White Paper
After Market Trading of Keating Reverse Merger Stocks

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I. Executive Overview

We are frequently asked about the trading activity and after market support in the stocks that we have taken public through a reverse merger. These questions come from both private companies considering merging into a Keating-controlled public shell company as well as from investors considering participating in a Keating private placement or public offering. The core assumption underlying the questions is the notion that both a company's stock price and its trading volume are 100% attributable to the efforts of Keating Investments. From an outsider's perspective, this is Keating's report card. While understandable, for a variety of reasons, this perspective is seriously flawed. The underlying assumption is that Keating controls (either largely or totally) all after market activities. In fact, historically we have had very little control, which has been a serious defect in our own business model. The purpose of this white paper is the following:

- To explain the difference in after market trading between an IPO and a reverse merger stock;
- To examine how public float is created in a reverse merger stock;
- To consider two wildly divergent views about how a reverse merger stock should be promoted;
- To demonstrate a major paradigm shift with respect to distribution that has occurred on Wall Street over the past 15 years;
- To highlight the important role of research as the foundation upon which an effective investor relations program is built, regardless of which approach is used;
- To describe how we are changing our business model to ensure that we have greater control, and corresponding accountability, for the after market trading of the stocks of our reverse merger portfolio companies;
- To introduce "After Market Support, LLC," a 100% Keating owned affiliate dedicated to addressing the highly specific needs of reverse merger companies and providing an alternative to traditional investor relations; and
- To share our perspective of value creation and how we measure our own results.

II. The Differences between an IPO and a Reverse Merger

A typical IPO takes over a year to complete. From the time that a company files its initial registration statement with the SEC to the time that the IPO is ultimately priced, the company is the subject of both extensive scrutiny and publicity. The scrutiny comes primarily from the financial data service providers and mutual/hedge funds that are in the business of tracking and investing in new public offerings, respectively. Wall Street's unwritten rule of thumb is to try to price IPO's so that the stock increases by approximately 10-15% on the first day of trading (the so-called "IPO Pop"). This "IPO Pop" let's Wall Street's underwriters declare victory for both sides—investors are able to show a quick gain and the issuers haven't left too much on the table. As a result, there is intense investor interest in the IPO pipeline as a source of potential short-term trading gains.

The publicity for an IPO comes with company road shows and from the extensive media coverage that is associated with waiting for the new issue to be priced. In many respects, it's like an expectant mother delivering a baby. Everybody knows she's pregnant and there is a shower (or two) along the way with a due date for delivery. When the mother finally gives birth, there is an announcement and all interested parties know the relevant details right away.

If an IPO is the "traditional" birthing process for emerging companies, then a reverse merger is the "adoption" model for going public. Specifically, a reverse merger usually takes place with zero fanfare and publicity. The investing public generally can have no way of knowing about a reverse merger until after it is completed.

In many respects, a reverse merger is analogous to an "IPO in reverse." What we mean by this is that there is a lot of buzz and publicity that accompanies an IPO. As a result, there is generally a liquid trading market from day one. Part of this liquidity, which will be described in significant detail later, is structural in nature—meaning that there is a sufficient number of freely tradeable shares at the outset. In a reverse merger, by contrast, it may take a year or so to get to the same level of trading volume. This year is used to promote and develop interest in the stock that would have otherwise been created in the IPO process as well as to increase the number of freely tradeable shares in the public float.

It should be noted that some reverse mergers are accompanied by heavy trading volume as soon as the transaction is consummated. There are a number of possible explanations for this, including the following:

- The promoters seek to "paint the tape" (in violation of NASD rules) by having friendly parties buy and sell with one another in effectively riskless transactions to create the appearance of heavy trading volume (which of course results in no new "real" shareholders for a company);

- Investors who participated in a private placement contemporaneous with the reverse merger engage (legally and ethically) in open market purchases to stimulate trading activity;

- The promoters carefully orchestrate buying from friendly parties on day one to create the appearance of public excitement about the announcement of the reverse merger; or

- There is a relatively high number of shares in the public float (20% or more) which allows an active market to develop more quickly than normal. In certain cases, this is caused by the illegal issuance of S-8 (i.e. freely tradeable) shares to promoters and capital raisers.

This heavy trading of the stock early can be disadvantageous if it is perceived as a "pump and dump campaign" designed for the short-term benefit of unethical promoters to sell their shares immediately following the closing of the reverse merger. In fact, many of the shares owned by unethical promoters may have become "freely tradeable" by fraudulent means in the first place (e.g. through the illegal issuance of S-8 stock).

For reasons described more fully below, unless and until more shares are brought into the public float, it is generally the case that there will be limited "legitimate" trading in reverse merger stocks. The challenge for our portfolio companies is to devise a strategy for creating bona fide long-term interest in the stock and, at roughly the same time, to ensure that there are enough shares in the public float for an active market to develop. At a higher level, this is a dilemma for all small public companies.

A micro cap company today effectively has two businesses to manage: (1) their core operations; and (2) the business of being a public company. Our general observation is that companies chronically and woefully under-budget for the latter. We are confident that with a thoughtful strategy, well-executed tactics and adequate budget, any of our exciting reverse merger companies will be able to "capture" the public company liquidity premium through an actively traded and liquid public stock.

III. How Public Float is Created in Reverse Merger Stocks

Another important difference between an IPO and a reverse merger is the size of the "public float," or the number of non-affiliate shares that are free to trade. In an IPO, anywhere from 20-50% of an issuer's common stock may be registered and freely tradeable on day one. By sharp contrast, the public float in a reverse merger consists only of those shares held by the stockholders of the public shell. Typically this number is in the range of 5-10%. However, this number may be significantly smaller because the controlling owner of the public shell (*e.g.* Keating) may own shares that are either restricted and/or subject to a lock-up agreement. In these cases, the public float may be reduced to as low as 1-2% of the number of shares of common stock issued and outstanding. For example, in a capital structure consisting of 10 million shares of common stock, the float might be as little as 100,000 to 200,000 shares. Under Rule 144, restricted securities must be held for a minimum of one year. After one year, each holder may generally sell up to 1% of the total shares outstanding in any 90-day period. After two years, there are no restrictions on resale (providing the holder is not an officer, director or 10%+ owner).

With such a limited number of shares available in the public float after the completion of a reverse merger, it is generally not possible for a liquid trading market to develop right away.

Since most companies that pursue a reverse merger do so in large part as a means to raise capital, one easy cure for a small public float is to register new shares for sale/resale in conjunction with an offering of equity securities. This registration can either take place before hand (in the case of a registered public, follow-on offering) or after an offering (in the case of a private placement). In a reverse merger, there is no magic bullet to solve the issue of very limited float. Unless and until securities are registered for sale/resale, it is very difficult for any type of an actively traded public market to develop.

One example of an effective way to create float on day one can be found in the China BAK Battery, Inc. (OTC BB: CBBT) reverse merger, completed in January 2005. In this transaction, the company raised $17 million in a private placement contemporaneous with the completion of the reverse merger. On the day after the reverse merger, CBBT filed a registration statement with the SEC registering all of the private placement investors' shares for resale. In all likelihood, this registration statement will be declared effective in 90-120 days, making those shares freely tradeable. In aggregate, the private placement investors' shares represented approximately 20% of the total outstanding.

It cannot be stressed heavily enough that creating the public float is only the first step in the process of creating a liquid trading market in a reverse merger transaction. The second step, described in more detail below, is to have an active and effective stock promotion campaign.

IV. Two Divergent Views on Stock Promotion

If Procter & Gamble launched a new product, how large would its budget be to advertise and promote the new product? Would it be $10 million, $20 million, $50 million or even more? Suffice it to say, the budget would be large, and the promotion would be intensive.

So when a new stock is created, by reverse merger or otherwise, why should the budget and general marketing principles used to promote that stock "product" be any different than those for a consumer product? We argue that they shouldn't, and therein lies the failure of many otherwise deserving micro cap stocks. In short, there is inadequate attention and financial resources dedicated to ethical stock promotion.

In its simplest form, there are two very distinct approaches to stock promotion: the "penny stock" approach and the "institutional" approach.

(A) The Penny Stock Approach

The penny stock approach hinges on the following assumptions:

- Companies go public to raise equity capital;
- As a general rule, most institutions will not fund companies that are not actively traded;
- Individuals will and do buy thinly or inactively traded stocks;
- The successful path to capital for micro cap public companies, therefore, involves two steps: (1) create buying through individual investors; and (2), then seek capital from institutions once there is an actively traded stock.

Moreover, the penny stock approach is predicated on the following behavioral assumptions with respect to the individual investor:

- ***Sizzle sells, steak doesn't***. Micro cap investors care about exciting stories, first and foremost. They care about growth, new technology, new products and services, and new markets. They care about home run potential. They do not care about "value", nor are they largely concerned with margins of safety or downside protection. The implication for this is profound: dull companies will make dull micro cap stocks that will never captivate significant investor interest. In short, penny stock promotional techniques will generally not work for dull, value stocks.

- ***Stock price***. Penny stock investors strongly prefer very low stock prices, because they believe that there is an opportunity to make a multiple return on their investments. Penny stock promoters recommend that a stock price should be between $.50-.75 at the start of a campaign. Stocks above $5 will not work (much harder for a stock to double or triple at $5.00 versus $.50), and that anything above $2 can become difficult.

- ***Content***. The content of news releases has to elicit a "visceral" response within 60 seconds. Stories and sizzle work. Complicated analysis, metrics and ratios do not. Also, critically, there has to be a steady flow of information (typically 4-5 meaningful releases over a 60-day period) to give the retail investor the feeling that there is always something going on with the company. But no amount of information flow will generally be able to overcome the lack of interest in a dull, micro cap stock.

The penny stock promotion uses a fully integrated marketing campaign to generate significant visibility for undervalued companies ranging from highly proactive, technology-driven communications, including sophisticated targeted e-mail and direct mail. In a penny stock promotion, companies pay anywhere from $150,000 up to $1 million in "third party marketing expenses" (i.e. above and beyond what they are paying an investor relations firm) over the first six months of a campaign, with the costs heavily loaded in the first few months. The third party marketing expenses are paid both for "sponsored mailings" (see below) and to "engines" (e.g. AllPennyStocks.com, PennyPicks.com, etc.) to create a "catalytic financial marketing event." The tangible benefit that companies gain is an actively traded stock, which is then used to facilitate a private placement of new securities.

Of course, if a company is not seeking additional capital, it may be a selling shareholder who is the immediate beneficiary of an active promotional campaign. And in many cases, the selling shareholder may bear some or all of the costs of the promotion. On the other hand, many private placement investors in reverse merger stocks are now requiring companies to reserve funds for stock promotion as a condition of the private placement.

Another technique that has become very popular and generally successful is the "sponsored mailing," where a glossy 8-12 page piece is sent by direct mail to anywhere from 250,000 to one million individual investors (at a cost of $1 per piece). In general, the pieces are well written with highly professional graphics and layout. This direct mail is "sponsored" by a financial newsletter whose ostensible purpose is to sell subscriptions to its own newsletter. In fact, the newsletter serves as the mouthpiece of the beneficiary of the promotion. The sponsored mailing has replaced e-mail spam as a very effective means to reach the individual investor with a specific call to action (i.e. buy the stock now).

Radio interviews and Internet TV financial programs are also effective non-traditional mediums for reaching the public directly. A hallmark of a highly successful promotional campaign is one that uses many pillars rather than a single one to reach investors directly.

Of course, it is critical that the timing of any promotional campaign should be coordinated with the addition of public float (for example, upon the effectiveness of a resale registration statement for private placement investors). A promotion in the absence of any available liquidity will cause the stock price to spike on limited volume and frustrate would be buyers of the stock.

(B) The Institutional Approach

The institutional approach differs in almost every aspect from the penny stock approach. Specifically, *adherents of the institutional approach believe* that:

- Any penny stock (generally a stock trading below $5 or on the Over-the-Counter Bulletin Board) must be viewed with suspicion. Therefore, capital structures should be set in a way that ensure that the stocks will have a minimum price of $5 per share;
- Ideally, stocks should trade on either the American Stock Exchange or Nasdaq SmallCap;
- Stocks should be promoted by investor relations firms primarily to sell side institutions (i.e. retail brokers) using traditional techniques (e.g. the broker lunch).

The logic is that the most efficient way to develop broad stock ownership is to have multiple retail brokers purchase the stock for all of their clients;

- Most paid-for research is generally tainted (although this view is softening based on the proliferation of higher quality research product); and
- Certain promotional campaigns (e.g. those with hype and exaggerated claims in news releases) should be viewed with suspicion ("pump and dump" programs).

It must be emphasized that the taint associated with penny stocks is very real. The abuses in the penny stock market by scammers are widespread and can be destructive to unsophisticated investors. As a consequence, nearly all major brokerage firms ban their brokers from soliciting penny stock orders (except in limited cases). And many mutual funds have internal policies prohibiting the purchase of stocks that trade at under $5 per share, on the Over-the-Counter Bulletin Board, or both.

So, which view is right? It depends. If a company has completed a reverse merger without contemporaneous financing and is seeking capital, we strongly advocate that a company should live in the penny stock world for a while to (a) develop an active trading market in its stock (first through the creation of additional public float, and then through an increase in volume); and (b) to complete its financing. This is critically important because volume begets volume. Without trading volume, as a general rule institutions cannot or will not become involved in the stock. A critical issue is the timing of a reverse stock split—for example to move a $1 stock to a $5 stock—to attract institutional interest.

On the other hand, if a company has completed its financing and otherwise qualifies for either an American Stock Exchange or Nasdaq listing, we would recommend that the company should skip the penny stock world altogether and position itself as an institutional stock. Of course, even as an institutional stock, a well-funded and active promotion campaign will be required to develop an active market in the stock. Remember, volume begets volume. No institution wants to be in a "roach motel" where it's easy to buy the stock but very difficult to sell it.

The two views converge in an interesting way. Once a penny stock company has completed its financing, it may then qualify for a listing on a higher exchange. The reverse stock split required to obtain a $5 stock price (for the higher listing) may in itself become a newsworthy event that marks the end of the penny stock campaign and the transition to an institutional approach. As mentioned earlier, the timing of a reverse stock split is critical and is somewhat of a Catch 22 in terms of attracting institutional interest. In an ideal world, the financing and reverse stock split would occur contemporaneously.

V. Paradigm Shift: Change in Focus from Sell Side to Buy Side

The goal of any investor relations campaign is to reach the ultimate buyers of stock. In the past 15 years, there have been a number of significant changes on Wall Street which, when taken collectively, represent a major paradigm shift in how issuers ultimately reach the public buyers of their stock. A synopsis of some of these changes is set forth below:

- ***Penny Stock Reform Act of 1990***. Effectively, this legislation has made it extremely difficult/impossible for retail brokers to recommend "penny stocks" (*i.e.* companies that trade on the Over-the-Counter Bulletin Board and/or for less than $5 a share) to their clients;

- ***NASDAQ reforms/decimalization***. As a result of various reforms, including the move from fractions to decimals in 2001 and the proliferation of Electronic Communications Networks, the number of market-makers on the Bulletin Board has decreased by about 75% in the past four years (from over 1,000 to approximately 225);

- ***Growth in hedge funds***. During this same period, the number of hedge funds in the U.S. alone has ballooned from under 1,000 to well over 5,000. Many of these new hedge funds represent relatively small pools of capital (*i.e.* under $25 million) that have total flexibility with respect to their investments; and

- ***Research***. As part of Wall Street's "Global Settlement" with the New York Attorney General, there have been major changes involving the separation of investment banking from research. This settlement will transfer $450 million annually from Wall Street to independent research firms for the next few years, fueling added growth to an already rapidly growing and competitive industry.

In short, the old sell-side oriented investor relations model focused exclusively on retail brokers pushing stock to their retail customers is defunct. In its place is a new distribution model focusing primarily on reaching buyers directly. Based on our own research (and examples which we will be to share), we believe that sponsored mailings and catalytic marketing events, as described above in the penny stock approach, are the most effective ways today to reach individual investors. By contrast, we believe that high quality equity research is the best way to develop institutional interest in a stock.

VI. The Role of Equity Research

Although there is a vocal minority of fund managers who believe that issuer-paid research is conflicted and not an appropriate form of research, increasingly institutional investors understand the dilemma that small companies face and are very willing to receive credible, issuer-paid research. Credibility is earned by providing the investment community with unbiased and innovative investment ideas coupled with accurate and valuable insights. Highly accurate research coupled with widespread distribution is the goal of all research providers. A synopsis of an effective research-driven model is set forth below:

- High-quality independent analysts produce…
- Accurate and insightful research, which creates…
- Demand for research from buy-side institutions, which results in…
- Increased interest and trading volume in the covered companies, which leads to…
- Improved stock price performance and increases in shareholder value.

Trying to convince Wall Street to provide analyst coverage for a small company's stock is a fundamentally flawed strategy because:

- Large Wall Street firms typically tie research coverage to investment banking business. Small cap companies cannot generate enough investment banking business to satisfy these firms.
- With new NASD disclosure requirements and the downsizing of Wall Street research, small cap companies are having more difficulty getting any research coverage at all.

Consider the following facts and statistics concerning the relationship between analyst coverage, institutional ownership and valuation:

- Small cap companies suffer from poor trading volume and lack of institutional ownership. Very thin trading volume results in irrational stock price fluctuations.
- According to a study by NASDAQ (March 2003), 44% of its 3,611 companies had no analyst coverage at all, and an additional 14% were covered by just one analyst.
- According to a study by Reuters, since January 2002 some 685 companies have lost research coverage, 98% of which have market capitalizations less than $1 billion.
- Almost 90% of U.S. public companies with market caps of $100 million or less have no research coverage, and 78% of companies with market caps under $250 million have no research coverage (*Source: Multex, JM Dutton*).
- Companies without research coverage trade at a discount to their covered counterparts. The discount results from a lack of liquidity in many small cap stocks. For companies with market caps under $250 million, the average P/E is 23.3 for covered companies and 20.3 for uncovered companies (*Source: Instream Partners, JM Dutton*).
- One analysis, in a 1999 study by professors Carl Chen and Thomas Steiner at the University of Dayton and Kam Chen at Western Kentucky University, found that the higher the number of analysts covering a stock, the higher the company's valuation. Each additional analyst can add about 2.5% to a stock's valuation, the study found.
- Increased analyst coverage is positively correlated with institutional ownership.

Analysts/Ownership	Market Capitalization (Millions)		
	$0 to $99	**$100 to $249**	**$250 to $500**
Average # of Analysts	1.7	2.6	3.9
Avg. Inst. Ownership	7.7%	28.5%	44.2%

Source: Multex, JM Dutton

- Without research coverage, companies are not included in the databases most commonly used by institutional investors.

- Attractive investment opportunities at the small cap end of the market are completely unknown to the institutional community.

In short, we strongly believe that a high quality research report with excellent valuation information should be an important part of any investor relations or stock promotion activity…regardless of approach. The key is quality. All too often, the "research report" is nothing more than a hastily composed company report, lacking any overall theme, any insight into the issuer's business model, a valuation opinion or offering any compelling reasons to own the stock. We think reports of this ilk are generally not read by serious investors and immediately end up in the trash bin, where they belong.

VII. Change in Keating Business Model

We strongly believe that after market success is highly correlated both to budget as well as to overall effort expended on the business of being a public company. As significant equity partners in and, in certain cases, advisors to our clients post-reverse merger, we have observed with regret that with one exception, all of our companies have woefully under spent on promotional activities. In nearly every case, this under spending has been accompanied by an equal neglect of managing the business of being a public company. As a result of our experiences and observations over the past four years, we have recently made some straightforward but nonetheless dramatic changes to our own business model. These changes can be summarized as follows:

- Our company selection process is now strongly biased toward exciting growth stories (that micro cap investors will care about) and away from stable, dull businesses that will be perceived as "value" situations and that will fail to generate enthusiasm or interest with the investing public;

- We are now financing most of our companies contemporaneously with the completion of the reverse merger and the subsequent filing of a resale registration statement immediately thereafter (in part, this contemporaneous financing also serves to generate some pre-trading awareness of the stock—similar to an IPO);

- We are advocating a policy of deferring company road shows and other significant promotional activities until there is an adequate number of shares in the public float (generally once a resale registration statement is declared effective);

- We are strongly recommending that all of our clients set aside adequate funds (up to $1 million in year one) to promote their stocks in a meaningful way. Although this is admittedly a very significant sum for a small company, we nonetheless advise that up to this amount should be set aside as a designated use of proceeds in any capital raise;

- For those companies seeking after market support but would not otherwise be raising capital, we advise that the same approach be utilized; albeit on a smaller budget. In certain cases, this may require capital to be raised for the sole purpose of promoting the stock (think of it as a liquidity enhancement allocation). Investors willing to provide capital for this purpose believe that the company is strong, exciting and deserving of funds to get their message out to Wall Street;

- We require all of our reverse merger clients to have research coverage, regardless of whether they ultimately choose a “penny stock” or “institutional” approach to their stock promotion; and finally

- We require all of our clients to consciously choose one strategic approach to stock promotion (prior to the completion of the reverse merger transaction) and to tailor their capital structures and stock prices accordingly.

VIII. After Market Support, LLC

After completing many reverse mergers over the course of the past four years, we have observed that:

- The work product (i.e. content) of most investor relations firms is exceptionally poor;
- Traditional investor relations activities generally are not effective and a waste of money; and
- Reverse merger companies have unique needs with respect to developing after market support that are not met by traditional investor relations firms.

In an effort to meet the unique needs of our reverse merger clients, we recently formed “After Market Support, LLC (AMS)” as a wholly-owned subsidiary of Keating Investments. AMS has two divisions: content and distribution. In the former, AMS creates high quality written materials around a central positioning message. In the latter, AMS uses both traditional and non-traditional techniques to promote the stock directly to investors. Much of the non-traditional work is sub-contracted to third party agents with marketing expertise in direct mail, television, radio and Internet promotion.

IX. Our Measure of Value Creation

We add and create value in two ways. First, we enable private companies to capture the significant valuation differential that exists between public and private companies. To be sure, we don’t lay any claim to the stockholder value that has already been created by our client companies. Instead, we measure the value of our services by the difference between the market capitalization of the public company and the private market value of the same company.

And second, we add value by creating liquid trading markets through which this valuation differential can be captured and monetized. Liquidity is virtuous. Liquidity is so important in the capital markets that investors generally attach a valuation premium of

100% or more for publicly traded companies compared to private companies with the same financial metrics. In the parlance of corporate finance, this valuation premium results in a "lower cost of capital" for public companies. Of course, unless there is an actively traded market in the company's stock, the value creation is illusory. The reason a "liquidity premium" exists is straightforward: investors are willing to pay up for the ability to sell stock quickly, even if they do not use that ability.

In the short-term, the goal of an ethical stock promotion campaign is to create awareness and to help create trading liquidity through a focused product launch. We believe that by (a) taking a company public through a revere merger, and (b) creating a liquid trading market for the stock, we are able to increase existing stockholder value by 100% or more. But the price of a stock over time will ultimately be determined by (a) the company's financial performance; and (b) the valuation that investors attach to those fundamentals. In the long run, the company's fundamentals will determine its destiny and stock price.