

Three Operational Modes of Back-door Listing in China

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Abstract: Backdoor listing refers to a transaction in which an acquiring company purchases a listed company and changes its main business. This paper provides a comparative analysis of the three operation modes for backdoor listing in China: reverse acquisition, agreement acquisition, and three-party cooperative acquisition. It discusses the advantages, disadvantages, transaction structure and compliance with the backdoor listing criteria defined by the China Securities Regulatory Commission (CSRC). The acquirer should consider the risks and benefits of each mode based on relevant legal provisions and regulations. Regulatory authorities, on the other hand, should use these provisions and regulations as screening tools to identify transactions that may pose serious risks to the capital market.

Keywords: Back-door Listing, reverse acquisition, Agreement acquisition, Three-party cooperative acquisition.

1. Introduction

Backdoor listing is also known as backdoor restructuring. The process of backdoor listing, also known as reverse merger, refers to a transaction in which the acquirer purchases a listed company and changes its main business. To determine whether a transaction qualifies as a backdoor listing, two conditions must be met simultaneously: a change in the actual controller of the listed company, and change in the listed company's main business. The change in main business implies a significant asset restructuring of the listed company. Backdoor listing needs to be evaluated in accordance with laws and regulations, including: firstly, the change in the actual controller of the listed company, referencing the Administrative Measures for Acquisition of Listed Companies (2020 Amendment); and secondly, the significant asset restructuring of the listed company, referencing the Administrative Measures for Significant Asset Restructuring of Listed Companies (2020 Amendment). To determine whether there has been a substantial change in the actual controller of the listed company and a significant asset restructuring, specific provisions in these two laws and regulations need to be analyzed. This paper introduces three modes of operation for backdoor listing in China: reverse acquisition, agreement acquisition, and three-party cooperative acquisition. By analyzing the definition, advantages, disadvantages, and transaction structures of each mode, this paper assists regulatory authorities in identifying and preventing potential risks to the Chinese capital market during the supervision process.

2. Mode 1: Reverse Acquisition

2.1. Definition

Reverse acquisition refers to the process in which the target company, which is to be acquired, is first acquired by the listed company through private placement. After the private placement is approved and the funds are raised, the acquirer then purchases a portion of the shares held by the major shareholder of the listed company in the form of cash.

2.2. Advantages

After the listed company's private placement is approved, the acquirer initiates the cash acquisition procedure, making the overall operation plan relatively secure. The initial use of the acquirer's own funds is relatively small.

2.3. Disadvantages

(1) Long operation cycle, approximately 12 months.
(2) High requirement for the professionalism and reliability of the financial advisory team.

(3) Requires high cooperation from the listed company: The acquirer can improve the cooperation level of the listed company by paying a deposit to the major shareholder in advance and providing value-added services to the listed company.

Whether it meets the criteria for backdoor listing defined by the China Securities Regulatory Commission (CSRC): It is possible. It needs to consider whether the actual controller of the listed company has changed and whether the future listed company will be involved in significant asset restructuring.

2.4. Transaction Structure

- ① Major shareholder: Major shareholder of the listed company
- ② Company A: Company designated by the acquirer
- ③ Loans: Company A lends money to the major shareholder for investing in the private placement shares
- ④ Repayment of part of the loan: The major shareholder pledges the shares obtained through the private placement for financing and repays the financing funds to Company A. The amount of financing is determined by the pledge rate of the shares.
- ⑤ Acquisition: The listed company achieves the acquisition of the target company by increasing capital or acquiring shares from the existing shareholders of the target company.

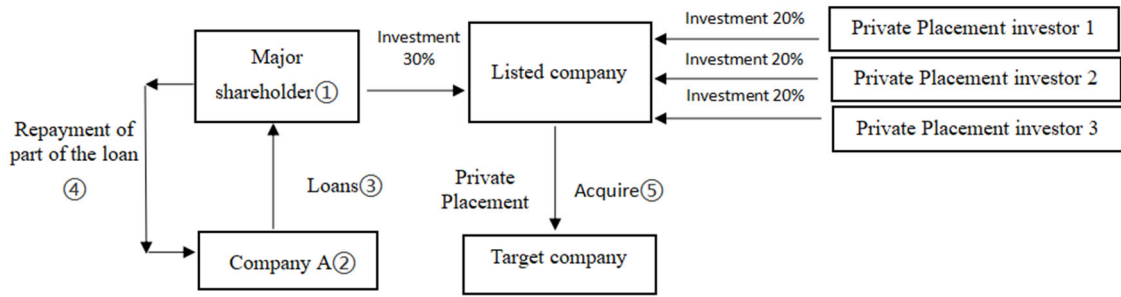


Figure 1. Transaction Structure of Reverse acquisition

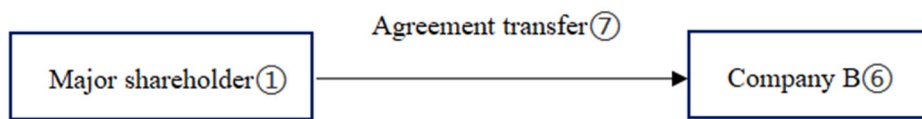


Figure 2. Transaction Structure of Reverse acquisition

- ① Major shareholder: Major shareholder of the listed company
- ⑥ Company B: Company designated by the acquirer
- ⑦ Agreement transfer: Company B purchases a certain percentage of the listed company's shares held by the major shareholder in cash.

3. Mode 2: Agreement Acquisition

3.1. Definition

Agreement acquisition refers to the acquisition party initially purchasing and controlling a listed company with cash, without altering the main business of the listed company. In the future, the listed company will raise funds through targeted issuance, and the funds raised by the listed company will be used to acquire the controlling rights of the target company, ultimately achieving a transformation of the main business of the listed company.

3.2. Advantages and Disadvantages

The acquiring party can prioritize the control of a listed company.

The initial cash acquisition by the acquiring party requires a relatively large amount of funds. The uncertainty of the subsequent targeted issuance of the listed company is strong. If the performance of the original business of the listed company is poor, the acquiring party may be exposed to the risks of the listed company being labeled as ST, *ST, or being delisted.

Whether it meets the criteria for backdoor listing defined by China Securities Regulatory Commission (CSRC): No. Because the acquiring party first controls a listed company, indicating that the actual controller of the listed company has changed. However, whether the listed company is involved in major asset restructuring needs to be determined based on the specific acquisition transaction of the listed company in the future.

3.3. Transaction structure

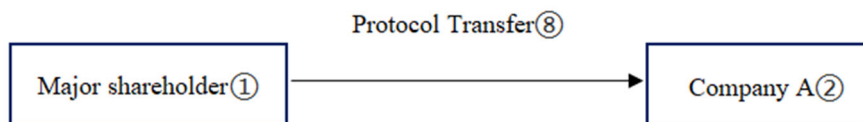


Figure 3. Transaction Structure of Agreement acquisition

- ① Major shareholder: Major shareholder of the listed company
- ② Company A: Company designated by the acquirer
- ⑧ Protocol Transfer: The acquiring party acquires the controlling rights of the majority shareholder in cash. The majority shareholder here refers to a company, not an individual.

4. Mode 3: Three-party Cooperative Acquisition

4.1. Definition

Three-party cooperative acquisition refers to the collaboration between the acquirer and a professional third-

party institution to achieve a backdoor listing. The specific steps involve the third-party institution's fund purchasing a controlling stake in a listed company, and the future listed company acquiring the target company designated by the acquirer through a directed share issuance.

4.2. Advantages and Disadvantages

The acquirer's own funds are not occupied in the initial stage.

The project is passive, and the acquirer lacks control. Both the acquisition of the controlling stake in the listed company and the future listed company's directed share issuance to acquire the target company need to be led by the third-party

institution. If the third-party institution discovers better target companies in the future or uncertain factors arise, the third-party institution can abandon the target investment designated by the acquirer and subjectively select the target for the directed share issuance.

Whether it meets the criteria for backdoor listing defined by China Securities Regulatory Commission (CSRC): No. The change of actual controller of the listed company is unrelated to the acquirer. Whether the future listed company is engaged in significant asset restructuring depends on the target company acquired by the future listed company.

4.3. Transaction structure

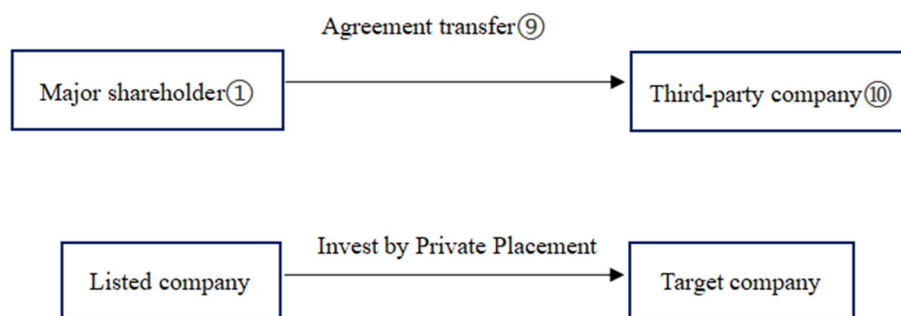


Figure 4. Transaction Structure of Three-party cooperative acquisition

① Major shareholder: Major shareholder of the listed company

⑨ Agreement transfer: The third-party company generally acquires the controlling stake of the major shareholder through a fund, where the major shareholder is a company, not an individual.

⑩ Third-party company: The third-party company generally refers to professional financial and stock advisory companies or investment consulting companies.

Factors to consider when selecting potential target listed companies for acquisition by the acquirer:

1. The listed company is not ST or *ST.
2. The net profit in the most recent financial report of the listed company should be positive.
3. It is preferable for the listed company to be a non-state-owned enterprise.
4. There is no financial fraud in the financial data of the listed company.
5. The listed company has no hidden external liabilities.
6. It is necessary to investigate whether the registered address of the listed company can be changed. If the registered address of the listed company can be relocated to some certain cities in China, the local government of that city can provide the listed company with cash subsidies and policy incentives such as land and factory subsidies in the range of tens of millions of yuan.

5. Conclusion

This paper analyzes three types of backdoor listing operation modes in China. A comparative analysis is conducted on the definition, advantages, disadvantages, transaction structure, and whether each mode violates the backdoor listing criteria defined by the China Securities Regulatory Commission (CSRC). Reverse acquisition, agreement acquisition, and three-party cooperative acquisition have their own advantages and disadvantages as operation patterns for backdoor listings. The acquirer needs to weigh the risks and benefits of each operation pattern based on relevant legal provisions and regulations. At the same time, regulatory authorities need to use corresponding legal provisions and regulations as a basis to screen and identify transactions that may pose serious risks to the capital market.

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