TIPS ON READING A PROSPECTUS

Before making any investment, ask for and review the **prospectus**. Many investors, however, avoid reading a prospectus before investing since it appears to be too difficult and time-consuming. As a result, some investors solely rely upon a salesperson to render a verbal summary of its contents, and are sometimes unpleasantly surprised to find out the investment they just made is not exactly what they expected. The explanation below not only highlights the major parts of a prospectus and various types of prospectuses, but also raises some important points to consider before making any investment in securities.

What is a prospectus?

A prospectus is a written document that provides important information regarding a securities offering. It is the primary sales tool of the company issuing the offering (the issuer) and the brokerage firms distributing the offering (the dealers). The Arizona Securities Act requires that a prospectus be prepared and provided to all investors who are purchasing a public offering. What investors must decipher from the information contained in a prospectus is what distinguishes one company from the next. With any prospectus, however, a healthy dose of skepticism is always appropriate.

Lure of the "Red-herring"—Is it a Trap?

Before any information regarding an initial offering is known or made public, a company may issue a preliminary prospectus to attract potential investors. The document's title page should be clearly marked in red ink as "preliminary" and thus, is often referred to as the "red-herring" prospectus.

For the unscrupulous promoter, the legal jargon contained in a red-herring prospectus can be used as a smoke screen to hide undesirable characteristics of a risky or a fraudulent investment. But even with legitimate companies, information contained in the preliminary prospectus is subject to change, either due to the comments provided by the U.S. Securities and Exchange Commission (SEC), the Arizona Corporation Commission's Securities Division and/or updated factual statements made by the issuer.

The Title Page—Verify Before You Buy!

At the top of the front page, look for the name of the issuer and the investment being offered. In a final prospectus, look for the cost of and number of shares being offered. The next and most important step is to check with the Securities Division to determine if the offering is registered in Arizona. If not, ask the promoters: Why not?

If the promoter has told you the security is exempt (issuer does not have to register with the state regulator), the next step is to contact an <u>independent</u> attorney, certified public accountant, or registered financial professional who can explain if the exemption is valid.

Even though a particular security may not have to be registered with the state, it is still subject to Arizona's general antifraud laws (regulations dealing with issuers or salespeople who mislead or misrepresent what is being offered or sold). The cost of investigating the exemption does not guarantee a good deal, but it can certainly decrease the chances of losing your entire investment to fraud.

Keep in mind that the following list of other prospectus sections described below may not appear exactly in the same order in your investment's prospectus.

The Summary—Take Notes and Ask Questions.

This section of the prospectus summarizes the main feature of the investment opportunity and typically provides an overview of company operations, including significant financial data such as projected sales revenue, gross income, net income, and earnings per share.

The summary is not intended to serve as a shortcut for you to avoid reading the body of detailed text found in the remaining portions of the prospectus. Instead, the summary will give you an idea of what the investment opportunity is all about and prepare you for the detailed information that follows. For what you don't understand, ask questions and obtain answers and clarifications from a certified and registered financial professional. If you don't understand, don't invest.

Certain Considerations—How much can I afford to lose?

Read this section very carefully. It contains a list of risk factors that could possibly cause your investment—and you—to lose money. Understand that, in general, investing can be a risky venture, and that even legitimate investment opportunities may cause you to lose money. Be wary of sky-high returns for little or no risk. Legitimate companies do not make guarantees and predictions of a high returns on investments. Ask yourself: Can I realize the same return on another investment with less risk? Finally, if the return on your investment sounds too good to be true, it probably is.

Use of Proceeds—Where does all the money go?

This section is where the issuer explains how the company intends to use your money. It's important to consider the company's intentions since they may directly conflict with your goals and risk tolerance level.

Ask yourself: Does the proposed use of funds seem reasonable? What restrictions, if any, are placed on the use of the proceeds? Most importantly, if this section is missing, don't invest.

The prospectus that is missing a use-of-proceeds section could actually be a "blind pool" offering where investors may know in what general industry their money in being invested, but are given no specifics to determine how their funds will be used. Securities scams often involve companies with no particular plan of business, other than to spend investor funds on a luxurious lifestyle for the promoters and their associates.

> ### *Caution for Investors*
> ***Even when investing with someone they know, investors should verify the registration of sellers and investment opportunities and investigate disciplinary histories by contacting the Arizona Corporation Commission's Securities Division at 602-542-0662 or toll free in Arizona, 1-866-VERIFY-9 (837-4399).***

The Financial Statements—Show me the Money!

Acquiring a picture of a company's financial situation requires a review some important data revealed in the Income Statement, Cash Flow Statement, the Balance Sheet, and the Statement of Changes in Financial Position for the past year. If this type of information sends your head spinning, look for the section of the prospectus that includes an explanation and analysis by the company's management.

Management should provide comment and analysis on current business trends and how a company's profits could be affected. Also, look at the company's competition and how that could affect the bottom line. If you need an objective review of this information, contact an independent, certified public accountant (CPA) or other financial professional (someone who's not earning a commission off of your investment) for assistance.

Dividend Policy—How Does My Money Work?

If receiving an income stream from your investment is your main objective, be sure to review the section covering a company's dividend policy.

First, examine the company's history of dividend payouts. Determine how much and for how long the company has been paying dividends. Ask: Are there any gaps in the income stream and if so, why? Some companies, for example, may be forbidden by their creditors to pay out dividends to investors.

Lack of dividends is not necessarily a sign of a poor performance since some companies are reinvesting profits back into the company to expand business operations or to upgrade equipment, allowing it to stay competitive, and increase profits. The bottom line is that if the prospectus is describing a growth-oriented company, don't expect a long history of dividend payouts.

Dilution—What's fair for my share?

In the dilution section, you can make some important comparisons regarding price per share. First, you can compare the price per share for existing shareholders with the price per share for new shareholders. Next, you can compare the price per share of book value (value of shares after the offering is sold out) with the price per share of the present offering price. Why the comparisons?

It's important to compare the stock's book value and present offering price because when a company issues additional shares of a security, it may reduce or "dilute" the value of the existing shares if the shareholders of the new issue pay a lower price than existing shareholders. The value reduction can also be in the form of voting power if the new shares are not issued in proportion to the holdings of current shareholders. Some offerings, however, may make anti-dilution provisions, particularly with options and convertible preferred stock.

Free Investor Resources

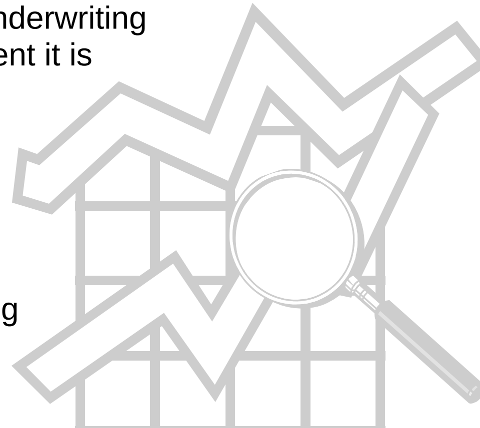
For more information on wise investing and other investment products, visit the Investor Resource Center, www.azinvestor.gov. To request a presentation for your group call the Investor Education Coordinator at 602-542-0428 or email at info@azinvestor.gov.

Management—Who's running the show?

In the management section, you should find a list of the company's management team and their qualifications. Because the success of the company (and your investment) depends upon how management runs the company's operations, take time to review this section. Specifically, consider factors such as experience and past results with other companies, age, education, as well as pay and other forms of compensation they may receive.

Underwriting—Who's Buying the Offering?

This section describes the terms of the underwriting agreement between the underwriter (the brokerage firm acting as an agent for the company issuing the offering) and the investor. Specifically, an investor can find out how the underwriting brokerage house is being compensated, and to what extent it is obligated to purchase unsold shares from the issuing company. There are various types of underwriting agreements involving public offerings that can affect the outcome of your investment—firm, best efforts, mini-max, or all-or-nothing.



First, in a **"firm"** underwriting agreement, the underwriting brokerage house is committed to buying all the shares that investors do not purchase. The brokerage house guarantees to the issuing company that it will assume financial responsibility for any unsold shares.

In the second type of underwriting agreement, the brokerage firm only promises to make its **"best effort"** to sell all the shares. This means the brokerage house does not assume a financial responsibility for buying the unsold shares of the offering.

The third type of underwriting agreement is the **"mini-max."** This agreement is merely a variation of "best efforts" where the issuing company establishes a minimum threshold sales level that must be obtained by the underwriting brokerage house or the offering is cancelled, resulting in investors receiving a refund.

The fourth type of underwriting agreement, the **"all or nothing,"** is a variation of the mini-max. In this form of underwriting, all of the shares of the offering must be sold to investors or the offering is null and void.

Within the underwriting section, you should be able to find out if the underwriting brokerage house is receiving more than just straight sales commissions, including, but not limited to:

- options—rights to buy or sell (without obligation) a security at a set price by a specific date,
- finder fees, or
- other considerations.

Contact Us

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