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New Fun in the Equity Market

By Dennis Monroe

The IPO market always has been a funding source for growing restaurant brands. And, restaurants are active in raising equity through individuals and private equity, using creative approaches. With the help of my law partner John Remakel who is the head of our securities practice, here is our take on what's valuable out there, including new laws and approaches to IPOs, and a couple of new twists to private placements.

The JOBS Act of 2012 marked the liberalization of the securities markets, which finally allowed private companies to generally solicit offerings to the public. Previously, private companies were limited to fundraising from investors with whom they had close or preexisting business relationships. Private companies couldn't market to prospective investors they didn't know or through broader means such as the Internet, print advertising and other media. This changed with the JOBS Act, which created new forms of capital raising described below:

New IPOs

The concept of mini-IPOs, also known as a Regulation A+ offering, significantly reduces the compliance and documentation burdens associated with traditional IPOs. Regulation A+ has two alternative structures with different capital limits for each—issuers in "Tier 1" offerings can raise up to $20 million in a 12-month period with $6 million sold into the offering by existing shareholders. For "Tier 2" offerings, issuers can raise up to $50 million in 12 months with $15 million sold by existing shareholders. Tier 2's require audited financials and have "short form" annual, semiannual and current reporting obligations with the SEC. Tier 1's don't require audited financials or ongoing SEC reporting, but have to comply with state "blue sky" securities laws.

Issuers in Regulation A+ offerings can test the waters and collect indications of interest from investors before filing with the SEC or going live with their offerings. Bobby's Burger Palace, a 17-unit fast-casual concept created by celebrity chef Bobby Flay, recently announced it was gauging interest in a $15 million Regulation A+ IPO. If successful, its shares will be registered with the SEC and listed on the NYSE under the symbol FLAY. And, parent company of the 200-unit Fatburger and Buffalo's Café concepts recently announced it looks to raise $20 million under the ticker FAT through a Regulation A+ offering.

Regulation A+ is attractive for restaurants that want to become public companies but don't want upfront costs and the ongoing compliance and reporting obligations as with traditional IPOs.

New considerations for private lacements

Most restaurant fundraising is through private placements, and much of it relies on Rule 506(b) and Rule 506(c). Both place no limits on the amount raised from investors—although we see both offerings range between $500,000 to $5 million. The key difference between the two is Rule 506(c), which was adopted through the JOBS Act, drops the prohibition on general solicitation and advertising, which is key for raising money more broadly. Rule 506(b) maintains this prohibition. However, in exchange for the ability to engage in general solicitation and advertising, the SEC requires all investors in a 506(c) offering to be "accredited," defined as having annual income greater than $200,000 or $300,000 jointly with a spouse or $1 million in net worth. In contrast, Rule 506(b) allows sales of up to a maximum of 35 non-accredited investors, although states may further limit the number of non-accredited investors.

Rule 506(c) is helpful to restaurants that typically have limited access to angel and high-net worth investors in gaining access to these networks by marketing their offerings more broadly through the Internet, social media, cold calls, mailings and investor presentations. Early accredited investor portals like Angel List, and now larger equity crowdfunding raises, all rely upon Rule 506(c).

Crowdfunding

Crowdfunding's final rules were adopted by the SEC in May 2016. While Title III was viewed as the law that would open private investing to the "crowd," it also came with limitations.

First, issuers relying upon Title III can only raise $1 million in a 12-month period. Investors with annual incomes or net worths of less than $100,000 can only invest the greater of $2,000 or 5% of their annual income or net worth. Investors with annual income or net worth of $100,000 or more can invest 10% of their annual income or net worth. All investors, regardless of income and net worth, may only invest up to $100,000 in a 12-month period in crowdfunding offerings.

The threshold amount is low, but it may be effective for startups to rely on this funding, especially new concepts with three to four units that need to grow. However, we don't know what kind of broad appeal this concept may have. Also issuers must file reports with the SEC—both at the beginning of the offering and annually. Although the dollar thresholds are within the range needed for many restaurant startups, the jury is still out on how successful Title III will be. Some fear the SEC has made Title III too restrictive to gain broad acceptance.

Reward-based crowdfunding
Sites like Kickstarter were around long before the JOBS Act and continue to be popular today. This method of crowdfunding—known as rewards- or donation-based—is exempt from securities laws so long as the reward is small, such as receiving food discounts, T-shirt/merchandise, preferred dining and event access and more in the restaurant.

Rewards and donation-based crowdfunding typically raises small amounts: individual contributions between $10 to $250, with campaigns ranging between $25,000 to $100,000 total raised. There's no equity in exchange for contributions, so rewards-and donation-based crowdfunding is ideal for food co-op models, early stage or project-focused campaigns where founders don't want to give up equity but need to build community involvement and brand loyalty.

We'll have to wait and see how it works out, but it's interesting to see high-profile companies like Bobby Flay's adopting new techniques, but I will be really excited once Johnny's Pizza from Omaha does a new IPO and beats the odds,—not just Bobby.

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