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SMALL-CAP EQUITY FINANCE MARKET MOUNTS 2ND-QTR SURGE

by Dan Lonkevich

The small-cap and microcap equity financing market mounted a resurgence in the second quarter as the broader equity markets rose.

The number of private placements of equity by U.S. public companies rose 6% from a year earlier. Initial public offerings almost doubled and the number of follow-on offerings increased by 43%. There was also more activity by special purpose acquisition companies.

The number of reverse mergers, meanwhile, was unchanged.

In general, companies were more willing to offer equity as the Dow Jones Industrial Average gained 2.31% during the second quarter and the Standard & Poor's 500 gained 2.82%.

Overall, there were 281 PIPEs worth $13.6 billion that were announced or completed during the quarter, compared with 264 transactions that raised $12.6 billion in the year-earlier period, according to PrivateRaise, The Deal's data service that tracks private placements of at least $1 million.

The dollar amount raised was the most in a quarter since 2008.

"The capital markets are less robust than they were in the first quarter, but it was still a very good quarter," said Richard Gormley, the head of alternative investments at **Lazard** in New York. "It was the best first half since the 2008 financial crisis."

During the quarter, Lazard arranged a $38 million private placement of convertible debt by **FuelCell Energy Inc.**, an $8 million convertible debt PIPE for **Pacific Ethanol Inc.** and a $17.1 million common stock deal for **Apricus Biosciences Inc.**

Gormley said that small-cap and microcap stocks are benefitting from a shift by portfolio managers toward equity investments and away from fixed income.

"Valuations are reasonable and stocks have done reasonably well," he said. "Most investors view the market as not overvalued. Fully valued maybe, but not overvalued."

Gormley said the third quarter is likely to see a "summer moderation," especially after three

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SEC ADOPTS RULES ENDING BAN ON SOLICITATION, 'BAD ACTOR' RULE

by Bill Meagher and Dan Lonkevich

The Securities and Exchange Commission voted July 10 to enact rules that will eliminate the prohibition against general solicitation and advertising of private placement offerings, finally allowing a long-awaited change under the Jumpstart Our Business Startups Act to take effect.

The SEC also adopted a rule to disqualify so-called "bad actors" from private placements, in connection with the Dodd-Frank Wall Street Reform and Consumer Protection Act.

The commission also proposed a new rule that would require companies

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quarters in a row of rising stock markets.

To be sure, the months of July and August are typically the slowest of the year in the PIPE market and most PIPE-issuing companies wait until after Labor Day to reassess their capital needs and consider PIPEs.

Since July 1, there have been at least another 21 private placements of equity, raising $406.5 million.

"We've had pretty good markets for some time and that has to abate," Gormley said.

The market has shown surprising willingness to shrug off concerns about the potential for shocks from Europe and China. Moreover, after an initial day of panic, the market also seems to have digested hints from the Federal Reserve of its intention to eventually start unwinding monetary easing.

If economic problems develop in the U.S., such as a sudden increase in unemployment, or re-emerge in Europe or China, the market may not be able to avoid a slowdown.

"It's hard for me to imagine it will," Gormley said.

Still, some dealmakers say the market has remained relatively strong despite the usual summer slowdown.

"We have seen the same steady increase in business since January," said Joseph Smith, a partner with the law firm of **Ellenoff Grossman & Schole LLC**, in an e-mail. "I chalk it up to a gradually improving economy combined with a greatly reduced fear factor on the part of investors. The notion of a complete economic meltdown seems fairly far-fetched at this point, so people are investing again."

Ellenoff Grossman advised placement agents on 15 deals worth $96.8 million during the second quarter. The firm also advised the issuers of five PIPEs worth $23.9 million and the investors on five PIPEs worth $6.55 million.

Liquidity Concerns

Growth in the private placement market over the past year has been heavily weighted toward registered PIPEs. Concerns about liquidity are continuing to hold back the market for unregistered PIPEs. During the financial crisis, funds that held restricted securities from unregistered PIPEs had a hard time selling them and found them difficult to value.

"Liquidity still remains the king," said Mitchell Littman, a partner with the law firm **Littman Krooks LLP**, in an e-mail. "Investors are ascertaining their risk by taking into account, among other things, their ability to have liquidity."

There were 112 registered direct offerings worth $8.53 billion in the second quarter, compared with 95 worth $6.77 billion a year earlier. Unregistered PIPEs totaled 169 worth $5.09 billion, compared with 169 worth $5.84 billion a year earlier.

The number of confidentially marketed public offerings, or CMPOs, increased to 24 deals worth $694.5 million from 22 deals worth $779.7 million, a year ago.

"Registered deals are paramount, but very small companies with a good story are still finding PIPE investors to do private raises," Smith said. "These tend to be very small deals, south of $5 million (and often south of your $1 million radar). We see no reason at this point to expect any slowdown for the remainder of the year."

The average PIPE in the second quarter raised $41.6 million, compared with $41.9 million a year earlier.

A significant share of the largest PIPEs were at-the-market offering facilities by energy companies and real estate investment trusts. ATM offerings are commitments to raise money through the issuance of stock at the issuer's discretion. They can be in force for several years and are rarely fully taken down.

During the second quarter, there were 51 ATM facilities worth up to $7.13 billion, compared with 41 worth $5.27 billion, a year ago.

Not including ATMs, there were only 230 PIPEs worth $6.49 billion in the second quarter, compared with 223 worth $7.34 billion, a year ago.

"The market is good but if you back out the ATMs, it's not amazing," said Charles Mather, the managing director of equity capital markets at **Janney Montgomery Scott LLC**.

Janney arranged only one PIPE

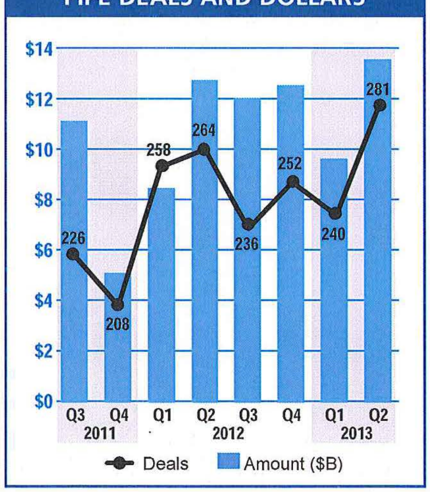
Top Q2 PIPE Placement Agents

Agent	Deals	$Volume
Roth Capital Partners	12	$233.59
Ladenburg Thalmann & Co.	9	$197.31
JMP Group, Inc.	6	$1,120.50
Stifel	6	$225.92
Dawson James Securities	6	$40.11
Jefferies Group, LLC	5	$278.42
Cowen and Company	5	$255.12
H.C. Wainwright & Co..	5	$36.26
Aegis Capital Corp.	5	$29.95
Craig-Hallum Capital Group	4	$78.86

Q2 PIPE Investor Ranking

Placement Agents	Deals	$Volume
Sabby Management	7	$33.64
Special Situations Funds	6	$13.59
RA Capital Management	6	$12.50
Downsview Capital, Inc.	6	$5.39
LH Financial Services	6	$3.00
Heights Capital Mgmt.	5	$8.19
Crede Capital Group LLC	4	$14.71
Wolverine Asset Mgmt.	4	$8.00
Hudson Bay Capital Mgmt	4	$7.05
Camber Capital Mgmt.	3	$14.70
EJF Capital LLC	3	$2.35
Kingsbrook Partners LP	3	$1.17
Iroquois Capital L.P.	3	$0.89
Equitec Group, LLC	3	$0.10

PIPE DEALS AND DOLLARS



during the second quarter, a $20 million common stock placement for **Cyclacel Therapeutics Inc.**

Enbridge Energy Partners LP, a natural gas pipeline limited partnership, announced the biggest PIPE of the quarter, a $1.2 billion private placement of convertible preferred stock to its general partner **Enbridge Inc.**

REIT **American Realty Capital Properties Inc.** issued the second and third largest PIPEs, a $455 million common stock deal and $445 million in convertible preferred stock.

Healthcare and pharmaceutical companies as usual led all industry groups with 88 PIPEs worth $1.31 billion. Technology companies announced 48 PIPEs worth $1.37 billion, followed by energy companies with 32 worth $5.35 billion.

"Volume from what I saw was largely driven by industry specific capital raising opportunities and not necessarily indicative of broad market appetite," said Ele Klein, a partner with **Schulte Roth & Zabel LLP**, in an e-mail. "I would expect a similar trend in the near term."

Schulte Roth advised the investors on a $76.2 million private placement of common stock by **First Security Group Inc.** in April.

IPO Surge

IPO activity almost doubled in the second quarter with 61 U.S.-listed deals raising $14.6 billion, according to data from Dealogic. That compared with only 34 IPOs raising $23.3 billion a year ago. The year-ago figures included **Facebook Inc.**'s $16 billion initial share sale.

Almost half of the second quarter's IPOs, or 27 deals, raised less than $100 million each.

ING US Inc., the U.S. insurance business being spun off by Dutch insurance giant **ING Groep N.V.** was the biggest U.S.-listed IPO of the quarter at $1.46 billion. **HD Supply Holdings Inc.** raised $1.1 billion. **Quintiles Transnational Holdings Inc.** raised $1.09 billion.

"It's an exciting time to be in IPOs," said Michael Pitt, the head of equity syndicate at **William Blair & Co.** in Chicago, in an interview. "We had the biggest first half in terms of deal count and gross spread in our history."

William Blair led or co-managed 43 IPOs and follow-ons in the first half. The IPOs included HD Supply, a $35 million deal for **Aratana Therapeutics Inc.** and a $395.25 million deal for **CDW Corp.**

"You're seeing the performance tails going up instead of declining," Pitt said. That's because the deals "have been priced well and have been received well. It's much easier to do in an up market."

The performance of IPOs in the quarter stands in sharp contrast to the performance of Facebook after its $16 billion IPO in May 2012. The social media company priced its IPO at $38 only to see its stock fall to less than half that price by September. Facebook is still trading well below its IPO price at around $26.

Pitt attributes the improvement in performance to an IPO market that has become "self-adjusting." After significant consolidation, the remaining investment banks in the business of underwriting IPOs have become much choosier.

"They've raised the bar," he said. "They don't want any screw-ups. They want bigger deals with more established companies. They're encouraging companies to stay private longer."

The Jumpstart Our Business Startups Act, enacted in April 2012, has also contributed to the improved outlook for IPOs, some say. It relieves businesses it defines as "emerging growth companies" from some of their previous public reporting obligations under the Sarbanes-Oxley Act and allows them to file for IPOs confidentially.

So far, Pitt said the JOBS Act's influence has been mainly in the "nuances" such as the ability to file confidentially. "We haven't seen the full impact yet, just the beginning," he said.

Pitt said the outlook for IPOs is positive because the economy is slowly improving.

"The money is starting to come out of bonds and will go into stocks," he said. "If the economy kicks in and we start to see some developments in technology and in life science, you could see an explosion in IPOs."

About 50% of IPOs are still coming from private equity firms looking to exit investments, he said. "When they start coming from private companies looking for capital to grow their own businesses, the IPO business will explode."

The number of follow-on transactions by U.S. listed companies surged 43% to 183 deals worth $48.9 billion from 128 deals worth $33.6 billion, a year earlier, according to Dealogic. Only 72 of the follow-ons raised less than $100 million, suggesting the increase was driven by larger, well-established companies.

The increase in follow-on activity may be coming at the expense of registered direct and confidentially marketed public offerings, said Janney Montgomery's Mather.

"Companies that might have done a CMPO or an RD are choosing to do follow-ons now," he said.

"The start to July is pretty good in the secondary market and as long as the secondary market holds these levels, the current small-cap equity financing activity should continue," he said.

SPACs

The second quarter also saw a resurgence in the moribund market for special purpose acquisition companies with one SPAC filing for an IPO and two completing IPOs. There were no IPOs by SPACs in the year-earlier quarter.

SPACs are blank-check companies that raise capital in IPOs and use the proceeds to acquire operating companies.

Capitol Acquisition Corp. II, controlled by Washington private-equity investor Mark Ein, raised $180 million in its initial share sale May 9 as investor demand allowed it to sell more stock than it previously planned.

The SPAC sold 18 million units, each consisting of a common share and a warrant, at $10 each. Capitol Acquisition had previously said it would offer only 15 million units.

Unlike many SPACs, Washington-based Capitol Acquisition Corp. II has not targeted any specific industries for acquisitions. The company said in its prospectus that it "will seek to capitalize on the approximately 21 years of private equity and venture capital investing experience and significant contacts of our Chief Executive Officer, Mark D. Ein."

Since 2007, Ein has been the co-chairman and majority owner of **Kastle Systems**, a firm specializing in building and office security systems, which he acquired through his personal investment holding company, **Leland Investments Inc.**

He also is the founder and CEO of **Venturehouse Group LLC**, a holding company that starts, invests in and manages technology, communications and related business services companies.

In the 1990s, Ein oversaw private equity firm **The Carlyle Group**'s technology and telecommunications investments.

Before launching Capitol Acquisition II, Ein started a previous SPAC, **Capitol Acquisition Corp. I**. It raised $262 million in its 2007 IPO and merged in 2009 with the REIT **Two Harbors Investment Corp.** in a deal valued at $592.2 million.

Another SPAC, **Medworth Acquisition Corp.**, completed its $52.8 million IPO on June 26. The Miami-based company said it intends to acquire a business in the U.S. specialty pharmacy, infusion pharmacy and drug distribution sectors.

Silver Eagle Acquisition Corp. filed on June 20 for a $250 million IPO to raise capital to buy a media and entertainment company. The IPO is expected to price on July 18, according to Dealogic.

The Santa Monica, Calif.-based SPAC is being sponsored by **Global Eagle Acquisition LLC**, which was founded by former **Metro-Goldwyn-Mayer Studios Inc.** boss Harry Sloan, Jeff Sagansky and James Graf in 2011, originally to sponsor another SPAC.

Their first SPAC Global Eagle Acquisition Corp. completed its IPO in May 2011 and raised $190 million. In January, the company acquired Row 44 Inc. and an 86% stake in Advanced Inflight Alliance AG for a total of about $430 million in stock. The two companies provide movies, television programming, games and Internet access to airline passengers. After the business combination, the company was renamed **Global Eagle Entertainment Inc.** Sloan and Sagansky are independent directors of Global Eagle Entertainment.

The second quarter was also relatively active with acquisitions by SPACs.

Prime Acquisition Corp. said on June 26 that it agreed to acquire Italian real estate assets of **Seba S.r.l.** and **Nova S.r.l.** from Italian financiers Francesco Rotondi, Giuseppi Pantaleo and Luca Massimo Failla for $26 million in stock, plus the assumption of debt.

The acquisition came after Prime signed a management agreement on May 23 with boutique advisory firm BHN LLC in connection with a previously proposed $200 million acquisition of a portfolio of Southern European real estate from **BHN S.r.l.** in Milan. BHN LLC is the U.S. affiliate of BHN S.r.l. It will manage Prime's assets following the acquisition.

BGS Acquisition Corp. said June 27 that it agreed to acquire **Black Diamond Holdings LLC**, a holding company with operations that include mining, healthcare and technology.

A previous deal for Denver-based Black Diamond to be acquired by another SPAC unraveled earlier this year.

BGS said in a statement that it will acquire Black Diamond in an all-stock transaction that values the company at $400 million.

Terms of the deal weren't immediately disclosed and representatives of the companies couldn't be reached for comment.

Black Diamond had previously agreed to combine with the SPAC China VantagePoint Acquisition Co. in August 2012 for $20 million in stock. That deal was called off in February.

Black Diamond owns a portfolio of small and development-stage companies, according to Securities and Exchange Commission filings. Its holdings have been said to include Eastern Resources Inc., a gold mining company in Montana; TransnetYX Holdings Corp., a provider of genotype-testing services for pharmaceutical and medical researchers; and Carbon Fuels LLC, which was developing a proprietary coal-refining process.

Reverse Mergers

There were 27 reverse mergers in the second quarter, where private companies went public by merging with U.S.-registered shell companies.

Twenty-one involved U.S.-based companies, three involved Chinese companies and three involved foreign companies from countries other than China.

Of the 27 reverse mergers in the second quarter of 2012, 19 were by U.S. companies, five were Chinese and three were foreign companies from other nations.

The number of alternative public offerings, reverse mergers that included PIPE financing, increased to a total of 10 transactions from six a year earlier.

The average deal size for those transactions declined to $970,000 from $1.33 million.

The largest alternative public offering in the second quarter raised $3 million for **Saleen Automotive Inc.**, which produces custom high-performance cars under the direction of former race car driver Steve Saleen.

David Feldman, a partner with the law firm of **Richardson Patel LLP** in New York, said that because the PIPE market has declined in recent years, many private placements are now more retail in nature, with non-institutional players doing the investing. "More deals that are smaller makes sense," he said.

Reverse mergers have, in the past, been a popular vehicle to bring China-based companies public in the U.S. At the reverse merger market's peak in 2010, 81 of that year's 258 reverse mergers were by Chinese companies, according to PrivateRaise.

The pace of those transactions has slowed to a trickle after a rash of Chinese accounting and stock frauds.

In the second quarter, three Chinese companies, **Life Nutrition Products Inc.**,

Moxian Group Holdings Inc. and **InZon Corp.** completed reverse mergers. None of the deals included PIPE financing.

Besides the three Chinese transactions, just three other reverse mergers were completed by foreign companies. Canadian-based **W.S. Industries Inc.** and **Rockford Minerals Inc.** closed mergers. **Xumani Inc.**, which listed its headquarters as the Cayman Islands, also went public by reverse merger.

Feldman said the decrease in foreign deals was the product of the troubled European economy and foreign companies accepting the dim view that capital markets have taken on reverse mergers.

Reverse merged companies have come under sharper scrutiny by the SEC and the Financial Industry Regulatory Authority in recent years, in part because of paid-for stock promotions.

Xumani was the subject of a $1.5 million paid stock promotion, according to Hotstocked.com, a website that tracks promotions. The company went public on April 29, and by May 10 it had a market capitalization of more than $77 million thanks to the promotions. The company had generated no revenues through the end of April, had assets totaling $72,145 and losses of more than $1.26 million. Xumani says that it's developing technology to improve the quality of live broadcasts over the Internet.

While healthcare and biotech companies have, in the past, found reverse mergers to be a low-cost alternative to IPOs, **Arch Therapeutics Inc.** was the sole company from this industry to go public using a reverse merger. in the second quarter

Beverage-related companies continue to use reverse mergers to gain public status. Water bottlers **Pinnacle Enterprises Inc.** and **NuZee Co.**; **Alkaline Water Co.**, which makes water purification systems; and **NOHO Inc.**, which distributes a beverage meant to prevent the symptoms of hangovers, all completed mergers in the second quarter.

Reverse mergers also proved relatively popular with energy-related companies. Wind turbine installation company **Windaus Global Energy Inc.**, alternate energy developer **Cornerstone Program Advisors LLC**, energy exploration company **Claimsnet.com Inc.** and oilfield services company **Aly Energy Services Inc.** all went public by merging with shell companies during the quarter.

-- *With reporting by Bill Meagher.*

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