



Three Tracks

Preparing yourself for Private Investing

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a white paper
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Summary

Direct private investing is the oldest form of investment (think Medici in the 1400's), but it's also still the most arcane. Success stories are all around us – virtually any household-name business you can think of was initially capitalized by individual investors.

That's the allure of private investing. But consistently successful investors don't achieve these results by accident – they prepare. Direct private investment requires a commitment to learning and an organized, thoughtful approach to each opportunity.

Unfortunately, it's difficult locating comprehensive resources in one place to guide private investors – that are both specific to direct private investment and relatively easy to comprehend – and then apply them to investment opportunities.

Carofin created its Knowledge Base to address this education gap and to provide a toolset for the private investor.

As with any complex challenge, it helps to break a problem down into smaller pieces. This is particularly true for private investment, since there are so many different factors to consider... industry sector, stage of business, type of security, etc.

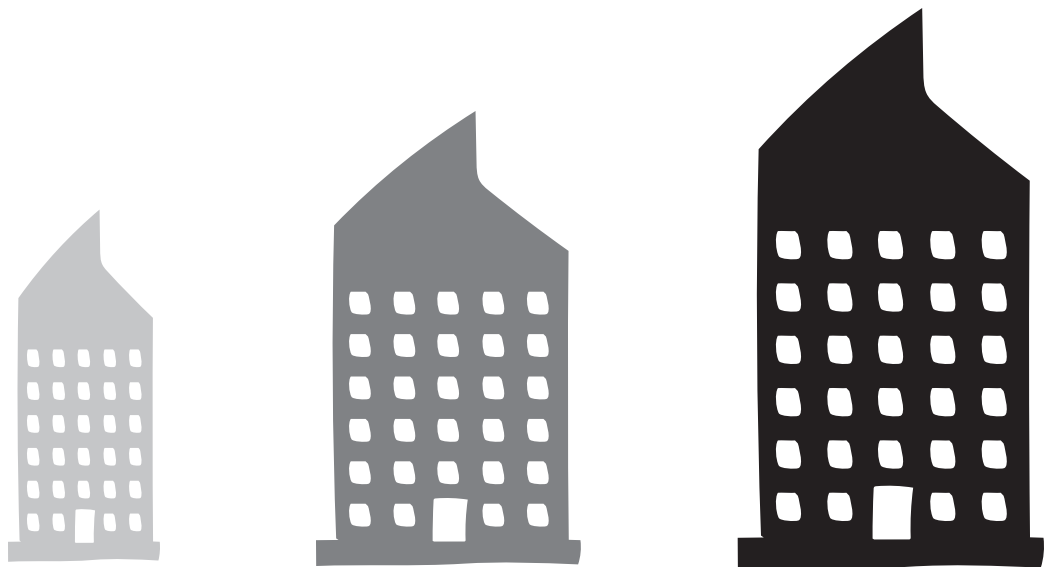
The material within the Carofin Knowledge Base (White Papers, articles, and videos) naturally falls into three categories - what we are calling the "Three Tracks."



THREE TRACKS

- ① **Personal Considerations** – Self-evaluation for suitability (“are these types of investments right for you?”) as well as investment portfolio management.
- ② **Issuer Evaluation** – Corporate analysis and due diligence
- ③ **Security Analysis** – Understanding complex financial instruments

Taken together, the Three Tracks provide a comprehensive framework to guide private investors as they build their personal understanding and prepare to invest the “Right” Way.

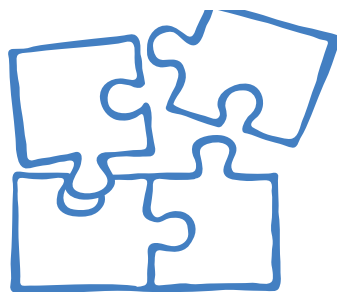


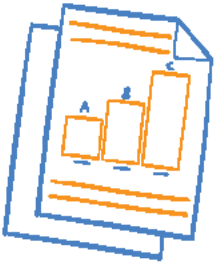
Personal Considerations

It doesn't make sense evaluating private investments if your circumstances don't line-up with the risks and limitations which are inherent to this investment class. Three basic questions an investor should ask include:

- » Am I legally able to invest (Accreditation)?
- » Is this type of investment right for me (Suitability)?
- » How should private investing complement my public investments (Portfolio management)?

The following White Papers have been created with personal investment considerations in mind:





Personal Considerations White Papers

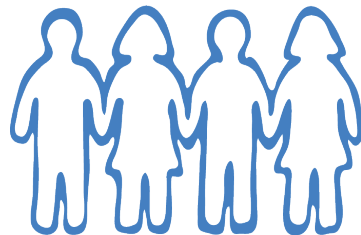
<p>Private Investing the “Right” Way</p>	<p>To consistently achieve the best investment performance, it is important that three aspects align:</p> <ol style="list-style-type: none"> ① Right Investor — Is the investor both Accredited and Suitable for these illiquid and, generally, higher risk investments? ② Right Amount — Is an appropriate amount being committed by the investor? ③ Right Security — Do the security and its inherent investment characteristics meet this investor's goals?
<p>Accreditation & Suitability</p>	<p><i>Accreditation</i> involves compliance with specific financial tests imposed by the S.E.C. (i.e., minimum net worth or annual income tests necessary to participate in these riskier offerings). <i>Suitability</i>, on the other hand, is a more subjective test to confirm that a security meets the investor's financial profile, risk tolerance, preferences and goals.</p>
<p>Private Lending and the Benefits of Diversification</p>	<p>Diversification is essential to private investment portfolio management. By making multiple, smaller investments, one can reduce the impact of specific issuer defaults and still generate a compelling overall ROI.</p>

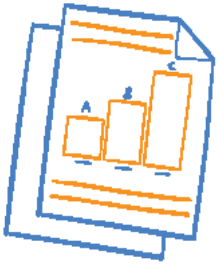
Issuer Evaluation -- Analyze the business in which you are investing

Companies are as different from each other as the people that run them, but there are ways to evaluate them that are efficient, comprehensive and consistent. Key questions for evaluating a company (the security Issuer) include:

- » What's the business's purpose & plan?
- » Who are the management & current owners?
- » How are marketing & sales approached?
- » What is the financial performance (past and projected) and capital structure?

These White Papers were created to help investors understand any business that's issuing a private security.





Issuer Evaluation White Papers

Primary Investment Considerations (or First Principles)

First Principles identifies the most fundamental considerations to evaluate a problem (or opportunity) and then determines the optimal response. Applied to private investing, it poses three simple questions that are essential to better understand an investment opportunity.

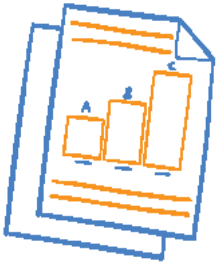
- ① The Opportunity — What is the business opportunity being pursued by the Issuer?
- ② The Challenge — Which tests is a business going to confront as it chases this opportunity?
- ③ The Solution — Is the Issuer approaching the opportunity in the most logical way, given these challenges?

Once the investor understands these central elements, follow-on due diligence becomes both better organized and more enlightening.

Five Elements of Private Investing

The “Five Elements” provides a simple Investment Overview structure. The Elements include:

- ① Purpose – Why is this capital being raised?
- ② Issuer – Who is issuing the security?
- ③ Security – What type of investment is being offered?
- ④ Repayment – What determines the success of the investment?
- ⑤ Risks – What can go wrong?



Issuer Evaluation White Papers

Seven Key Questions for Evaluating a Private Company

A framework for a deeper, but still fundamental analysis, “Seven Questions” efficiently guides prospective private investors to understand an operating company. This provides a solid foundation from which to conduct more detailed due diligence.

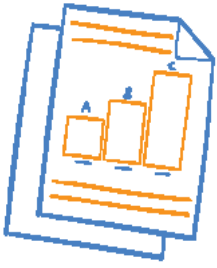
- ① What does the company do?
- ② Who are the key managers of the business?
- ③ What stage is the business, and is the investment being offered appropriate?
- ④ Who are the company’s customers?
- ⑤ How is the product or service produced?
- ⑥ How does the company make money?
- ⑦ How will investors be paid back?

Seven Key Questions helps investors when evaluating issuers of private debt, venture capital or private equity.

Evaluating Venture Investments

Nine “Leaps of Faith” helps to quickly evaluate and contrast venture-stage equity investments (“venture capital” investments). They include:

- ① Has the entrepreneur launched a start-up before?
- ② Is the company’s product or service simply an improvement to existing practices or a disruptive technology?
- ③ Do they have a product?



Issuer Evaluation White Papers

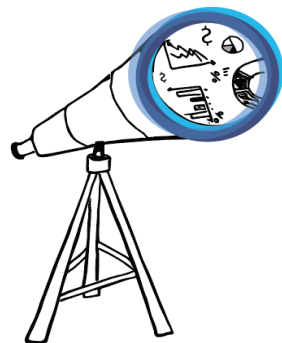
	<ul style="list-style-type: none"> ④ What are the customers' motivations for buying the product ⑤ Do they have customers? ⑥ Are distribution channels and a sales pipeline in place? ⑦ Has the management team been assembled? ⑧ Is the business ready to scale? ⑨ What is the competition? <p>Once addressed, these questions provide investors with a base for further due diligence as they evaluate venture capital investments.</p>
<p>Due Diligence Guidelines</p>	<p>A guide for conducting more extensive analysis of an Issuer.</p>

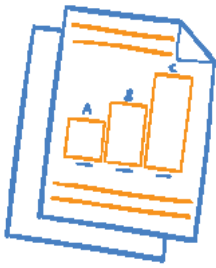
Security Analysis – Understand the security you're buying

One can invest in a growing company but still end up with lackluster investment returns if the underlying security isn't structured to adequately benefit investors from the Issuer's success. Key areas for evaluating a security include:

- » What type of security is being offered?
- » How does it rank relative to other securities of the Issuer?
- » How is it designed to perform for an investor?

These White Papers review the types of securities issued in private placements.





Security Analysis White Papers

<p>Understanding Private Securities</p>	<p>This reviews common debt and equity securities in private placements, what they represent as obligations of the issuers and how they are designed to perform for investors.</p>
<p>Alternative Investment ROI's</p>	<p>This paper reviews ranges of investment yields (Return on investment or "ROI") appropriate for various types of direct private investment in operating companies.</p> <p>The most common methods for calculating return on investment (ROI) are first reviewed — including cash-on-cash, simple interest, and internal rate of return (IRR). Private investments are then contrasted with publicly registered investments.</p> <p>With this background, range of ROI are presented for the major classes of private debt and private equity investment including Venture Capital, Private Equity, Senior Debt, and Subordinated Debt (Mezzanine Lending).</p>
<p>Revenue Royalty Notes</p>	<p>A debt investment wherein the current return and principal repayment are each tied to Issuer payments which are a fixed percentage of the Issuer's gross revenues — up to a capped total return (e.g., 1.5x the original principal amount).</p> <p>If the Issuer's sales grow faster, the capped return is reached more quickly, and the IRR is higher. If the sales growth is slower, and it will take more time to reach the capped return, the IRR is lower. If the capped return is not repaid by the maturity date, any additional amounts due to reach the capped return become due and payable.</p>



Conclusion

Most consistently successful investors are inquisitive and critical about a prospective investment – inquisitive in the sense that they want to understand the opportunity and the factors which affect its eventual success or failure. Critical because an enthusiastic Issuer may downplay the inherent risks.

The information contained in Carofin’s Knowledge Base helps investors more broadly understand factors which affect success or failure of a private investment.

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