Frozen Food Gift Group, Inc. (FROZ)

Steer Clear of this Reverse Merger

Rating: **SELL**

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RESEARCH REPORT:

BACKGROUND:

What does an e-commerce retailer that sells and ships frozen desserts and a manufacturer of recreational, utility, and power sports products have in common? The answer is absolutely nothing – unless you consider Wall Street and the concept of a reverse merger.

A reverse merger (also known as a reverse takeover or reverse IPO) is a way for a private company (in this case APT Group) to go public by merging with a public shell company (in this case FROZ). At the closing of the merger, the shell company issues a substantial majority of its shares and board control to the shareholders of the private company. Upon this exchange, the privately held company becomes a publicly held company without the process and expenses of going through a traditional IPO. The ability to separate out the process of going public and the raising of capital (two functions that are combined in a traditional IPO) simplifies the process greatly. In addition, this process takes place over a much shorter time period than a traditional IPO (as little as 30 days in a reverse merger compared to potentially a year or more in an IPO).

Although APT Group can capitalize on FROZ's existing losses (currently there is a roughly $1.9 million accumulated deficit) by carrying forward these losses and applying them to future income, additional risks are assumed by APT Group as well. For example, FROZ could have existing lawsuits, poor recordkeeping, and/or other unforeseen liabilities. Further, aside from the negative stigma of associating this transaction type with fraudulent companies, reverse mergers have a history of failing to deliver any value to its shareholders. In fact, in 2011, the SEC issued an investor bulletin cautioning investors about investing in reverse mergers stating that they may be prone to "fraud and other abuses."[1]

COMPANIES INVOLVED:

In looking at a reverse merger, it is essential to consider both companies involved and their histories (both qualitatively and quantitatively, if available).

Frozen Food Gift Group, Inc. (FROZ) is an e-commerce retailer formed in 2009 that sells and ships frozen desserts, ice cream, ice cream cakes, ice cream sundae party boxes, and associated food products to

consumers and business customers. The company utilizes Global Specialty Products, Inc. of Orange, CA to handle operational functions including production, order processing, order customization, packaging and shipping. This vendor also produces FROZ's ice cream under a private label with SendaScoop. Last year, one of its subsidiaries, Miami Ice Machine Company (MIMCO), entered into an agreement with

BioZone Scientific International to incorporate the latest-generation ice machine sanitation technologies into the complete line of MIMCO ice machines.

The company faces a multitude of risks including, but not limited to, the fact that their independent auditors have raised substantial doubt as to their ability to continue operating as a going concern; they currently (and have always) operated at a loss; they currently generate little to no revenue; they are largely dependent on their CEO Jonathan Irwin for management and financial assistance; and they operate in the food gift industry which is very competitive especially given FROZ's limited product sales and brand equity.

Further fueling the idea that the company's financial reporting is poor (to say the least), FROZ filed a notification of late filing simply saying that it is unable to complete its annual report (Form 10-K) ended December 31, 2013 without an "unreasonable effort and expense." As such, the latest financial data that is currently available is from September 30, 2013 and shows an accumulated deficit of nearly $1.9 million since 2009. Furthermore, since its inception, FROZ has only generated $156,000 in revenue with none of that amount coming in 2013. Meanwhile, overall expenses have come down slightly but still remain high, and the company has increased its outstanding share count thus diluting its shareholders over the years. Lastly, as expected, the company has generated increasingly negative cash flows (both operating and free). Given these circumstances, it is no surprise that they entered into a reverse merger agreement with APT Group as FROZ would most likely have filed for bankruptcy at some point in the near future anyway. Although that still might happen after the reverse merger, I believe that APT's products definitely have more potential than FROZ's products do.

Taking a look at the other company in the reverse merger – APT (American Performance Technologies) Group – the company could not be more different than its public shell company. The APT Group is a holding company that manufactures and distributes recreational, utility, and power sports products through its subsidiaries. The company offers mini bikes, electric and dirt bikes, go-karts, scooters, portable generators, carburetors, and automotive engines. The company's mission is to "improve the environment by creating resources and opportunities for working families and communities" and does this by "manufacturing advanced products for a global marketplace."[2] The company is focused primarily on its SmartCarb carburetor, SonicFlow 2-Cycle Engine, and MotoVox motorsport product line.

The biggest problem with analyzing APT's potential is the fact that there are no financial statements available to the public other than the few numbers that the company has previously announced in their press releases. It appears that their MotoVox product line could generate a decent amount of sales going forward, but data regarding profits and margins have not been made public yet. In a recent press release from earlier this year, the company stated that their MotoVox products have generated an estimated $25 million in about three years – significantly more than the $156,000 in revenue FROZ has generated since its inception. These revenue numbers are based on the sale of approximately 100,000 power sport products over the years, and the company expects sales to continue to grow – especially

since these products are available in some major retailers such as Kmart and Sears Auto. The company claims that sales volume nearly tripled in 2012-2013, but expects 2014 to be a "transition year" as "management fortifies the company's already well-established foundation to capture dominating market share, expand to international markets and establish the MotoVox brand as a household name."[3]

Although management seems fairly optimistic about the future of MotoVox (and APT in general), I see a couple of problems with the information in the press release. First, despite Kmart being a big box retailer, they do not have the presence they once had and have been closing stores across the US for some time. Second, if a profitable, multinational and well-run company such as Ford Motor Corp (F) sees 2014 as a "transition year" and the market sells off shares of that company by over 10% on that news, there is no doubt in my mind that the market will not be happy when APT says 2014 will be a transition year as well. This will ultimately show up even further (if the stock isn't already back down to near zero) when the company's sales volume of MotoVox slows to less than triple the year's previous numbers. Further, the additional expenses in expanding overseas will significantly impact the company's margins and bottom line, thus pressuring shares even more.

Aside from APT's MotoVox product line, their other products/technologies (i.e. SmartCarb fuel system and SonicFlow small engine technology) could potentially help generate additional and significant revenue for the company in the future. This is especially true given the environmentally-friendly nature of both of these technologies, as well as the fact that most technologies that help improve fuel economy and lower emissions are currently at the forefront of investors' minds. The growing acceptance of alternative and environmentally-friendly technology should help APT garner additional attention in the future. However, given APT's lack of experience operating as a public company and without a significant management and marketing team, the true growth potential of these products and technologies may never be realized.

Lastly, while the company provided some guidance that it expects to earn between $16 and $20 million in 2014 with the potential to double revenues in 2015, investors should take that with a grain of salt. First, that is the company's own guidance which is unreliable at best. Second, and most importantly, the company has not provided us with any data regarding expenses, margins, cash flow, shares outstanding, etc. As such it is nearly impossible to say whether or not these *projected* revenue numbers are good or bad, or what they really mean for the company and shareholders. In the end, the most prudent thing for investors in FROZ to do is to wait and see what the new company will look like after the reverse merger is 100% completed and access to APT's financials have been granted.

CONCLUSION:

In my opinion, an investment in FROZ is unwarranted at this time given the reverse merger with the APT Group, especially given the fact that financials from APT are not currently available and the existing financials for FROZ are in no way positive. Although there is some guidance and possibly decent products in APT's patented technologies and product lines, I would steer clear of this stock until there is more clarity. Lastly, the fact that the APT Group was previously involved in a similar reverse merger with ProTek Capital last year and was mutually discontinued, offers additional and unnecessary risk in this reverse merger with FROZ.

Sources:

1 Gallu, Joshua. "Reverse-Merger Stocks May Be Prone to Fraud, Abuse, SEC Says in Warning." Bloomberg. 9 June 2011.
2 APT Group Website, About Us. www.powerapt.com/about-us.php.
3 PRNewswire Press Release Feb 10, 2014. "Frozen Food Gift Group Announces LOI to Merge with MotoVox."

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