OPINION

Dos and Don’ts for Private Companies when Reverse Merging

To principals of, and advisors to, privately-owned companies:

It’s well-documented that publicly-held companies are generally worth considerably more than similar private companies. There are many good reasons for the disparity--liquidity, of course, is paramount. Also, it’s much easier to raise capital, because investors see the exit strategy; and, public companies can use stock options to hire more qualified employees, whose talent enables public companies to increase revenues, profits and value. Not to mention, of course: the added prestige and personal wealth of the principal shareholders (which I just mentioned).

To be sure, however, going public isn’t for the faint of heart. So, before a private company embarks upon this route, the following not all-inclusive list of Dos and Don’ts should be considered carefully:

The Dos:

Do retain experienced attorneys—especially those who have completed many reverse mergers—to represent your private company. The documents that are required, especially the Reorganization Agreement, the “Super 8-K,” and the filings with the SEC, FINRA, OTC Markets, the state of incorporation of the public company and probably the private company (depending on the structure of the transaction), are often complex and very detailed.

Do engage experienced, PCAOB-registered accountants to audit the private company’s financial statements. The reputation of the accounting firm is important in establishing and maintaining credibility of the new-public company in the investing community.

■ BY JOHN LOWY, Esq.

Don't go into the reverse merger process blindly. Going public is an important milestone for any private company. So, and as noted above, communicate early in the process, and often, with experienced advisers who have gone this route before.

Do try to hire a CEO and a CFO with previous public company experience. These two persons will be the "face" of the public company at most, if not all, shareholder meetings, conferences, telephone conferences, etc. with investment bankers, company podcasts and presentations, etc. In my experience, if the private company's principal does not have this background, he or she is often "kicked upstairs" to be Chairperson, thus allowing the new CEO to fend with Wall Street, among other duties. Finding, hiring and retaining quality persons with the requisite experience and reputation to be CEO and CFO isn't easy, and—candidly—it will probably be expensive; but in the long run, it will be a bargain.

Do carefully check the backgrounds of the people you are dealing with on the public company side, before the reverse merger is completed. There are many "bad boys" lurking, looking for unsuspecting private companies to reverse merge into what could become a "pump and dump" scheme.

Do retain a reputable Investor Relations firm to best get the company's message out to the investment community, shareholders and others. Using an IR firm is usually helpful in several areas: getting the word out to the Street about the company, introductions to broker-dealers, investment bankers, and in some instances to direct sources of capital.

Do: prepare and disseminate, as widely and as often as possible, news/announcements about the company. This can be tricky, because your obligation as a public company is to file periodic reports (three 10-Qs and the 10-K each year), plus 8-Ks as and when material events occur. So, for example, it would be inconsistent, and probably a violation of securities laws, to make a glowing announcement and then, shortly after, file a dismal 10-Q without making an announcement with the same distribution. And take note that there are different newswire services, some of which provide better distribution than others; be sure to use one which has the widest distribution, and use it consistently.

The above are many, but not all, of the Dos for private companies that want to go public by reverse merging. Here are some of the don'ts (many are the opposite of the Dos):

Don't go into the reverse merger process blindly. Going public is an important milestone for any private company. So, and as noted above, communicate early in the process, and often, with experienced advisers who have gone this route before.

Don't think that going public via reverse merger is a "get rich quick" deal. As noted above, there are many reasons why a private company can gain important advantages by being public; but most of those advantages take time to take effect. And, they don't take effect automatically; rather, they require additional time and effort beyond what executives devote to running their business. Put another way: executives should devote 100% of their time to running their business, as usual, and an additional 50% or more to what is involved with being a public company. Difficult math, but it makes the point.

Don't ignore your shareholders: as a public company, they can be your biggest supporters (or your adversaries). They, and the investing public in general, need to be informed of company developments as they occur. Also, have a good website—essential.

Going public is a major step in a company's corporate history. Like any other endeavor, there are good ways and bad ways to go about it. But by working with experienced and competent advisers following the other "dos" above, and avoiding the "don'ts," the process of becoming and then being a public company can be a lot less arduous, and far more rewarding, both emotionally and financially. ■

www.ocgfinance.com

John Lowy is the founder (in 1990) and senior partner of John B. Lowy, P.C. (www.johnlowylaw.com), and (in 1993) of Olympic Capital Group, Inc. (www.ocgfinance.com), both based in New York City. John is a highly-respected and acknowledged expert in reverse mergers, representing public companies, capital formation, strategic consulting and initial private and public offerings of all types.

As an attorney, an advisor and principal, John has led or participated in more than 200 such transactions, creating market value well in excess of $5 billion. He has been instrumental in leading the process by which these companies have raised capital or reverse merged, and achieved listings on the NASDAQ or the AMEX, or were sold to larger companies.

In addition to the U.S., John has completed transactions for clients based in at least 15 foreign countries. The sectors in which his clients are engaged range from low tech to high tech, cryptocurrency/blockchain, real estate, pharmaceuticals, medical devices, biotech, oil and gas, mining, renewable energy, entertainment, food, agriculture, education and retail, among others.

He received his undergraduate degree from Tufts University and graduated from the University of Pennsylvania Law School, and is a licensed attorney in New York and New Jersey. He is a frequent contributor to MicroCap Review.

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