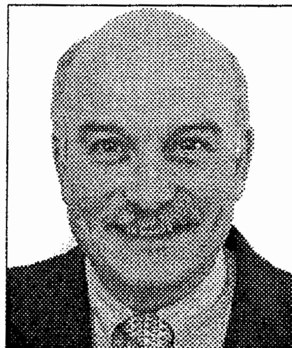
COMPANY INTERVIEW

# Tech Strategies LLC



**PETER GRAFFMAN** is the Managing Director of Tech Strategies LLC, a firm that specializes in consulting with public companies to develop financing strategies and corporate growth and development strategies. Prior to founding Tech Strategies, Mr. Graffman worked as a consultant to venture capital funds and companies seeking venture funding and was a successful entrepreneur. Mr. Graffman founded two software companies, one of which, InfoCellular, was sold to LHS Group, a NASDAQ listed public company. Prior to founding InfoCellular, Mr. Graffman spent 10 years in academia as an Assistant Professor of Operations Management and Information Systems at the Boston University School of Management and Bentley College. During his academic career, he served as a consultant to many private and public organizations including: Southwestern Bell Mobile Services (now Cingular), American Express, Chase Manhattan Bank, Bank Boston, U.S. Army, and The Department of the Navy. Mr. Graffman has an MBA with honors and is ABD, Doctor of Business Administration from Boston University where he was elected Beta Gamma Sigma. He is a member of The Association for Corporate Growth, The Council of Communication Advisors and The Massachusetts Telecommunications Council. Mr. Graffman serves on the Advisory Boards of several technology companies and academic institutions.

(YAM305) **TWST: Would you describe your firm?**

**Mr. Graffman:** Tech Strategies specializes in consulting with public companies to develop financing strategies and advise on corporate growth and development.

**TWST: What do you mean by financing strategies?**

**Mr. Graffman:** In today's market, there are a large number of financing options available to companies in order to fund company growth. In order to finance a company properly, there are many variables that must be looked at in choosing the right financing strategy. When institutional investors analyze financing or making an investment in a company, they may look at very specific characteristics of the company in making the investment or financing decisions. If they are making a private investment in a public company, they may look at trading characteristics of the company's stock — i.e., price and volume. Some investors may look at the company's balance sheet, others take a look at the company's growth potential and some may take a holistic approach to investing. We analyze the company to determine which type of investment or debt would be appropriate for the company, at this time, to meet their short-term and long-term financing objectives. We take investing or lending styles of the institutions into account and help the company develop the appropriate financing strategies. We then introduce institutional investors to the company that would be appropriate to achieve those strategies.

**TWST: Why is it better for a company to approach a consultant such as Tech Strategies in this process rather than just basically turning this process over to the CFO or Treasurer?**

**Mr. Graffman:** Oftentimes, we have what I would call "unconventional funding sources" that we can use to help finance the company. For instance, if you go to an investment bank, an investment bank obviously has relationships with many funding sources. Typically, they would use the same Rolodex of funding sources that they are familiar with.

We look at alternative approaches. As an example, reverse mergers are becoming increasingly interesting to people because of publicity they have been receiving. Reverse mergers present an opportunity for certain private companies to take advantage of raising capital in a much more cost-efficient fashion. Of course, it has to be the right type of company. We also work with public companies called BDCs (business development corporations) whose sole charter is to invest in companies. Oftentimes a public company may not realize that a particular type of funding source is more attractive at this particular point in the company's life cycle. My associates and I have been involved in managing public and private companies, so we try to give the company different perspectives on financing. We develop a strategy on how to raise money in the most capital-efficient fashion given their short-term and long-term financing needs.

**TWST: In your view, what is the right type of company for a reverse merger?**

**Mr. Graffman:** That's a good question. I get calls all the time from companies looking to do reverse mergers, because our Website talks about it and explains some of the process. First of all, the company has to have what I would call "significant revenue," since investors want to see a company that knows how to manage that business properly and is profitable or near profitable. Most importantly, a company has to have a 12-18-month plan that will be attractive to the public markets. This means that they should have a business plan that shows growth and presents management's perspective on how to achieve it. Also, the company has to have shown that that they have been able to execute their business plan in the past.

Typically a good reverse merger candidate will be a company that could have easily raised money privately, but it was not an attractive option because of unfavorable terms that seriously dilute existing shareholders or require giving up board seats to investors who don't add a lot of value to the company. However, as a public company, that particular company most likely will be able raise money in a less dilutive fashion and control their own destiny.

**TWST: You mentioned corporate development before. Do you also advise companies on their strategy after they have become public?**

**Mr. Graffman:** Yes. This is a very important factor. The picture we try to paint to the companies is this. If you have the characteristics to become a public company, you have to understand that this is going to mean not only managing your company from a business perspective, but also managing your company from the public perspective. As a public company there are three parts of the company that need to be managed: the management of the core business;) management of the public side from a shareholder and potential investor perspective; and from the regulatory perspective. Managing the public side involves disseminating the company's business and financial goals to the public market in a simple, concise and consistent fashion. By doing this, shareholders and potential investors will be able to determine whether the company is achieving its goals. That's the only way you are going to build shareholder value — to achieve your business plan and also communicate that well to the public markets. That's one of the things that some companies don't understand.

The third side of managing a public company, the regulatory side, requires extensive management. You are subject to all of the SEC and FASB regulations now in effect. This requires a tremendous amount of effort on the part of the company.

**TWST: What do you do to help companies manage the regulations?**

**Mr. Graffman:** For companies that we are consulting with or have consulted with in going public, a number of service providers work with us who are legal and accounting experts in this area. For instance, a company often has an accounting firm that they worked with as a private company. That firm may not be as well suited in the preparation of financial information for regulatory filings. They also might not understand all of the various accounting regulations that are applied to a public company. Consequently, we bring in service providers who will help the company in these areas. They may not necessarily replace the company's existing legal and accounting teams, but they will augment the services that these people provide. We try to do it in a cost-effective way, because obviously one of the issues that scares people today is the cost of being a public company, especially since the implementation of Sarbanes-Oxley. There are new sets of regulations, and we try to bring in service providers that will help the companies understand and implement them. Eventually some of these companies will want to bring some of these tasks in-house and we can help them transition gradually.

**TWST: And generally, you are saving people money by putting them in touch with the right people.**

**Mr. Graffman:** Yes, exactly. Sometimes we have clients who will look at doing reverse mergers. They'll go out and speak to some of the Big Four accounting firms, and immediately get scared away based upon the "Fear of God" that these accounting firms instill in them. In a recent *Financial Times* article, it discussed how the Big Four have doubled their fees to US clients based on the additional work required by Sarbanes-Oxley. We work with service providers who are independent but are also SEC-recognized. Our attorneys and accountants will help augment the company's existing service providers to fulfill the companies needs in terms of filings, legal opinions and financial statements.

**TWST: Do you also work with interested third parties like venture capital firms or investors in trying to find solutions to finance?**

**Mr. Graffman:** Yes. We have a network of deal sources and funding sources. We are also engaged by investment banks to consult with them on financing strategies for some of their clients. We are currently in discussions with venture capital firms that are taking an interest in a new way of taking their companies public. They are now exploring the potential of using reverse mergers for creating liquidity for some portfolio of companies. We also work with a number of funding sources. There is a fund on the West Coast that we work with that exclusively funds reverse mergers. We also have a network of accredited private investors that are interested in putting money into these deals

**TWST: Can you please discuss some of your successful deals?**

**Mr. Graffman:** We were involved with Halozyme, a biotech company in the San Diego area. Halozyme is an interesting company. This company has a recombinant enzyme, which replaces a bovine derived product for breaking down cell membranes. They were a late stage company seeking early stage capital. Initially they were looking to raise $8-$10 million, and they hired an investment bank to raise that money. The investment bank was successful eliciting two term sheets from two different venture capital firms for about $8 million. It would have met their funding requirements well, except that the term sheets that were received from the venture capitals "crammed" existing shareholders from about 70% ownership in the company to around 25% ownership. So there was a significant dilution involved in doing this deal.

The investment banker called us for help in looking at different funding alternatives. In looking at the deal it was apparent that the company had a strong management team, they had major revenue potential with a relatively low-risk strategy in terms of achieving that revenue. They had clearly defined, unique, and well-validated intellectual property and we thought that they really had a huge upside potential with minimum additional investment. Based on that analysis, we determined that the company would be a good candidate for a reverse merger. We, with the investment bank, brought the opportunity to this fund in California, Grove Street Capital Advisors. Working with the fund, a financing strategy was put together that included bridge financing to provide the company with an immediate cash infusion and funding the balance of the $8 million on the completion of the reverse merger. This provided the company the capital it needed, and when they were done, instead of being diluted to less than 30%, the management had roughly 45% ownership in the public entity.

**TWST: Where is the company now?**

**Mr. Graffman:** The company went public in March 2004 via a reverse merger, as an OTCBB company, and soon after applied for AMEX listing. They are now listed on the AMEX Exchange under the symbol HTI and just recently succeeded in raising another $14 million in capital October through a private placement. Halozyme has also submitted a 510(k) application for their first product for IVF, Cumulase to the U.S. Food and Drug Administration (FDA), which remains under review. When approved, the company's partners will target distribution of Cumulase to a US market consisting of nearly 90,000 ICSI cycles in 2005. The stock came out at $4 and now trades in a narrow range around $2/share. The market cap is approximately $100 million.

**TWST: Can you please describe your personal experience in reverse mergers and business? When did you start?**

**Mr. Graffman:** I describe myself as having a very strong management background grounded in business academics. I was a college professor for 10 years, ending my academic career as an Assistant Professor at the Boston University Graduate School of Management. During my academic career, I created a consultancy practice developing innovative IT strategies for large companies. Out of that consultancy practice, I founded a systems integration firm to implement these strategies developed for my clients.

One of my clients was a large wireless telecommunication carrier. We developed a software package for this carrier that we spun out into a separate software company. By 1998, 25 of the largest wireless telecommunication carriers in the world were our customers. We sold the company to a publicly traded wireless telecom billing software company. After selling the company, I helped raise capital for and joined three different software startups.

I also was a consultant for a number of venture capital firms in the Boston area. Around 2001, venture capital funds took a real beating. A lot of portfolio companies were going down the drain and VCs were shedding portfolio companies quicker than dogs shed their coat in the spring. Luckily for me, I was given the opportunity to do some business development for an institutional investor on the West Coast specializing in private investment in public equities (PIPE) transactions. This fund was also interested in funding reverse mergers.

So it was my work with them in the reverse merger area, looking at opportunities and doing all the groundwork and research, which gave us some background there. From an academic perspective, I'm very skilled at research, and I used my academic research background to study the reverse merger process, historically looked at reverse mergers, what made them successful, and what made them fail. We also looked at the mechanics of the transaction to understand from a legal and regulatory perspective what needed to be done and how to get it done. In addition, to be successful, you have to understand aftermarket support. This support involves getting the companies' message out, attracting investors, and building shareholder value. There are a lot of pieces and parts that are required in doing the reverse merger, and it's important to understand how these pieces all fit together in order to create a successful transaction.

It is not difficult to identify a reverse merger candidate, but it is difficult to complete the process from start to finish. Beyond the regulatory issues and all the pieces and parts in the process of completing the reverse merger, aftermarket support is tremendously important. Just because you start trading as a public company doesn't mean the public will line up to buy stock. It doesn't do a company any good to have a public company with no liquidity and no following. They might as well be a private company.

**TWST: Would you discuss any mechanical aspects or technical aspects of reverse mergers that our readers can avoid or execute on?**

**Mr. Graffman:** One of the major issues in a reverse merger is what we call "shell hygiene." When you merge a successful private company into a public company, that public company may or may not be engaged in business activity at this particular point in time. This public company may have liabilities that are not apparent under due diligence. It is difficult to check every county courthouse in the country to see if the company has liens or judgments against it. Additionally, there is the possibility that there are company shares in what I would call "unfriendly shareholder" hands that could present a problem when the merged entity starts trading on completion of reverse merger. There are many issues concerning a particular shell company that may have adverse effects in the merged entity.

So it's very important to understand the company you are merging with and the shareholders who are involved. There is the possibility that existing shareholders start dumping their shares on the market. This is especially a concern when the public company has been dormant from a trading perspective for any given time. These shareholders now could have liquidity and dump their stock. That could potentially be a problem.

So even if you can identify mechanically all the various regulatory, legal and accounting issues you need to deal with, you still have to deal with the "hygiene" of the shell. It's critical before going forward with the reverse merger.

**TWST: Could you describe a great aftermarket support portfolio or package that management needs to take into account upon completion of the reverse merger?**

**Mr. Graffman:** There are two key audiences you are trying to address with aftermarket support. You are trying to make the company visible to retail investors and also make the company visible to institutional investors. Obviously, there are certain characteristics about companies — share prices and liquidity, etc. — that may potentially make the company interesting to institutional investors. For instance, most mutual funds are not interested in companies whose share price is less than $5 or market cap is less than $100 million. That means that if a company has a price below $5, you have to look the retail markets to support your company in terms of liquidity. That means, of course, having good research available to the retail market. The idea is to have a company that can produce legitimate research about the company, its prospects, its business and its growth, something that when retail investors read, they can understand the potential of the company.

The second thing, of course, is getting that research out to the investor community. That typically is done through a variety of different channels. There are a number of investor relations and PR firms that are good and have good strong retail support. Their particular focus in investor relations and PR is geared toward a broad-based retail brokerage environment.

A good example of one channel for IR/PR is firms that solicit and maintain a database of opt-in types of e-mail participants. In addition, potential investors can get information from a company-sponsored Website or through an investor relations firm on a continuous basis. This information can be disseminated through video and audio interviews with the company's management and basic information that can highlight the company's business plan and the value to a potential shareholder.

If you can maintain a share price and market cap at certain levels, the company may be of interest to institutional investors. This requires broader aftermarket support that can be gained through relationships with large brokerage firms and large investment banks that maintain research departments and can sponsor research about that company. That typically means the company will have to develop a relationship with an investment bank and make them understand the potential value to institutional investors. The investment banks provide buyside research services to institutional investors. These include investment reports and investment conferences where companies can present their wares.

**TWST: Could you discuss the difference between a credible independent research provider and somebody who is more promotional?**

**Mr. Graffman:** First of all, we look at research from companies that develop research reports that are independent from the promotional, investor relations/public relations side of the business. You want to identify a research company that can write well, can explain the important highlights of the business in layman's terms, is honest, can explain the upside/downside potential, and lay it out in a simple, concise, and unbiased way that is easy to understand. That's the key. It's pretty easy to take a look at a research firm that's producing promotional types of reports because they are focused on one side — the upside. Quite frankly, the SEC is watching company's press releases and research reports very carefully. This is especially true when there are dramatic upward movements in stock price that can be correlated to the release of news or research. So the key thing is to make sure that the research writer is independent and unbiased.

Typically, we will look at the background of the people performing the research and where they have worked in the past. After the big investment bank meltdowns in 2001, a lot of good researchers were let go. Some of them set up shop independently. A lot of the people who we deal with have worked for the research departments in reputable investment banking houses. After leaving the iBanks, they developed a niche following and are respected in the industry. We just focus on those types of individuals and stay away from any groups that would be viewed as purely promotional. Once the research report is complete, then the research report can be made available on an independent basis from a number of different sources.

Today, most companies have a portal that they use for investor relations that has a wealth of information about the company. It contains presentation material from the company; it may have broadcast material that may have originated on radio or TV, and any company press releases. The research report would be one of those pieces of material that could be available to the public.

Again, promotional is okay as long as what you are promoting is the truth, and certainly it has to be tempered with any potential cautionary issues related to the company. Every company has an upside and a downside, and you have to present both sides of the equation and let investors make their own informed decisions on whether the company is a good investment.

**TWST: You mentioned the $5 mark. I have seen a lot of companies go public with the reverse merger price of around $2 to $3. Why do they do that?**

**Mr. Graffman:** When you develop a plan to do a reverse merger, you have to look at the capital structure. A company has an intrinsic value, whether it's a private company or a public company. There has to be some type of comparative value assessment of the company in order to bring the company out as a public company, much like an IPO. Valuation has to be somewhat accurate in order to maintain a share price. My feeling is that the public markets never lie; a company is worth what the public markets value it at. Valuation is different for a public company than it might be when a venture capital or private equity firm values a company. I've worked with many companies that raised money from venture capital firms. When venture capitalists make investments into private companies, their valuation doesn't necessarily have to make sense. Sometimes I have seen VCs overvalue companies in order to convince management to do the deal with them. I have seen management get excited and think, "Wow! Our company is worth that much!" Sometimes company management may miss the fine print. Some of these term sheets may have liquidation preference for multiples of the VC's investment. In these cases an overvalued company is not so risky to a VC because they can get X times their investment out of the company before anybody else gets a nickel. In essence, the high valuation does not make as much difference to them because of the preference terms and liquidation multiple.

On the public company side, however, valuation is a bit tricky. You try to make an assessment on what share price the market will sustain this company at based on the capital structure. For example, at price of $3, the market cap is 3 times the issued and outstanding shares. So if you look at a company coming out, you try to deliver the message of what a comparable public company is. In the end a company is going to be valued at whatever the market perceives the company value to be. So you have to be careful in terms of determing what a potential price might be. Certainly if there is not much liquidity in the stock as it comes out, at whatever the price is, it might not be a real gauge of company valuation.

Where you really determine valuation is when liquidity increases and you see significant buying and selling. So you have to be careful. For example, if you figure that a company share price is worth $2 per share based on your valuation and capital structure, you have to make sure that that's a sustainable price in the market.

Another consideration when determining the share price of a company as it comes out as merged public entity is how share price might affect investor demand and liquidity. For example, what will be the impact stock at $2 per share versus a $10 per share? It may be more attractive to retail investors to buy a company at $2/share than at $10 per share. If that is the case, the board may

want to consider adjusting the capital structure, based on company valuation, to theoretically achieve that price level.

**TWST: If you are going to price the stock and you know that institutional interest dramatically goes down below $5 a share, can you entertain the idea of a reverse stock split?**

**Mr. Graffman:** You certainly can, but a reverse stock split not only increases price but also reduces the liquidity in the stock. So it is important to look at the capital structure of the company. For example, if you have 25 million shares outstanding, which is a respectable number of shares to be trading in the public market, and the stock is trading at $1 when you wanted to get it to $10, you would have to do a 10:1 reverse split. This would reduce 25 million shares outstanding to 2.5 million, which doesn't give the company much liquidity. This creates an issue of the company trading really tightly, where a sale or purchase of a large number of shares in the company could dramatically affect the share price. So it's a trade-off in the capital structure or the price of the stock and whether or not you want to do a reverse split.

If the share's price gets down below $1, then that's something you will certainly want to consider. I remember the case of a well-known public company, Portal Software, a telecom billing software company (NASDAQ:PRSF). It is a NASDAQ company and traded for a long time after the telecom crash below $1. I think it ran down to $0.70. When the share price got up around over $2, they did a 5:1 reverse split — and brought the share price up to $10. Then management missed their projections, and the share price dropped back to just a bit over $2, where it has been for the last year or so. Some people say that you if you do a reverse split, then you are possibly putting the company in position for a lower market cap if the company doesn't have good fundamentals. Portal Software is a good example. If a company's share price is drifting lower because of poor fundamentals and you do a reverse split, you haven't cured anything.

**TWST: If you reverse the reverse-split, what happens?**

**Mr. Graffman:** Other than creating a lot of revenue for the transfer agent, I don't see the point, other than creating more share liquidity and a lower share price.

**TWST: Could you discuss some of the elements that make you most excited about reverse mergers and small cap financing in general?**

**Mr. Graffman:** I'm excited about the opportunity it offers for certain companies. Again, I am talking about companies that meet the criteria I spoke about earlier. It gives the companies the ability to access capital markets in a much more efficient fashion. For the right company, you can raise money a lot easier than you can as a private company. I am seeing many companies that have great management teams with business plans that include completing accretive acquisitions. Typically they need to raise capital in order to complete these acquisitions. I am meeting with these companies and talking to them about how they can implement their acquisition strategy much more effectively through a combination of raising capital in the public markets and using their public company stock as "currency" in completing the transaction. That's one of the most attractive reasons for a company to go public today through reverse mergers, not only raising money more efficiently, but also using their stock to effectively implement acquisition strategies. Today, there are a lot of companies evaluating this strategy.

**TWST: Thank you. (DW)**

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