

Microcap Stock: A Guide for Penny Stock & Small Cap Stock Investors

Introduction

Information is the investor's best tool when it comes to investing wisely. But accurate information about "microcap stocks" — low-priced stocks issued by the smallest of companies — may be difficult to find. Many microcap companies do not file financial reports with the SEC, so it's hard for investors to get the facts about the company's management, products, services, and finances. When reliable information is scarce, fraudsters can easily spread false information about microcap companies, making profits while creating losses for unsuspecting investors.

In the battle against microcap fraud, the SEC has toughened its rules and taken actions against wrongdoers, but we can't stop every microcap fraud. We need your help in winning the battle. Before you consider investing in a microcap company, arm yourself first with information. This alert tells you about microcap stocks, how to find information, what "red flags" to consider, and where to turn if you run into trouble.

What Is a Microcap Stock?

The term "microcap stock" applies to companies with low or "micro" capitalizations, meaning the total value of the company's stock. Microcap companies typically have limited assets. For example, in cases where the SEC suspended trading in microcap stocks, the average company had only \$6 million in net tangible assets — and nearly half had less than \$1.25 million. Microcap stocks tend to be low priced and trade in low volumes.

Where Do Microcap Stocks & Penny Stocks Trade?

Many microcap stocks trade in the "over-the-counter" (OTC) market and are quoted on OTC systems, such as the OTC Bulletin Board (OTCBB) or the "Pink Sheets."

- **OTC Bulletin Board** The OTCBB is an electronic quotation system that displays real-time quotes, last-sale prices, and volume information for many OTC securities that are not listed on the Nasdaq Stock Market or a national securities exchange. Brokers who subscribe to the system can use the OTCBB to look up prices or enter quotes for OTC securities. Although the NASD oversees the OTCBB, the OTCBB is *not* part of the Nasdaq Stock Market. Fraudsters often claim that an OTCBB company is a Nasdaq company to mislead investors into thinking that the company

is bigger.

- **The "Pink Sheets"** The Pink Sheets — named for the color of paper on which they've historically been printed — are listings of price quotes for companies that trade in the over-the-counter market (OTC market). "[Market makers](#)" — the brokers who commit to buying and selling the securities of OTC issuers—can use the pink sheets to publish [bid](#) and [ask](#) prices. A company named Pink Sheets LLC, formerly known as the National Quotation Bureau, publishes the pink sheets in both hard copy and electronic format. Pink Sheets LLC is not registered with the SEC as a stock exchange, nor does the SEC regulate its activities.

How Are Microcap Stocks & A Penny Stock Different From Other Stocks?

Lack of Public Information The biggest difference between a microcap stock and other stocks is the amount of reliable, publicly available information about the company. Larger public companies file reports with the SEC that any investor can get for free from the SEC's website. Professional stock analysts regularly research and write about larger public companies, and it's easy to find their stock prices in the newspaper. In contrast, information about microcap companies can be extremely difficult to find, making them more vulnerable to investment fraud schemes.

No Minimum Listing Standards Companies that trade their stocks on major exchanges and in the Nasdaq Stock Market must meet minimum listing standards. For example, they must have minimum amounts of net assets and minimum numbers of shareholders. In contrast, companies on the OTCBB or the Pink Sheets do not have to meet any minimum standards.

Risk While all investments involve risk, microcap stocks are among the most risky. Many microcap companies tend to be new and have no proven track record. Some of these companies have no assets or operations. Others have products and services that are still in development or have yet to be tested in the market. Another risk that pertains to microcap stocks involves the low volumes of trades. Because microcap stocks trade in low volumes, any size of trade can have a large percentage impact on the price of the stock.

Which Companies File Reports With the SEC Including Penny Stocks?

In general, the federal securities laws require all but the smallest of public companies to file reports with the SEC. A company can become "public" in one of two ways — by issuing securities in an offering or transaction that's registered with the SEC or by registering the company and its outstanding securities with the SEC. Both types of registration trigger ongoing reporting obligations, meaning the company must file periodic reports that disclose important information to investors about its business, financial condition, and management.

This information is a treasure trove for investors: it tells you whether a company is making money or losing money and why. You'll find this information in the company's quarterly reports on Form 10-Q, annual reports (with audited financial statements) on Form 10-K, and periodic reports of significant events on Form 8-K.

A company *must* file reports with the SEC if:

- it has 500 or more investors *and* \$10 million or more in assets; or
- it lists its securities on the following stock markets:
 - American Stock Exchange
 - Boston Stock Exchange
 - Chicago Stock Exchange
 - Cincinnati Stock Exchange
 - International Securities Exchange
 - Nasdaq Stock Market
 - New York Stock Exchange
 - Pacific Exchange
 - Philadelphia Stock Exchange; or
- its securities are quoted on the OTCBB.

If you'd like to learn more about the SEC's registration and reporting requirements, read [Q&A: Small Business and the SEC](#).

All OTCBB companies must file updated financial reports with the SEC or with their banking or insurance regulators. Any company that does not file timely reports with the SEC or their banking or insurance regulators is removed from the OTCBB.

Tip: When an OTCBB company fails to file its reports on time, the NASD will add a fifth letter "E" to its four-letter stock symbol. The company then has 30 days to file with the SEC or 60 days to file with its banking or insurance regulator. If it's still delinquent after the grace period, the company will be removed from the OTCBB. You'll find a list of securities that have been removed from the OTCBB at www.otcbb.com.

With few exceptions, companies that file reports with the SEC must do so electronically using the SEC's EDGAR system. EDGAR stands for electronic data gathering and retrieval.

The EDGAR database is available on the SEC's website at www.sec.gov EDGAR. You'll find many corporate filings in the EDGAR database, including annual and quarterly reports and registration statements. Any investor can access and download this information for free from the SEC's website. [Click here](#) if you want to view detailed instructions on how to use EDGAR.

Caution: By law, the reports that companies file with the SEC must be truthful and complete, presenting the facts investors find important in making decisions to buy, hold, or sell a security. But the SEC cannot guarantee the accuracy of the reports companies file. Some dishonest companies break the law and file false reports. Every year, the SEC brings enforcement actions against companies who've "cooked their books" or failed to provide important information to investors. Read SEC filings — and all other information — with a questioning and critical mind.

Which Companies Including Penny Stocks Don't Have to File Reports?

Smaller companies — those with less than \$10 million in assets — generally do not have to file reports with the SEC. But some smaller companies, including microcap companies, may choose voluntarily to register their securities with the SEC. As described above, companies that register with the SEC must also file quarterly, annual, and other reports.

A Word About Offering Requirements

Any company that wants to offer or sell securities to the public must either register with the SEC or meet an exemption. Here are two of the most common exemptions that many microcap companies use:

- **"Reg A" Offerings** Companies raising less than \$5 million in a 12-month period may be exempt from registering under a rule known as Regulation A. Instead of filing a registration statement through EDGAR, these companies need only file a printed copy of an "offering circular" with the SEC containing financial statements and other information.
- **"Reg D" Offerings** Some smaller companies offer and sell securities without registering the transaction under an exemption known as Regulation D. Reg D exempts from registration companies that seek to raise less than \$1 million dollars in a twelve-month period. It also exempts companies seeking to raise up to \$5 million, as long as the companies sell only to 35 or fewer individuals or any number of "accredited investors" who must meet high net worth or income standards. In addition, Reg D exempts some larger private offerings of securities. While companies claiming an exemption under Reg D don't have to register or file reports with the SEC, they must still file what's known as a "Form D" within a few days after they first sell their securities. Form D is a brief notice that includes the names and addresses of owners and stock promoters, but little other information about the company. You may be able to find out more about Reg D companies by contacting

your state securities regulator.

Unless they otherwise file reports with the SEC, companies that are exempt from registration under Reg A, Reg D, or another offering exemption do not have to file reports with the SEC. For more information about the registration requirements and offering exemptions, read [Q&A: Small Business and the SEC](#).

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This is not an offer or solicitation: The term “penny stock” generally refers to low-priced (below \$5), speculative securities of very small companies. While penny stocks generally trade over-the-counter, such as on the OTC Bulletin Board or in the Pink Sheets, they may also trade on securities exchanges, including foreign securities exchanges. In addition, penny stocks include the securities of certain private companies with no active trading market. Always perform your own due diligence and consult a professional financial advisor. .

