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China – Law Firms

Chinese Companies Ringing The Bell On Many Exchanges

*The Editor interviews **Mitchell S. Nussbaum**, Partner, Loeb & Loeb LLP.*

Editor: You have represented many U.S. and foreign companies in private and public transactions, including those in the People's Republic of China, Taiwan and Thailand. How did you come to have expertise in this area?

Nussbaum: I began working in this area in the mid-1990s because around 1994 Chinese companies started trying to list on U.S. exchanges. Some of the early deals were ADR deals – government-owned enterprises that were public companies in Hong Kong that decided to do ADR listings in the U.S. At the same time, I also became involved with some of the private companies that were not listed anywhere but were trying to complete IPOs in the U.S. At that particular time, just prior to the Internet and dot com boom, there was a vibrant IPO market, particularly for small and mid-cap companies.

The IPO markets lost favor for Chinese companies because U.S. investor attention turned toward dot com and telecom companies, so I became very active in reverse mergers of Chinese companies, an alternate means for them to become public companies in the U.S. The Chinese companies sought this method because there was a more likely successful conclusion to the process than with an IPO, which is very market dependent.

About three years ago, SPACs became one of the hottest sectors of the market. Our firm became very active with some of the initial Chinese SPACs. Our practice now consists of IPOs, reverse mergers of these Chinese companies and SPACs, and we continue to represent them as going concerns after they go public. We represent their ongoing securities compliance needs, M&A activity, financing activities and general corporate work.

Mitchell S. Nussbaum

Editor: Of particular interest for our China Special Section is your representation of Chinese companies in helping them to gain admittance to trading on the American Stock Exchange. Why the American Stock Exchange?

Nussbaum: The benefit that the American Stock Exchange has had in this process has to do with the reverse mergers in particular. They have a listing standard which allows companies to list when they have a stock price of $2 per share as long as they have a market valuation of $50 million. NASDAQ does not have such a competitive feature, having a higher dollar per share requirement. Also, if a company applies for the NASDAQ Small Cap Market, it has to hold its trading price for 90 consecutive trading days. That is not an easy thing to do because prices fluctuate. With the Amex you do not have to hold the price for a long time.

Once listed, these companies are on the bulletin board or the AMEX giving them a period of time to use that listing to grow so that they qualify for the larger exchanges. We have had clients from that platform transfer to the NYSE or NASDAQ. The Amex offers a good opportunity to get off the bulletin board which is a positive thing for some of these companies.

Editor: Have these companies had a big problem complying with Sarbanes-Oxley?

Nussbaum: That is a big issue right now. We help companies complete the certification disclosure standards and set up proper committees to comply with Sarbanes-Oxley. The main issue relates to Section 404 for accelerated filers since those types of issuers need to comply with that section this year. It is a huge challenge for Chinese companies. The good news for most of the accelerated filers is that they may have the resources to be able to comply. The bigger concern is with the non-accelerated filers (those with less than $75 million dollar valuations) who may have more difficulty, given their more limited resources, unless the SEC agrees to defer this requirement further.

Editor: I understand that Chinese companies are reaching out to make acquisitions abroad, particularly in the oil and gas and technology sectors. Was a principal reason for their listing that they could use their public securities as an acquisition medium?

Nussbaum: Yes. One of the advantages for going public in the U.S. is that they have additional currency for acquisitions. A lot of the successful companies have used their public securities as consideration for domestic acquisitions. It has been successful for everyone involved because they have typically been able to buy other Chinese companies at low valuation multiples using their public securities. When they acquire those companies and consolidate their financial statements, there tends to be a valuation arbitrage between the multiple at which they are buying these companies compared to what the parent public company is trading

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for on a consolidated basis. This represents the sole business plan for some of our clients. They want to go public in the U.S. with a business and then supplement it by using their stock as consideration for acquisitions.

Editor: Do you see signs of the government's interest in having its companies invest abroad?

Nussbaum: As the first phase of an emerging China, we see domestic companies trying to obtain financing – whether it be large, small or project based. These companies need growth capital. The second phase commences once they grow in the private sector, build their profits and cash reserves; then I think you will see further investment and acquisitions abroad.

Editor: How can a foreign investor rely on the documentation, financial statements, title opinions, etc. accompanying a Chinese company's offering for an investment or sale?

Nussbaum: When I first started getting involved with investments in China, there were three ways that you could invest in China as a foreigner. You could invest on a private basis (private placements in a Chinese company); you could lend money to a Chinese company; or you could invest in a Chinese company that is a U.S. public company. At that time it was my feeling that initially the preferred method would be investing in public companies because of the transparency typically associated with a public company. The other two methods of investing do not offer the foreign investor any transparency. For instance, if you invested in a private company, you could not monitor how the proceeds were managed or used. Back then, one way to address the transparency problem in private equity was that private equity firms would invest and run the company in a way to ensure the intended use of proceeds of the investment. On the lending side, local parties who know how to seize collateral if needed are the best source of those types of funds.

The public arena has been an excellent way for foreigners to invest in China because U.S. GAAP accounting standards are applied to their financial statements – with quarterly statements filed every quarter and year-end audited financial statements. One of the benefits of these companies listing on U.S exchanges is that the U.S legal system has a tremendous amount of integrity assuring investors they can rely on GAAP accounting, if properly applied. Although this is not a guarantee against any misappropriate behavior or scandal, the U.S. accounting system and securities rules bring a great deal of credibility to the system. One of the reasons why these companies come to the U.S. to raise capital is the very high degree of transparency of our regulatory system.

Editor: Do the Asian markets such as the Hong Kong or Shanghai stock exchanges have any rules that investors can rely on?

Nussbaum: They do. The Hong Kong exchange is patterned after the British system so it does have rules. There are tons of company listings in Hong Kong. The advantage that Chinese companies enjoy in coming to the U.S. is that they are able to obtain greater valuations than they do in Hong Kong. Believe it or not, the listing process is less expensive here than in Hong Kong – another reason to come here.

The reasons for staying on the Hong Kong exchange are fear of Section 404 reporting, a more familiar culture and language as well as closer proximity to their operations. There are many Hong Kong bankers who are always going back and forth from mainland China to build relationships and strong ties with Chinese companies. Taking your company to the U.S. is a distant move. Those are some of the reasons why companies choose one exchange over another. The largest two national exchange systems are the U.S. and Hong Kong. Singapore has proven that Chinese companies trade at very small valuations. The issue with the Shanghai exchange has been the market cap for the exchange is less than that of one large cap U.S. company. Chinese companies have more certainty in getting a deal done because the government will approve a list of a certain number of deals each year, but not all of them make the cut.

Editor: In the usual closing documentation of a transaction, which rules do you prefer as the favorite means stated for resolving any dispute?

Nussbaum: U.S. investors demand U.S. law and U.S. jurisdictional provisions to govern a transaction – often New York or Delaware law, making sure these companies will submit to jurisdiction here. My experience has been that Chinese companies understand that this is what they have to do when going public here. Rarely will one want to bring a suit in China or be subject to Chinese laws which none of the non-Chinese investors have any sort of familiarity or comfort with.

Editor: Do you think that membership in the WTO has made a difference in the way China conducts business with the international community?

Nussbaum: I think the WTO has made a difference. China has a national mandate to be more accepted in the international community, and I think that they seek to enforce conformance with the demands and standards of the international community. The WTO is part of this bigger picture. I think there is increasing comfort from a national level that measures will be taken in China that will conform to what people are looking for internationally.

Editor: Do you have any thoughts about our vast trade imbalance with China and where this will be in ten years?

Nussbaum: It will depend on what happens with the Chinese currency and whether we have an increased valuation of the Chinese Renminbi, which many people forecast will happen (it is no longer pegged to the U.S. dollar). It is likely to appreciate in value, most likely due to trade imbalances. Then again we do not know where the U.S. currency will be at any time. Those are political measures that will have some effect on the trade imbalance and may satisfy some of the constituencies in the U.S.

However, looking at the big picture, China is a different economy now. For example, the entire automotive industry in the U.S. is looking to build cars in China. So is the automotive industry in Japan and Germany. For the next 10 to 20 years, China will be the manufacturing center for the world.

Editor: Do you foresee a continuous growth in cross border transactions on the part of the Chinese?

Nussbaum: Absolutely. You have hundreds of millions of consumers coming online. They want to consume foreign products. You have a tremendous entrepreneurial and capitalistic spirit going on in the country which did not exist before. You have more capital coming into the country with a manufacturing workforce that will export a lot of goods. You are seeing a country that has been in the Communist shut-down for 50 years that has recently emerged. They are a huge participant in the international global economy. Everyone agrees that they will be the second largest market in the world for the next 20 years and the largest producer in the world. That means that there will be a lot of cross border transactions.