

# OSLER



OSLER GUIDE

## Reverse Take-Overs in Canada

### **Reverse Take-Overs in Canada**

A reverse take-over structure is often used where a traditional initial public offering is not feasible or practical. This guide is a practical tool to assist directors and officers, potential acquirors and investors in understanding the issues surrounding reverse take-overs.

© 2011 Osler, Hoskin & Harcourt LLP  
All rights reserved.

## **TABLE OF CONTENTS**

What is a Reverse Take-Over (RTO)?	2
Why Do an RTO?	4
RTO Options	6
General Steps to Completing an RTO	8
Other Issues	10
How We Can Help	12

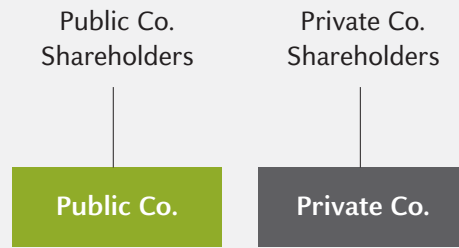
## What Is a Reverse Take-Over (RTO)?

Companies wishing to access the Canadian capital markets by listing on the Toronto Stock Exchange (TSX) or the TSX Venture Exchange (TSX-V) may become listed through a number of methods including a traditional initial public offering (IPO), through a special purpose acquisition vehicle (SPAC) or by completing a reverse take-over (RTO) of an existing listed issuer.

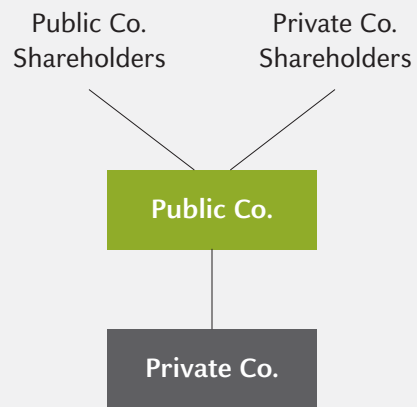
Generally, an RTO is a transaction whereby a company which is publicly listed on a stock exchange (Public Co.), but which has few if any assets, acquires all of the securities of a private company which has substantial assets and/or operations (Private Co.), resulting in Private Co. indirectly “going public.” Public Co. acquires the securities of Private Co. by issuing to Private Co.’s shareholders a significant number of shares in Public Co. (equivalent in value to the assets or operations of Private Co.).

Typically, the result of an RTO is a change of control in the ownership of Public Co. and in many cases, the former shareholders of Private Co. hold a large majority of the shares of Public Co. which remains listed on a stock exchange and which now also has assets and/or operations.

**Figure 1**  
**Pre-RTO Ownership**



**Figure 2**  
**Post-RTO Ownership**



## Why Do an RTO?

The IPO process in Canada is time consuming, uncertain and relies on public market conditions. An RTO structure is often used where a traditional IPO is not feasible or practical. An RTO does not necessarily include an equity financing component, so it is often used where the principal goal of the transaction is liquidity for shareholders from the stock exchange listing, versus an IPO where capital raising from the public is generally the principal goal. For example, during times of volatility in stock markets an IPO may be difficult to successfully conclude and risky if market conditions change and the offering cannot be completed.

In such circumstances a company can instead acquire a stock market listing, liquidity for its shares and access to the public capital markets, by completing an RTO involving a company which is already listed on an exchange. An RTO transaction is generally shorter in duration to complete and is more cost efficient from a professional fees basis than an IPO.

Certain Advantages of an RTO Compared with an IPO	Certain Disadvantages of an RTO Compared with an IPO
<ol style="list-style-type: none"><li>1. Volatility of stock markets mitigated.</li><li>2. Public Co. may have existing relationships with investment dealers and investors which can be continued.</li><li>3. Transaction predominantly regulated by a stock exchange rather than securities commissions.</li><li>4. Does not create the liabilities associated with filing a prospectus.</li><li>5. There is a pre-existing shareholder base which will make it easier for underwriters to effect a distribution and assist with liquidity considerations.</li><li>6. In many cases, no additional equity need be raised, avoiding further dilution to existing shareholders.</li></ol>	<ol style="list-style-type: none"><li>1. Public Co. acquisition increases cost of transaction.</li><li>2. Shareholders of Private Co. will suffer some dilution.</li><li>3. Careful due diligence of both Public Co. and Private Co. must be conducted, potentially adding time and cost to the transaction.</li><li>4. RTOs becoming subject to increased scrutiny by stock exchanges.</li><li>5. Corporate structuring issues post-closing may be more complicated.</li></ol>

# RTO Options

Many public companies in Canada are created and maintained for the purpose of engaging in RTO transactions with Private Co.'s seeking to access the Canadian capital markets in situations where an IPO is not the most viable alternative. Other Public Co.'s have wound up or disposed of their prior business and may have cash or other attributes as their only asset.

The preferred RTO transaction structure is dependent on a number of factors including the Private Co. sector and the maturity and sophistication of the Private Co.'s business. Although RTOs have typically been completed predominantly in the oil and gas and mining sectors in Canada, RTOs are not restricted to these sectors and are prevalent in other sectors, including the renewable energy sector and the industrial sector.

There are multiple forms of RTO transactions to gain access to the Canadian capital markets including the following:

TSX	TSX-V
<ul style="list-style-type: none"> <li>• Reverse Take-Over (Back Door Listing)</li> </ul>	<ul style="list-style-type: none"> <li>• Reverse Take-Over</li> <li>• Capital Pool Company (CPC) Qualifying Transaction (QT)</li> </ul>



An RTO may be structured on the TSX-V as a QT or structured on the TSX or the TSX-V as a traditional RTO. In the case of a QT, the TSX-V listed entity is a CPC and has been listed for the sole purpose of completing its QT. Generally, both structures result in the control being held by the former shareholders of Private Co. and require that, following the transaction, Public Co. meet the Tier 1 or Tier 2 listing requirements of the TSX-V or the Exempt Issuer or Non-Exempt Issuer standards of the TSX. The decision as to which exchange to list on will be partially driven by the minimum listing requirements of each exchange, which establish minimum net asset, working capital, aggregate market value and float requirements which must be met.

Each form of transaction involves the entering into of an agreement between Private Co. and Public Co. (at a minimum) which, depending on the structure of the transaction, may be one of the following: a share exchange, amalgamation, merger, or other transaction structure.

In the case of a traditional RTO, the transaction may include deal protection measures for the benefit of Private Co. including break fee and non-solicit provisions and deal protection measures for the benefit of Public Co. including shareholder lock-ups. In each case, the transaction agreement sets out the key terms of the RTO including timing, closing conditions, covenants of the parties and representations and warranties.

RTO's are often completed by way of statutory arrangement or amalgamation but can be completed in a number of ways including:

RTO Structure	General Characteristics
Amalgamation	<ul style="list-style-type: none"> <li>• Amalgamation of Public Co. (or a subsidiary) and Private Co.</li> <li>• Requires Public Co. shareholder meeting and 66<sup>2</sup>/<sub>3</sub>% approval</li> </ul>
Arrangement	<ul style="list-style-type: none"> <li>• Provides RTO structure flexibility</li> <li>• Requires court approval</li> <li>• Requires Public Co. shareholder meeting and 66<sup>2</sup>/<sub>3</sub>% approval</li> </ul>
Share Exchange	<ul style="list-style-type: none"> <li>• Shareholder approval not required in certain instances including QTs</li> <li>• Each Private Co. shareholder must enter into transaction agreement or second step shareholder meeting would be required</li> </ul>
Change of Control Event	<ul style="list-style-type: none"> <li>• May require take-over bid or meeting circular</li> </ul>

## General Steps to Completing an RTO

### **(A) Choose a Structure**

Consider the shareholders, costs, timing and tax, corporate, securities and other applicable laws when determining structure.

### **(B) Due Diligence**

Both Public Co. and Private Co. should conduct thorough due diligence of the other early in the transaction. Typically, Public Co. will have minimal assets and liabilities but it is important that Private Co. satisfy itself that there are no hidden, inherent liabilities in Public Co.

### **(C) Private Placement**

Often a private placement of securities, whether at Public Co. or at Private Co., is conducted at the same time as the RTO to ensure that following the RTO, Public Co. is able to meet the exchange listing requirements and have sufficient working capital to conduct its business post-closing. If so, the investment bank(s) involved in the private placement will also conduct due diligence of both companies. Securities offered in connection with a private placement may be subscription receipts (which automatically exchange into common shares of Public Co. upon completion of the RTO) or shares of Private Co. (which are exchanged for shares of Public Co. upon completion of the RTO). In the event that the private placement is of common equity of Public Co. (the closing of which may be conditional on the closing of the RTO transaction), a hold period (currently four months) would apply.

#### **(D) Preparing a Disclosure Document**

Regardless of whether Public Co. is listed on the TSX or TSX-V, Public Co. will be required to prepare a disclosure document containing prospectus-level full, true and plain disclosure concerning each of the companies to the proposed RTO, management, governance matters and other topics. The TSX and TSX-V will typically review the disclosure document before it can be sent to shareholders or otherwise publicly filed. This may be time consuming.

During the course of their review, the TSX or TSX-V may impose escrow requirements on certain shareholders and may require a fairness opinion or even an independent valuation if there is a related party transaction involved. They will also require evidence as to the experience and capability of management, and all members of management will be required to provide Personal Information Forms and to submit to police background checks. It is also likely that fulsome executive compensation disclosure for the three most recently completed financial years will be required.

#### **(E) Shareholder Meeting**

Typically both companies to the RTO will be required to hold a shareholder meeting to approve the RTO. The threshold of shareholder approval required depends upon the structure of the transaction and could be: a simple majority; a special majority; or a special majority together with a majority of the minority shareholders. However, in the case of a QT, provided that the Public Co. is not required under its governing corporate statute to hold a shareholder meeting, a shareholder meeting is not required. Nevertheless, Public Co. must deliver to the TSX-V and file on SEDAR a filing statement which contains substantially similar disclosure to that required in the context of a shareholder meeting.

If a shareholder meeting is required, Public Co. will be required to prepare its disclosure document (management information circular) and hold a meeting in compliance with applicable securities and corporate law.

## Other Issues

Completing an RTO typically takes three to six months. Each of the following issues can significantly impact this timing and requires careful managing.

### **(A) Financial Statement Reconciliation**

It is likely that the disclosure document will have to include three years of audited annual financial statements of both Public Co. and Private Co., quarterly financial statements, management's discussion and analysis of the financial statements and *pro forma* financial statements of Public Co. incorporating the financial results of Private Co. as at a specified date.

Depending upon the jurisdictions of the parties involved, reconciliation of financial information may be required. In addition, effective January 1, 2011, financial statements for Canadian public companies must be prepared in accordance with International Financial Reporting Standards.

### **(B) Sponsorship**

The TSX and TSX-V generally require that an approved sponsor be involved in the RTO, and the process of finding a sponsor should be commenced early. Investment banks that are Participating Organizations (of the TSX or TSX-V) are often selected as sponsors. Sponsors must complete prescribed forms which will require the completion of due diligence.

If a brokered private placement is completed at the same time as the RTO or there is significant involvement of an investment bank in connection with the RTO, the RTO will likely be exempt from the sponsorship requirement provided that the necessary due diligence has been conducted relating to the RTO and the related filing statement (in the case of a QT) or management information circular.

### **(C) Escrow**

Securities held by persons such as officers, directors, promoters and other insiders of the Public Co. post-closing will be subject to the escrow policies of the TSX or TSX-V and will be released from escrow on an incremental basis. The timing and the securities that are the subject of each release will depend on tests prescribed by the policies of the appropriate exchange. Where securities issued to acquire assets are equal to the value of the assets, escrowed securities will be released over a shorter period of time. Release schedules differ for different tiers of TSX-V issuers and depend upon other regulatory requirements which must be considered.

### **(D) Directors and Management**

There are independence and residency requirements which must be met by directors of public companies in Canada. In addition, the TSX and TSX-V will review the skills, competency and eligibility of management. Committees of the boards of directors must be struck in compliance with applicable stock exchange and securities laws.

### **(E) Technical Report**

If the RTO target is a mining company, compliance with National Instrument 43-101 – Standards of Disclosure for Mineral Projects (NI 43-101) is required. This will involve filing a technical report for material mineral resource properties held by the target, and necessary qualified person consents, which are prepared in accordance with the requirements of NI 43-101.

### **(F) Post-Closing Considerations**

Upon completion of the RTO the post-closing Public Co. will be a publicly traded company and a reporting issuer in some or all jurisdictions in Canada. Consequently, the company will have ongoing continuous disclosure obligations including preparing and filing annual audited financial statements, quarterly financial statements together with related management's discussion and analysis and an annual information form in the case of companies listed on the TSX. The company and certain members of management are liable for the contents of these documents. The company must also make timely disclosure of all material facts relating to it.



# How We Can Help

**RTOs have inherent complexities that need to be clearly understood and properly addressed. Experienced legal counsel is essential on all RTOs and for all clients, ranging from local start-ups to global enterprises.**

With the benefit of years of experience advising on successful RTOs, Osler can be trusted to provide clients with the right level of cost-effective legal advice required to lead a successful deal, for several reasons:

## **Involvement in High Volume and Range of Transactions**

We are effective at advising on and staffing all types and sizes of transactions, whether for domestic, cross-border or multi-national companies.

## **Breadth and Depth of Related Expertise**

Our leading RTO practitioners are complemented by top-ranked expertise in tax, securities/regulatory, banking & financial services, litigation, pensions, employment/executive compensation, mining, oil and gas, and all other specialized areas that are key to effecting a successful RTO transaction.

## **Client Focus**

We understand the business imperative behind a transaction and the business environments in which our clients operate. Our “client first” approach pervades every aspect of our firm culture and we bring that approach to the way we structure and negotiate a deal, mitigate risk and staff and efficiently manage files.

## **U.S./Cross-Border Legal Services**

We offer seamless legal services north and south of the border. Our Canadian and New York offices regularly work together to resolve cross-border issues in connection with RTOs, providing strategic, innovative advice.

# OSLER

Toronto

Montréal

Calgary

Ottawa

New York