

## **Reverse mergers offer a strategic alternative to IPOs**

Thinking about going public, but concerned about the state of the securities markets? If so, consider a reverse merger. Regarded as an easier and less expensive alternative to an initial public offering (IPO), reverse mergers have never been more popular.

### **Activating a dormant company**

A reverse merger occurs when a privately owned business merges with a public — typically dormant — company that serves as the deal's "shell." The shell company officially buys the private company by issuing new publicly traded stock. Then, the private company acquires a majority stake (as much as 90%), contributing all of its privately traded shares to the shell company.

At the end of the deal, the private company owners have majority control of the newly merged companies. They now can issue publicly traded shares without having to go through the IPO process.

### **Illustrious history**

Reverse mergers have a long history. Ted Turner's Turner Broadcasting System is the result of a 1970 reverse merger with Rice Broadcasting. And a host of major companies, including RadioShack Corp., Occidental Petroleum Corp. and Blockbuster Inc., all have their origins in reverse mergers. More recently, hedge fund Halcyon Asset Management and Web-based publisher Fund.com have successfully completed the process.

Reverse mergers enjoy broad popularity among companies of various sizes and industries. In 2007, 222 reverse merger transactions were completed, with an average deal size of \$55 million. Compare that to the 234 IPOs completed last year, with an average deal size of \$229 million.

### **Speed and economy**

One reason for the rapid growth of reverse mergers is that they're generally faster and cheaper than IPOs. A reverse merger's base costs can be as low as \$75,000, compared with an average \$200,000 tab for a similar-size IPO. Of course, you'll also need to factor in fees and the cost of purchasing a shell company, for a total bill in the \$200,000 to \$900,000 range.

And reverse mergers sometimes can be completed in as little as a few weeks, compared with the six-to-12-month IPO process. Much of the grunt work, such as finding an investment bank underwriter and registering with the Securities and Exchange Commission (SEC), was already done by the shell company when it went public.

### **Picking up the perfect shell**

If you think your company should go the reverse merger route, it's critical that you find the right public shell corporation. The company should have no assets or liabilities on its balance sheet and no pending lawsuits, liens or other legal claims against it. Yet it should remain a legitimate, SEC-registered entity. Once you've found an appropriate shell,

you'll need to raise additional capital. Companies might offer private placements, place new bond issues or make secondary stock offerings.

You'll also need to get up to speed on SEC reporting requirements, tax regulations and legal documents required for a deal with a public company. For example, you'll need to file at least two years of audited financial statements a few days after merging with an SEC-compliant shell. If your current advisors don't have much experience with public companies or reverse mergers, enlist the help of financial and legal professionals who do.

Once you've completed the deal and traded shares with the shell, your business will officially become a wholly owned subsidiary of the former shell company. But you'll control the new entity, and will likely want to change the name of the shell to your own company's.

### **Why do it?**

Reduced cost and increased speed are among the top reasons to consider going public via a reverse merger. But there are other strategic reasons as well:

***Stock options.*** If your company wants to compensate employees with stock options without initiating a public offering, a reverse merger can provide you with a ready supply of public stock.

***Acquisition financing.*** If your company intends to make business acquisitions, you could use a reverse merger to access publicly traded stock that can then be used to finance deals.

***Retaining a majority.*** If your private company fears ownership dilution, a reverse merger may be preferable to losing control to outside investors in the public market. Reverse mergers allow private company owners to retain large majority stakes in their companies.

***Lower risk.*** A reverse merger protects your company from the whims of the public marketplace. An IPO can live or die depending on timing and other market variables, but reverse mergers are completed at your pace and are under your control.

### **Funding for growth**

If you need to be able to offer public shares to pursue your growth plans, but would prefer to avoid the risk and expense of an IPO, a reverse merger may just be the ticket. Selling off your company — at least on paper — can make you the owner of a company with the possibility of much greater potential.