

## Where is the PPM?

Facebook's private placement memorandum is missing

Goldman clients received an email on Sunday were required to sign a nondisclosure agreement, without receiving the usual private placement memorandum or PPM.

PPMs disclose the terms of a deal and provide financial information.

"Only losers go public and disclose now?" That could be the complaint when asked to make a decision to invest without the usual disclosure provided by a PPM. Without any public registration and now without a proper form of disclosure, "Goldman expects us to give them money on blind faith apparently," one investor stated according to an online Reuters story on Wednesday.

A minimum investment of \$2 million, as rumored, is inconsistent with the SEC requirement of only 500 investors. \$50 billion divided by \$2 million would mean 25,000 investors.

All this recent attention is forcing the SEC to face the embarrassment that time and again it has allowed itself to be manipulated by bank counsel into rulings that permit special legal entities with hundreds of members to constitute "one investor." Other private companies want to raise money without going public if they do not have to; twitter is one of many.

Otherwise, the latest news in:

- minimum investment and the investment deadline (just a few days to decide apparently) may be subject to change
- metrics compare favorably to Google's public debut in 2004
- Facebook has \$2 billion in annual revenue but may not be profitable
- Goldman's valuation of Facebook @ 25 times revenue is an unseemly rich valuation when Goldman is taking 4.5 points from the front end
- Facebook's investors expect to double their money in five years
- Facebook funds are all being formed as Reg D 506 LLCs

Now there is speculation that [the SEC investigation](#) into secondary market trading could accelerate the social network's IPO timetable. Makes for a great story, except that it doesn't make much sense.

**Here's the background:** Once a private company has 500 shareholders, SEC rules require the company to register its private stock and disclose financial results. Facebook employee shareholders do not count toward that threshold, via special SEC exemption, but lots of those employees have since sold stock on the secondary market. Some of those sales have been to "Facebook funds," or pools of capital raised specifically to invest in Facebook shares.

These Facebook funds posit themselves as singular shareholders, so even a couple hundred of them shouldn't matter. The SEC, however, is likely to have a different opinion.

Traditionally, regulators have differentiated between blind pools raised for a diversified portfolio (such as a venture capital fund) from pools raised to invest in a specific issuer (i.e., Facebook funds). The former is counted as a singular shareholder, because investors are handing money and investment decisions over to a manager. The latter is counted as the sum of its underlying investors, since the "manager" is really just a broker (providing access at a reasonable price). Not exactly sure where this is codified, but one fund formation attorney told me that it had been industry standard since he began practicing in 1988.

Considering the number of Facebook funds that have been raised, and that each one can easily have one hundred investors, it is likely that Facebook already has crossed the 500-shareholder threshold (unless the SEC allows Facebook's employee stock exemption to apply once employees sell their shares to a third party -- something which is currently prohibited).

So Facebook soon may be required to disclose its financial data, including to secondary market investors who currently trade in a haze of amenable ignorance.

**Here's the "IPO" theory:** Once Facebook no longer is allowed to keep its financial data private, it might as well go public. This theory basically plays into the "paranoid Zuckerberg" meme, in which his privacy is tantamount but yours is expendable. Moreover, Facebook will be subject to costly regulations like Sarbanes-Oxley, which could be offset by public offering proceeds.

Let me (literally) count the reasons that B doesn't necessarily follow A:

1. Plenty of companies are forced to disclose financial information, but nonetheless choose to remain private. For example, virtually any company owned by private equity firms, but whose debt is publicly-traded.
2. I cannot imagine that Facebook is not already in regulatory compliance (or damn close), even though it doesn't yet need to be. The company hired David Ebersman from Genentech more than a year ago to be its CFO, to get its financial records in order. The incremental cost increase of needing to provide his work to the SEC will be minimal.
3. There are many benefits to being private, besides keeping financial data secret. As a private company, Facebook needn't meet quarterly earnings projections. It needn't meet regularly with bank analysts. Or with hedge funds. It also will be better able to keep quiet about non-financial events, such as product strategy and competitive pressures.

To be clear, I'm not saying that Facebook won't go public soon. After all, "someday" could always be today (or tomorrow).

But the decision will be Facebook's, and Facebook's alone. The SEC investigation's outcome might ruffle some Facebook feathers -- and even cause secondary market valuations to fall -- but will not directly precipitate an IPO. Even though, again, it does make for a great story.

Tags: [Venture Capital](#), [Facebook](#), [Secondary trading](#)

[5 Comments](#) | [Add a Comment](#)

● [15](#)

●

●

● [Email/Print/RSS](#)

The Facebook funds are formed as an LLC so the investors should be counted as 1 for each fund created for the 500 limit. Facebook's exemption was a Reg D 506 and under those rules to calculate the number of purchasers as long as they are all accredited it states:

A corporation, partnership or other entity shall be counted as one purchaser. If, however, that entity is organized for the specific purpose of acquiring the securities offered and is not an accredited investor under paragraph (a)8 of this section, then each beneficial owner of equity securities or equity interests in the entity shall count as a separate purchaser for all provisions of Regulation D, except to the extent provided in paragraph (e)1 of this section.

Posted By Bill, Austin Texas: December 30, 2010 12:02 pm

Actually, the SEC look-through applies to the 100 investor limit for funds claiming an exemption from the Investment Company Act under Section 3(c)(1) of it. The 500 person limit comes from Section 12 of the Securities Exchange Act and has no such look-through provision.

Also, there is a huge difference between having 500 stockholders (like FB must worry about) and 500 bondholders (like a pe firm worries about): having 500 shareholders subjects a firm to both mandatory disclosure AND proxy regulation. Once that happens, FB will effectively become a publicly traded company, albeit one with an extremely thin float. Of course, FB could still hold off on an official "public offering" and live this sort of weird existence for a while. But this seems ill-advised as it will have lost the chance to capitalize on the momentum that builds when a company as hyped as FB finally reveals its secret sauce.

Posted By rpb: December 29, 2010 5:32 pm

Our government (USA) NEVER seems to tell the truth. It takes a site like Wikileaks or a life-changing movie like "Stock Shock-The Short Selling of the American Dream" (which saved me a bunch of money) to identify and punish the people taking advantage of U.S. citizens. I recommend we all watch and learn. The DVD is [at http://www.stockshockmovie.com](http://www.stockshockmovie.com) site if you want to save a buck. Let's take the power back.

Posted By JFan, Hollywood, CA: December 29, 2010 5:13 pm

I doubt FB would want to be an SEC registrant without having a public offering. PE company debt is different as the equity is non-tradeable and tightly controlled. FB as an involuntary registrant b/c the 500 holder rule would be like a pink sheet company. There are few of those of any size or scale.

The SEC will look into the trading and how it can occur without any information, and presumably conclude that it is all sophisticated buyers and sellers who can fend for themselves under the securities laws. I'm sure they will also look at some of the entities formed solely to purchase FB stock to confirm they in fact should be counted only as one holder, particularly since they hold a single asset unlike most funds, not looked through to count their beneficial owners. Presumably this will pass muster as well given that there are smart people involved in setting these up.