The Lane

Evaluating Direct Private Investments

By Bruce Roberts

a white paper
brought to you by
The Knowledge Base
at carofin.com

carofin
MEANINGFUL INVESTMENTS
VITAL CAPITAL

Introduction

"The Lane" is a fundamentals-based investor guide for identifying and better understanding the basic elements of a business. This methodology should help you to determine whether an investment in one company is a better private investment alternative than another.

Applying the Lane's simple framework to investment analysis and due diligence helps organize what is, arguably, the most challenging type of investment analysis – evaluating a private company.

Every business is both complex and unique. Its "business model" represents a build-it-as-you-go puzzle that the enterprise creates, implements, and continually evolves to generate profits.

So how can a prospective investor efficiently identify and then adequately evaluate a given company's business model?

Fortunately, despite their many differences, every business is based upon two ingredients: its Customers and the Products (or services) it sells them to. Simply put, a business will thrive or fail depending on its ability to:

1. Identify and attract enough Customers with a similar need (a business Opportunity);

2. Create and profitably deliver a compelling Product (a business Solution) to those Customers.

If this sounds basic, it is. But it's also the essential first step toward understanding a business.

Too often an investor, in his or her analysis of a private company, gets distracted by extraneous details without first identifying the primary elements of the business. Details are critical to thorough due diligence, but one must prioritize them to evaluate them in relation to fundamental business drivers.

Some businesses are inherently better than others. They focus their resources on a very good business "Lane" that efficiently delivers their Products to targeted Customers.

When comparing investments, the Lane provides a simple reference point:

- Empty lanes – No competition, or maybe no active Customers (textiles made from banana fiber)
- Crowded lanes – Highly competitive; a much better Product is needed (think streaming services, protein bars, hearing aids or cosmetics)

- Faster lanes – The Opportunity is urgent; Products must be delivered quickly (sterilization devices or specialty delivery parachutes for use in war zones)

- Wider lanes – A bigger Opportunity or one with more room to operate (perhaps electric charging stations)

- Clear lanes – A direct path to building a business (providing broker-dealers with the ability to capture texts to meet their compliance obligations)

- Curvy lanes – Many Challenges; a tougher business to execute (retail stores, cruize lines, and restaurants with constantly changing regulatory protocols)

Better businesses generate greater sales, with better profit margins, and over longer periods. When well executed, better businesses are more likely to provide investors with the rate of return they expected when they invested in that company's securities.

First ... First Principles

See
Primary Investment Considerations – First Principles of Investing

Before presenting The Lane, we need to introduce the First Principles analytical process. Credited to the Greek philosopher and mathematician Aristotle, this approach to problem solving is now applied in business by many leading investors and entrepreneurs.

First Principles underpin The Lane's methodology.

Aristotle argued that reasoning by "First Principles" removes the impurity of assumptions and conventions. Getting to the basics helps focus the mind on the pertinent essential elements of a problem where reasoning by analogy might lead one astray.

When applied to business, First Principles includes three fundamental lines of questioning:

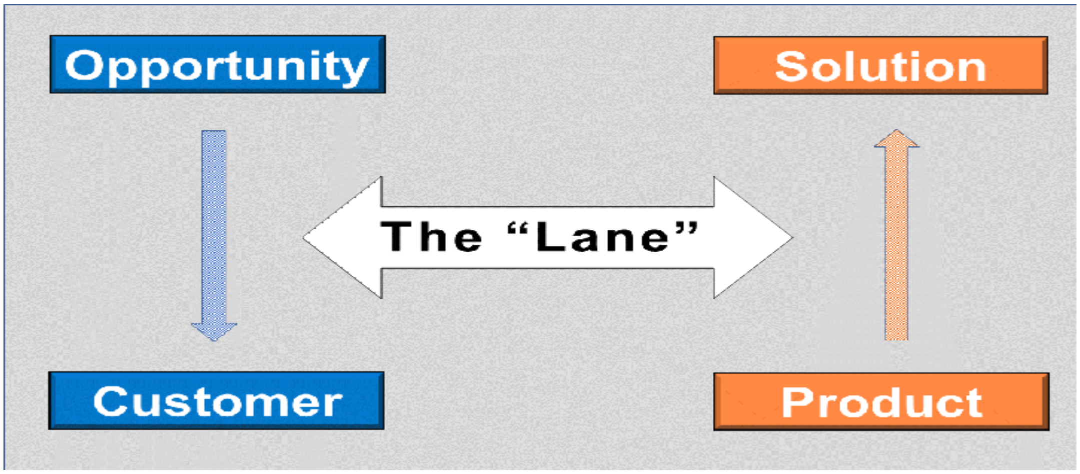
- **Opportunity –** What is the underlying business opportunity? What does the Customer need (or want)?
- **Challenges –** What obstacles must the enterprise first overcome to address the Opportunity to meet this need? Delivering a Product and, equally importantly, selling the Product to Customers, are the most critical Challenges a business faces.
- **Solution –** What Product (or service) profitably addresses the Customer's need despite the many inherent Product-related Challenges and Customer-related Challenges?

The Lane ... Identifying and Evaluating

The Lane applies First Principles to direct investing.

As noted earlier, the fundamental elements of any business are its Customers and the Products (and/or services) that it creates to meet its Customers' needs.

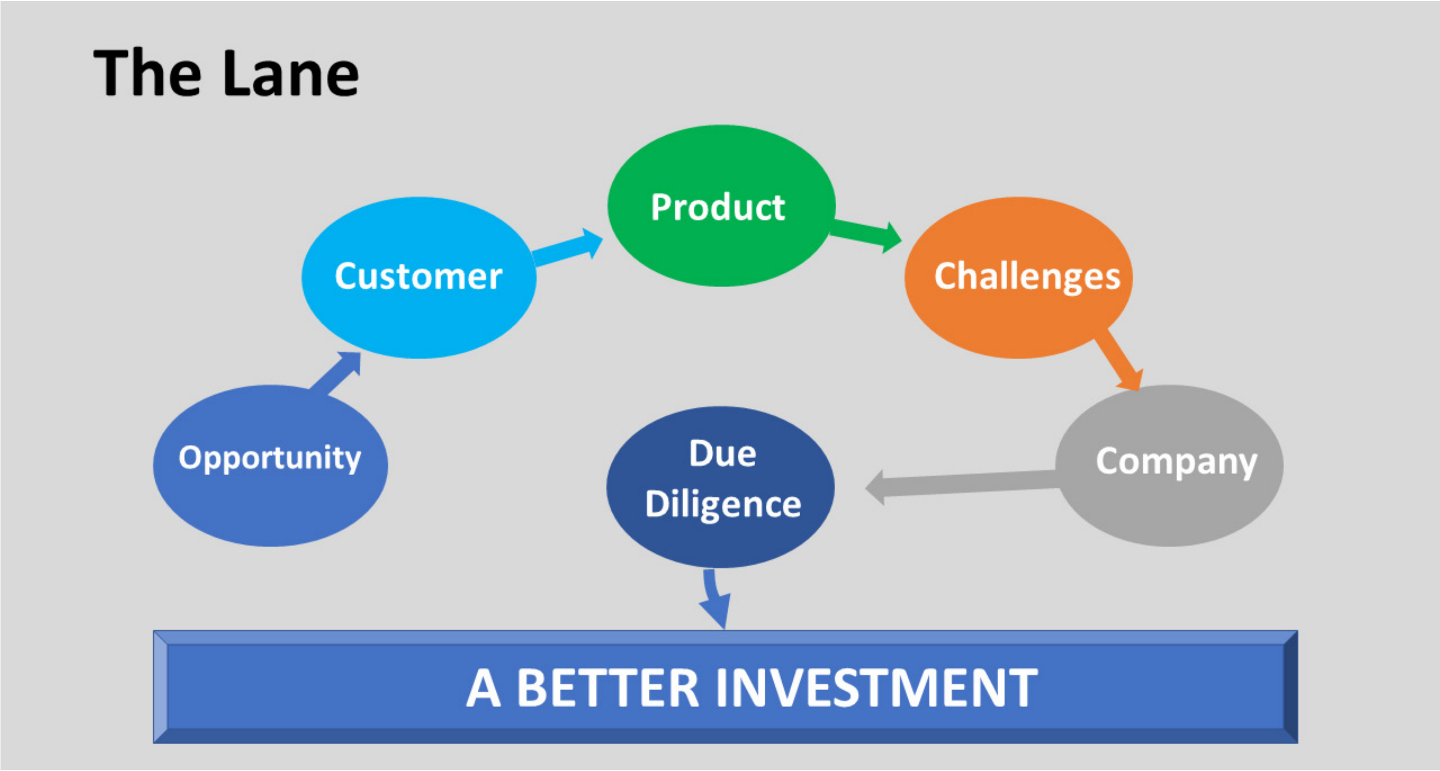
The "Lane" is a methodology for investors to follow first to gauge a Company's chances for success. This framework helps determine whether an opportunity is worth considering further versus another direct investment.



The Lane guides a prospective investor through a process that prioritizes an understanding of:

1. The business Opportunity and target Customers;
2. The Product and how it addresses the Opportunity;
3. The Customer-related Challenges;
4. The Product-related Challenges;

5. The company's organization and whether it addresses the Challenges;
6. Further due diligence needed for a deeper understanding and verification of the above.



Opportunities ... are determined by Customers

"Every company's greatest assets are its customers, because, without customers, there is no company."

Michael LeBoeuf, Business author and former management professor

Most companies fail <u>not</u> because they can't produce Products, but because they can't sell enough of their Products.

A business can have a great Product, in theory, but without Customers, it's a Product in need of Customer validation – in effect, a solution looking for a problem – which isn't usually a great backdrop to an investment.

Major considerations for understanding the factors driving Customer purchases include:

- **<u>Why</u> would the Customer purchase the Product?** Is it **FEAR** (the Product addresses a pressing Customer "need" or fear of missing out) or by **VALUE** (a nice-to-have Product, but a "want" that the Customer can defer)?

  In general, sales occur faster when the motivation to purchase a product is driven by an urgent need, particularly when the product represents a new technology that requires the Customer to adapt to its use.

- **<u>How</u> is the decision made to purchase the Product?** — Individually or through some group process? The fewer persons involved in purchasing decisions, the faster sales will occur.

- **Is it a <u>one-time purchase or a repeat purchase</u>?** One-time sales require the business to constantly attract new Customers, whereas replacement sales (think razors/razor blades) generate repeat purchases and a more predictable revenue stream.

Solutions ... A Product or a Service

Once an investor has identified the Opportunity, he or she will find it much easier to evaluate the Solution – a Product or a Service that the business provides (or is developing) to meet that Opportunity. Businesses with founders and management having substantial experience in the same industry (or specific circumstances as the targeted Customers) usually identify, create and deliver better Solutions.

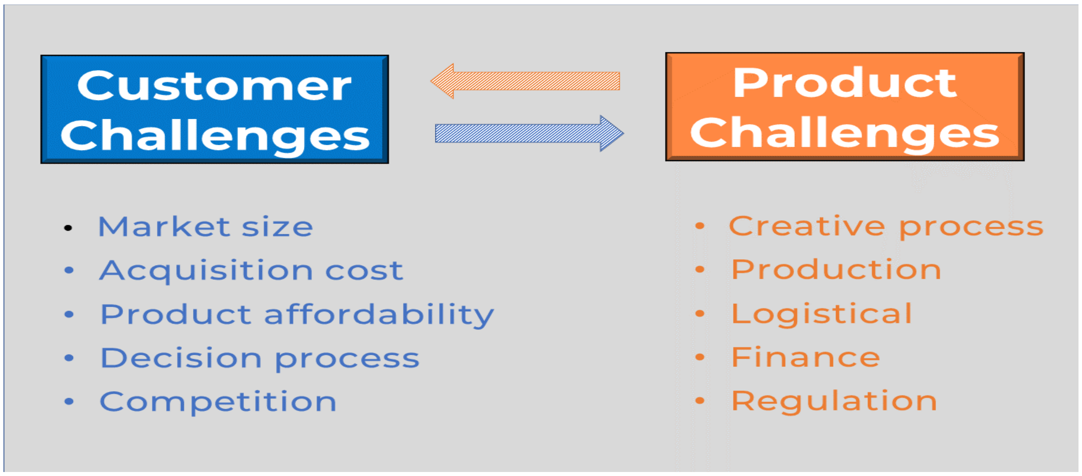
A Product is typically a manufactured item that a company delivers to a Customer who then uses it independently. Once purchased, for the most part, it's the Product that satisfies Customer's needs. The company may need to provide ongoing Customer support, but it is episodic, such as early Customer training or the occasional maintenance and repair.

Services, on the other hand, include ongoing or intermittent Customer support, and this is often highly interpersonal. There's little in the way of a "leave-behind" other than a "job well-done." The services provided must fulfill the Customer's needs, but the persons providing the Services are often required to be more outgoing – more adept at working with other people, often the same people, on a regular basis.

Therefore, the Challenges inherent to Product-producing businesses are very different than those of Service-providing businesses.

Challenges … Customer and Product

If a business' basic ingredients are its Customers and Products, it follows that businesses face two primary types of Challenges: Customer Challenges and Product Challenges.



CUSTOMER CHALLENGES

Whether a business-to-business or business-to-consumer sale, Customer Challenges include:

- **Market size** – An important first step when assessing the potential for the investment is to accurately gauge the size of potential Customer demand. Smaller market Opportunities can limit investment returns.

- **Affordability/Value Proposition** – Can the Customer afford the Product? Is its value obvious relative to its price?

- **Connection** – Ironically, despite the highly connected world we now live in, it's more difficult to build Customer relationships than ever before. Today's potential Customers are ever more resistant to solicitations because communication channels have proliferated (infinite internet sites, hundreds of TV stations, evolving social media platforms, etc.).

- **Messaging** – A concise story that efficiently conveys a Product's value proposition is critical but not easy to craft and communicate.

- **Purchasing process** – As noted above, the fewer decision makers required for a purchasing decision, the easier it is to make a sale.

- **Competition** – Is the Lane already crowded? People are creatures of habit and they take comfort from familiarity – even if the Product they are currently using isn't perfect. Therefore, investors should not underestimate the Challenges represented by entrenched competition for Customers.

A solution looking for a problem
often leads to a more challenged investment.

EXAMPLE: Motivated Buyers … "must buy now"

Arms for the Ukrainian conflict – As this is being written, the Ukrainian conflict has been waged for almost nine months. Clearly, superior Western weaponry is making the difference for the Ukrainian side (versus outdated Russian armament, though abundant).

However, Western stockpiles are limited, so manufacturers of military supplies critical to Ukrainian support are experiencing urgent demands by Western governments trying to support the Ukrainians.

These purchasing decisions cannot be deferred.

EXAMPLE: Little time pressure ... A purchase can be deferred

Buying a new car – While some people are "driven" to always own new cars, most replace theirs every 6-8 years, according to CNBC. It's a value decision. Does the utility of a newer vehicle out-weigh the operating costs and related inconvenience of my current automobile? The decision can take months, and it often involves more than one household member expressing their opinion and influencing the decision.

These purchasing decisions can be deferred.

PRODUCT CHALLENGES

Different Products result in different Product Challenges. The flip side to Customer affordability is the Product's profitability. Product Challenges include:

- **Creation –** Some Products are more difficult to create than others. This can involve the underlying science, design Challenges, customization, etc.

- **Production –** What's required to produce the Product? Will the business produce it, or will the company out-source its fabrication? The more the business manufactures, the higher the necessary capital expenditure (CAPEX). Out-sourcing, while requiring less capital, increases the risk of vendor performance, an important trade-off to evaluate.

- **Profitability –** What are the inherent "margins" of the business (product price minus cost of production, marketing & sales, and overhead)? Even if the company makes a sale, what's left over, and will the profit margin grow with increased sales? What's the "bottom line" inherent to this Lane?

- **Logistics –** Reliable logistical support is essential. The more "global" the supply chain, the more vulnerable to disruption from world events. The more the company relies on third-party vendors to produce the product and ship it to the company, the more things can go wrong which are out of the business' direct control.

- **Finance –** How much third-party capital (Venture capital, private lenders, loans, grants, etc.) is required to create and deliver the Product? Some businesses are very capital intensive (like producing a car or computer chip); some are not (like creating a web site or an application). Is the market Opportunity proportionate to the capital required to achieve positive cash flow from sales?

  IMPORTANTLY – If more capital is required (it usually is), can you be confident that the company can secure it? Investors face significant "liquidity risk" when the company needs additional capital after their investments. No matter how compelling the Opportunity, it may be too difficult to finance.

- **Regulation –** Government regulation permeates virtually every aspect of business. Regulatory compliance must be integral to the ongoing execution of the business, or its lack will eventually impede the business' progress.

Example: Capital required plus development risks

Life science investments – Developing a new therapeutic drug is a high-risk, very expensive undertaking because of the capital, time and required regulatory approvals.

Example: Capital required plus development risks, cont'd

To prove a new drug that works but is safe, it must do so through several levels of "clinically approved trials," which often cost well over $100,000,000. Even then, success is not guaranteed.

If successful, potential investor rewards are huge. But there is also an enormous risk that the Product won't make it to the finish line – for smaller companies, selling the drug to big pharma for commercialization – and investors will lose all the investment.

Example: Capital required

A new automobile manufacturer – Years ago, Carofin was engaged to finance a start-up automobile manufacturer. Upon further investigation, it became clear that to create a clay model would require $20,000,000 of start-up investment. To get the first car off the assembly line would take $350,000,000!

Because of the changes in the industry, in particular the evolution of out-sourcing to component assemblers, $350,000,000 was, from a historical perspective, a relatively smaller amount of capital for launching an altogether new car company. Still, the company required too much capital for this "proof of concept" stage business, and, consequently, we decided to pass on the opportunity.

If more capital is required (it usually is), can you be confident that the company can secure it? No matter how compelling the Opportunity, it may be too difficult to finance.

Is the Business Ready for the Challenges?

As the Challenges are identified, it follows that the business must have the organization, staffing and other resources necessary to meet those Challenges.

Every company faces some level of resource constraint, even the largest. The company's organization, for any given stage of business development, should reflect what's most needed at that period of the company's development.

Naturally, young companies, particularly those trying to create a novel technology, will focus on development before allocating resources to production. <u>But they still need to be marketing, making sales calls and preparing to support Customers, or they won't develope a product that best meets the Customers' needs</u>.

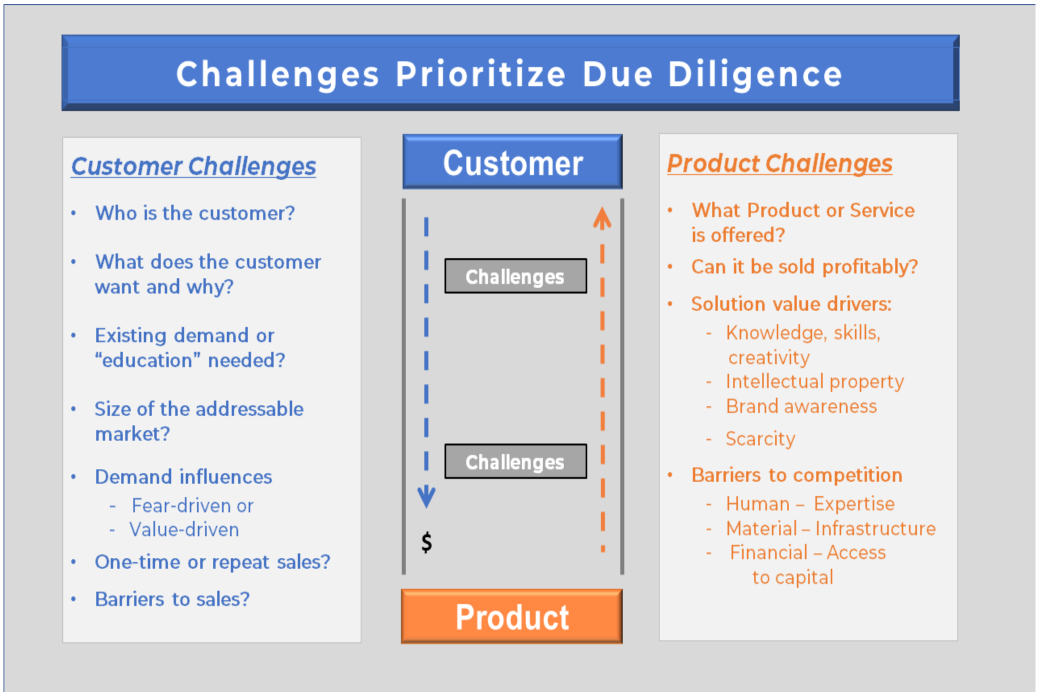
So, is the company well-positioned to sell its Customers a Product or Service?

What's the next step? Due diligence.

Due diligence for any investment involves a thorough investigation of all aspects of the business. This includes independently evaluating whether the statements in the offering document, if there is one (and there should be), are complete, consistent and accurate, with no material facts omitted.

Diligence requires an investor to evaluate an abundance of background information. But, without proper organization, it's also a process where a few trees can quickly obscure an understanding of the forest. For example, a former CEO of a Fortune 500 company may not be well suited to lead a start-up, no matter their stellar reputation.

The clarity the Lane provides to investors prepares them to customize and prioritize their due diligence effortspective investment.



Selecting the Better Investments

Once the Lane has been brought into focus, potential investors will have a better “minds-eye” with which to:

- Understand the two-way flow of commerce between any business and its Customers;
- Contrast the Challenges facing one potential investment relative to those of other potential investments ... to select better private investments.

So, the question isn’t just “what’s a business’ Lane,” but what’s the nature of the Lane? You can use the table on page 20 to compare your investment opportunities by their Lanes.

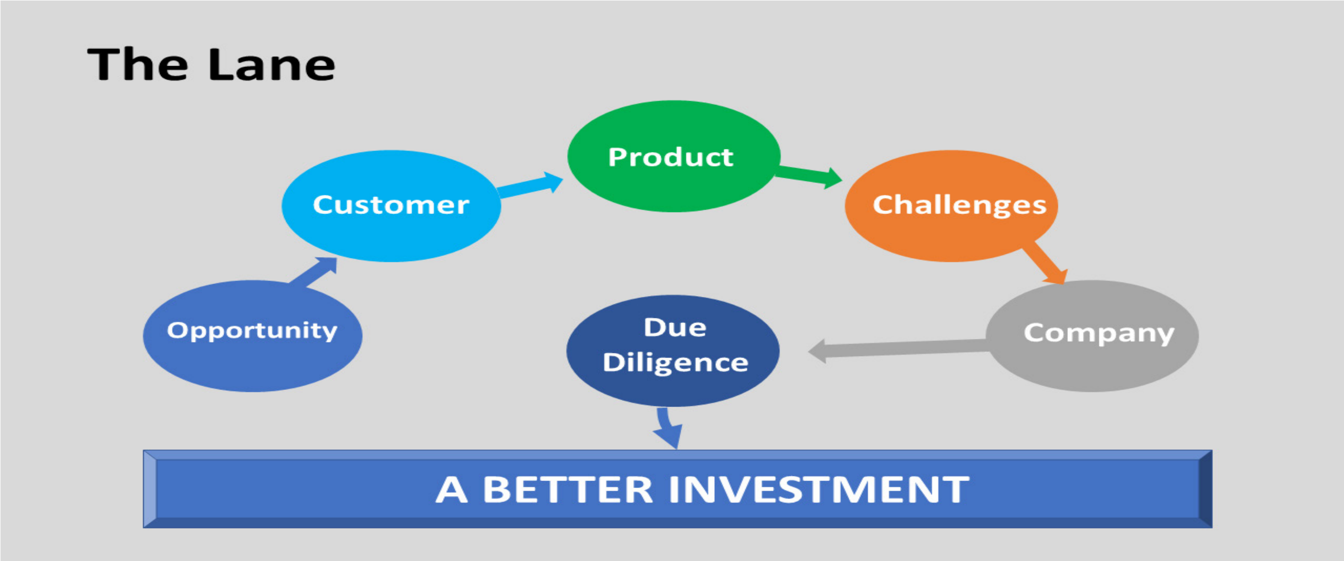
As noted in the Introduction above, better businesses generate greater sales, with better profit margins, and over longer periods.

When well executed, they are more likely to provide investors with the rate of return they expected when they invested in that company’s securities.

Does a Company have a reasonable chance to succeed?

Across all asset classes, private markets have grown to around five times the level they were at back in 2007. Over the same period, public markets have seen two times growth.

Though one business is very different from another, each is fundamentally based upon its Customers and the Products it sells them … its Lane. Identifying and understanding a company's Lane, early in the investment analysis process before deeper due diligence is conducted, is critical to being well informed.



This simple framework will help you organize your understanding of each private company investment you consider:

1. The business Opportunity and target Customers;
2. The Product and how it addresses the Opportunity;
3. Challenges related to the Customer and the Product;
4. The company's organization and whether it addresses the Challenges;
5. Further due diligence needed for a deeper understanding and verification of the above.

While risks should always be considered, an investment in a fundamentally superior business model is more likely to succeed.

As investors place more vital capital into private companies, Carofin believes in giving investors as many assessment tools as possible to achieve the most satisfying investment result.

The Lane helps investors determine whether a given company is positioned to succeed and whether an investment in that company is a better investment alternative.

Relevant White Papers:

Primary Investment Considerations – First Principles of Investing

Five Elements of Private Investing

Seven Key Questions for Evaluating a Private Company

MEANINGFUL INVESTMENTS — VITAL CAPITAL

Carofin* offers Direct Private Investments that reflect our firm's 26 years of experience across 200+ transactions. If you would like to consider participating, we welcome a discussion with one of our registered representatives at a time of your convenience.

Bruce Smith, Investor Development
Email: bsmith@carofin.com
Tel: 203-209-1262
Schedule a call here

Nash Roberts, Sales and Syndication
Email: nroberts@carofin.com
Tel: 828-393-0088 x602

Financial terms used herein are more fully defined in the Carofin's Glossary of Investment Terms.

If you like reading these papers and want to stay current, please "Follow us" on LinkedIn.

As always, please reach out to schedule a call if you have questions. (828.393.5401)

And, if you are ready to consider investing in our alternative investments, please click here.

* Carofin and affiliate

Edited and designed by Bruce Smith

Using Lanes to Compare and Contrast Investments.

	Opportunity #1	Opportunity #2
The Lane		
Opportunity		
Customers		
Solution		
Product		
Customer Challenges		
Market size		
Connecting with Customers		
Communicating Value		
Product affordability		
Decision process		
Competition		
Product Challenges		
Creation		
Production		
Profitability		
Financing		
Logistics		
Regulation		

carofin

MEANINGFUL INVESTMENTS — VITAL CAPITAL

Securities are offered through Carofin, LLC, Member of FINRA/SIPC. Carolina Financial Securities is an affiliate of Carofin and both Broker-Dealers are affiliates of Carolina Financial Group, LLC.
Our firms seek to present vital capital with meaningful investment opportunities through the fundamental analysis of the businesses we seek to finance. Such analysis is usually conducted through a First Principles approach.
When we provide you with a recommendation, we have to act in your best interest and not put our interest ahead of yours. At the same time, the way we make money creates some conflicts with your interests. You should understand and ask us about these conflicts because they can affect the recommendations we provide you. Here are some examples to help you understand what this means:
Proprietary Products: Our firms will often present investments that are only available through them, which may result in a higher placement fee. The Firms will receive the placement fee regardless of your investment performing as expected.
Administrative Agent Services: CFG Financial Services, LLC, an affiliate of our firms, will act as Administrative agent for the securities while they are outstanding. Given that our firms have an interest in providing recurring services to the Issuer, while the administrative agent looks after the interests of investors, there may be a conflict of interest between the firms and its affiliates.
Our firms offer brokerage services to accredited investors, exclusively through the sale of private placements. the offerings we bring to market are carefully selected, and any recommendation you may receive from us will be limited to these offerings. Therefore, we may be unable to adequately compare the risks and benefits of the offerings we bring to offerings presented by other financial professionals. While our firms will often present new investments and discuss such investment's risks and benefits with you, the ultimate authority to make such investment rests solely with you.Our firms do not hold any investor cash or securities, and securities offered by us often have no easily assessable market value, so our firms will not monitor the market value of your investment on an ongoing basis. The investments we present often require a minimum investment of $5,000 for equity offerings and $10,000 for debt offerings.
Fees and costs may reduce any amount of money you make on your investments over time. Our firms are mostly compensated through placement fees, which are payable by the issuer, meaning that the firms will be compensated by receiving a percentage of the funds raised in an offering, regardless of the investment performing as expected. Such placement fee is usually between 3% and 7% (please find the specific Placement Fee for this offering in the "Placement Agent Fees" section of the "Security Terms". Given that different investments have different placement fees, we may often have a conflict of interest when presenting these investments to you. The Firms' bankers are often compensated by receiving a percentage of the placement fee, and may have their own conflict of interest when presenting you with offerings they structure.
Private placements are high risk and illiquid investments. As with other investments, you can lose some or all of your investment. Nothing in this document should be interpreted to state or imply that past results indicate future performance, nor should it be interpreted that FINRA, the SEC or any other securities regulator approves of any of these securities. Additionally, there are no warranties expressed or implied as to accuracy, completeness, or results obtained from any information provided in this document. Investing in private securities transactions bears risk, in part due to the following factors: there is no secondary market for the securities; there is credit risk; where there is collateral as security for the investment, its value may be imped if it is sold. Please see the Private Placement Memorandum (PPM), and the complete list of contents for each contemplated investment for a more detailed explanation of the securities Summary of Terms, Investor Suitability Standards, Confidentiality, Securities Matters and Risk Factors.

Caution Regarding Forward-Looking Statements

Certain statements herein may be “Forward-looking” in that they do not discuss historical facts but instead note future expectations, projections, intentions, or other items relating to the future. We caution you to be aware of the speculative nature of forward-looking statements as these statements are not guarantees of performance or results.

Forward-looking statements, which are generally prefaced by the words “may,” “anticipate,” “estimate,” “could,” “should,” “would,” “expect,” “believe,” “will,” “plan,” “project,” “intend,” and similar terms, are subject to known and unknown risks, uncertainties and other facts that may cause our actual results or performance to differ materially from those contemplated by the forward-looking statements.

Although these forward-looking statements reflect our good faith belief based on current expectations, estimates and projections about, among other things, the industry, and the markets in which we operate, they are not guarantees of future performance. Whether actual results will conform to our expectations and predictions is subject to several known and unknown risks and uncertainties, including risks and uncertainties discussed in the offering materials for each specific investment.

Consequently, all the forward-looking statements made herein are qualified by these cautionary statements and there can be no assurance that the actual results anticipated by us will be realized or, even if substantially realized, that they will have the expected consequences to, or effects on, your investment. We undertake no obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, except as required by law.