

Going Private: U.S. Listed Chinese Companies

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Many U.S. listed Chinese companies have their eye on going private, with a growing number of such transactions having recently closed. This is the combined result of the current weakness of the U.S. capital markets, significant losses in the value of many U.S. listed Chinese companies, and pessimistic market forecasts that have resulted in trading at values below what controlling shareholders, management or private equity firms may think certain companies are worth.

Why Companies May Go Private

- **To save costs.** There are considerable costs associated with being listed on a U.S. exchange, including ongoing regulatory compliance and defending against shareholder lawsuits and other litigation. Further, in the case of leveraged buyouts, acquirers and targets may realize tax and accounting benefits of a more leveraged capital structure, as compared to a public company.
- **Strategic business reasons and the ability to manage the company .** Private companies are not required to publicly disclose competitive information, are provided more flexible corporate governance, and can focus on business objectives rather than investor relations issues and the short-term pressures of appeasing shareholders. Moreover, a going private transaction can allow for the restructuring of a company's businesses in ways that would adversely affect its stock prices in the short run if it remained a public company.
- **The ability to realize value.** Going private may allow shareholders to realize a better price for their shares than they would otherwise realize from continuing to hold the shares or selling them on an exchange. Further, companies may go public because analysts consider a company's share valuations to be low when compared to what the company could generate from other equity markets such as Hong Kong or Mainland China.

Challenges

Going private presents companies with challenges as well, including the inability to utilize the public markets to obtain immediate financing, a diminished public profile, and less transparency. Further, the going private process can be arduous and many such transactions are challenged in court.

Structures

A going private transaction may take various forms. Factors that influence the choice of structure include the need for outside financing, the composition of shareholders, and the likelihood of a competing bid for the company. Going private transactions are commonly structured as buyouts (either mergers or tender offers), and in some cases as reverse stock splits.

Special Committees

In order to mitigate litigation risks for the breach of fiduciary duties, boards need to ensure the fairness of a transaction to the company's shareholders, particularly where transactions involve controlling shareholders. As such, it is common for a board to appoint a special committee of independent directors.

Listing in Mainland China or Hong Kong

Some companies plan subsequent listings in Hong Kong or Mainland China, where they speculate the valuation for their companies may be higher. For companies that were delisted or suspended from U.S. exchanges, the stigma associated with such could pose a challenge with respect to a subsequent listing, as stock exchanges and regulators require issuers to disclose their history.

Conclusion

Some basic questions that the directors and senior management of all U.S. listed Chinese companies should be asking themselves when considering going private, include: what is the most appropriate going private structure? What is a price that is demonstrably fair? Is the special committee of the board sufficiently independent? How should detailed records be maintained of board and special committee meetings, transaction negotiations and other proceedings? How can the risk of litigation be minimized?

Sheppard Mullin received the "Taking Private 2011 Deal of the Year" award by *China Business Law Journal*, in recognition for its representation of Tongjitang Chinese Medicines Company Limited in connection with the company's going private transaction. To read more about the Tongjitang transaction, please [click here](#). If you have any questions, please contact the Sheppard Mullin attorney with whom you regularly work, or one listed below.

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