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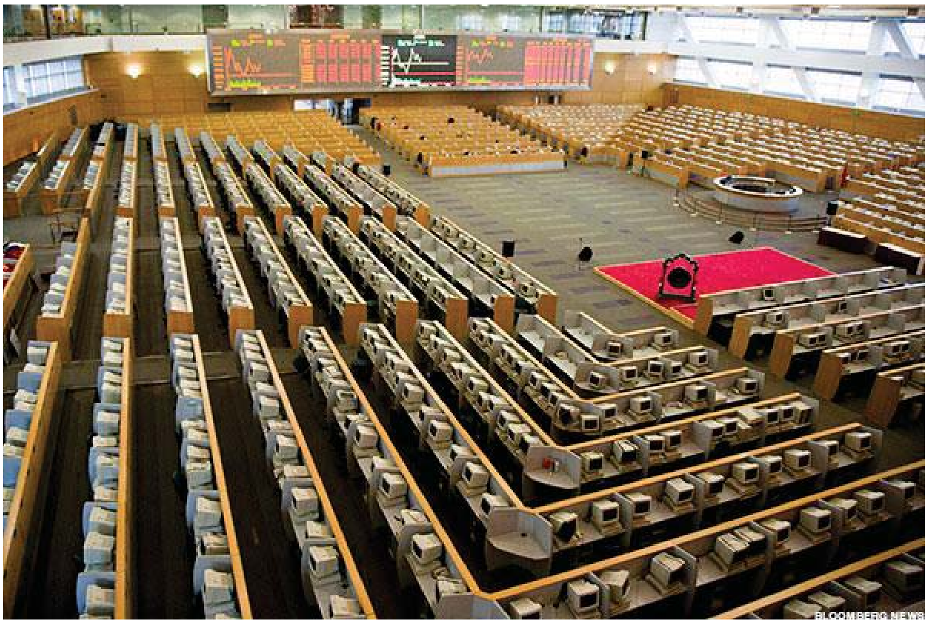
# China securities regulator struggles with companies returning from U.S. stock market

*Chinese companies are leaving the U.S. markets to go private and relist at home, but the China Securities Regulatory Commission says not so fast.*

By Bill Meagher Updated on May 12, 2016, 07:40 PM ET



BLOOMBERG NEWS

You can't go home again.

That seems to be the message the China Securities Regulatory Commission is sending Chinese companies that went public in the U.S. but now want to use reverse mergers to return home.

Chinese companies that went public in the U.S. and raised billions of dollars from U.S.-based investors in private-investment-in-public-equity deals, saw their domestic valuations plunge after a series of accounting frauds, probes by the **Securities and Exchange Commission** and delistings by the New York and **Nasdaq** stock exchanges.

Now some of those same companies have gone private or have offers to do so, and are eyeing listings on the Shanghai or **Shenzhen** Stock Exchange through reverse mergers.

But Chinese regulators, wary of the rich valuations the companies are drawing as they come home to the Middle Kingdom, have other ideas. The CSRC announced last week it was examining how companies returning from the U.S. would impact the exchanges, hinting that change could be just around the corner.

Leaks out of the normally tight-lipped regulator indicate that it is considering capping the valuation multiples for deals involving companies that have previously been listed overseas. Another possible move by the CSRC may be to limit the number of reverse mergers used to gain access to Chinese exchanges by companies that were previously public in another country.

"This is the latest public reason why their markets are so volatile," said Dan McClory, who heads up Bonwick Capital Partners LLC's China and West Coast investment banking practice. "First it was the short sellers pointing out frauds, and then it was speculators and commodity traders and now its reverse mergers."

McClory said he believes the CSRC isn't so much concerned about the use of reverse mergers, but that liquidity is the real issue. "I think the way they look at it is there is only so much liquidity and capital in China, and if a lot of it is going towards closing on going-private transactions, it is an issue for their markets," he said.

The CSRC may be looking for a scapegoat, but this is no small issue for at least 23 U.S.-registered companies worth $30.6 billion that have plans to go private and reemerge in China, including an $8.2 billion reverse merger involving **Qihoo 360 Technology Co. Ltd.** (QIHU).

Qihoo, a Chinese Internet security company, has been talking about going private since January 2015, with the latest offer pending since June.

Dealogic plc data shows that at least 10 companies have already closed going-private transactions yielding proceeds of $7.3 billion since January 2015. But a going-private transaction hasn't closed since September of last year.

Peter Fuhrman, CEO of China-based investment bank China **First Capital**, thinks the delist-relist plans are in real trouble.

"First, this $80 billion spent on China company delist-relists was done mainly on an unhedged hunch, not a certainty or even a high probability," he said in an e-mail from Shenzhen. "It may now turn out to be one of the biggest blunders in recent private equity history."

Fuhrman continued, "It all looked so simple, like a child could do it. Buy a US-listed Chinese company at a six multiple then quickly relist in China at sixty. Unfortunately the likelihood of getting that domestic Chinese IPO was never high, it was always uncertain. Now it's even more so. If you can't sell your shares, well, buying even at 6X multiple begins to look expensive indeed."

While China's three stock markets in Hong Kong, Shanghai and Shenzhen have been choppy, the CSRC and other government agencies have concerns beyond how the reverse merged companies might trade. China's legendary growth has slowed, falling to a 25-year low of 6.9% last year.

Moreover China's Vice Premier Zhang Gaoli said last week that the county has no plans for stimulating growth by expanding credit and China was still on target to hit a gross domestic product of 6.5% to 7%. Gaoli did say that his government is looking to deleverage the economy.

President Xi Jinping said China's economy was "big but not strong" and he complained of "outstanding problems of unwieldiness, puffiness and weakness," in a January speech first made public May 10 in China Daily.

The yuan has run into some headwinds, and a number of hedge funds have placed bets against the currency, including Odey Asset Management, Omni Partners LLP, Horseman Global Fund, **Passport Capital LLC** and **Third Point LLC**, according to letters to investors.

China's initial public offering market has been awaiting new reforms that could allow for companies and investors to have more of a say in the registrations. More than 750 companies are waiting to list.

"The Chinese delayed indefinitely plans to move to a registration-based IPO system, and still will control closely the number and timing of IPOs," Fuhrman said. "The delist-relist companies now come at the tail of a very, very long queue."

Then the government indefinitely delayed previously announced plans to open a new exchange in Shanghai, known as the "Strategic Board" that was meant to be the listing ground for these returnee companies, Fuhrman said.

"The final blow now seems to have fallen. The CSRC is likely going to make it harder, if not impossible, for returnee companies to use reverse takeovers to list in China."

McClory agrees. "The CSRC is never going to allow the reverse merged companies to leapfrog companies waiting in the IPO queue, especially when the companies in the queue are being held there by other Chinese regulators."

Investors have always been fascinated by China because of the sheer scale of the economy. So when China-based companies began expressing a desire to access the U.S. capital markets, bankers, securities lawyers and dealmakers were only too happy to assist the companies with reverse mergers with registered shell companies.

China specialists emerged, embracing the foreign companies and the opportunity for deal volume that came with the sector. According to **PrivateRaise**, The Deal's private placement data service, 269 Chinese companies used reverse mergers to go public in the U.S. since 2008, with 67 of those companies raising about $600 million at the time.

But that doesn't fully capture the economic impact the sector had on equity fundraising. PrivateRaise shows that since 2008, Chinese companies have gone on to raise $14.8 billion in the PIPEs market.

But by the summer of 2010, short investors like Jon Carnes, known as Alfred Little, Dan David at GeoInvesting LLC and Carson Block at Muddy Waters LLC began targeting some Chinese companies that were not what they seemed. Differences between financials filed in China and with the SEC were publicized in reports on the Internet. Tales of accounting fraud became common place as the SEC investigated some Chinese reverse merged companies and senior exchanges delisted several companies.

At one point the SEC privately begged the CSRC to help it with its open investigations into reverse merged companies, but the Chinese regulator declined.

In 2011, the SEC asked the **New York Stock Exchange** and Nasdaq to fashion rules making it harder for companies going public using reverse mergers to qualify for listings on the senior exchanges. Among those new standards was a requirement that reverse merged companies "season" for at least one year by trading over the counter. An exception was made for companies which went public with an underwritten offering of at least $40 million.

As valuations began tanking for U.S.-registered, China-based companies and capital began drying up, companies and dealmakers began searching for ways to reenergize the sector, finally landing on going-private transactions.

McClory said he regularly receives calls from investors in China with capital on the sideline looking for a home, but those players are particular about possible mergers. "The companies need to be in technology, pharma, mobile, they don't want anything in real estate or manufacturing," he said. "They are looking for elevated multiples."

Perhaps the highest profile example of a U.S.-registered company going private and then utilizing a reverse merger to relist in China is advertising company **Focus Media Holding Ltd.**, now known as Focus Media Network Ltd.

The company was the subject of a critical short report by Muddy Waters in 2011, alleging the company exaggerated its advertising network in China, overpaid for acquisitions and claimed to make deals it never closed.

The company was taken private in May 2013 in a deal worth $3.87 billion with backing from a number of Asian investors as well as private equity firm **Carlyle Group**, and delisted. It used a reverse merger to relist in Hong Kong last year, in a deal valued at $7.3 billion.

Last September, the company and its founder and CEO Jason Jiang, paid the SEC $55.6 million to settle allegations that it made inaccurate disclosures about a partial sale of a subsidiary to insiders, one of which was Jiang, while it was still a public company.

The irony over more controversy attached to reverse mergers is not lost on McClory. "To longtime observers of Chinese reverse merged companies and the sector, the CSRC having issues with reverse mergers is really pretty hilarious. Isn't the pot calling the kettle black?"