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NEWS, INFORMATION AND ANALYSIS OF SMALL CAP EQUITY FINANCE

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CHINA POISED FOR IPO FLOOD

China's financial markets regulator gave the green light for five initial public offerings on the Shanghai and Shenzhen markets, lifting a 14-month freeze on new flotations and prompting expectations of a flood of listings in the coming months. The China Securities Regulatory Commission approved the IPO of industrial valve maker Neway Valve (Suzhou) Co. Ltd., which wants to list in Shanghai. Truking Technology Ltd., Zhejiang Wolwo Bio-Pharmaceutical Co. Ltd., Guangdong Qtone Education Co. Ltd. and Guangdong Xinbao Electrical Appliances Holdings Co. Ltd. are expected to list on the Shenzhen exchange. The five are seeking to raise about $353 million.

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Small-cap financing market surges

IPOs nearly double, follow-ons, PIPEs jump in the fourth quarter

BY DAN LONKEVICH

The small-cap equity financing market surged in the fourth quarter of 2013 with a near doubling in the number of initial public offerings and double-digit growth in follow-on offerings and private investments in public equity, compared to the same period of 2012, as the broader equity markets touched new records.

Special purpose acquisition companies completed four IPOs in the fourth quarter, unchanged from the year-earlier period, although the size of deals was larger. Two new SPACs filed for IPOs.

Reverse mergers were the only down segment of the small-cap financing market as private companies found it relatively easier to complete IPOs than in the past, thanks to the Jumpstart Our Business Startups Act, which allowed companies to file confidentially for IPOs and avoid cumbersome disclosure requirements.

The Standard & Poor's 500 Index gained 9.92% in the fourth quarter, while the Dow Jones Industrial Average gained 9.56%.

The biggest impact on the small-cap equity financing market "has been improved cash flows to institutional investors and increased interest on the buy side for growth stories," said Charles Mather, co-head of equity capital markets at **Janney Montgomery Scott LLC** in New York.

Investor sentiment has improved along with the economy and has boosted the market for IPOs, follow-ons and PIPEs, Mather said.

To be sure, he noted that while IPOs and follow-ons showed tremendous growth, the expansion of the PIPE market was "good, but a little more tepid."

Janney helped arrange two IPOs, 12 follow-ons and one PIPE, a confidentially marketed public offering.

Mather said he expects continued growth for IPOs, follow-ons and PIPEs in the coming years as the economy picks up steam.

It's "evidence of a steadily rebounding economy, a happy stock market with some increased liquidity in the microcap sector, and investors of all stripes looking for returns," said Joseph Smith, a partner with the law firm of **Ellenoff Grossman & Schole LLP,** in an e-mail.

Given the steady market rise through the entire year, "you don't have the issuers which are forever holding out until their stock recovers: they figured out that it had re-

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States play role in IPO alternative?

BY RONALD OROL IN WASHINGTON

New rules under consideration by the nation's securities regulator to hike the amount companies can raise in smaller public market offerings significantly limits the role of state securities regulators.

However, regulatory observers argue that the Securities and Exchange Commission may well revise its measure before adoption to include a more streamlined role for state securities regulators in overseeing this new category of deals.

At issue is a measure known by Washington insiders as Reg A+, a provision mandated by the Jumpstart our Business Startups Act, or JOBS Act, which allows companies to raise up to $50 million annually without many of the costs and delays associated with an initial public offering. The provision is an expansion of an existing but little-used Regulation A rule that permits companies to raise up to $5 million without registering their securities with the SEC.

Backers contend that Reg A+ will create an intermediate level of public securities, opening up new options for small companies to raise money from retail and institutional investors, all of which will act as stepping stones to full-blown IPOs and new jobs at the funded companies. And, they say, it could act as a catalyst to spur

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covered, so they raised money if they needed it," he added.

"For 2014, I just see more of the same until some outside force changes the dynamic."

The number of U.S.-listed IPOs surged 87% to 73 deals raising $25.3 billion, from 39 worth $9.15 billion, according to data from Dealogic.

Five IPOs raised at least $1 billion. Those were **Plains GP Holdings LP**'s $2.91 billion offering, **Hilton Worldwide Holdings Inc.**'s $2.71 billion IPO, **Twitter Inc.**'s $2.09 billion deal, **Antero Resources Corp.**'s $1.8 billion IPO and **Empire State Realty Trust Inc.**'s $1.07 billion.

The fourth quarter also saw an increase in the number of small IPOs, with 21 deals raising less than $100 million.

The smallest included a $17 million IPO by **Ideal Power Inc.**, a $29 million deal by **ADMA Biologics Inc.**, a $31 million offering by **NMI Holdings Inc.** and a $50 million deal by **TetraLogic Pharmaceuticals Corp.**

"There is no question that a more robust IPO market, and in particular IPOs of 'brand names' such as Twitter, have a ripple effect in the market," said Mitchell Littman, a partner with the law firm of **Littman Krooks LLC** in New York, in an e-mail.

It generates more market interest, which in turn generates more market activity, he said. Adding to that factor is the continued frothiness of the top of the market, which has had a similar effect.

"The uptick in smaller deals, is also not a surprise," Littman said, attributing it to "a combination not only of those who have been on the sidelines for a while, but (ironically) perhaps certain investors who have enjoyed that frothy market that are a bit concerned that perhaps that run is petering out, the result of which is looking for more unpolished gems that have the potential to have larger than average returns; and traditionally that mining has occurred in the smaller market space."

The number of follow-on offerings increased 40% to 223 worth $55.9 billion from a 159 deals worth $42.65 billion, according to Dealogic.

The biggest follow-ons were by **Facebook Inc.**, which raised $3.85 billion, **Crown Castle International Corp.**, which raised $3.06 billion, and **Barrick Gold Corp.**, which raised $3 billion.

Another 107 deals raised less than $100 million. The smallest were **Cel-Sci Corp.**, which raised $3 million, **American Eagle Energy Corp.**, which raised $4 million, and **Response Genetics Inc.**, which raised $5 million.

For all of 2013, the number of U.S.-listed IPOs gained 58% to 230 deals worth $61.8 billion from 145 deals worth $47.2 billion in 2012. The number of follow-on offerings rose 32.5% to 807 deals worth $201.7 billion from 609 deals worth $187 billion in 2012.

"Two hundred and thirty IPOs was a strong improvement from any of the last five years," said Carter Mack, president of investment bank **JMP Group Inc.**, in San Francisco. "We're getting back to the levels we saw in 2004 to 2007. I still think the number could rise a lot higher."

Mack, who was part of the industry group that lobbied for the JOBS Act, which was enacted in April 2012, said "we cited figures from the mid-1990s when IPOs averaged over 500 a year and a lot were smaller deals."

"The JOBS Act has been big plus and the improving economy has also been a big plus," he said.

The easing of disclosure requirements and "the optionality of being able to file confidentially has encouraged a lot of companies to file."

Mack said JMP Group had its best year ever managing or co-managing 33 IPOs for the year and 10 in the fourth quarter, including being the book runner on the IPO of homebuilder **LGI Homes Inc.**, which was up 61% from its offering price, as of Jan. 9.

The average IPO was up 45% in the fourth quarter and 40% for the full year, Mack said.

JMP worked on 33 IPOs (a 14% market share) with an average performance of up 57%, including being a bookrunner on the best performing IPO of the year, **Insys Therapeutics Inc.**, which had risen almost fivefold. The $36.8 million deal was co-book run by **Wells Fargo Securities LLC**.

JMP Group also has about a dozen IPOs in its backlog for the first quarter including a couple in the $30 million to $40 million range and another couple in the $50 million to $60 million range, Mack said.

"Small deals can be great opportunities for investors," he said. "A fair amount of investors are interested in smaller deals."

Mack said the improvement in the IPO market has been fairly broad although largely focused on life sciences, technology, energy, residential real estate and consumer finance.

"It was the best year ever for biotech IPOs," he said.

JMP has been lucky to be focused on industries whose companies have been actively pursuing IPOs.

"It feels like the window is solidly open," Mack said. "We've seen consistently performing IPOs. We continue to see good companies coming to market. We haven't seen the irrational exuberance. These companies have incubated for a while. They're more mature and better companies than we've seen in the past. We'll see a lot of activity in the first quarter and it should extend at least through the first half."

The number of PIPEs in the fourth quarter of 2013 rose more than 25% to 316 transactions, with the biggest gains coming from smaller unregistered deals.

The fourth quarter's 316 PIPEs raised $12.9 billion, compared with 252 deals that raised $12.4 billion in the fourth quarter of 2012, according to PrivateRaise, The Deal's data service that tracks private placements of at least $1 million.

It was the best fourth quarter for PIPEs since the fourth quarter of 2010 when a rising stock market spurred 347 PIPEs worth $13.4 billion.

For the year, the number of PIPEs increased 8.2% to 1,093 deals worth $45.9 billion from 1,010 deals worth $45.7 billion, a year earlier. It was the best year for PIPEs since 2010 when 1,137 deals raised $31 billion.

The number of unregistered PIPEs increased 29.4% to 220 deals worth $6.58 billion in the fourth quarter from 170 deals worth $7.57 billion, a year earlier.

Registered direct offerings, including confidentially marketed public offerings, or CMPOs, rose 17% to 96 deals worth $6.32 billion in the fourth quarter from 82 worth $4.85 billion, a year earlier.

The number of CMPOs rose 26.7% to 38 worth $1.33 billion in the fourth quarter from 30 worth $1.65 billion, a year earlier.

At-the-market facilities also increased to 40 deals worth as much as $4.94 billion in the fourth quarter from 33 worth as much as $2.86 billion.

Equity-line PIPEs totaled 21 deals worth as much as $258.15 million in the fourth quarter, unchanged from 21 deals worth as much as $369.5 million.

During the fourth quarter, the average deal

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size was $34.6 million, compared with $39.55 million, a year earlier.

Only 22 PIPEs in the fourth quarter raised at least $100 million, including nine ATMs. The fourth quarter of 2012 included 27 deals that raised at least $100 million, including 10 ATMs, one equity line and $3.1 billion raised in a private placement of convertible debt by **Sprint Corp.**

Enterprise Products Partners LP completed the biggest PIPE of the recent quarter, a $1.25 billion ATM. **Avago Technologies Ltd.** and **BlackBerry Ltd.** each completed $1 billion convertible debt deals.

Healthcare companies announced 107 deals worth $2.2 billion in the fourth quarter. Technology was the second-most-active sector with 51 PIPEs worth $3.38 billion. Energy companies did 46 worth $3.86 billion.

Roth Capital Partners LLC was the most active PIPE placement agent, with 15 deals worth $404.4 million. The Newport Beach, Calif.-based firm helped arrange a $76.5 million deal for **Lannett Co.** and a $60.4 million PIPE for **Synta Pharmaceuticals Corp.**

Cowen & Co. ranked second with 13 deals worth $652.2 million, followed by **MLV & Co.** with nine worth $938.2 million.

"First off, these numbers reflect what I've been hearing from other market participants," said Jack Hogoboom, a partner with the law firm of **Lowenstein Sandler PC** in Roseland, N.J., in an e-mail. "2013 was a strong rebound year in the capital markets, and that was particularly true for smaller public companies."

Low interest rates and the lack of attractive fixed-income investments appear to have driven high demand for equity investments that provided the opportunity for above-average returns, he said.

"The strong stock market created an updraft that resulted in investors recording significant gains for 2013. In turn, this drove demand for additional equity investment products. The demand is most evidenced by the strong increase in IPO activity, particularly in the biotech space.

"We worked on a number of successful IPOs in 2013 and the wide range of deals that got done during the year was evidence of the strong demand," Hogoboom said.

"Encouragingly, the strong market also resulted in a resurgence of the PIPEs market, which had been decimated as a result of the 2008 meltdown. That's extraordinarily good news as it shows that investors are willing once again to take on liquidity risk in appropriate circumstances. The strong PIPEs market provided additional flexibility to smaller public companies, many of whom continued to be stymied by the limitations in the 'baby shelf' rules," he said.

The so-called baby-shelf rules limit how much stock smaller companies can sell in registered transactions. A company with a public float of less than $75 million can sell securities registered on the Securities and Exchange Commission's Form S-3 shelf registration statement worth no more than one-third of the company's public float in any 12-month period.

"Early indications are that 2014 will continue the trend started in 2013, at least through the first quarter," Hogoboom said. "We and other firms have a strong backlog of projects that carried over into 2014. For the first time in a number of years, many of us have some insight into what will occupy us in the first quarter."

Four SPACs completed IPOs in the fourth quarter, raising a combined $364 million, compared with four that raised only $205 million, a year earlier.

SPACs are blank check companies that raise money in IPOs which they use to acquire operating businesses. They typically take up to two years to make their first acquisition and give the money back to investors if they find nothing to buy or the investors don't like the merger target.

Levy Acquisition Corp. raised $150 million from its IPO Nov. 19, which it plans to use to acquire businesses in the restaurant and hospitality sectors. Levy Acquisition was sponsored by **Levy Family Partners LLC** and is led by financier Lawrence Levy, 69, who previously cofounded Levy Restaurants in 1978.

The second biggest SPAC IPO was by **Quartet Merger Corp.**, which was sponsored by hedge fund **Crescendo Partners LP** and raised $84 million for acquisitions in an industry or industries to be named.

Quartet is led by CEO Eric Rosenfeld, who is also CEO of New York-based Crescendo.

Cambridge Capital Acquisition Corp. raised $70 million in its Dec. 23 IPO sponsored by **Cambridge Capital LLC**, while **Global Defense & National Security Systems Inc.** raised $60 million in its IPO sponsored by defense contractor **Global Strategies Group**.

At least two SPACs filed for IPOs in the fourth quarter, including Levy Acquisition.

The other was **Hennessy Capital Acquisition Corp.**, a SPAC sponsored by middle market private equity firm **Hennessy Capital LLC**, which filed Dec. 20 to raise up to $115 million.

Chicago-based Hennessy Capital Acquisition said it plans to build a diversified industrial manufacturing or distribution business through acquisitions. It is led by Daniel Hennessy, who is also the chairman and CEO of Hennessy Capital LLC.

At least three SPACs announced business combinations or acquisitions in the fourth quarter, while another scrapped a planned merger.

In October, **Lone Oak Acquisition Corp.**, sponsored by **BBS Capital Management LP**, agreed to acquire **Arabella Exploration LLC**, an oil and gas producer with assets in the Delaware Basin of Texas, for $39.6 million in stock.

Also in October, **Committed Capital Acquisition Corp.** acquired ONE Group LLC, a private operator of high-end restaurants for boutique hotels and casinos, for $90.9 million in cash and stock.

In December, **Hyde Park Acquisition Corp. II** agreed to merge with Southern California oil and gas producer **Santa Maria Energy Holdings LLC** in a deal valued at up to $215.9 million.

BGS Acquisition Corp. on Nov. 27 called off its $95.8 million stock-and-cash deal to acquire **TransnetYX Holding Corp.**, a provider of genetic testing services, after too many BGS shareholders decided to sell their shares in a tender offer, rather than invest in the acquisition.

The pace of reverse mergers in the last quarter of 2013 was off 36% from the previous quarter, and about 29% year-over-year, according to data from PrivateRaise.

A total of 25 reverse mergers were completed, with 76% of those transactions involving U.S.-based companies. It was the lowest deal total for a quarter since the third quarter of 2012, which saw just 21 transactions completed.

Although a wide-open IPO window certainly impacted reverse merger activity, reverse mergers as a vehicle have also fallen from favor because of regulatory pushback, changes in company-seasoning requirements before they are allowed to list on the Nasdaq or New York Stock Exchange, and a hangover from fraud involving

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China-based reverse merged companies in recent years.

Alternative public offerings, reverse mergers which include PIPE financing, also declined last quarter. Just nine transactions worth a total of $65.4 million were completed as compared to 14 deals worth $160.3 million in the previous quarter, a decrease of almost 60%. The fourth-quarter total raised is even less impressive if the **Ignyta Inc.** deal, worth $54 million, is subtracted. The average deal size drops from $7.2 million to $1.4 million if Ignyta is pulled from the mix.

Ignyta, a San Diego-based biotech focused on treating cancer, continued the trend of some biotech companies opting to go public through reverse mergers rather than IPOs. The company was joined in the quarter by **Advanced Vaccine Therapeutics Inc.**, a New York-based company developing a chemotherapy drug for prostate and colon cancer. Advanced Vaccine raised $660,000 in its Dec. 13 reverse merger.

"For tiny companies trying to raise capital, liquidity is still a problem," said David Feldman, a partner in the law firm **Richardson Patel LLP**'s New York office. "For some of these companies, what makes sense is to do a reverse merger, and do a separate financing later on, after they have been a public company for a while."

He said there is no shortage of companies wanting to go public. "One of the things that could be impacting the use of reverse mergers is an increase in companies looking at doing self-filings in order to go public."

Mark Elenowitz, managing director at **Tri-Point Capital Advisors LLC** in New York, said that investors are still not comfortable in general with the microcap and small-cap sector. "The lack of liquidity is still a major issue for investors, and the fact of the matter is that this sector always trails the general market anyway," he said. "Institutional investors, hedge funds and PIPE players still don't see a rebound in this area."

In the past, China-based companies have utilized reverse merger transactions as a way to go public in the U.S. But in the fourth quarter just one deal involved a Chinese company. **China Tianfeihong Wine Inc.** completed its merger Dec. 30, with no money raised in the transaction. Still, that was one more deal than was completed in the previous quarter. For the year, just five China-based companies went public using reverse mergers.

A total of 123 reverse mergers were completed in 2013, compared with 128 in 2012. ■ *—Bill Meagher contributed to this report.*

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regional boutique investment banks, brokers and smaller law firms to start offering financial and legal advice for these kinds of deals.

The proposal, introduced unanimously by the bipartisan SEC Dec. 18, requires offerings be reviewed by the SEC but exempts issuers from having to register with states and open their books to costly and time-consuming reviews in multiple jurisdictions prior to the offering.

However, the three Democratic commissioners on the five-person SEC indicated that they may support a more streamlined role for state review of these deals that is being drafted by the North American Securities Administrators Association, the lobby group for state securities regulators. "The commissioners have said ... 'We're keeping our minds open about how a coordinated process could work here and we want to hear from the state securities regulators to see if we are missing the mark,'" said Robert Kaplan Jr., managing partner at **Kaplan Voekler Cunningham & Frank PLC**.

Seeking to ameliorate concerns about duplicative and overly burdensome state regulation heaped on top of federal oversight, NASAA is setting up a simplified multistate filing process where one state's examiners take the lead in reviews. NASAA hopes the SEC will approve the use of the simplified approach—or some variation—when it adopts Reg A+ later this year. State regulators worry that the federal agency is too busy to do a good job ferreting out fraud in this area.

"State examiners are uniquely situated to review these types of offerings to try to root out bad and fraudulent deals," said NASAA deputy general counsel Rick Fleming. "We know the local businesses and the local players. We're not looking to stand in the way of legitimate companies seeking to raise capital."

However, practitioners who have seen companies shy away from the older Reg A approach worry that even a streamlined process will discourage dealmaking if they think states will be meddlesome. David Sirignano, partner at **Morgan Lewis & Bockius LLP** in Washington and a former chief of the SEC's office that administers M&A rules, said such a process could render these types of deals "impractical." He said that states employ a system that involve significant regulatory discretion beyond that required by the SEC.

"Even though the NASAA proposal contemplates some of those principles will not apply, most counsel fear that such a mandatory state review process would render Reg A+ deals impractical," he said.

Kaplan acknowledged that the streamlined approach contemplated by NASAA would cut down on the number of people and regulatory letters an issuer must deal with when offering securities. However, he added that every state has a different approach to reviews and the lead reviewer would still include concerns and questions raised by other states in the comment letter to their issuer.

In addition, Kaplan added, even though the NASAA proposal contemplates specific review deadlines, the lead reviewer would likely delay approval of the offering until after all the concerns raised by other states were addressed, adding to the kind of lengthy delays that have made the old Reg A rule unworkable.

"The lead reviewer could say that unless you make this other state security regulator happy, we won't complete the review and allow the offering to happen," Kaplan said.

Kaplan notes that while some state reviews of traditional Reg A offerings are "very responsive and straightforward," taking only a few weeks, other have taken six to eight months. He added that with some deals, the startup companies doing the offering have never received any responses from some state regulators, leaving the firms with no choice but to close up their offerings in those jurisdictions.

The biotechnology sector has responded positively to the original SEC proposal. Charles Crain, a policy expert at the Biotechnology Industry Organization, said the biotech industry wants it adopted as first proposed. BIO has serious concerns

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