CROWDFUND CAPITAL ADVISORS

The 2018 State of Regulation Crowdfunding -
U.S. securities-based crowdfunding under Title III of the JOBS Act[1]
Prepared for the US Securities & Exchange Commission

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Introduction

Regulation Crowdfunding allows startups and SMEs to raise up to $1,070,000 per year from both retail and accredited investors by utilizing registered funding portals (or broker-dealers) to conduct exempt offerings online. This exemption requires issuers to file a Form C and post online disclosures about a company's operations, team, financials and other material information for investors to review. Regulation Crowdfunding started in the United States on May 16, 2016. The third calendar year for the industry ended on December 31, 2018. Because data about issuers, their financial wellbeing, and the capital that is committed is public information we can analyze the data and bring transparency to a segment of the markets (exempt private offerings) that has been fairly opaque until the JOBS Act went into effect.

The results of the data reveal that while the industry is still in its infancy, the traction is starting to pick up. This is supported via triple digit growth in unique offerings, proceeds and investors. More importantly, firms are successfully using Regulation Crowdfunding to raise meaningful capital in a relatively short period of time and at costs that are less than a typical Regulation D offering.

Unlike Venture Capital where less than 6.5%[2] of firms successfully raise funds, the success rate in Regulation Crowdfunding hovers around an impressive 60%. A key data point for industry followers is the fact that the average raise ($270,996) actually addresses the "valley of death" issue many firms face after they have expended their internal or personal capital.

[1] This study was prepared for the Securities and Exchange Commission by Crowdfund Capital Advisors (CCA). It is an abbreviated version of the complete 2018 State of Regulation Crowdfunding. This analysis is not intended to inform the Commission about compliance with or enforcement of federal securities laws. The views herein are those of the authors and who are not employees or representatives of the Commission. This study uses as its framework a prior study performed by Vladimir Ivanov and Anzhela Knyazeva of the Securities and Exchange Commission. The intent is to include data points and variables that have already been published by the Securities and Exchange Commission and might be familiar to the Commission. The analysis of this report comes from data collected by Crowdfund Capital Advisor's CCLEAR Regulation Crowdfunding database. We are grateful to the following platforms that shared data to enable a more accurate analysis: Microventures, Republic, SeedInvest, StartEngine, and Wefunder.

[2] https://www.forbes.com/sites/sageworks/2017/07/02/focus-on-your-business-not-on-venture-capital/#3cd6e1cc7e76

What makes the data most interesting is the fact that Regulation Crowdfunding is proving to be a jobs engine (creating on average 2.9 jobs per issuer), economic generator (pumping over $289 million of revenues into local economies) and industry supporter (enabling 82 unique industries in regions across the USA). When analyzing annual report filings, data shows that capital received from the crowd may contribute to year-to-year increase in corporate revenues. This may be due to the vested interest the crowd now has in their firm which leads to a form of "crowd marketing" on behalf of the issuer.

There remains much potential for Regulation Crowdfunding. Not only does it engage local communities to become investors in local businesses, but it provides a viable alternative to traditional finance (i.e. credit card, bank loans and/or venture capital). This potential may be realized sooner if the $1.07 million cap were to be increased as well as certain recommendations implemented per a 2017 U.S. Treasury report, the Fix Crowdfunding Act and the JOBS and Investor Confidence Act of 2018.

Key findings[3][4]:

- The number of unique offerings increased 144% from 474 in 2017 to 680 in 2018
- Proceeds for campaigns that closed in 2018 increased 154% from $71.2 million in 2017 to $109.3 million in 2018. Total proceeds by the end of 2018 was $194 million
- The number of successful offerings increased 189% from 221 in 2017 to 417 in 2018
- The average success rate of offerings increased from 58.9% in 2017 to 63.9% in 2018
- The average raise for all successful offerings that closed through 2018 was $270,996
- The average successful campaign lasted 113 days
- The total number of investors in successful offerings increased 190% from 77,558 in 2017 to 147,448 in 2018
- Issuers were successful at raising funds in 39 states (including the District of Columbia)
- Revenues for all unique issuers successful with Regulation Crowdfunding exceeded $289 million
- 172 Issuers that filed annual reports reported creating a total of 498 jobs between their annual report date and the prior year. On average these firms created 2.9 jobs
- Revenues for Issuers that filed annual reports increased on average 131% between the year in which they leveraged Regulation Crowdfunding and the Prior Fiscal Year.

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[3] Data collected by CCLEAR predominately falls under the Regulation Crowdfunding exemption. Regulation Crowdfunding permits parallel offerings. In certain instances, our data on offerings may exceed the $1.07 million Regulation Crowdfunding cap. We include parallel offering data on Regulation Crowdfunding offerings when it is publicly reported and/or provided by portals.

[4] Data for offerings is updated daily by CCLEAR. We are grateful to the platforms for providing updated closing information on campaigns and backers. 2017 year-end data may have changed to reflect updated information from portals and hence may represent a difference in amounts between the 2017 State of Regulation Crowdfunding report and this one.

Analysis:

1. The overall Regulation Crowdfunding market is still in its infancy at only Year 3. We are still waiting for the inflection point at which issuers, investors and dollars will grow exponentially.
2. Year to year growth in unique offerings show that the market continues to expand at a steady rate. There is much room for growth with Regulation Crowdfunding offerings accounting for only 1.2%[5] of all Regulation D offerings.
3. The velocity of capital into funded offerings continues to be steady without showing signs of abnormal activity or irrational investor behavior.
4. The rapid increase in the number of offerings and investors proves that there continues to be an appetite for Regulation Crowdfunding from both issuers seeking capital as well as investors looking to diversify.
5. Comparing the average days to close (113) in 2018 and average raise ($250,635) of a successful Regulation Crowdfunding campaign to a traditional Regulation D offering, Regulation Crowdfunding most likely represents the most efficient, cost effective[6] way to raise capital for startups and SMEs.
6. Given the high (and improving) success rate for offerings, Regulation Crowdfunding continues to represent a very structured and viable alternative for access to capital for startups and SMEs.
7. Given the ability for firms to leverage capital raised to scale operations and create jobs, Regulation Crowdfunding should be promoted more by local Chambers, the Small Business Administration, the US Treasury and the Securities and Exchange Commission.
8. Given the lack of irregularities or fraud, Regulation Crowdfunding (and the structure under which it provides for transparency), should be advocated by policy makers and government organizations.
9. Regulation Crowdfunding could benefit from the recommendations in the US Treasury Report "A Financial System That Creates Economic Opportunities – Capital Markets[7]," from October 2017 that seek to further reduce costs and complexity, the Fix Crowdfunding Act of 2016 as well as the JOBS Act 3.0 of 2018.

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[5] A Securities and Exchange report titled "Capital Raising in the U.S.: An Analysis of the Market for Unregistered Securities Offerings, 2009-2017," revealed that in 2017 there were 37,785 Regulation D offerings reported on Form D filings, accounting for more than $1.8 trillion raised in new capital. If there were 474 successful Reg CF offerings in 2017, this would equate to 1.2% of offerings.

[6] In a report CCA authored for VentureBeat titled "How much does a Regulation Crowdfunding campaign actually cost?" it was uncovered that the costs to create a campaign landing page, create company disclosures, film the video, hire a marketing firm, lawyer and accountant average around 5.29% of a raise. This is much less than a typical Reg D offering costs in legal and accounting fees alone.

[7] The full report "A Financial System That Creates Economic Opportunities" can be found here: https://www.treasury.gov/press-center/press-releases/documents/a-financial-system-capital-markets-final-final.pdf. Recommendations begin on page 40.

10. Regulation Crowdfunding could be poised for serious growth if the SEC would increase the issuer cap from $1,070,000 to $20,000,000[8]. This would address some of the issues (and hence lack of usage) that exist with Regulation A+, Tier One offerings, address the funding opportunity for small/medium firms that need in excess of $1.07 million, and position the United States as the leader in investment crowdfunding.

Market Activity

The following represents offering activity in the Regulation Crowdfunding[9] market for offerings initiated during January 1, 2017 - December 31, 2018 as well as those that closed and were funded during January 1, 2017 - December 31,2018.

During this period, there were 680 unique offerings by 720 issuers, seeking a total of $42.3 million based on the target amount, excluding withdrawn offerings. The median (average) offering targeted approximately $25,000 ($58,791). Almost all offerings accepted oversubscriptions up to a higher amount, typically close to $1 million, corresponding to the maximum amount sought of $218.2 million in the aggregate. Since the law requires all or nothing financing for the minimum threshold to close, issuers appear to be setting a lower target amount. This has been a trend as the median target offering amount dropped from a high of $50,000 in 2016 down to $25,000 in 2018. As shown below, the average successful issuer is raising 4.3 times the targeted amount.

As of December 31, 2018, approximately $109.3 million in proceeds was reportedly raised for 417 offerings by issuers. For the offerings that reported raising at least the target amount, as of December 31, 2018, the median (average) amount raised was approximately $92,678 ($250,635). The median and average amounts have been trending down as the increase in the number of successful campaigns grows faster than the increase in the total capital raised. Currently the average amount raised among all successful campaigns is $270,996; an amount that can cover an issuer through the "valley of death[10]."

For offerings initiated since 2016, 117 were withdrawn by issuers or associated with a funding portal whose FINRA membership was terminated and registration withdrawn, seeking a total of

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[8] CCA co-authored a letter to the SEC in July, 2018 seeking to increase the Regulation Crowdfunding cap from $1.07 million to $20 million. The letter provided data on the current state of the industry as well as seven reasons why the adjustment was necessary. The letter was signed by the leading industry platforms as well as influencers.

[9] Several portals allow concurrent offerings. Such offerings, while few, relate mainly to those offerings that exceed the $1,070,000 Regulation Crowdfunding cap and mainly conduct parallel Regulation D Rule 506(c) (Accredited Investor Crowdfunding) and Regulation Crowdfunding offerings. Where reported by portals, we collect and report on these concurrent offerings and include their totals in the figures below.

[10] The Valley of Death is commonly referred to as the period of time between the time when a company is self-funded and the time at which it can typically receive outside financing. Many global studies have been done on where the Valley of Death begins and ends. Based on our research we estimate it begins at $25,000 and ends around $250,000.

$9.3 million based on the target amount. Including allowance for oversubscription, these withdrawn offerings were seeking up to $72.4 million based on the maximum amount. $2.8 million was committed by 2,911 investors to these offerings and, per the final rules must be returned to investors since the offerings closed and failed to hit their minimum targets.

Most offerings solicited in all states. Since 2016, nearly all 50 states had offerings with the exception of Montana, North Dakota, Nebraska, Kansas and Iowa. California leads with 29.4% (426) of all offerings, followed by New York with 10.2% (148), Florida with 6.8% (97), Texas with 6.5% (94), and Massachusetts with 4.3% (62). California leads with 34.1% of all proceeds ($67 million), followed by Texas with 12% ($23.6 million), Massachusetts with 10.9% ($21.3 million), New York with 8% ($15.7 million), and Utah with 4.9% ($9.6 million).

Including all offerings through 2018, the most popular type of securities was common stock (used by 427 issuers), followed by "simple agreements for future equity" (287), debt (108), convertible debt (106), preferred stock (105) and revenue share (98). With the emergence of Initial Coin Offerings (ICOs), the industry saw its first token offerings at the end of 2017. These offerings used "simple agreements for future tokens" (SAFT) alone or sometimes in conjunction with common stock, convertible notes, preferred stock and even membership units. The most popular state of incorporation was Delaware and the most popular location of the business was California.

The median issuer had under $30,000 in assets, under $4,500 in cash, $300 in debt, $45,000 in revenues, and 3 employees. About 47% of issuers reported non-zero revenue and 10% of issuers reported a net profit in the most recent fiscal year. Among issuers that reported non-zero assets in the prior fiscal year, the median growth rate was 122%.

220 companies filed annual reports (Form C-AR) with the Commission. 30.4% of those companies reported creating jobs. Total jobs created was 498. Average number of jobs created was 2.9 per firm. For all companies filing Form C-AR average revenue increased 137% from the Prior Fiscal Year. Net Losses for those same companies increased in average 180% as they most likely were using the cash raised to invest into operations and jobs.

Offerings initiated during this period involved 16 intermediaries. Overall, as of December 31, 2018, there were 61 funding portals registered with the Commission and FINRA. 13 are no longer listed as active on FINRA's Funding Portals We Regulate webpage. Funding portals have so far accounted for most of the offering activity. The median intermediary percentage fee was 5%. Intermediaries took a financial interest in the issuer in approximately 40.3% of offerings.

Conclusion

2018 represented a strong second year for Regulation Crowdfunding. The industry appears to be methodically growing with no unusual activity or irregularities. The promise of Regulation

Crowdfunding as a jobs and economic engine are starting to prove true. As with any material changes to the capital markets, initial traction can be expected to be slow as investors slowly become aware of the opportunity and risks. Now that fears and concerns have been mitigated, we expect the industry to exceed $250M in funded offerings during 2019. When considering the growth of securities-crowdfunding globally, we expect the U.S. market to reach $1B in funded offerings within the next 5 years. This industry and amount funded can be further supported by making adjustments to the exemption that would allow for greater investment caps as well as make the exemption more efficient.