

Public Financing for SMEs

The TSX Venture Exchange announced on April 12, 2010 amendments to its capital pool companies program (CPC). Notably, the maximum aggregate gross proceeds to the treasury of a CPC before listing increases from \$2 000 000 to \$5 000 000. Furthermore, the minimum total amount of seed capital has been increased where the gross proceeds of the CPC exceed \$2 000 000. The present letter reflects those amendments.

SMEs are always seeking out new sources of financing and the means to support their business strategies. The Capital Pool Companies Program (the "CPC Program") created by the TSX Venture Exchange (the "Exchange") provides them with a source of financing and a way to list their securities on the Exchange.

It can serve businesses in a variety of sectors, from mining to real estate. By its nature, the program falls somewhere between a traditional initial public offering and a merger and acquisition transaction.

ASSISTANCE TO ENTREPRENEURS

It should be noted that the name of the program is somewhat misleading. It might very well have been called the Assisted Capital Pool Companies Program, since its objective is to promote the stock exchange listing of businesses through the assistance of experienced administrators.

Thus, the CPC Program relies mainly on the competence of the management members of a Capital Pool Company (a "CPC") and requires them to possess a positive track record with public corporate governance and the ability to raise funds.

STOCK EXCHANGE LISTING

There are three principal ways to obtain a listing on the Exchange:

- Initial public offering ("IPO")
- CPC Program
- Reverse takeover

The main characteristic of the CPC Program, compared to an IPO, is that the CPC, at the time of its first listing on the Exchange, has only one activity: seeking out a qualifying transaction. Within 24

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months of its initial listing on the Exchange, the CPC must complete its qualifying transaction, namely, a transaction allowing it to satisfy the regular listing conditions of the Exchange.

A fourth way, relating to a listing on the Toronto Stock Exchange ("TSE"). It is the Special Purpose Acquisition Company ("SPAC") program, also known in French as SAVS ("sociétés d'acquisition à vocation spécifique"). SPACs are similar to CPCs and have the same objective as CPCs, but they must raise at least \$30M in the course of their IPO. On this subject, see Index De Grandpré, Corporate Financing, Public Financing for SMEs, August 2008.

THE EXCHANGE

The Exchange is owned by the TMX Group, which also owns the TSE and the Montréal Exchange. Its role is to foster the public financing of emerging SMEs.

The Exchange is open to Canadian and foreign companies. It provides an organized market for investors looking for investment opportunities in SMEs. The Exchange is a dynamic marketplace, with its own particular investment risks. In 2007, of the 273 new issuers listed on the Exchange, 180, representing 65% of new Exchange listings, were generated by the CPC Program. The Exchange's success can be measured by the number of companies that, after an active period on its trading floor, have graduated to a "senior" exchange such as the TSE, the New York Stock Exchange (the "NYSE") or NASDAQ. In 2007, 20 companies that began as CPCs were listed on the TSE, representing 9.7% of new TSE listings.

TYPE OF FINANCING	2008	2009	2010 (3 MOIS)
	(IN MILLIONS OF DOLLARS)		
INITIAL PUBLIC OFFERING	225,1	90,3	37,8
PRIVATE PLACEMENT	4 666,9	3 816,7	1 310,4
ADDITIONNAL PUBLIC OFFERING	608,5	936,7	356,5
TOTAL	5 500,5	4 843,7	1 704,7

As at March 31, 2010, only two of the 196 listed CPCs were from Québec. A significant part of the financing of Exchange listed companies subsequent to their IPO stems from private placements made by individuals or institutional investors. The following table sets out the financing obtained through an IPO or otherwise.

THE CPC PROGRAM

The CPC Program is essentially a two-stage process. The first stage consists in temporarily listing the common shares of the CPC on the Exchange and raising funds that will be used to identify and evaluate assets or a business in order to proceed with a qualifying transaction.

The second stage consists in completing the qualifying transaction, so that the resulting company can be listed under the Exchange's regular listing conditions. Once the qualifying transaction has been completed, the resulting company ceases to be governed by the special CPC rules and becomes listed as a regular issuer on the Exchange. Certain companies have used the CPC Program to list their securities on the TSE.

MANAGEMENT BY THE VENTURE EXCHANGE

The CPC Program has the principal characteristic of being well structured and managed by a recognized exchange. In particular:

- The CPC Program is the creation of an experienced and well-organized exchange.
- Its requirements are designed to ensure investor protection.
- Directors and officers of a CPC must have demonstrated their integrity, especially with regard to securities matters, and have shown relevant experience in the management of a public company and an ability to carry out a qualifying transaction.
- Directors and officers of the CPC must invest their own funds in the company at the onset of the entire process; they may lose their investment if no qualifying transaction is completed within 24 months of the listing of the CPC or if they fail to abide by the rules of the Exchange.

- After an IPO, a CPC's only activity must be the identification and evaluation of business opportunities in order to complete a qualifying transaction. During this period, a CPC may use its funds only for the purpose of fulfilling the objectives of the CPC Program.
- The qualifying transaction is subject to approval by the minority shareholders if the transaction involves persons not dealing at arm's length with the CPC.
- The CPC is subject to the same continuous disclosure obligations as other public issuers.

STRATEGIC ADVANTAGES

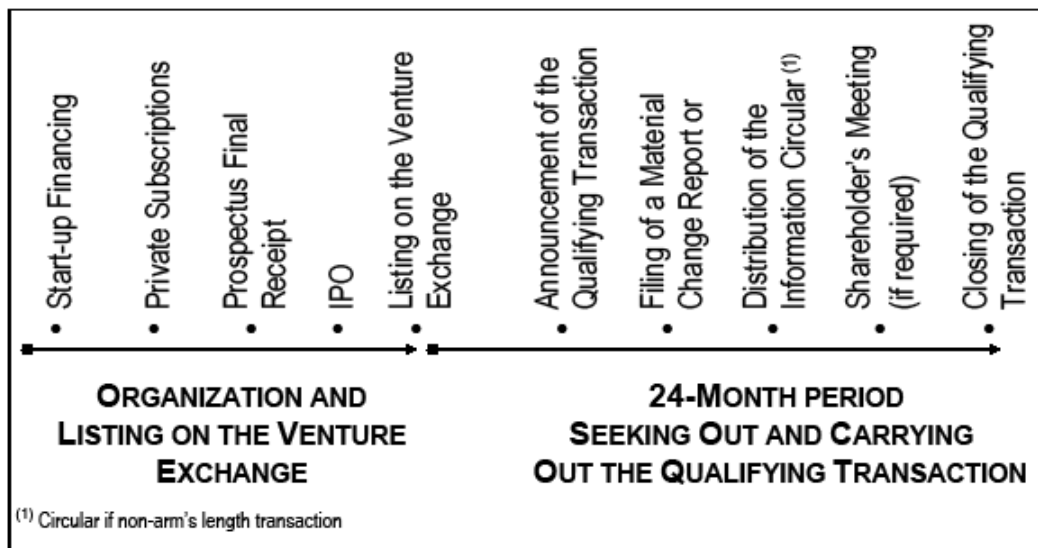
The CPC Program offers strategic advantages by matching a business with a management team experienced with the public capital markets, among other things. It provides access to a stock exchange listing where the financial burden of the IPO is primarily assumed by the CPC. The CPC Program should be considered when an operating company needs access to the public capital markets, but cannot easily do so through an IPO.

The degree of certainty of the result sought by an operating company—listing its securities on a recognized exchange—is the main advantage of the CPC Program. By comparison, in order to be successful, an IPO requires the participation of a syndicate of agents, as well as favourable market conditions. Such an operation will only be undertaken as a best-efforts underwriting, an underwriting in which the brokerage firms do not promise to reach a given result, but merely agree to use their best efforts to achieve the intended result, that is, carry out an IPO, without guaranteeing the outcome.

THE ORIGINS OF A CPC

Blind Pool CPC — In the first scenario, a CPC is launched by financial promoters. It completes an IPO and is listed on the Exchange as a CPC. At that point, it has not yet identified assets or a target company. Based on the reputation of its promoters, it is hoped the CPC will complete a qualifying transaction that creates value.

Operating Company CPC — The second scenario involves a non-arm's length transaction. In such a case, the CPC is incorporated and then listed on the Exchange by the directors or shareholders of an operating company, or persons close to it. At that point, the qualifying transaction is foreseeable, but not certain. It should be noted that the CPC Program cannot be used if an agreement in principle with respect to a qualifying transaction exists or is almost certain. There must be a significant condition, beyond the control of the parties, which could result in the transaction in question not proceeding and another transaction taking its place. For example, it could be contingent on obtaining financing concurrent with the qualifying transaction.



ADVANTAGES OF THE PROGRAM

Listing a company on the Exchange through a qualifying transaction with a CPC is advantageous for the company for the following reasons, among others:

Cost

It is a method of listing on the Exchange where the CPC assumes a large portion of the risk of completion.

Due Diligence

The IPO is an opportunity to raise funds to perform a due diligence examination of a targeted operating company and to carry out the qualifying transaction.

Listing Requirements

The CPC Program gives access to public capital markets to companies that do not meet all the listing requirements of senior exchanges such as the TSE, the NYSE or NASDAQ.

Minimum Number of Investors

When it is not certain that the IPO will attract at least 200 shareholders, one of the key listing requirements of the Exchange (300 shareholders for the TSE), a CPC makes it possible to fulfil this requirement.

Market Conditions

Market conditions are not always favourable for an IPO. For instance, a company could seek to list on the Exchange during a period when the market is not accepting IPOs. A listing through the use of a CPC would allow it to benefit from a market recovery.

Freely Tradable

Some investors willing to acquire stock in a company insist on freely tradable securities. For example, a company could take advantage of a private placement opportunity that is interesting, but is subject to the condition that the securities eventually become freely tradable, an objective it could achieve through a CPC.

In addition to the above-mentioned considerations for becoming a listed company which are specific to CPCs, the usual considerations also apply, such as:

Consolidation

A listed company has access to a type of currency often required for carrying out a business consolidation strategy.

Estate Planning

Within the context of estate planning, a company owner may want a larger market and increased liquidity for the shares of his company.

Human Resources

Attracting qualified executives may be easier with an inducement such as a stock purchase plan or a stock option plan which a public company is able to offer.

Exposure

The company may benefit from increased visibility for the marketing of its goods and services.

Transparency

A public company, because of the disclosure requirements, provides an added degree of confidence to investors and creditors.

OVERVIEW

Seed Shares

The starting point for a CPC is an initial investment of at least \$100 000 and at most \$500 000 by the directors and officers of the CPC, who are issued common shares in return. These seed shares are issued at a discount from the IPO share price. Their price must be at least equal to the greater of 5¢ or 50% of the IPO share price. Only common shares may be issued before the qualifying transaction.

Each director and officer must subscribe for shares for a minimum of \$5 000. These shares will be governed by an escrow agreement in

order to guarantee that the rules of the CPC Program are respected. As mentioned below, the directors and officers will be entitled to stock options of the CPC at the same price as the IPO share price.

Private Subscriptions

Subject to the above-mentioned \$500 000 maximum as regards shares subscribed prior to the IPO, shares may be issued to subscribers who are neither directors nor officers of the CPC. Given that these subscribers are not directors or officers of the CPC, they are not entitled to stock options. In order to avoid having to prepare a prospectus for this distribution, the subscribers will have to satisfy the conditions set forth in Regulation 45-106 respecting prospectus and registration exemptions, commonly referred to as a private placement.

Initial Public Offering

The CPC carries out an IPO, issuing common shares for a price of at least 10¢. Upon completion of the IPO, the CPC must have at least 200 "public" shareholders.

Total funds raised by issuing the IPO shares must equal at least \$200 000, without exceeding \$1 900 000. Total funds raised through seed shares, IPO shares and private

placements may not exceed \$2 000 000 before the qualifying transaction is completed. However, additional private placements are frequently carried out concurrently with the qualifying transaction.

Listing on the Exchange

After its IPO, the CPC is listed on the Exchange as a CPC for a maximum period of 24 months.

Once the CPC is listed on the Exchange, its shares begin to trade. It should be noted that a CPC's ticker symbol includes the identifier ".P". If the CPC fails to proceed with a qualifying transaction during this period, its shares will be delisted and the shares issued to persons not dealing at arm's length with the CPC will be cancelled and the shareholders will be entitled to require that the CPC be wound up. Alternatively, with the approval of the majority of the arm's length shareholders: (i) the CPC can file an application for listing on NEX, an alternative stock exchange offered by the TMX Group; and (ii) only half of the shares issued to non-arm's length parties will be cancelled.

Identification of a Qualifying Transaction

After an IPO, a CPC's only business and expenditures must be limited to identifying and evaluating opportunities and completing a qualifying transaction.

Qualifying Transaction

The purpose of a qualifying transaction is to allow the resulting company to satisfy the regular listing requirements of the Exchange.

This second step of the CPC Program begins with the CPC entering into an agreement in principle with the target company or the vendor of assets and the preparation of a CPC filing statement. If the qualifying transaction is not at arm's length, a detailed information

circular will have to be prepared and the qualifying transaction will be subject to approval by the majority of the public shareholders. The purpose of the circular is to disclose details of the qualifying transaction.

If a CPC experiences difficulties identifying or completing a qualifying transaction within the 24-month limit, it may, under certain conditions, undertake a merger with another CPC or a reporting issuer or ask the Exchange for a time extension.

Concurrent Private Placement or Public Distribution

Concurrently with the qualifying transaction, the resulting company may raise additional funding, exceeding the above-mentioned aggregate \$2 000 000 limit, through a private placement or a public distribution. This supplementary funding may be required in order for the company resulting from the qualifying transaction to satisfy the Exchange's regular listing requirements or simply carry out its business plan.

Listing as a Regular Issuer

Once the qualifying transaction has been completed, the resulting company registers as a regular issuer on the Exchange or on the TSE. From that moment onward, the company is no longer considered a CPC and is governed by the rules applicable to all TSE listed issuers. Moreover, certain undertakings, in particular as regards the escrow of the incorporators' shares, survive beyond the change of status.

USE OF THE FUNDS

The use of the CPC's funds during the period preceding the qualifying transaction is regulated and those funds may only be used to identify and evaluate assets and businesses with a view to completing a qualifying transaction. Until the qualifying transaction has been completed, the CPC may only use the lesser of 30% of the gross proceeds raised or \$210 000 to pay for its general and administrative expenses. This maximum does not apply to underwriting commissions (which cannot exceed 10%) or costs or to the expenses for identifying, evaluating and completing the qualifying transaction. The balance of the funds is transferred to the company resulting from the qualifying transaction or is returned to the shareholders in the event of a winding-up.

Certain payments to parties not dealing at arm's length with the CPC are prohibited prior to the completion of the qualifying transaction. These payments include salaries, consulting fees, directors' fees, intermediation fees and loans and advances. During the period prior to the qualifying transaction, all expenditures for investor relations activities are also prohibited, as are expenses to acquire or lease motor vehicles.

MANAGEMENT

Before completion of its qualifying transaction, a CPC's only assets are the funds it has raised and its team of directors and managers. The CPC Program depends largely on the qualifications of members of that team and, consequently, great importance is attached to their selection. Directors and officers must be residents of Canada or the United States or must have demonstrated a positive association as directors or officers with one or more public companies that are subject to a regulatory regime comparable to that of a Canadian exchange. They must collectively prove that they possess public company experience and are capable of identifying, evaluating and completing a qualifying transaction. The criteria and information used by the Exchange to determine whether these conditions have been met are the following:

- A positive track record with junior companies, as evidenced by the growth of such companies;
- The ability to raise additional funding;
- A favourable track record of corporate governance and compliance with securities legislation;
- Where warranted, technical expertise in the appropriate industry sector;
- The ability to identify, develop and complete the acquisition;
- Positive experience as directors or senior officers of public companies in Canada or the United States, as evidenced by the growth of such companies and/or the listing of such companies on a senior exchange such as the TSE, the NYSE or NASDAQ.

It should be noted that each of the proposed directors will be subject to an extensive legal investigation by the regulatory authorities.

INCENTIVE STOCK OPTION PLANS

Stock options may be granted only for common shares of the CPC and only to its directors and officers and, in certain circumstances, to its technical consultants. Optionees who cease their functions with the issuer after the qualifying transaction has been completed see their unexercised stock options expire within 12 months after such date or 90 days after the date on which the optionee ceases to be a director, officer, technical advisor or employee of the resulting issuer, whichever period is longer. Furthermore, stock options may be granted to the CPC's agent (the best efforts underwriter), as described below.

The number of shares that may be issued upon the exercise of the options cannot exceed 10% of the number of common shares outstanding after the closing of the IPO, and the number of common shares reserved under option for issuance to any given person may not exceed 5% of the common shares outstanding after the closing of the IPO. This percentage is 2% for a technical consultant. The exercise price cannot be less than the higher of the IPO share price or the discounted price at the time of the grant of the option.

Except for options held by an agent, no options may be exercised before the qualifying transaction has been completed, unless the purchaser agrees, in writing, to place such shares in escrow until the qualifying transaction has been completed. The shares will then be released over a period of 18 to 36 months, depending upon the tier on which the resulting issuer becomes listed and other factors.

ESCROWED SHARES

In order to protect investors and, among other things, prevent abusive speculative transactions, some of the CPC's securities must be held in escrow or be subject to a hold period for a period of 18 to 36 months. Escrow means that trading in certain securities issued by the CPC is restricted and that those securities are deposited with a third party.

All of these securities will be cancelled if, in particular, the qualifying transaction is not completed within 24 months following the listing on the Exchange, unless a majority of the arm's length shareholders approve the cancellation of only half of the securities.

Securities subject to escrow include, among others, seed shares issued at a discount to the IPO price and securities held by persons controlling the CPC or related to the CPC.

FOREIGN QUALIFYING TRANSACTIONS

If the qualifying transaction does not constitute an acquisition of significant assets in Canada or the United States and the resulting issuer does not operate in the oil or gas sector, the transaction will generally be permitted, but will be subject to filing of a disclosure document in the form of a prospectus. Given that qualifying transactions are subject to the same requirements regarding disclosure, sponsorship, escrow, price and minimum listing requirements as are other newly listed issuers, the Exchange concluded that there was no reason to prohibit foreign transactions.

THE IPO AGENT

In each of the territories in which an IPO takes place, the CPC must have a securities dealer acting as agent who is authorized to distribute such securities. The securities are distributed by one or more securities dealers by way of a prospectus. The agent's commission may not exceed 10% of the gross proceeds raised through the IPO. Agents are entitled to options covering common shares of the CPC at the IPO issue price and the number of common shares to be issued upon the exercise of the options cannot exceed 10% of the total number of IPO shares. These options must be exercised within 24 months after the CPC has been listed on the Exchange.

Le tableau suivant résume la situation après l'opération admissible :

	Actions	Prix	Total	%	Actions sous options
Actionnaires fondateurs	1 000 000	10 ¢	100 000 \$	2,1	
PAPE	6 000 000	20 ¢	1 200 000 \$	12,8	
Options fondateurs		20 ¢			700 000
Options placeur		20 ¢			600 000
Financement concomitant	12 000 000	25 ¢	3 000 000 \$	25,5	
Opération admissible	28 000 000	25 ¢	7 000 000 \$	59,6	
Total	47 000 000		11 300 000 \$ ⁽¹⁾	100	

⁽¹⁾ Avant frais d'émission

A SIMPLE EXAMPLE

Five promoters wish to invest in an SME that will eventually become a reporting issuer. At this stage, they have not yet identified a target company. They will attempt to identify a company that, once listed on the Exchange, will have good potential.

They agree to invest \$100 000 in the capital stock of a newly incorporated private company, representing an individual investment of \$20 000 for 200 000 shares at 10¢ per share. Each director receives stock options for the purchase of 140 000 common shares at 20¢ a share for a period of five years following the date of listing of the common shares on the Exchange.

Under the CPC Program, the company carries out an IPO in which it issues shares, at a price of 20¢ per share, to at least 200 shareholders from the public, for a total consideration of \$1 200 000.

The agent receives stock options for the purchase of 600 000 common shares at 20¢ a share for a period of 24 months following the date of listing of the common shares on the Exchange.

The company then obtains a listing on the Exchange as a CPC.

During the period when it is seeking out and evaluating potential qualifying transactions, the CPC can use a maximum of \$210 000 for its general and administrative expenses. There are no limits on the expenses related to the identification and evaluation of potential transactions. However, certain persons, including the directors, cannot receive funds for their services.

The directors of the CPC and the owners of a target corporation agree to proceed with a qualifying acquisition on the basis of a value of \$7 000 000 for the target corporation. The CPC will pay the

acquisition price for the target corporation by issuing 28,000,000 common shares at 25¢ per share. Furthermore, so that it can complete its business plan and meet its need for capital amounting to \$3 000 000, the resulting issuer will issue 12 000 000 new shares at 25¢ per share.

USE OF THE CPC PROGRAM TO LIST A REAL ESTATE INVESTMENT TRUST

Recently, real estate investment trust promoters have incorporated CPCs whose qualifying transaction consisted in converting the CPC into a real estate investment trust through a plan of arrangement, acquiring an initial property and carrying out a major public offering in order to establish a real estate portfolio.

The members of De Grandpré's Corporate Finance team are available to advise you and provide guidance every step of the way should you wish to consider the possibility of using the CPC Program.

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