely driven by investors using short-term rather than long-run, forward-looking fundamental valuation.

Despite these idiosyncrasies within the private market, it is still reasonable to conclude that technology and new regulation has played an important role in expanding the overall private placement market. With the online private placement market increasing from $350M to $525M in 2015 alone, accounting for almost 0.42% of the new market volume, thousands of new deals being completed, and the overall abnormal filing volumes, we would expect this trend to continue to accelerate given current market conditions and regulations.

One caveat to this conclusion is that, alongside the abnormal number of filings, the number of erroneous filings has also gone up. We go into this in detail in our full report, but we believe that companies view the long-term costs of non-compliant transactions as minimal compared to the short-term costs of assuring they are done correctly. This can be explained by both lack of enforcement of regulation on the SEC's part, as well as lack of ability of accredited investors to demand a higher risk premium from companies that do not file correctly. This shortcut is detrimental to companies paying for compliant transactions, investors looking for compliant transactions, and the future of the private placement market.

Accordingly, we believe that increased integration of broker-dealers into the private placement market will assist the SEC in making a uniform and compliant filing and capital raising process to assure the protection of all accredited investors.

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