

Comprehensive Research Analysis of IPO vs. Reverse Merger

CAN YOU HANDLE THE TRUTH?

REVERSE MERGER AND IPO – TWO LEGITIMATE OPTIONS FOR ACCESSING THE PUBLIC CAPITAL MARKETS

Reverse merger or Reverse Takeover (“RTO”) is a very simple concept: a merger of two businesses whereby a private company is merged into a public company and the private company’s leadership controls the combined public entity. After the merger, the combined company no longer has anything to do with the reverse merger process. Reverse merger is a common practice widely used by companies listed on all stock exchanges worldwide. In Asia, the reverse merger process is particularly viewed favorably as a quicker and more certain access to public capital for an Emerging Growth Company (“EGC”) while the IPO approach has many advantages for a larger company.

REGULATORS REVIEW EQUALLY BOTH REVERSE MERGERS AND IPOs

Securities regulators worldwide impose disclosure requirements on reverse merged companies that are in every way equal to those required in IPOs. In fact, from a legal perspective and from a public disclosure point of view, in either a reverse merger or an IPO that involves a consummated financing, the same set of SEC disclosure documents is required which is the Form S-1 registration statement filed with the SEC. The verdict: **Reverse Merger + Capital Raise = IPO**

The facts are clear: In the United States, more than 1,600 companies (about 20% of all public companies in America) have become public companies through the reverse merger process. Approximately 74% of all reverse mergers in the U.S. capital markets are conducted among U.S. based, “home grown” American companies. These reverse merger companies have raised billions of dollars in capital and are in good standing. The second largest pool of reverse merger companies in the U.S. is from the State of Israel, not China.

In April 2012, “Burger King” announced going public via a reverse merger to list on the New York Stock Exchange. Burger King’s plan to list via a reverse merger rather than an IPO was because "...the company didn't have to go through the time-consuming process of doing an IPO", as quoted in a BusinessWeek article [here](#). **Burger King is not alone. Other well-known reverse merger companies include the New York Stock Exchange, Texas Instruments, Inc., Occidental Petroleum Corp., Tandy Corp. (RadioShack), Warren Buffett’s Berkshire Hathaway Inc. and many others.** These American icons have all been created via the reverse merger process and they have one thing in common - there is nothing wrong with the reverse merger approach.

**THE NASDAQ AGREED: THE NASDAQ STOCK MARKET’S OFFICIAL
VIEWS TOWARDS REVERSE MERGER AND IPO – “THEY ARE IDENTICAL”**

On February 2, 2011, in a [CNBC TV interview \(video link is here\)](#), Mr. Robert Greifeld, the well regarded and visionary CEO of the NASDAQ OMX Group candidly discussed the NASDAQ's official views towards listing reverse merger companies, particularly those from China. *Mr. Greifeld stated: "Let's make it clear – they are identical, the accounting firms that audit the Chinese companies have to be approved by PCAOB just the same as US company has to be. So those are identical and there are no differences,"* in reference to the auditing standards of Chinese reverse mergers in comparison to other public companies listed on the NASDAQ. *Mr. Greifeld continued during his CNBC interview: "...understand that when you do a reverse merger you are in no way, shape, or form bypassing any listings standards. You are trying to just save some time getting the shelf registration approved. But you still have to have your books and records approved. So that's not a shortcut or backdoor..."*

WHY IS THERE SO MUCH NEGATIVITY ABOUT THE REVERSE MERGER PROCESS? THE ANSWER: ILLEGAL SHORT SELLERS COLLUDE WITH PAID REPORTERS TO MISLEAD THE PUBLIC

Much of the negativity about reverse merger portrayed in the media is motivated by stock manipulators - self-serving illegal stock short sellers who encourage and/or pay for propaganda published by their allies in the financial media, often after they have built large short positions against a company. As illegal short sellers, tabloid writers and internet bloggers conspire to repeat the same lies in order to drive down the share price of a company, the repeated lies often become the "truth" in public opinion. Also, eager regulators and law enforcement officials are regularly pitched "doomsday" stories by tabloid writers and short sellers, and are often innocent enough to be misinformed, misled and believe in short seller nonsense, the same way regulators were misled by a convicted felon and stock short seller [Barry Minkow \(article link\)](#). Legitimate businesses and innocent people suffer as a result. Illegal short sellers make money by manipulating declining share prices and the investing public in America loses billions of dollars. This article that suggests [collusion between market manipulators and the financial reporters \(website link is here\)](#) could happen to any company. *As detailed below, several short seller conspirators that appeared to have ties to tabloid writer [Roddy Boyd \(background link\)](#) were recently arrested in China. **Roddy Boyd is the modern-day [Barry Minkow](#).***

INSTITUTIONAL INVESTORS DO NOT DISTINGUISH BETWEEN IPO AND REVERSE MERGER

Institutional fund managers generate 90% of the entire daily trading volumes across all U.S. stock exchanges. Long term oriented institutional fund managers are indifferent to whether a business has become public through an IPO or a reverse merger. It is the financial performance of a business over time that matters to them. Initial Public Offering ("IPO") is the first sale of stock by a private company to the public. **IPO or Reverse Merger accomplishes exactly the same goal: a public company with potential to raise growth capital. There is nothing good or bad about either approach.**

A SMALL COMPANY IPO IS A FANTASY, IMPOSSIBLE TO CARRY OUT

A small company IPO is simply not a viable option in today's market reality. On average, an IPO attempt takes a year to complete and involves many upfront costs including legal,

travel and audit expenses. If market conditions are not ideal, an IPO is often cancelled which can jeopardize survival of a company. Lessons were learned during the Internet Age of early 2000s when hundreds of Emerging Growth Companies died and jobs were lost after their IPOs had failed to materialize during market crash. Further, the minimum size of an IPO demanded by major investment banks is \$75 million, far beyond the reach of the vast majority of companies anywhere in the world. **A successful IPO is like “hitting a jackpot” in a lottery.** It is good only when an IPO is sold otherwise the effort is a total loss. Here is the market reality: in the first quarter of 2012 which had the best bull market in the U.S. since 1998, there were only 127 IPOs worldwide amongst all stock exchanges combined (*of which, 51% took place on Chinese stock exchanges*). How many registered businesses are there in the world? More than 30 million in China alone...The odds of successful IPOs stack up against Emerging Growth Companies which provide more than 80% of all jobs in America. A WALL STREET JOURNAL article dated September 1, 2011 titled [More IPOs Pulled In August Than Any Month In 10 Years \(website link\)](#), accurately describes how negative market conditions could doom a company’s plan for an IPO.

BENEFIT ANALYSIS: IPO VS. REVERSE MERGER

	<u>IPO</u>	<u>REVERSE MERGER</u>
100% Guaranteed Public Listing Success:	NO	YES
100% Success in Raising Capital /Timing of Successful Public Listing :	NO/Uncertain	YES (via a successful PIPE financing)/ 1 Month
Must Hire Underwriters:	YES	NO
Must Pay Underwriters Fees (7%-10% of total proceeds):	YES	NO (If no placement agent)
Must Engage Law Firms, Apply the Same Legal Standards:	YES	YES
Financials Audited Under the Same U.S. GAAP standards:	YES	YES
Auditors Follow the Same SEC and PCAOB Requirements:	YES	YES
Comply With the Same SEC Reporting and Disclosure Requirements:	YES	YES
Listed on a Stock Exchange:	YES	YES
Filings Reviewed by the SEC in Follow-on Financing (S-1):	YES	YES
Estimated Costs involving a \$10 Million Financing:	\$1.5 Million	Less than \$500,000

U.S. listed China based companies: 100% of all China based reverse merger companies in fact are already audited by accounting firms that are inspected by the PCAOB at least once in every three calendar years, a standard PCAOB examination schedule.

43% OF ALL U.S. LISTED CHINA BASED COMPANIES WERE REVERSE MERGERS (AS OF FEB 4, 2011)

U.S. Listed China-based Companies (Feb 4, 2011):

Total number of companies: 258

Reverse merger companies represent 43% of all public companies

	Exchanges		
	NASDAQ	NYSE	NYSE AMEX
Reverse Mergers:	82	11	16
Reverse mergers as % of all companies:	51%	14%	80%
IPOs (Initial Public Offerings):	79	66	4
IPOs as % of all companies on the Exchange:	49%	86%	20%
Total On Each Exchange:	161	77	20
Total Market Capitalization:	\$14.9 bn	\$42.1 bn	\$2.2 bn
Median Market Capitalization:	\$158 mln	\$185 mln	\$95 mln

SOURCE: NASDAQ.com, NYSE.com, AMEX.com, Bloomberg

MORE IPO COMPANIES WERE DELISTED THAN REVERSE MERGER COMPANIES

Extensive research by compiling Bloomberg and SEC data proves contrary to the popular belief that Chinese reverse merger companies tend to fail more often than the traditional underwritten IPO companies. **The Fact:** more IPO companies have been delisted than those that have become public via the reverse merger process. China based companies delisted by U.S. stock exchanges in 2011 (As of Oct 2011):

SUMMARY:

Delisted Companies:	IPO	Reverse Merger	RM – SPAC
29	15	12	2
% of Total:	52%	41%	7%
Full SEC Reviews:	100%	100%	100%
Going Private, Voluntary Delisting:	5	1	---
Financing by Underwriters:	100%	100%	100%
Reason for Delisting – Disclosure:	67%	33%	---
Reason for Delisting – Late Filings:	39%	50%	11%

CHINESE COMPANIES GIVING UP THE U.S. MARKETS – THE MARKET TREND OF “GOING PRIVATE”

Due to low market valuation among China based companies in the U.S., a new business model has emerged worldwide since 2010 – “taking private” select U.S. listed China based companies and relisting them in China at potentially higher prices. A well written article published in [USA Today titled: Some Chinese Companies Giving Up Their U.S. Listings \(article link\)](#) accurately describes this continuing market trend.

CASE ANALYSIS: RAMPANT ILLEGAL SHORT SELLING TAKES PLACE IN THE U.S. CAPITAL MARKETS

In November 2011, NASDAQ listed China based reverse merger company [Harbin Electric, Inc.](#) (HRBN) was acquired in an \$800 million merger acquisition at \$24 per share and generated approximately 1,200% in investment returns for its initial U.S. based

investors since it had become public via reverse merger at \$2 per share. The Harbin stock was the most heavily shorted stock of a China based company publicly listed in the U.S. in 2011. In its “going private” transaction, Harbin was advised by Goldman Sachs, Morgan Stanley and global law firms Davis Polk, Gibson Dunn and Skadden Arps.

Rampant illegal short selling market manipulation occurred in HRBN shares and tabloid writer and stock manipulator [Roddy Boyd](#) stood out as the front man for the criminals. During the yearlong “going private” process, the Harbin stock was “attacked” frequently by tabloid writers and anonymous online bloggers who knowingly published false articles based on fabricated data. According to Harbin management, many of the tabloid writers were paid or benefited from certain illegal short seller hedge funds including [Valiant Capital](#), [Kingsford Capital](#), Tiger Management and others. Through their clearing firms including **Goldman Sachs, JP Morgan and Merrill Lynch**, they engaged in the classic acts of “short and distort” schemes in their coordinated efforts to drive down HRBN’s share price. An example, Harbin shares were on the SEC’s Regulation SHO list for 5 months in a row, indicating rampant illegal naked short selling of HRBN shares and broad failure by clearing firms to timely settle trades - both of which were blatant violations of U.S. securities laws. A tabloid writer and blogger by the name of [Roddy Boyd \(background link\)](#) stood out as the front man for the illegal short sellers and benefited from such schemes. **Harbin management implied that Roddy Boyd has some “close friends” within the FBI in New York that often timely “update” Roddy Boyd of ongoing investigations. Roddy Boyd and his network of hedge fund clients then build short positions against those companies based on such “tips”.**

Investigative reports provided by former FBI agents appear to indicate that online blogger and tabloid writer [Roddy Boyd \(article link\)](#) and his father **Michael Boyd**, a hedge fund manager based in Connecticut, may have colluded with other identified tabloid writers and hedge funds and built together heavy short positions in HRBN shares that was subsequently followed by coordinated “short and distort” attacks on HRBN stock, based on dissemination of knowingly false and fabricated data involving Harbin. Former FBI agents’ investigative reports also revealed a curious fact that the various parties associated with Roddy Boyd and his wife Laura Boyd maintain more than a dozen bank accounts in various locations between North Carolina and Connecticut. [A REUTERS article \(web link here\)](#) described the active role that tabloid writer [Roddy Boyd](#) had played in the shorting of HRBN stock.

Arrests of illegal short sellers in China and each of them possibly facing up to 12 years in prison: It’s believed that Chinese law enforcement has taken actions against short sellers involved in illegal shorting of HRBN stock and stocks of other U.S. listed China based companies. In late 2011, several individuals believed to have been paid by certain identified short seller hedge funds to supply fabricated data to the likes of [tabloid writer Roddy Boyd were arrested](#) in China. During the course of investigation, China’s Ministry of State Security (MSS) uncovered extensive evidence of collusion, distortion of basic facts, and payments made among illegal short selling hedge funds, their paid tabloid writers including [Roddy Boyd](#), and their links to several U.S. financial media including the *Barron’s* magazine and a reporter from the *Financial Times*. The massive naked

short selling schemes affected stock price of HRBN and many other U.S. listed China based companies. Some of the best known short seller publishers in the U.S. have obtained their “reports” from the same distorted sources in China, as revealed by the Chinese police. A *Bloomberg/BusinessWeek* article titled [Short Seller Drops Muddy Waters Model for SEC](#) accurately described brazen acts of illegality and “short and distort” schemes orchestrated by some of these illegal players. Upon information and belief, short seller **Jon Carnes**, his Chinese wife **Liu Li** (a Fujian native) and several others are currently fugitives wanted by the Chinese police. Since 2011, the inaction against illegal short sellers by U.S. law enforcement has become an issue of bilateral conflict between U.S. and China - a matter of national security for both China and the United States. Without enforcement actions against illegal short sellers in the United States, integrity of the highly regarded U.S. securities markets is severely compromised.

Enforcement of U.S. federal securities laws against illegal short sellers promotes market integrity and is a matter of U.S. national security, but so far not much has been done in this critical area. In the case of Harbin Electric, as further evidence of illegal acts, it took an outrageous 3 weeks, rather than 3 days, as required under securities rules for clearing firms, to settle transactions involving the exchange of shares for \$24 per share in November 2011 when the going private transaction was completed. Various U.S. clearing firms including Goldman Sachs and JP Morgan acted as clearing firms for short seller hedge funds, like [Valiant Capital](#), [Kingsford Capital](#) and others, that had participated in the naked short selling of HRBN shares.

THE CONCLUSION

Global investment capital flows freely across borders. Over the long run, business execution and management integrity matter the most. A company will fail if its management team commits fraud. Companies with consistent earnings growth, honest management and good corporate governance tend to do well. In that regard, it doesn't matter if a company has become public initially via an IPO or a reverse merger.

ADDITIONAL READING AND RESEARCH:

- 1) [David Feldman, Esq.](#), a leading legal expert on the subject of reverse mergers in the United States and an author of several books on this subject. His website provides some of the best knowledge on the subject of reverse merger. His website is <http://www.reversemergerblog.com/>
- 2) [James Baxter, Esq.](#), Chairman of New York Global Group - a Harvard Law School graduate and a seasoned corporate finance attorney formerly with the global law firm of Sullivan & Cromwell. Mr. Baxter is also the former Head of Far East Investment Banking at Merrill Lynch. His views on the U.S. reverse merger markets are reflected in his opinion piece written to the U.S. Securities and Exchange Commission, available at the SEC website [here](#):
- 3) [Mitchell Nussbaum, Esq.](#), Chairman of Securities and China Practice Group at global law firm Loeb & Loeb provided a [TV interview with Washington Post /](#)

[Bloomberg](#) on the subject of reverse merger. Mr. Nussbaum and law firm Loeb & Loeb represent the most U.S. listed China based companies as their clients.

- 4) [Timothy Halter, CEO of Halter Financial Group](#), is the most active reverse merger transaction expert worldwide. Mr. Halter has executed more reverse merger transactions than any others in the world. He owns the Halter China Index and the reversemerger.com. Visit his website: www.reversemerger.com