



FRIEDLAND CAPITAL INC.

**Equity Financing Strategies for Micro-Cap and Small-Cap Publicly
Traded Companies**

INTRODUCTION

While there is no question that it's not the easiest task to obtain financing for a small-cap or micro-cap company, there are many financing strategies open to small-cap and micro-cap publicly-traded companies.

During a booming market, companies often seek to raise capital through a private placement because it is faster than a public offering. But in a bad or mediocre market, public companies often have nowhere else to turn, and various types of private equity financing are the only options available. Additionally, regardless of market conditions, micro-cap and small-cap companies usually find it extremely difficult, if not impossible to raise capital through a public offering. This is primarily due to concerns regarding potential shorting of a company's shares and other market support issues.

These "private placements" are securities that are privately sold to investors and cannot be resold until they are registered with the Securities and Exchange Commission ("SEC"), or an applicable exemption for the resale of the securities is available.

Private placement financing strategies basically fall into four categories:

- A. Private Investments in Public Equities, or "PIPE" Programs
- B. "Traditional" private placements, typically with an investment banking firm as placement agent (including "Private Investments in Equity" or "PIEs")
- C. Private placements, with strategic investors as the investors
- D. Institutional placed private placements

In general there are two basic kinds of private placements, "traditional" and "structured." Traditional private placements generally offer better terms for the companies. In a structured transaction, the investor typically gains if the stock price rises and is protected if the stock price decreases.

The protective feature of a structured transaction is often a "reset mechanism." This allows the investor to obtain more shares of the company's stock if the share price drops.

A. PRIVATE INVESTMENTS IN PUBLIC EQUITIES OR PIPES

In a PIPE transaction, investors typically purchase securities directly from a publicly traded company in a private placement. Depending on the structure of the transaction, this can be done at a premium to, or at a discount from the market price of the company's common stock. Because the sale of the securities is not pre-registered with the Securities and Exchange Commission (SEC), the securities are 'restricted' and cannot be immediately resold by the investors into the public markets. Accordingly, the company will usually agree as part of the PIPE transaction to register the restricted securities with the SEC. Thus, the PIPE transaction can offer the company the speed and predictability of a private placement, while providing investors with a nearly liquid security.

A significant advantage of PIPE transactions compared to traditional public offerings is that they can be completed rapidly - typically two to three weeks from kick-off to closing. In a typical PIPE transaction, due diligence is limited in scope because of the compressed time frame, and generally consists of a review of the company's filings with the SEC and press releases and investigative conference calls with the company's management, counsel and accountants.

The documentation for a PIPE financing is relatively minimal: typically consisting of an offering circular summarizing the terms of the financing and containing a description of the business of the company taken directly from the company's filings with the SEC, a purchase agreement, a registration rights agreement, an investor questionnaire, a legal opinion from company counsel and, in the case of a convertible preferred stock offering, a certificate of designations or charter amendment defining the rights and privileges of the preferred stock.

After the closing of the financing transaction, the company and its counsel typically prepare and file the registration statement to register for resale by the investors the common stock issued (or issuable on conversion of preferred stock or other securities issued) in the PIPE. Typically, the registration statement is filed within ten days after the closing, and the company is required to use its best efforts to have the SEC declare the registration statement effective within thirty days after the filing. The SEC may elect to review and comment on the registration statement, which could delay the effectiveness past this 30-day commitment. Once the SEC is satisfied with the registration statement, it will declare it effective and resales of the PIPE securities may begin. The company must keep the registration statement up to date during the entire time that PIPE investors are reselling their restricted securities pursuant to the registration statement.

B. TRADITIONAL PRIVATE PLACEMENTS

When one thinks about private placement financing, what usually comes to mind is what can be considered to be a "traditional" private placement. So called traditional private investments are typically arranged through investment banking firms, with the investment banking firms usually serving as placement agent. These include Private Investments in Equity, or "PIEs".

Simply stated PIEs are equity transactions where the investor is willing to not base their investment decision solely on trading volume, but one where they are interested in the company's business, and prospects for the future of the company itself. PIE® investor's objectives are typically a one to three year investment horizon, with transactions not requiring immediate or short-term registration of the shares. (PIE® investors will typically invest in "144" shares, with a one year hold).

With the reputation of the investment banking firm at stake, due diligence can be a grueling process. The negotiations regarding price, terms and structure can be lengthy.

Advantages and Disadvantages

Advantages include sponsorship by investment banking firms, who have track-records that can be verified. Typically, if an investment banking firm serves as a placement agent for a private placement financing, the firm will also "get involved" in supporting the shares and share price in the

market. Disadvantages include the time required to negotiate and close a transaction, which more than likely can be in the three to four month range.

C. PRIVATE PLACEMENTS WITH STRATEGIC INVESTORS

Strategic investors can often be the best investors. Most importantly, strategic investors are most likely to understand the company's business and prospects for the future. Often they have a "strategic reason" for investing, and therefore see advantages to their involvement other than simply financial returns from the investment. Often the investment is combined with contractual or strategic relationships including marketing or distribution agreements, or research and development relationships.

Advantages and Disadvantages

Advantages include a strong partner who understands the industry. Disadvantages often include lengthy due diligence, valuation issues which often put little value on the share trading price, and the frequent desire for strategic investors to become "active" investors rather than "passive" investors.

D. Institutional placed private placements

Having an institutional investor can be an excellent way for a publicly-traded company not only to obtain financing, but to start to obtain an institutional investor base for its shares. It is often difficult to find institutional investors, and more than likely the due diligence process can be lengthy. Negotiations regarding valuation are often made with little or no regard to share price.

Advantages and Disadvantages

Disadvantages include lengthy due diligence, and tough negotiations regarding terms which often include board representation, and valuation issues which often do not take into consideration the share trading price.



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