PIPEs

What Agents Need To Know

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Financing Continuum

Private | Hybrid | Public

Less Liquid | More Liquid | Liquid

- Conventional private placements
- Private placements with trailing registration rights

- Traditional PIPEs
- Structured PIPEs
- Private equity lines

- Registered direct offerings
- 144A offerings

- Underwritten offerings
- Bought deals
- At-the-market offerings
- Equity shelf programs

Less Liquid   More Liquid   Liquid

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What Does This Mean for Your Clients?

- It's important to prepare for a financing so that when the market "window" opens, an issuer can finance quickly.
- An issuer must understand the different range of financing alternatives.
- It's become more difficult to understand the range of alternatives because there is great confusion concerning financial products/financing methodologies.

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A Potential Issuer Must Answer:

- how much money do you need?
- how quickly do you need it?
- how much dilution can you tolerate?
- what kind of investors do you want to attract?
- what near-term and long-term effects will the offering have on your stock?
- can a financing reduce your overhang?
- can you provide an orderly exit for affiliates, VCs or other long-time investors?
- how will the financing be viewed by the market?
- how will your disclosure be affected?

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PIPEs: Changing Terminology

"PIPE" has come to mean any private investment in a public company, including:

- A traditional PIPE;
- A private placement with delayed (or trailing) resale registration rights;
- A private convertible preferred (fixed or floater) or structured PIPE;
- A venture-style or change-of-control private placement;
- A registered direct; and
- A private equity line or equity shelf program.

Financing Structures and Investors

In addition to navigating through the terminology, agents need to understand that deal structures and investors are closely linked. For example:

- Sector buyers and issuers with liquid stocks;
- Sector buyers and issuers with less liquid stocks;
- Combination: sector buyers and financial buyers (hedge funds and cross-over funds); and
- Change of control purchasers: the VC's and distressed asset purchasers.

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Traditional PIPEs

Standard Terms of Traditional PIPEs

- Private placement to selected accredited investors;
- Investors irrevocably commit to purchase a <u>fixed</u> number of securities (usually common stock) at a <u>fixed</u> price, not subject to market price or fluctuating ratios;
- Immediately following execution of purchase agreements with investors, issuer files a resale registration statement covering resales from time to time of restricted securities;
- Closing of private placement occurs promptly upon notice of SEC's willingness to declare the resale registration statement effective; and
- Resale registration statement kept effective until shares may be sold under Rule 144(k).

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Relevant Considerations

- Engagement Letters
  - Should outline the agency fee, provide exclusivity, set out deliveries and provide for indemnification.
- Due Diligence
- Private Placement Memo
- Purchase Agreement

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Closing Conditions

- Purchase agreement contains standard representations and warranties;
- Delivery of a comfort letter and legal opinions (including a 10b-5 negative assurance) to placement agent (often not the case in straight privates and privates with trailing reg. rights);
- Delivery by investor to issuer and issuer’s transfer agent of a certificate as to compliance with prospectus delivery requirement before obtaining unlegended stock certificates; and
- Closing conditions limited to no occurrence of any material adverse change between execution and closing and SEC’s willingness to declare the resale registration statement effective.

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Considerations for Issuers

- Cannot issue more than 20% of outstanding stock in PIPE without shareholder approval;
- Purchaser, not issuer, bears full market risk;
- Short timetable, provided that there is no SEC review of resale registration statement;
- Format familiar to sophisticated institutional investors;
- Typically involves modest discount-to-market price;
- Compliance with Regulation M is required. Regulation M period applicable from the date of execution of private purchase agreements; and
- Can be used for primary and secondary sales.

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Traditional PIPE Offerings

- Advantages

- Low transaction expenses
- Attracts institutional or accredited investors
- No incentive for investor to hedge commitment by shorting the stock
- Transaction is not disclosed to the public until commitments from purchasers are received
- Investor executes a definitive purchase agreement
- Streamlined information and marketing material
- SEC certainty concerning treatment of PIPE transaction
- Possible to close and fund within seven days of “circle” (assuming no SEC review)
- Investor bears pricing risk after “circle”

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Traditional PIPE Offerings

- <u>Weaknesses</u>
- Investor will require a discount to market
- Limit on number of “blackout” periods for the issuer during effectiveness period of resale registration statement
- Can only be marketed to accredited investors
- Cannot sell more than 20% of issuer’s outstanding stock without receiving prior stockholder approval

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How Does a Traditional PIPE Differ from Other Financing Alternatives?

- The best PIPE candidates are issuers eligible to use an S-3 (or an F-3) for a resale registration statement;
- By comparison to a regular private placement, a PIPE will be executed more quickly;
- PIPEs generally are controlled by the placement agent, not by lead investors;
- Compared to privates with trailing reg. rights, PIPEs will have a lower discount-to-market;
- Because a traditional PIPE does not close until a resale registration statement is effective, it may not be a good technique for an issuer in immediate need of cash;

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How Does a Traditional PIPE Differ From Other Financing Alternatives?

- PIPE purchasers will be able to obtain clean shares shortly after the closing;
- PIPE purchasers usually are sector buyers; and
- Little likelihood of shorting prior to announcement in fixed price traditional PIPEs.

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Considerations

- Deal size: how much money can you raise
- Marketing the deal
- Disclosure issues
- Market dynamics, pricing and dilution
- Investors
- Market perception

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Privates with Trailing Resale

The Current Standard

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Standard Terms of Privates with Trailing Resale

- Private placement to selected accredited investors;
- Investors irrevocably commit to purchase a <u>fixed</u> number of securities (common stock or fixed rate/price preferred stock) at a <u>fixed</u> price, not subject to market price or fluctuating ratios;
- Purchase agreements are negotiated and executed with investors;
- Transaction funds and closes; and
- Issuer undertakes to file a registration statement covering the resale by the investors of their shares.

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Closing Conditions

- Purchase agreement contains standard representations and warranties;
- Delivery of legal opinions (frequently including a 10b-5 negative assurance) to placement agent and investors;
- Usually obtain comfort letter; and
- Delivery by transfer agent to investors of legended stock certificates.

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Considerations for Issuers

- Cannot issue more than 20% of outstanding stock in PIPE without shareholder approval;
- Short timetable upfront;
- Format familiar to investors;
- Depending on timetable for filing of resale registration, may involve a significant discount-to-market;
- Universe of buyers is more limited than for traditional PIPEs;
- Can be used for primary and secondary sales; and
- May involve penalty payment upon failure to have resale declared effective.

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Privates with Trailing Resale

- Advantages/Weaknesses
  - Generally fast execution;
  - Little need for public disclosure until definitive purchase commitments have been obtained;
  - Discount-to-market may be high (discount will vary depending on availability of registration rights and other factors);
  - Investors will vary greatly;
  - Similarly, the type of security that will be issued will vary; and
  - Execution costs generally will be lower than those for a public financing.

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Considerations

- Deal size: how much money can you raise
- Marketing the deal
- Disclosure issues
- Market dynamics, pricing and dilution
- Investors
- Market perception

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Structured PIPEs

Standard Terms of Structured PIPEs

- Few “standard” terms;
- Private placement to selected accredited investors;
- Investors commit to purchase convertible securities (preferred stock or debt), the conversion price of which may adjust or reset based on the issuer’s stock price either at the time of funding, at the time of conversion (a “future-priced” security) or based upon, or subject to, another trigger event;
- Resale registration statement will be required either prior to, or following, the funding;
- Penalty provisions associated with registration rights or with the availability of conversion shares; and
- Particularly in distressed situations, a structured PIPE may include operating and financial covenants.

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Considerations for Issuers

- Cannot issue more than 20% of outstanding stock;
- Purchaser and issuer share the market risk;
- Issuer must be certain that there are pre-negotiated caps or floors to protect the issuer from excessive dilution ("death spiral" or "toxic convert" effect);
- A format that is more common for (although not limited to) financial buyers, like hedge funds; and
- Structure of security offered may encourage shorting; consequently, the issuer should contractually restrict the hedging activities of deal participants.

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Considerations

- Deal size
- Marketing the deal
- Structuring the security
- Market dynamics, pricing, dilution and shorting
- Overhang
- Investors
- Market perception

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Change-of-Control PIPEs

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Standard Terms of Change-of-Control PIPEs

- Private placement usually only to a handful of institutions or VCs;
- Investors purchase a fixed number of securities (usually common stock or preferred stock) at a fixed price;
- Investors purchase a very significant percentage of the issuer’s outstanding voting securities, resulting in a change of control transaction; and
- Usually requires a shareholder vote to approve the transaction and related changes (amendments to the issuer’s poison pill, Board representation, etc.).

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Consideration for Issuers

- Longer timetable. Typically, VCs or distressed buyers will conduct their own extensive diligence, which may require several weeks or months.
- Non-public information. VCs and distressed buyers will want to enter into confidentiality agreements in order to obtain and review non-public information.
- Operating covenants. Investors will want to put in place stringent operating covenants, which will affect the issuer's day-to-day business.
- Board representation. VCs will want Board representation and may require a majority of the Board seats.

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Special Legal Considerations for Issuers

- Poison pill. Such a transaction generally requires amending an existing shareholder rights' plan.
- Charter amendments. The issuer likely will be required to amend its charter documents to designate a new class of shares, grant pre-emptive or other special rights and, possibly, increase the number of authorized shares.
- Going private concerns. Depending upon the size of the transaction, it may raise going-private issues.
- Fairness opinion. The Board is likely to want a fairness opinion in respect of the transaction.

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Considerations

- Deal size
- Structuring the security
- Distressed vs. Venture investors
- Market dynamics, pricing and dilution
- Market perception
- Overhang
- Rights offerings post-deal

Registered Direct Offerings

Registered Direct Offerings

- The market is in a cycle where registered direct offerings work well;
- A registered direct is most efficient when the issuer already has an effective primary shelf registration statement (although registered directs also can be used to sell secondary stock); and
- Registered directs are being marketed and sold by the private placement groups of many large investment banks as “registered PIPEs” or “strategic publics.”

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Standard Terms of Registered Directs

- If a shelf registration statement does not already exist, a registration statement on the appropriate form is filed with the SEC;
- Offering is conducted on an agency basis by the placement agent. Although the placement agent is likely to be a statutory underwriter, use of the firm's capital is not required;
- Offering is either on an all or nothing basis or, occasionally, on a min./max. basis;
- Purchasers do not negotiate or sign individual purchase agreements with the issuer;

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Standard Terms of Registered Directs

- Escrow agent is used unless it is an “any or all financing” because the transaction is covered by the “best efforts offering” rules;
- Closing can occur as soon as the registration statement is declared effective (if there is no shelf in place); and
- Closing occurs on a normal T+3 schedule.

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Registered Direct Offerings

- Advantages

- Fully registered distribution
- Potential investors review familiar documents (i.e., “red herring” and prospectus)
- Transaction closing procedures similar to an underwritten transaction (does not require legal review or negotiation)
- Lower discount to market than any private transaction
- Typically faster than an underwritten public offering (lower probability of SEC review since it is targeted at an institutional investor group)
- Difficult to short compared to a regular public deal because of limited distribution

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Registered Direct Offerings

- <u>Weaknesses</u>
- Higher transaction costs than a traditional private placement
- Issuance in the public domain (it will be known that the registrant has filed a registration statement, unless issuer has a shelf and registered direct being done as a takedown)
- Subject to SEC review
- Subject to Regulation M, so placement agent cannot stabilize stock
- Must have committed orders because placement agent cannot take any stock into inventory

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Considerations for Issuers

- Press release announcing filing of registration statement mentions* that offering is targeted to selected institutional investors. This factor tends to limit, or eliminate, shorting of the securities between filing and closing;

- Registered directs normally are used for follow-on offerings, but can be used for IPOs. With follow-on offerings, discount to market is usually no greater than with a standard follow-on;

- Because the distribution of the securities is covered by a registration statement, investors have immediate liquidity. In fact, the securities trade on a "when issued" basis;

**only if issuer does not have a shelf registration*

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Considerations for Issuers

- The 20% Rule is being applied to Registered Directs unless agents can demonstrate broad distribution;
- Because these transactions are registered, offerings can be made to virtually any potential investor, subject to appropriate suitability requirements;
- Registered directs are typically faster (and cheaper) than firm commitment deals and not subject to a significant discount (like a private transaction); and
- Hedge funds are unlikely to short between filing and closing.

Considerations

- Deal size
- Marketing the deal
- Disclosure issues
- Market dynamics, pricing and dilution
- Investors
- Market perception

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Equity Distribution Programs

At-the-Market Offerings

- An offering of equity securities by an issuer “into an existing trading market for outstanding shares of the same class at other than a fixed price on or through the facilities of a national securities exchange or to or through a market maker”;
- The registration statement must be on a Form S-3 or on Form F-3;
- The amount of voting stock to be registered for an at-the-market offering cannot exceed 10% of the aggregate market value of the company’s outstanding voting stock held by non-affiliates;
- These are becoming more common, especially for companies (like biotech companies or REITs) which require cash on a regular basis; and
- The pricing achieved in at-the-market offerings varies depending on whether the “take-downs” are based on formula-pricing or pure market prices.

Considerations of Other Legal and Regulatory Issues

- SEC registration statement questions
- Primary versus secondary stock
- Disclosure issues and Reg FD
- 20% Rule
- Shareholder votes

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Conclusions

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	Money	**Speed**	**Dilution**	**Financial Statements/Ratings**	**Tax**	**Disclosure**
PIPE	Small to medium sized deals	Moderate to fast	May be a concern	Usually common equity strengthens balance sheet.	Neutral	Disclosed after completion through a press release.
Registered direct	Small to large deals	Fast	Usually not a concern	Usually common equity strengthens balance sheet.	Neutral	Disclosed either at pricing (if off a shelf) or at filing (if using a bullet registration statement).
Equity distribution program	Small deals	Depends	Not a concern	Usually common equity strengthens balance sheet.	Neutral	Initially disclosed upon filing. Interim sales disclosed quarterly.

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