

THE REVERSE MERGER REPORT

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Shell Mergers: Year in Review

by Meghan Leerskov

The shell merger market grew steadily in 2007, buoyed by the U.S. Securities and Exchange Commission's approval of regulations that improve access to capital for small companies. The rules, approved late in the year, are generally thought to be a boon to reverse merger companies and investors, and many believe they will positively impact future deal flow. They included a highly circumscribed codification of regulatory perspective stemming from the infamously opaque "Worm/Wulff letters" regarding shell stock that is also encouraging for the market.

Chinese companies eagerly in search of U.S. capital and *en vogue* energy plays also helped drive up the deal count for the year to 222 completed transactions, a meager increase of about 5% compared to the previous year's 211 deals. In fact, no month saw any less than double-digit deal totals during

2007, a first for any annual period going back to 1993.

Merger deal flow has remained fairly consistent since 2004, fluctuating from a low of 203 deals that year to a high of 222 in 2005 and 2007.

The year's deals were collectively valued at \$8.36 billion in total market cap at year's end, a 14% increase from the \$7.33 billion value created in 2006. The average merger during the year was valued at \$52.55 million, down from \$59.77 million in 2006.

The fourth quarter, typically a period of accelerated merger activity, was the most prolific of 2007. The quarter's 71 mergers generated about \$1.75 billion in value, or an average of \$37.37 million per deal, which was down about 16% from the previous quarter.

For comparison, the traditional public offering market continued to dig itself out of post-bubble doldrums, racking up 234 offerings worth \$54 billion,

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Slow to Embrace Reverse Mergers, India Takes Interest

by Mark Mueller

At first blush, India appears to be a great potential source of reverse merger deals. The country's services and technology-focused business sectors are thriving. Foreign investments into India's businesses are at an all time high, and its ties to the U.S. remain strong.

But while a small number of blank check companies targeting Indian ventures have successfully made their way to market and begun making acquisitions, smaller shell merger deals in the country have been slow to gain traction.

The lack of deal flow could begin to change soon, however. The upcoming year should see more India-based firms acquire U.S. shells in reverse merger deals combined with PIPEs, industry watchers say.

A handful of deals are said to be in the works, although none have been announced as of yet.

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Familiar Structure Avoids Circulars Entirely

by Richard Meyer

While some China dealmakers are getting all worked up over complex, cutting edge workarounds, with fancy handles like “slow walk option” and “Sina structure,” and others are bravely taking the much-dreaded Circular 106 head on, a third course is emerging. And it is emerging in a way from the history books.

TriPoint Capital Advisors has a deal on the table that uses one of the most mature, best recognized, and most consistently regulated structures in China: the joint venture. It has been around since the late 1970s, when the country first started to do business with the West but feared foreign control of local companies. While China is not always sure how to deal with many types of international transactions, it is very comfortable when a joint venture is proposed. TriPoint dusted off this old standby and found that it may just fit into both reverse merger and SPAC worlds.

“It’s a new twist on an old structure,” says Lou Taubman, general counsel at TriPoint.

Specifically, TriPoint is utilizing something called a cooperative joint venture. Unlike a regular joint venture, where each side makes an investment and owns the company based on how much they put in, a cooperative joint venture is owned in common, and the split is determined by agreement.

In the case of the TriPoint deal, the foreign investors get 75% “ownership” at the outset. That number will fall to 50% as the initial capital contribution is paid back. The key here is that there is no Chinese participation in the offshore entity – that participation is what triggers approval by Chinese regulators called for by Circular 106, which requires companies setting up offshore entities for the purpose of

domestic investments to get permission from the Ministry of Commerce. The local partners are getting foreign capital and upside if the company performs well post-transaction, but all within the confines of a straightforward joint venture structure.

The circulars are never an issue because under Chinese law a special purpose vehicle (SPV) is never actually created. For that reason Taubman doesn’t even like to call what he’s trying to do a workaround. It is something completely different from what concerns the Chinese regulators, yet it accomplishes what both the foreign investors and Chinese partners want. It does have regulatory approval as a joint venture, so it gets an official stamp, but it does not have to go anywhere near the SPV quagmire.

“Everyone is looking for workarounds in reverse mergers,” said Taubman. “The beauty of this structure is that it doesn’t really fall under the circulars. It is under the Joint Venture Law and doesn’t involve the use of an SPV. The Chinese ownership is staying on the Chinese side of the joint venture so you don’t have to go through SAFE, Mofcom or the CSRC the way you would if you were doing a traditional reverse merger.”


Taubman declined to name the target company, saying that he wanted to wait until the deal is actually completed in mid-February. He also added that the structure was developed with a great deal of help from **Thelen’s** Thomas Shoemith in Shanghai. But TriPoint has given the structure a name: the Cooperative Venture Acquisition Corp., or CVAC.

Taubman concedes that originally the idea was 106 driven. But he says that since coming up with the CVAC, TriPoint has found that it has great potential beyond just being a reverse

merger substitute. Taubman believes that it can operate in a SPAC-like manner, but offer more stability. The CVAC starts with a run on the board from day one and then can go out and find other targets. A SPAC starts out as only an idea and some talent.

“The advantage over a SPAC is that the investors will actually see the first acquisition when they go into it,” he says. “They are funding the first cooperative joint venture. With a SPAC you are betting on a management team. The investor has all the risk of what the first investment is going to be and you have to go through the shareholder vote on that. We have already got our first joint venture done.”

Taubman says that the Sina structure, in which there is no ownership exchanged, but virtual ownership achieved through contracts that promise all economic benefit to the foreign investors, is probably fairly solid from the regulatory standpoint. But he wonders whether there aren’t other reasons to be concerned. Lacking true ownership, the foreign shareholders are dependent upon the other side respecting the contract or, short of that, they are dependent upon their ability to enforce that contract in Chinese courts.

“You could see a situation where the stock is not performing well in the U.S. or they just don’t like being a public company; things aren’t going rosy and they just want to divorce themselves,” he said. “I can see a situation where they just stop sending money and come up with a reason why it’s not working out. The foreign entity would have to enforce its rights in Chinese courts and I see that being a hard road.” 

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