

Accessing the U.S. Public Markets

Brilliance or Insanity ?

September 2014

haynesboone

Setting precedent.

U.S. Capital Markets — Right for You ?

1. Does the U.S. Capital Markets Make Business Sense?

Benefits

- **Less Expensive Funding and Long Term Capital** — large injection of capital: lower cost of capital with potential for more
- **Higher Market Value** — value of public companies tend to be higher (liquidity: availability of information: ascertainable value)
- **Currency for M&A** — shares can be used as currency to purchase other companies. particularly U.S. or European companies
- **Increased Prestige/Reputation** — visibility enhanced for a public companies: U.S. often regarded as the “gold standard”
- **Depth of Market and Vibrancy of Analyst Coverage** - industry specific, but U.S. has very deep markets and heavy analyst participation
 - US capital markets for 2013 was reported at \$1.72T
 - 24 US IPOs by Chinese companies in 2013 (\$1.6B)
 - 29 announced US IPOs by Chinese companies in 2014 H1.
 - Closed Chinese company US IPOs amounted to over \$6.2B in 2014 H1



U.S. Capital Markets — Right for You ?

1. Does the U.S. Capital Markets Make Business Sense?

Benefits (cont.)

- **Liquidity for Investors** — PE/other private investors can exit
- **Key Personnel** — shares can be used as compensation so company can attract and retain key personnel
- **Supports Long-Term Growth** — with the liquidity of freely tradable shares. the company has more options to support and finance its next phase of development
- **Accepts Flexible Corporate Governance Structures** - disclosure based system, so more flexibility in structuring control
 - Super Voting Securities (Alibaba)



U.S. Capital Markets — Right for You ?

Downsides

- **Current Heavy Scrutiny of Chinese Companies** — regulators and investors
 - SEC established the “Cross-Border Working Group” in 2010
 - Up to June 2013, the Cross-Border Working Group’s efforts led to initiated deregistration proceedings of more than 50 US public companies based in China
 - ❖ China Cast Education; Rino International; Longtop; New Oriental Education
 - SEC established the “Financial Reporting and Audit Task Force” in July 2013
- **Increased Expense** — cost of going public in the U.S. is significant
- **Expensive On-going Compliance Cost** — U.S. public companies are required to disclose and certify its financial and non-financial information on a periodic basis
- **Loss of Control** — public shareholders (actual control depends on shareholding pattern); mandated corporate governance requirements; activist shareholders
- **Loss of Privacy** — full disclosure of the company's business, operations, finances, directors' and officers' compensation and share ownership may cause some sensitivity
- **Pressure to Perform** — management is under constant pressure to balance short-term demands for growth with long-term strategies
- **Restriction on Insider Sales** — stock sales by insiders are generally limited



U.S. Capital Markets — Right for You ?

Downsides (cont.)

- **Opens Company Up to Other U.S. Regulations** — FCPA (U.S. listed companies); OFAC (U.S. companies)
- **Heavy Investor Relation Investment** — large time commitment by management and IR resources required to keep good relationship with investors
- **Vulnerable to Hostile Takeovers and Short Selling Attacks** — being public reduces a company's ability to control ownership and exposes it to unsolicited acquisition threats
- **No Turning Back** — taking a company private in the U.S. is very difficult and costly
 - Recent survey of 20 “go-private” transactions of China based US listed companies of at least US\$100M in size and closed by February 2014 – longest took 26 months; average 10 months
- **Litigation Risk** — U.S. is a very litigious market
- **Regulatory Risk** — U.S. regulators are very diligent



U.S. Capital Markets — Right for You ?

2. Are You Suitable for the U.S. Markets?

****Different Industries have different markers for the below criteria:*

- **Attractive Track Record** — does your company outpace the industry average in growth?
- **Prospects of maintaining strong sales and earning growth** — need to demonstrate that there would likely be an increasing annual growth rate over a period of time
- **Visibility of Products/Services to Consumer/Investor** -the higher the visibility, the better the chance of success in the U.S. markets
- **Financial Reporting Capabilities** — U.S. public companies are required to file periodic filings containing its financial statements with prescribed data requirements and adherence to rigorous SEC accounting and disclosure guidelines
- **Disclosure Controls and Financial Statement Integrity** — needed to meet shorter financial reporting deadlines and satisfy regulatory concerns



U.S. Capital Markets — Right for You ?

2. Are You Suitable for the U.S. Markets? (cont.)

- **Leadership Quality and Sophistication** — maintain credibility and investor confidence
 - Top Management
 - Financial Management
 - Board of Directors
 - Audit Committee
 - Stability
- **Corporate Governance** — credibility and investor confidence
 - SOX requires fully independent audit committee + “audit committee financial expert”
 - Dodd-Frank Act requires disclosures of independence of compensation committee; conflict mineral usage and any payments to governments for resource extraction.
- **International Venture Capital or Private Equity Backing** — investor confidence
- **Strong External Auditors** — credibility and investor confidence
- **Propensity for Transparency** — strong independent board and record of public filings



U.S. Capital Markets — The IPO Process

Paradigm Shift

- 1. Disclosure Based System** — foremost consideration is whether the Company has disclosed all material non-public information so as to create an "even playing field" for investors. If you've told them everything and they still choose to invest, then it's their choice
- 2. Oversight — Regulator vs. Regulator + Private Litigation**
 - U.S. market relies on the Plaintiff's Bar to supplement the oversight of companies' disclosures — class action litigation
 - Other jurisdiction often relies only on the regulators to police the company
- 3. Function of the Prospectus — Insurance Policy on Disclosure**
 - Litigation concerns
 - Gun-Jumping concept



U.S. Capital Markets — The IPO Process

Statutory Framework

1. There are two main U.S. federal statutes governing securities transactions in the U.S.
 - Securities Act of 1933, as amended (the “33 Act”)
 - Securities Exchange Act of 1934, as amended (the “34 Act”)
2. The 33 Act requires that a registration statement be filed with the SEC before any offer of securities is made, and be declared effective by the SEC before any sale is made
3. Prospectus used to offer and sell securities must meet the requirements of the 33 Act



U.S. Capital Markets — The IPO Process

Statutory Framework (cont.)

4. The 2012 Jumpstart Our Business Startups Act (“JOBS Act”) — loosened certain requirements on going public in the U.S.
 - JOBS Act created a new class of issuer — emerging growth companies (EGC)
 - EGCs are issuers with total annual gross revenue of less than U.S.\$1 billion during the most recent fiscal year
 - EGCs have lower reporting requirements. both during the IPO process and during the 5 years after they're public
 - EGC can submit their registration statement confidentially and only need to publicly file their registration statement at least 21 days before the start of any “road show”
 - EGC may engage in “test-the-waters” communication to gauge investor interest during pre-filing period and after filing



U.S. Capital Markets — The IPO Process

Actual Process

1. There are three Critical Periods In the Formal U.S. IPO Process
 - Pre-Filing Period. *No offers to sell and buy.* During the “Pre-Filing Period”, you may not “offer” any security unless registration statement has been filed with the SEC. The term “offer” is very broadly construed to include many activities in connection with the promotion of a sale of the company's securities. Violations are called “gun-jumping”
 - Waiting Period (Post-filing but before Effectiveness). *Certain kinds of offers OK, but no binding agreement to sell.* Prospectus used to make offers must meet the requirements of the 33 Act. The term “prospectus” is again very broadly construed to include any promotional writing or broadcast referring to a security for sale
 - Post-Effective Period. *Sales is OK.* SEC has declared your registration statement effective and you can sell your securities using that “effective” registration statement



U.S. Capital Markets — The IPO Process

How Do I Prepare for a U.S. IPO?

1. **Reorganization of Corporate Form** - may take 1-2 years
2. **Build an Effective Management Team** - able to present the company's story to international investment banks and investors and has international sophistication
3. **Develop Budget and Forecasting Capacity** - U.S. public companies are expected to have sophisticated budget and forecasting capabilities. both during the IPO process and as a public company afterwards
4. **Independent Members of Your Board** - all major U.S. stock exchanges and markets require a majority of independent directors on your Board. A director has personal liability for information contained or omitted in the registration statement
5. **D&O Insurance** - protect your officers and directors



U.S. Capital Markets — The IPO Process

How Do I Prepare for a U.S. IPO? (cont.)

6. **Create a U.S. Compliant Audit Committee** — Sarbanes-Oxley Act (SOX) and major U.S. stock exchanges have detailed requirements for the independence; financial acumen and allowed scope of authority of the Audit Committee members
- Comprised entirely of independent directors
 - Have at least one "financial expert"
 - Is directly responsible for the appointment, compensation and oversight of the company's independent auditor
 - Have authority to engage independent counsel and advisors



U.S. Capital Markets — The IPO Process

How Do I Prepare for a U.S. IPO? (cont.)

7. **Corporate Governance Requirements** — both NYSE and NASDAQ have corporate governance listing standards. Set this up and more importantly, get into the habit of practicing it
 - Board composition, structure, process (including nomination and compensation)
 - Codes of Business Conducts and Ethics
 - Internal audit function establishment
 - Process for approving related party transactions
8. **Audit Financial Statements and Resolve Potential Disclosure and Accounting Issues** -easier and more cost efficient to perform audits in the normal course of business.
9. **Manage and Build Company's Public Image** — positive image will enhance initial sales effort and maintain the public's interest in the aftermarket.
Building visibility and public



U.S. Capital Markets — Post IPO

I'm Public, Now What Happens?

- The whole point of a U.S. IPO is to maintain a liquid market in the U.S., which means that you will need to maintain investor enthusiasm for the company and avoid becoming thinly traded
 - You will get a better chance for future secondary offerings (i.e., additional capital) if you maintain a liquid market
- Effective distribution and support of the stock, full transparency in public disclosures, as well as continuing security analyst interest is necessary to maintain investor enthusiasm
- Pay attention to the makeup of your company's shareholder base and you will understand the pressures that you will face



U.S. Capital Markets — Post IPO

I'm Public, Now What Happens?

- A foreign company that lists its securities on NYSE or NASDAQ is required to file annual and other periodic reports under the 34 Act. Failure to comply may result in civil liabilities or criminal sanctions or delisting from the exchanges.
- Material misstatements or omissions in these periodic reports may also result in civil liability, criminal sanctions and/or delisting from the exchanges



U.S. Capital Markets — Post IPO

Annual Reports on Form 20-F

- An annual report on Form 20-F must be filed within four months after the end of each fiscal year by any foreign company which has a class of securities registered under the 34 Act
- The information required to be included in the Form 20-F is very similar to the information provided in the registration statement on Form F-1 during the IPO.
 - Sarbanes-Oxley requires CEO and CFO certifications on "disclosure controls and procedures" and "internal control over financial reporting" ("Section 306" and "Section 902 Certifications")
 - Disclosure on adoption of codes of ethics and whether the company's audit committee has a "financial expert"



U.S. Capital Markets — Post IPO

Current Report on Form 6-K

- Form 6-K requires the furnishing of information which is material with respect to the foreign company and which:
 - Has been filed with a stock exchange and has been made public by that exchange:
 - Has been made or is required to be made public pursuant to the law of the company's home country: or
 - Has been distributed or is required to be distributed to its securities holders.
 - Basically, anything that the company deems of material importance to its securities holders
- Foreign private issuers are required to file interim (rather than quarterly) reports. However, if an issuer chooses to file quarterly reports, it should file it under Form 6-K



U.S. Capital Markets — Post IPO

Schedule 13D or 13G Reports for Major Shareholders

- Any person who acquires the beneficial ownership of more than 5% of the total outstanding voting securities of an issuer must, within 10 days after such acquisition, send to the issuer and file with the SEC, a statement on Schedule 13D. A person is deemed to be the beneficial owner of the shares if he or she, directly or indirectly, has or shares the power to vote or the power to dispose of such shares
 - Schedule 13D requires substantial disclosure on (i) identity of acquirer; (ii) source and amount of funds used; (iii) purpose of acquisition; (iv) amount and percentage of securities held by the acquirer; and (v) details of acquirer's involvement
- Any person who acquired beneficial ownership of more than 5% of the total outstanding voting securities of an issuer before the IPO must file a statement on Schedule 13G within 45 days after the end of each calendar year (i.e., by February 14th)
- Reports on Schedule 13D and Schedule 13G must be amended if any material change in the facts set forth therein have changed



U.S. Capital Markets — Post IPO

Reports to NYSE and NASDAQ

- NYSE and NASDAQ requires listed companies to disclose to the public any news or information which might reasonably be expected to materially affect the value of its securities. Copies should be sent directly to NYSE or the NASDAQ



U.S. Capital Markets — Chinese Companies

Challenges

1. SEC enforcement initiatives — heavy scrutiny by the SEC's Cross-Border Working Group on China-based issuers
 - Wave of reverse take-over transactions (RTO) starting in 2007, combined with a series of auditor resignation, civil lawsuits and allegations of fraudulent accounting practices by short-sellers attracted the SEC's attention and resulted in focused enforcement action on China-based issuers
 - Cross-Border Working Group – established in 2010
 - Up to June 2013, the Cross-Border Working Group's efforts led to initiated deregistration proceedings of more than 50 US public companies based in China
 - Financial Reporting and Audit Task Force — created July 2013 to catch financial reporting fraud at an earlier stage
 - Brought an action against the Chinese affiliates of the Big Four accounting firms for refusing to produce audit work papers and other documents related to China-based companies under investigation by the SEC for potential accounting fraud against U.S. investors
 - Heightened scrutiny on VIE structures and resulting accounting treatment



U.S. Capital Markets — Chinese Companies

Challenges (cont.)

2. The “State Secret” Dilemma

- September 8, 2011 — SEC filed a subpoena enforcement action against Deloitte in the Longtop case for refusal to produce audit work paper
- August 27, 2012, the HK Securities and Futures Commission (“SFC”) sued Ernst & Young on the Standard Water case for refusal to produce audit work paper
- December 4, 2012, SEC sued Big 4 and BDO for refusing to produce audit work paper
- May 7, 2013, CSRC, China Ministry of Finance (“MOF”) and the PCAOB signed a Memorandum of Understanding on Enforcement Cooperation
- January 23, 2014, the SEC Administrative Law Judge suspended Big 4 and BDO for 6 months
- April 21, 2014, the MOF issued Interim Provisions on the *Cross-border Implementation of Audit Business by Accounting Firms* (Draft for Comment)
- May 23, 2014, HK courts rejected Ernst & Young's argument and ruled that it will have to produce the audit work papers to SFC despite China's State Secret Laws



A magnifying glass is positioned over a financial statement table, highlighting a specific row. The table contains numerical data with three columns of values. The highlighted row shows a value of 23394 in the first column, 46.00 in the second, and 92.00 in the third. Other rows include values like 24378, 26952, 510515, 506781, 92001, 95001, 94011, 514278, 518003, 534941, 90010, and 0120.

24378	0.00	1.00
26952	0.00	0.00
23394	46.00	92.00
510515	0.00	0.00
506781	0.00	0.00
92001	0.00	0.00
95001	0.00	0.00
94011	0.00	0.00
514278	0.00	0.00
518003	99.00	99.00
534941	0.00	0.00
90010	20.00	20.00
0120	0.00	0.00

U.S. Capital Markets — Chinese Companies

Challenges (cont.)

3. Director and Officer Liabilities

- Civil Liability for public disclosure that contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading under the 33 Act and the 34 Act
- Often sued in private actions when company is sued for disclosure violations
- Any litigation (even ones that have no merit) will be very costly for the individuals
- D&O insurance and contractual indemnification

4. Being Subject to Other U.S. Regulations

- FCPA is applicable to any company listed on a U.S. exchange
 - SEC disclosed in November 2013 that they recovered over \$240 million in the 12 months ended November 2013 on FCPA and have filed 40 FCPA enforcement actions in past 3 fiscal years
- OFAC is applicable to any U.S. company — so if a China-based issuer went public via a RTO and merged into a U.S. company. then OFAC applies
- Iran Threat Reduction and Syria Human Rights Act of 2012 is applicable to any US public company.



Liza L.S. Mark

Administrative Partner, Shanghai Office
liza.mark@haynesboone.com

Shanghai International Finance Center, Tower 2, Unit 3620, Level 36
8 Century Avenue, Pudong, Shanghai, 200120
T +86.21.6062.6183



Liza Mark is a partner in the Capital Markets and Securities Practice Group of Haynes and Boone, LLP. Liza has concentrated her practice on securities, private equity investments and cross-border M&A. She represents issuers, investment banks/financial intermediaries, and investors in financing transactions, including equity and debt public offerings and cross-border private placements, both in Hong Kong, India and in the U.S. She is experienced in U.S., India and Hong Kong corporate finance transactions, including Hong Kong and Indian IPOs, Rule 144A offerings, SPAC acquisitions, PIPEs, Asian in-bound equity offerings and private placements of debt and equity securities. She also regularly advises clients regarding private equity investments, mergers and acquisitions, corporate governance and U.S. securities laws public company reporting and compliance.

Liza has particular financing experience in industries such as energy, transportation and logistics, healthcare and clean technology. She has worked closely with foreign private issuers in their securities offerings in India, the United States and in the Hong Kong markets. She has also worked with financial institutions in connection with international offerings of equity and debt securities and structured products, as well as medium-term note programs.

Prior to joining Haynes and Boone, Liza was a partner at Dorsey & Whitney LLP.