Financing Alternatives for Mid-size or Smaller Public Companies

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Capital raising alternatives

- Underwritten offering (marketed)
- Public deal with lead investors or “anchor” investors
- Public deal that is pre-marketed confidentially
- PIPE or registered direct
- At-the-market offering
- Rights offering to existing investors
- 144A offering

Selected financing situations

- Topics for discusion
  - PIPE
  - Registered direct
  - Pre-marketing offering

PIPE: original meaning

- Traditionally, a PIPE (Private Investment in Public Equity) is the privately negotiated sale (i.e., a private placement) of a public issuer's equity or equity-linked securities to investors, with the sale conditioned upon a related registration statement being filed with, and declared effective by, the SEC (permitting immediate or prompt resale)

PIPE: new meaning

- PIPE has come to mean any private investment in a public company, including:
- Traditional PIPE
- Private placement with post-closing resale registration rights
- Registered direct
- “Equity line of credit” or equity shelf program

Private placement PIPE terms

- Private placement to accredited investors
- Investors irrevocably commit to purchase a fixed number of securities at a fixed price
- Investors enter into purchase agreement
- Transaction funds and closes
- Issuer undertakes to file a registration statement for the resale of shares by the investors
- More “mainstream” financing, now being used by large public companies as an alternative to a marketed follow-on, a bought deal or an overnight deal on shelf registration

Registered direct

- Priced like a public offering; confidentiality similar to a private placement
- "Best efforts" placement of registered common stock off an existing effective shelf registration, generally to a limited number of institutional investors; securities are immediately eligible for resale
- Issuer must already have an effective primary shelf registration statement (can also use to for secondary sales)
- Two considerations:
  - Nasdaq and other 20% rule limitations
  - 1/3 cap on primary offering by smaller reporting companies

Registered direct

- A registration statement on the appropriate form is filed with the SEC (and declared effective)
- Placement agent conducts offering on an agency basis. Placement agent is likely to be a statutory underwriter, but use of the firm's capital is not required
- Offering is either on an all or nothing basis (escrow required) or on a minimum/maximum basis (escrow required) or on an any or all basis (escrow not required)
- Purchasers generally do not negotiate or sign individual purchase agreements with the issuer
- Closing can occur any time when registration statement is effective
- Closing on a normal T+3 schedule

Issuer considerations

- Transactions are registered, offering can be made to virtually any potential investor, subject to appropriate suitability requirements
- Registered directs are typically faster (and cheaper) than firm commitment deals
- 20% Rule is applied to registered directs unless agent can demonstrate broad distribution

Nasdaq considerations

- NASDAQ Rule 5635(c) requires shareholder approval for transactions involving issuance that may exceed 20% of the pre-transaction total shares outstanding or voting power that are priced at less than greater of book or market value
- Other exchanges have similar rules

Nasdaq considerations (cont'd)

- May exceed 20% if made in connection with the acquisition of stock of another company
- Issuances that may result in a change of control
  - Transaction resulting in an investor (or group of investors) obtaining a 20% interest (or right to acquire such an interest) is a change of control for 20% rule purposes
  - Exception for pre-existing control positions

Nasdaq considerations (cont'd)

- NASDAQ considers the following factors in aggregating private placement transactions for purposes of the 20% rule:
  - Timing of the issuances
  - Commonality of investors
  - Existence of contingencies between the transactions
  - Similarities between deal structures
  - Commonalities as to use of proceeds
  - Timing of the board of director approvals

Pre-marketed offering

- With market volatility, focus on speed of execution has intensified
- Important for issuers to be able to avoid shorting activity or other aberrational trading that may result from a “launch” announcement or from a broad based marketing effort
- Offerings are often marketed over an overnight or one-day period to shorten exposure to price/market risk
- Issuers and underwriters confidentially pre-market their offerings prior to the public announcement

Process

- Investors will receive material, non-public information regarding the issuer and the offering
- Investors must agree to keep this confidential
- Investors must agree not to trade while in possession of the material, non-public information

Non-disclosure agreement

- Need not be a formal written agreement, but it would be prudent to create an "audit trail" with a binding contractual confidentiality agreement between offeror and offeree.
- E-mail – two alternatives:
  - One-way e-mail to the potential offeree setting forth the confidentiality obligation; or
  - Two-way e-mail that asks for confirmation of acceptance of the confidentiality obligation by the potential offeree.

Pre-marketed offerings

- Issuer already has an effective shelf registration statement
  - Will the eventual offering be a public or a private offering?
  - Is the issuer's disclosure current? File updated risk factors? Provide guidance on the current quarter?
  - How best to update (if needed)?

Pre-marketed public offerings (cont'd)

- Plan ahead for all required or desired filings (e.g., Form 8-K, preliminary prospectus supplement or FWP, term sheet, press release, final prospectus supplement)
- Consider issuer's internal policies and procedures
  - Communications policy
  - Trading policy
  - Insider participation

"At-the-market" offering

- An offering of securities into an existing trading market at the publicly available bid price, rather than at a fixed or negotiated price
- Commonly referred to as "equity distribution" or "equity dribble out" programs
- Shares are "dribbled out" to the market over a period of time at prices based on the market price of the securities
- The number of shares sold in any single offering is not considered significant relative to the public float or daily trading volume
- No special selling efforts

Rights offering

- A rights offering provides an issuer's existing shareholders the opportunity (right) to purchase a proportionate number of additional shares at a specific price per share.
- The price is typically set at a discount to the recent trading price of the issuer's stock.
- All shareholders are given the right to purchase shares based on the number of shares they own on a specified record date.
- The rights offering typically remains open for a period of two to four weeks, usually starting from the day that the issuer's registration statement becomes effective (there are no federal securities laws requiring the rights offering to be open for a specified period of time).

Rights offering (cont'd)

- Capital raising opportunity
- Issuer may be able to complete without an investment bank (cheaper), or at lower commission
- Provides shareholders an opportunity to make an additional investment, usually at a discount to market
- Enables shareholders to avoid being diluted by the issuance of the new equity