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Alternative Public Offerings: An Emerging IPO Option

Using APOs to Go Public and Gain Faster and More Cost-Efficient Access to Capital Markets

THURSDAY, JUNE 16, 2011

1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

Today's faculty features:

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Alternative Public Offerings: An Emerging IPO Option

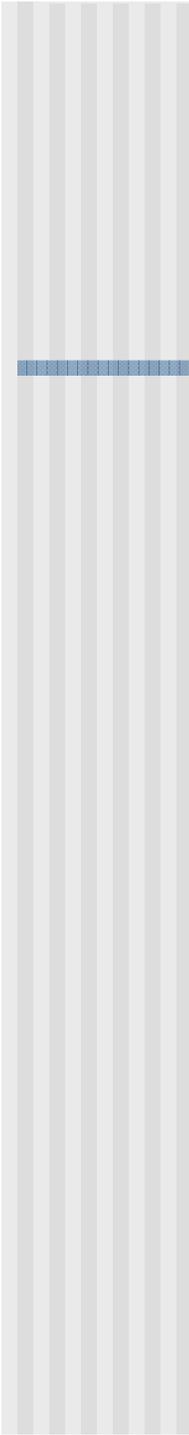
Introduction to Reverse Mergers

Presented by

David N. Feldman, Esq.
Partner
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Presented to

Strafford Business Publications
June 16, 2011



❖ *Topics*

1. Brief overview and introduction to reverse mergers and other alternatives to traditional IPO's
2. Why now?
3. Advantages of reverse mergers vs. IPOs
4. Latest SEC rules and their impact
5. Self-Filings
6. SPACs

❖ *Introduction*

- ▶ Public shell companies and the shell market
- ▶ Reverse triangular merger and other structures
- ▶ Rule 419 and its progeny
- ▶ Brief Review of Latest SEC Rulemaking
- ▶ Importance of financing
- ▶ Challenge of market support

❖ *Why now?*

A combination of factors led to the current reverse merger popularity:

- ☑ Maturation of industry
- ☑ Latest SEC Rules
- ☑ Challenges in smallcap IPO market
- ☑ New stage in the company growth cycle
- ☑ Changes in PIPE market
- ☑ Coming to America – despite current challenges
- ☑ “WRASP” and “re-IPO” structures

❖ *Advantages of Reverse Mergers over IPO's*

- ▶ Lower costs
- ▶ Quicker process
- ▶ No IPO window necessary
- ▶ Less management attention required
- ▶ No risk of underwriter withdrawal
- ▶ Less dilution
- ▶ No underwriter

❖ *Latest SEC rules and their impact*

- ▶ In June 2005, the SEC passed a rule change requiring substantial and timely disclosure following a reverse merger with a shell company (which is an SEC reporting company). It was effective November 2005.
- ▶ The rule states:
 - Within 4 business days following a reverse merger with a shell company (or other transaction that effects a change in control or makes the shell no longer a shell), the entity must file a Form 8-K containing the information that would be required in a Registration Statement on Form 10
 - Form 8-K must include audited and pro forma financials
 - “Shell company” defined as having no or nominal assets (other than cash) and no or nominal operations (intentionally vague)

❖ *Latest SEC Rules continued*

- The rule also amended Form S-8 to prohibit its use by shell companies (Form S-8 is used to register securities for offer and sale in connection with an employee benefit plan). Shell companies may use Form S-8 sixty days after filing its Form 8-K in connection with its reverse merger.
- ▶ The rule applies equally to foreign companies.
- ▶ Rule is generally hailed as positive development leading to more transparent transactions and being troublesome only to unsavory players.

❖ *Latest SEC Rules continued*

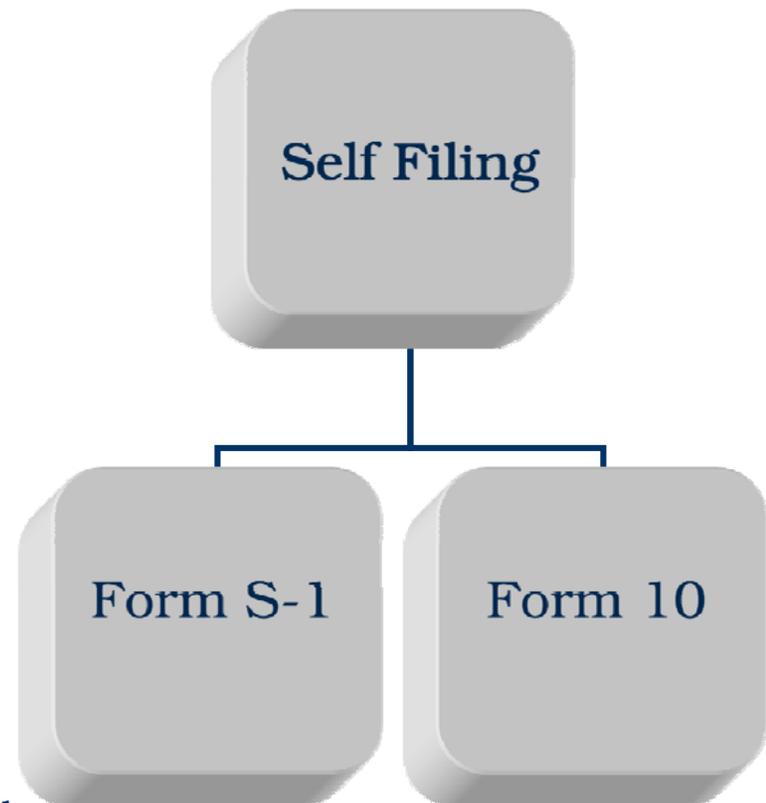
- Rule 144 Changes Effective February 15, 2008:
 - Eliminated bar on use of Rule 144 by shell holders
 - Require hold until one year after release of “Form 10 information”
 - “Evergreen” requirement to be current for 12 months prior to Rule 144 sale – controversial, request for rulemaking submitted to eliminate
 - Pink Sheet non-reporting never have Rule 144 after ceasing to be a shell until Form 10 information plus one year

❖ *Self Filings*

- **Private company requirements**
 - ☑ Sufficient shareholder base & shareholder status
 - ☑ Timing and valuation of financing
 - ☑ Wall Street savvy advisor or management team

- **Benefits**
 - Avoid hassles such as due diligence, scrubbing a shell and negotiating with shell promoters
 - Retain equity
 - Avoids Rule 144 restrictions on former shells

- **Drawbacks**
 - More time consuming
 - Possible delays in financing – but helped by 2007 interpretation



❖ *SPAC's – Coming Back..*

Benefits

- Over an IPO
 - Quicker and less expensive
 - No negotiating with underwriter
 - Less focus on IPO window
 - Money accounted for and price is set
 - Seasoned management team
- Over another reverse merger
 - Cash (over \$5 million)
 - Active trading market
 - Completely clean shell
 - Professional players
- Over self filing
 - Cash
 - Quicker
 - Wall Street savvy team

Drawbacks

- SPAC's
 - May have less market support than an IPO
 - Require the expensive process of preparing an investor proxy or tender offer document
 - May not gain shareholder approval of merger or sufficient agreement not to tender
 - Many have an industry or marketplace focus which limits the field of potential companies to merge with
 - Give the company less control than self filings
 - Cause more dilution to management post merger than self filings
- Other Concerns:
 - Overhang of warrants
 - 20% of company given to SPAC management
 - Two-year time limit (some even less now)

Alternative Public Offerings: An Emerging IPO Option

**APOs Regulatory Framework Rules and Regulations /
Changing Landscape**

Presented by

Donald C. Reinke

Chair Capital Markets / Securities Practice

Strafford Business Publications Webinar

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Existing Regulatory Rules and Regulations

- SEC Release No. 33-8587 July/2005 — Reverse Merger Disclosures (adopted by SEC on June 29, 2005)
- In 2005 the SEC adopted new rules that made reverse mergers more time consuming and expensive to consummate

Existing Regulatory Rules and Regulations

- Rules require
 1. The former public shell to file an 8-K within 4 business days containing all of the information otherwise required in a Form 10 Registration Statement;
 2. Must include audited financials for the former privately held business and pro forma financials for the combined business;
 3. Public Shell companies may not register compensatory plans under Form S-8 until 60 days after they cease being a shell company (filing their 8-K);
 4. "Shell companies" No or nominal operations; and either: No or nominal assets; Assets consisting solely of cash and cash equivalents; or Assets consisting of any amount of cash and cash equivalents and nominal other assets.

Existing Regulatory Rules and Regulations

- Rule 144 rule Changes Effective February 15, 2008
- The revised Rule 144 changes included a reduction of the holding period for “restricted securities” under US laws from two years to (i) twelve months for companies private in the US, or (ii) six months for companies public in the US

Existing Regulatory Rules and Regulations

- Shell Companies not eligible for Rule 144 but...
- An issuer can “cure” its shell status by meeting the following requirements:
 - is no longer a shell company as defined in Rule 144(i)(1);
 - has filed all reports (other than Form 8-K reports) required under the Exchange Act for the preceding 12 months (or for a shorter period that the issuer was required to file such reports and materials); and
 - has filed current “Form 10 information” with the SEC and at least one year has elapsed since the issuer filed that information with the SEC

Existing Regulatory Rules and Regulations

- Regulation S Issuances

Significantly, although not part of the original proposal, the SEC adopted conforming amendments to Regulation S. Consistent with the Rule 144 revisions, the “distribution compliance period” for US public companies also has been reduced to six months. Among the implications is a reduction of the time period during which Category 3 Regulation S issuers are precluded from having their securities dematerialized and settled electronically in CREST. Regulation S shares that have been held by non-affiliates of the issuer will become eligible to be resold free of all resale restrictions after (i) six months for US public companies, or (ii) one year for US non-public companies. The additional year that Rule 144 previously imposed upon Regulation S securities of Category 3 US domestic issuers is eliminated for all practical purposes.



Existing Regulatory Rules and Regulations

- NASDAQ Proposed Revised Reverse Merger Listing Requirements
- On May 26th NASDAQ issued new revised proposed listing requirements for companies going public using a reverse merger

Existing Regulatory Rules and Regulations

- Must trade in the US on a national securities exchange or the over-the-counter market or a foreign exchange for at least 6 months and maintain a \$4 bid price for at least 30 of the 60 trading days immediately prior to filing the listing application
- Before applying to list, you must also file with the SEC all required information covering the transaction, including audited financial statements for the combined entity

Existing Regulatory Rules and Regulations

- Must also file the most recent two required periodic SEC financial reports (Forms 10-Q or 10-K) containing at least six months of information about the combined entity before approval is obtained

Recent Regulation D Changes and Proposed Changes

- Net Worth Change for Accredited Investors — exclude principal residence
- Bad Actor Disqualification —
 - Covered Persons — Officers, Directors, 10% Stockholders, etc.
 - Disqualifying Events — Criminal Convictions, Court Injunctioned, SEC Disciplinary Orders and more
- May not Rely on Rule 506 for private exempt issuances in PIPEs, Reverse Mergers, etc.

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Capital Raising In Connection With APOs: PIPEs and Other Private Investments

June 16, 2011

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Capital Raising In Connection With APOs: PIPEs and Other Private Investments

- **What is a traditional PIPE ("Private Investment in Public Equity")?**
 - **US Securities laws provide that the issuance of securities must be pursuant to registration or an exemption from registration.**
 - **A PIPE is an exempt placement (Reg D/ 4(2)) of equity or equity linked securities of a public company to a limited number of private investors.**
 - **Securities can include any combination of: common stock, convertible notes, convertible preferred stock and warrants.**

Capital Raising In Connection With APOs: PIPEs and Other Private Investments (con't)

- **Simple space a decade ago. Now this space has drastically expanded to include:**
 - **Registered Direct Offerings (offer to purchase off a shelf registration statement to a select group of institutional investors);**
 - **CMPOs (marketed on a confidential basis to a select list of institutions and flips into a public offering);**
 - **Directly purchased convertible 144A or high-yield styled deals; and**
 - **Equity lines and equity lines combined with PIPEs.**

Capital Raising In Connection With APOs: PIPEs and Other Private Investments (con't)

- **Logistics:**
 - Typically the capital raise will close simultaneously with, and be conditioned on, the merger transaction.
 - Deal documents will be negotiated directly with a lead investor or individually with each investor in a small group of investors.
 - Documents typically include: Securities Purchase Agreement, Convertible Note, Indenture or Certificate of Designations for Preferred Stock, Warrants, Registration Rights Agreement, Lock-Up Agreements, Voting Agreements and/or Security Documents.

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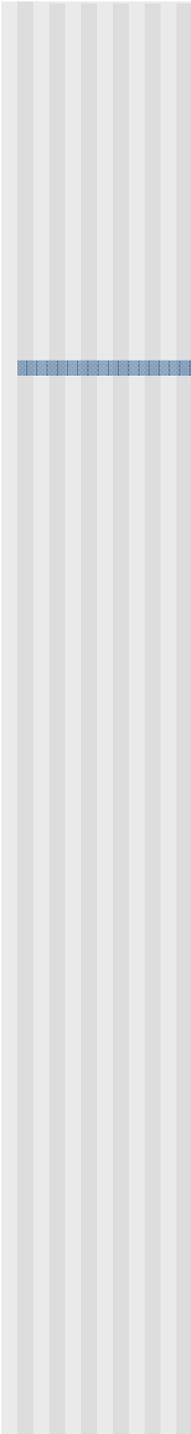
Donald C. Reinke
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❖ *Q&A With the Panel*

- o Key Considerations in Choices
 - Self-filing
 - Reverse merger with OTCBB shell
 - Reverse merger with Pink Sheet shell
 - Reverse merger with Form 10 shell
 - Regulation A offering
 - Rule 504 offering

❖ *Q&A With the Panel*

- o Legal Issues and Considerations of APOs
 - Reverse Triangular Merger/share exchange
 - Shell capitalization – splits and authorized stock
 - Changes in board – Schedule 14f-1
 - Changing the shell's name
 - Issuance of merger shares as offering
 - Value of reps and warranties
 - Shell due diligence



❖ *Q&A With the Panel*

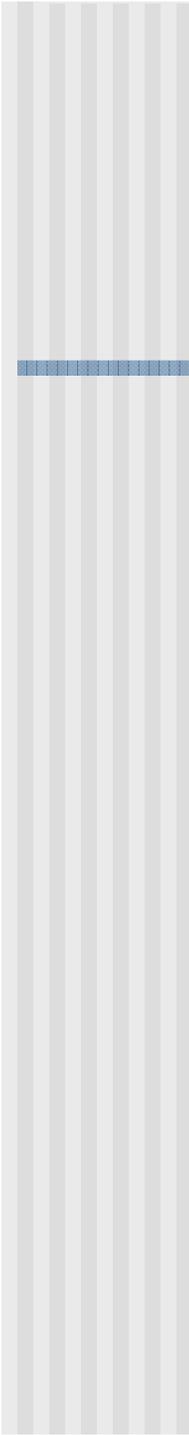
- o Pros and Cons of Registered vs. Unregistered Offerings
 - S-3 eligibility
 - Discounts to market
 - Timing

❖ *Q&A With the Panel*

- Outlook for China Reverse Mergers/APOs
 - Growing number of class actions, started with short sellers
 - SEC industry wide investigation
 - Auditors resigning including Deloitte
 - Problems include companies that completed IPOs or fully registered and due diligenced offerings
 - Isolated situation or tip of the iceberg?

❖ *Q&A With the Panel*

- o Market environment – OTCBB, OTCQB, BX, etc.
 - Will OTCBB remain?
 - OTCQB and OTCQX growing fast
 - New BX Venture Market owned by Nasdaq starting fourth quarter 2011
 - Will NYSE AMEX change if Bourse buys NYSE?
 - Best candidates for Nasdaq markets



❖ *Q&A With the Panel*

- Regulatory Concerns in Capital Raising
 - Ensure private offering exemption if applicable
 - General solicitation issues
 - Regulation FD
 - “Over the wall” procedures
 - Rule 135c releases

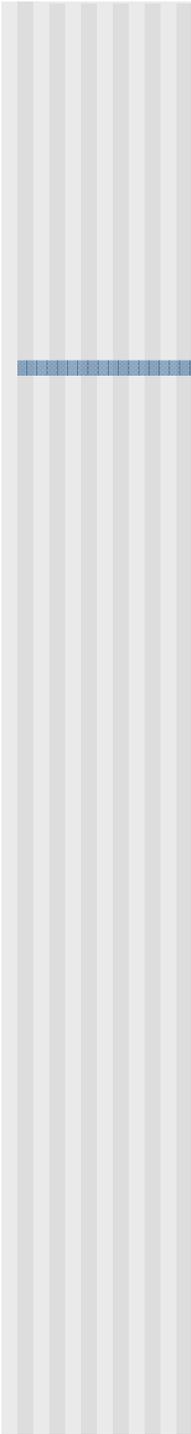
❖ *Q&A With the Panel*

- o Regulatory Considerations Affecting APOs and post-reverse merger companies
 - Sarbanes-Oxley, esp. Section 404(b)
 - Rule 144(i) – “evergreen requirement”
 - Super 8-K
 - Footnote 32/172



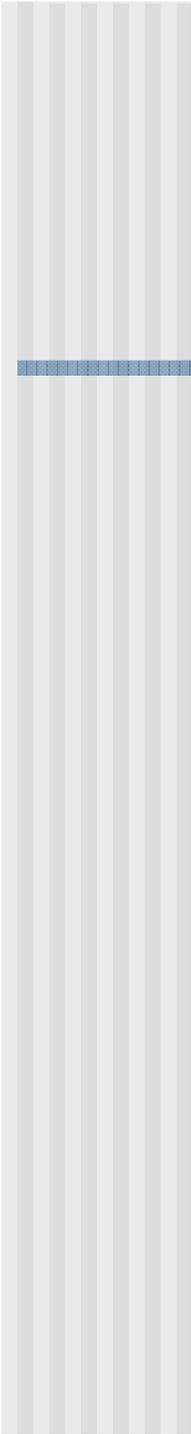
❖ *Q&A With the Panel*

- o Issues in seeking post-reverse merger financing
 - Retail vs. institutional
 - Liquidity challenges
 - Uplisting considerations
 - Rule 144(i) considerations



❖ *Q&A With the Panel*

- o Critical components for APO success/ IPO vs. APO
 - Industry/stage of development/market cap
 - Timing/cost/risk of completion
 - Developing market support



❖ *Q&A With the Panel*

- o Alternatives to US Markets
 - AIM
 - Canada
 - Hong Kong
 - Berlin

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