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SMALL CAP MARKETS

- Chinese companies are moving to shed a controversial deal structure.
- SPACs are embracing the perks of the JOBS Act.
- The SEC nixed going private to get emerging growth status.....2
- Blackstone led the \$400M Knight Capital bailout.....3

DATES & DEADLINES

- A listing of important events coming up in the small cap financing market.....3

PIPEs

- Crest invested \$57M in WesternZagros.....4
- Jefferies led a \$54M PIPE for Exact Sciences ...4
- A123 Systems inked a \$450M deal.....5
- Provident New York got \$46M from Endicott and others.....5
- Vringo raised \$31M to buy patents.....5
- Platinum-Montaur provided \$20M for a drug delivery product.....5
- Salman and others raised \$18M for Pretium...6
- Total invested \$15M in Amyris's joint venture. 6
- Solta's CMPO raised \$15M.....7
- Griffin arranged \$13M for Oragenics's infection treatment.....7

EMERGING GROWTH COMPANIES

- Bregal Sagemount invested \$20M in Vital Insights.....8

ALTERNATIVE PUBLIC OFFERINGS

- Hyde II is the first SPAC without warrants ...9
- Australia Acquisition's deal with Harbinger was held up by the SEC.....9
- Prime Acquisition is buying a Chinese auto part maker.....10
- FlatWorld struck a deal with mortgage REIT Orchid Island.....10
- China Medical Technology asked the SEC to suspend it.....11
- A SPAC's sponsor is giving it a YouTube channel.....11
- A promoter in the "Rudy" scandal pleaded guilty to fraud.....11
- Page settled with the SEC for stock promotion.....13
- The Naked Boxer Brief company raised \$800K.....13
- Siris will pay \$1.1M to the SEC in a settlement.....14

SMALL CAP EQUITY FINANCE ACTIVITY...18

ISSUER INDEX.....30

VIEs UNDER FIRE

by Bill Meagher

The SEC's probe of **New Oriental Education and Technology Group (EDU)** is the latest example of the ongoing controversy surrounding the variable interest equity structure in China, a corporate model originally designed to allow foreign investment in sectors deemed sensitive by the Chinese government, such as Internet or technology companies.

New Oriental, a Beijing-based company that purports to be China's largest provider of private educational services, said July 11 that it had strengthened its corporate structure by altering its VIE. Two days later, the company was informed by the Securities and Exchange Commission that the regulator had opened a formal investigation into the company's VIE structure, according to New Oriental's latest financial filings.

The structure typically involves an offshore wholly foreign-owned enterprise, which has control over a domestic licensed company, the VIE. The VIE is controlled through a series of contracts rather than share ownership in the

operating company. Through the contracts, foreign investors "control" ownership and management of the domestic company without violating China law and without actually owning the company.

Companies that have used a VIE structure include **Baidu.com Inc. (BIDU)**, **Sohu.com Inc. (SOHU)** and **SINA Corp. (SINA)**.

China-based paper manufacturer **Orient Paper (ONP)** recently told *The DealFlow Report* it plans to shed its VIE structure in the name of becoming more attractive to investors spooked by the increase in fraud scandals involving Chinese companies.

"The Chinese don't like the VIE because it flies in the face of their law, and (U.S.) investors don't like it because it doesn't work," said Drew Bernstein, a director at Orient Paper and founding principal at auditing firm **Marcum Bernstein Pinchuk**, which has offices around China and in New York. Orient Paper has retained Tom Shoosmith, a partner at the

VIEs continued on page 16

SPACs DECLARING THEMSELVES AS EMERGING GROWTH COMPANIES UNDER JOBS ACT

by Dan Lonkevich

At least three special purpose acquisition companies, **Hyde Park Acquisition Corp. II (HPAC)**, **Infinity Cross Border Acquisition (INXBU)** and **CIS Acquisition**, have declared themselves as emerging growth companies under the JOBS Act to take advantage of the law's reduced disclosure requirements without objection from the Securities and Exchange Commission and many more are expected to follow suit, market observers say.

To be sure, SPACs were not expressly mentioned in the Jumpstart Our Business Startups Act, which Congress passed and President Obama signed into law in April. The law was supposed to make it easier for emerging growth companies – defined as companies with less than \$1 billion in annual revenue that have not gone public

SPACs continued on page 15

SMALL CAP MARKETS

SPACs continued from front page

before Dec. 8, 2011 – to go public and to create new jobs.

SPACs are blank check companies with few employees that raise money in initial public offerings to spend on acquiring an operating business. They typically have up to about two years to make an acquisition after an IPO and if they fail to consummate one are required to give the money back to investors.

The JOBS Act aimed to boost the prospects of emerging growth companies by reducing their disclosure requirements, which had become especially costly for the smallest companies. When such companies go public, they now only have to provide two years of audited financial statements instead of three. They don't have to have auditors attest to the reliability of the companies' internal controls over financial reporting, as other companies do under Section 404 of the Sarbanes-Oxley Act. They also don't have to disclose as much information about executive compensation.

The reduced disclosure of audited financial statements may not mean very much for SPACs because they are little more than shells with no operating businesses and as a result don't have audited financial statements. The law's relief from other disclosure requirements will be helpful, however, especially when it comes to allowing SPACs to file confidentially.

An SEC official said the commission doesn't object to SPACs declaring themselves as emerging growth companies as long as the SPACs meet the requirements.

"The emerging growth company definition is so broad" that SPACs meet it, said Mitchell Littman, the founding partner of **Littman Krooks** law firm in New York, who has advised SPACs in the past. "But I don't think Congress thought about SPACs when they came up with the JOBS Act."

Littman said there's no reason a SPAC shouldn't qualify as an emerging growth company because "it is just there to set the stage for an acquisition. The bottom line is if you have less than \$1 billion in annual revenue, you're an EGC."

Both Littman and Mitchell Nussbaum,

a partner with the law firm **Loeb & Loeb**, which is advising on CIS Acquisition's IPO, said they expect more and more SPACs to declare themselves as emerging growth companies.

Meanwhile, all three of the SPACs that have declared themselves as emerging growth companies fall well below the \$1 billion annual revenue limit.

Hyde Park Acquisition II, the SPAC led by Laurence Levy and Edward Levy, raised \$75 million on Aug. 7 from its SPAC IPO, which it plans to use to make an acquisition of a business or businesses.

The New York-based company hasn't identified an industry or geographic region for its targeted business. The only requirement the company has placed on the acquisition is that it must account for 80% of the money held in trust after the IPO in order to meet Nasdaq stock market requirements. Eighty percent of \$75 million would be about \$60 million.

Hyde Park Acquisition CEO Laurence Levy couldn't be reached for comment.

Infinity Cross Border Acquisition raised \$46 million in an IPO on July 25 to fund an acquisition of a growth company in Canada, Europe, Africa or Israel that can be enhanced by the sponsors' expertise in developing strategic partnerships with Chinese companies.

Tel Aviv, Israel-based Infinity Cross Border said it plans to acquire one or more growth businesses with an enterprise value between \$32 million and \$150 million, which should keep it well under the \$1 billion limit established by Congress in the JOBS Act.

CIS Acquisition filed to raise \$100 million from an IPO and the Moscow-based blank check company plans to use the proceeds for acquisitions in Russia and Eastern Europe. The company is hoping to take advantage of business opportunities created by Russia's entry into the World Trade Organization later this year.

CIS Acquisition said it will be looking to acquire middle market businesses, which it defined as those with an enterprise value of between \$20 million and \$150 million.

SPAC market observers welcomed the news that SPACs have been embracing the scaled disclosure requirements of the JOBS Act.

"None of that [disclosure] stuff matters," said Phillip Goldstein, the founder of **Bulldog Investors** in Jersey City, N.J., which invested in the Infinity Cross Border SPAC IPO. "You're a SPAC. It's ridiculous and it's a waste of money. It's unnecessary red tape and cost."

"Everybody in the SPAC world is going to do it because every growth company is going to do it," said David Miller, an attorney with **Graubard Miller** in New York. "There's no reason not to. It allows you to avoid auditor attestation of financial statements under Sarbanes-Oxley, to not have to disclose information about executive compensation and to not have hold a non-binding vote compensation. It's a no brainer and a money saver."

About 50 companies have submitted IPO filings to the SEC confidentially as emerging growth companies under the JOBS Act, according to SEC staff. The SEC staff declined to identify how many of them are SPACs. At least two of the submissions were by SPACs, according to the *Wall Street Journal*.

"The real issue behind the quiet filing is that staying hidden sometime helps," said Littman Krooks' Littman. "If you think you're going to get nailed by the SEC, then staying quiet is a good thing. You can pull the filing and no one's the wiser."

Even so, Littman said SPACs may have more to benefit from not filing confidentially.

"If I was advising a SPAC, I could argue that you wouldn't want to file confidentially," he said. "You have a specific time period in which to make an acquisition. If you're on the radar and your filings are on Edgar, you're getting free publicity. Potential business partners can look on the filings and see this big pool of money you have. It can help a SPAC consummate an acquisition."

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