TAKEOVERS

GOING PUBLIC, CHINESE STYLE

To get listed overseas, companies are getting U.S.-traded outfits to buy them

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BIG-TICKET IPOS IN NEW York and Hong Kong for Chinese banks and insurance companies make headlines. But in recent years another class of Chinese company has been quietly tapping the international capital markets. Enterprises that don't have the heft or profits for a splashy initial public offering are finding they can get a coveted overseas listing through a reverse merger.

Here's how it works. The Chinese business is typically acquired by a U. S. shell company that is worthless, except for one thing: It's publicly traded. The American board then resigns, the Chinese board takes over, changes the company's name, and issues new stock to hedge funds and other new investors, raising millions of dollars in fresh capital. One example: Sinovac Biotech Ltd., a respected Beijing-based maker of vaccines, executed a reverse merger in 2003 and subsequently raised $12 million.

For more and more Chinese companies, a reverse merger is faster and less onerous than an IPO. Sometimes the process takes as little as a few months, says Peter D. Zhou, managing director of American Union Securities Inc., a New York firm that has helped broker 10 such deals since 2005 and is currently working on another nine. One is the pending takeover by Carson City (Nev.)-based Ticketcart Inc., a defunct online retailer of printer cartridges, of Tieli Xiaoxinganlin Frog Breeding Co., which markets nutritional supplements made from Chinese forest frogs. All told, some 150 Chinese companies have taken the reverse-merger route since 2005. "The Chinese are realizing that there's a lot of money here," says Zhou.

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Many in the financial world aren't happy about the popularity of these takeovers. Something few Chinese executives consider is that Americans generally shun such shells, as they typically trade over the counter, says Neil A. Torpey, a Hong Kong-based partner with law firm Paul, Hastings, Janofsky & Walker. "Nobody follows them, there's no market in the shares," he says. "So after having gone through a lot of time and expense and effort, the underlying purposes aren't realized."

So why do Chinese companies bother? One reason is simple: They have few other options. Small companies in the country's rust belt or in industries that aren't sexy are unlikely to draw the interest of the venture capital and private equity investors swarming over China. Plus there's a two-year wait for a listing on the booming Shanghai or Shenzhen stock exchanges. "If a U.S. financier says 'I can get you public in two months,' that's a pretty good pitch," says one American hedge-fund manager who wants to remain anonymous because he has invested in a Chinese company that executed a reverse merger.

Another reason Chinese companies favor these deals is that there's less interference from investors. Reverse mergers are usually followed up with a private placement. The hedge funds that typically buy these shares are content to allow management to continue operating unfettered, whereas private-equity outfits would typically demand a greater say in decision making, along with board seats.

Some Chinese companies involved in such deals have, however, found themselves in legal trouble. Fertilizer maker Bodisen Biotech Inc. and now-defunct China Energy Savings Technology Inc. face shareholder class actions alleging improper disclosure.

Still, investors argue there's nothing fundamentally disreputable about reverse mergers. Some well-known Chinese companies, such as Sinovac and Shenzhen-based battery maker China BAK Battery Inc., have graduated from the OTC market to the American Stock Exchange or NASDAQ. "As we see more of them grow to multimillion market caps, there is more research, more liquidity in the stocks," says Mark Fleishhauer, Hong Kong-based portfolio manager at Jayhawk Capital Management, a hedge fund that invested in 11 reverse mergers in 2005, including BAK Battery.

But even fans of the reverse-merger option recognize its shortcomings. With estimated annual revenues of $15.4 million in 2006, Sinovac would probably not need to take the reverse-merger route today. Says Helen G. Yang, Sinovac's international business manager: "If we wanted to list now, an IPO would be a better choice." •

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