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Alternative Capital Raising Options for Public Life Sciences Companies in a Challenging Market

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WEBINAR

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Introduction

- In light of current market conditions and continued uncertainty relating to the COVID-19 pandemic, public life sciences companies are carefully assessing their financial position, liquidity and cash runway.
- Companies should evaluate their ability to access the capital markets through more traditional capital raising transactions (e.g., follow-on equity offerings), as well as potentially available alternatives, such as:
  - ATMs
  - PIPEs
  - Registered Direct Offerings
  - Equity Lines
  - Rights Offerings
  - Convertible Debt Offerings
  - Non-Convertible Debt Finance Options

Introduction

– Public life sciences companies should also consider other potential liquidity sources, such as federal and state COVID-19 related relief programs, as well as other potential options such as strategic collaborations and licensing transactions, royalty and revenue monetization transactions and, where appropriate, M&A transactions and other strategic transactions.

At-the-Market Offerings (ATMs)

– Overview
  - Company enters into equity distribution or sales agreement with one or more investment banks
  - Sales made over time at then prevailing market prices pursuant to registration statement, with issuer having control over timing, volume, minimum price and other sale parameters
  - Sales may be made on or through the facilities of stock exchange or an ECN, or to participating investment banks purchasing as principal (such as a block trade)

At-the-Market Offerings (ATMs)

– Advantages
  - Well accepted financing mechanism in the life sciences space
  - Program can be set up quickly
  - Flexibility, with ability to control timing and volume of purchases, set minimum pricing and other parameters
  - Sales are made over time at market prices, with little disruptive effect on stock price
  - Able to source natural interest in stock (e.g., reverse inquiry sales)
  - Minimal requirement of management time (no roadshow or other significant marketing efforts)
  - Lower transaction costs relative to other equity capital markets transactions

At-the-Market Offerings (ATMs)

- Considerations
  - Availability of Form S-3 or F-3 primary shelf registration statement (or Form F-10 for Canadian issuer under MJDS)
  - Ability to raise significant amount of capital quickly is limited (sales are generally “dribble out” in nature, although program can be set up to contemplate larger block trades)
  - Limited discretion over shareholder placement
  - Initial set up and ongoing due diligence and disclosure obligations
  - Sales are at fluctuating prices
  - Overhang considerations

At-the-Market Offerings (ATMs)

– Other Selected Issues
  - Limitations for “baby shelf” issuers
  - Block trade/bought deal considerations
  - Regulation M considerations
  - Blackout period considerations
  - Interplay with other equity capital markets transactions

PIPEs

– Overview

- Private placement of equity and/or equity-linked securities, with back end registration rights
- Can involve the issuance of common equity, convertible or straight preferred equity or debt, or a combination of securities, and may also include warrants
- Depending on the transaction, investors may seek board seats and other minority investor protections and rights
- Investors can include private equity funds, hedge funds, venture capital funds, sovereign wealth funds, family offices, mutual funds, pension funds, high net worth individuals and other accredited investors

PIPEs

– Overview (Con’t)

- Often a transaction of choice in the following situations:
  – difficult market conditions;
  – where speed and/or confidentiality are important considerations;
  – strategic issuances, such as bringing in a significant private equity or other institutional investor or a strategic partner;
  – where a registration statement may not be available or usable (e.g., no effective shelf registration or insufficient capacity, or financial statements or SEC filings are not current, or required acquisition related financials are not yet available);
  – to finance a contemplated acquisition or other significant transaction; and
  – distress/rescue financing situations or as a financing of last resort.

PIPEs

- Advantages
  - Structuring Flexibility – Structure can be optimized to meet objectives of issuer and investors, including amount of capital to be raised, types of securities to be sold, and issuer and investor rights and protections
  - Speed of execution – Transactions can be completed quickly, and need not be hampered by lack of availability of a registration statement or availability of financial statements that might be required in a registered offering
  - Deals can be completed confidentially, prior to public disclosure and without advance pressure on stock price
  - Ability to target investors to fit issuer’s needs
  - Can be incorporated into a broader transaction with a strategic partner or financial investor

PIPEs

- Considerations
  - Deal terms can be very dependent on relative bargaining power of parties and investor demand/deal competition
  - Bespoke transactions can require significant negotiation and structuring
  - Depending on transaction dynamics, need to be aware of potential for significant discount on pricing and highly dilutive transaction features (e.g., floating conversion or exercise prices, pricing resets, ratchet adjustments, and similar provisions), provisions that may affect future ability to raise capital, as well as investor rights requirements, such as board seats and/or observer rights, voting/consent rights, participation or similar rights, covenants and other investor rights
  - Structuring should consider need to comply with stock exchange shareholder approval rules and other applicable stock exchange rules
  - In transactions involving a related party, a significant issuance relative to the issuer’s market capitalization or that will result in an investor acquiring or holding a large ownership stake, an issuer should be particularly mindful of fiduciary duties and, where a related party is involved, related party transaction considerations

PIPEs

- Selected Issues
  - Confidentiality and Regulation FD
  - Stock exchange shareholder approval requirements and other stock exchange rules
  - Potential need for investor due diligence and receipt of material non-public information by investor
  - Disclosure considerations with respect to investor
  - Issuer considerations such as restrictions on investor short sales and hedging activity, investor lock-ups, transfer restrictions (e.g., in addition to customary private placement transfer restrictions, investor lock-up, volume limitations, restrictions on transfers to competitors or large block sales or sales to large stockholder, etc.), standstill arrangements, voting agreements and investor confidentiality obligations

PIPEs

– Selected Issues (Con’t)
  - Investor considerations such as board or observer rights, consent/approval rights, information rights, covenants, issuer lock-up, participation rights/pre-emptive rights/ROFOs and other anti-dilution protections, indemnification and other rights
  - Resale registration rights and registration-related considerations (e.g., shelf registration vs. demand and piggyback rights, ability of investor to require issuer participation in an underwriting, etc., and potential SEC limitations on amount of securities that can be registered for resale)
  - Use of placement agent/financial advisor
  - HSR, CFIUS, DGCL Section 203 (or similar provisions), change of control and regulatory ownership limitation issues, restrictions in organizational documents and contractual agreements, existing rights plans, NOL implications, and similar considerations

PIPEs

– Selected Issues (Con’t)

- Transaction documentation (e.g. subscription agreement, investor rights agreement, registration rights agreement and, as applicable, documentation governing rights of applicable securities, such as a preferred stock certificate of designations, convertible note or indenture, warrant agreement, etc.)
- Sign and close vs. delayed closing
- Hedging and short sale considerations
- Regulation M considerations
- Section 13 and Section 16 considerations for investors

Registered Direct Offerings

- Overview
  - Similar to a PIPE, but with securities sold off effective primary registration statement, allowing investor to receive registered securities
- Advantages
  - Confidential transaction process prior to signing and announcement of transaction (similar to PIPE)
  - Transaction terms can be better customized to meet investor requirements (similar to PIPE)
  - Purchasers receive registered securities, and so pricing may be subject to lesser discount relative to a PIPE

Registered Direct Offerings

- Considerations
  - Wall crossing/confidentiality mechanics
  - Nasdaq and NYSE treat as a private offering for purposes of shareholder approval rules (e.g., need to comply with "20% rule," "change of control" rules, etc.)
  - Where used, placement agent(s) typically act on "best efforts" basis
  - Placement agents will typically require underwritten offering level due diligence, comfort letters, legal opinions and 10b-5 negative assurance letters
  - Other considerations similar to PIPE

Registered Direct Offerings

– Selected Issues
  - Similar in many respects to PIPE
  - For “baby shelf” issuers, limitations on offering amount
  - Written communications are subject to prospectus rules
  - FINRA filing may be required, if not exempt from filing requirements
  - Contingency structures (e.g., “all or none” and “min-max” structures) need to comply with additional SEC and FINRA requirements
  - Regulation M considerations
  - Prospectus Supplement required to be prepared and filed with SEC

Equity Lines

– Overview

- Arrangement with an investor that provides an issuer with a committed source of capital over a period of time (often ranging between 18 and 36 months), pursuant to which the issuer has the right (but typically not the obligation) to draw down, or put, its securities to the investor on contractually agreed terms and conditions pursuant to the equity line agreement.
- Equity lines may be done off an existing primary shelf registration statement, or on a private placement basis with registration rights. In either case, the investor will require liquidity for purchased securities at the time of any draw down.
- Price of securities at draw down are typically formula based, and linked to the market price of the issuer’s stock at the time of draw down.
- Transaction is effectively a PIPE or registered direct offering with delayed draws and pricing determined at time of draws (akin to an ATM, but with a predetermined purchaser and pricing mechanic).
- Issuers historically have tended to be smaller cap companies.

Equity Lines

- Advantages
  - Provides a committed source of capital over time
  - Draw downs are at issuer’s discretion, typically with no obligation to draw down
- Considerations
  - Where pricing of draw downs is based on market price at time of draw, equity lines can potentially be very dilutive, and issuers can experience significant stock price volatility and pricing pressure around time of draws
  - May use a forward-looking pricing formula, with price determined subsequent to delivery of a draw notice and issuer not knowing draw price until after draw notice is delivered; can also be structured so that pricing formula is backward looking and/or provide for a floor, giving issuer greater certainty around pricing at time of draws
  - Equity line provider may require an up-front commitment fee, often payable in common equity

Equity Lines

– Selected Issues

- Transactions are subject to compliance with stock exchange shareholder approval rules (e.g., 20% rule); accordingly, may need to cap issuances at 19.9%.
- Equity line providers will often want 9.9% or 4.9% caps, so as to stay below Section 16 or Section 13 thresholds.
- SEC takes position that equity lines are indirect primary offerings by an issuer and that equity line providers are underwriters that need to be named as such in prospectus. SEC also imposes strict requirements around transaction structure in order to register equity line shares for resale.

Equity Lines

– Selected Issues (Con’t)

- Because transaction is viewed as an indirect primary offering, registration statement must be on a form that the issuer is eligible to use for a primary offering.
- For “baby shelf” issuers, 1/3 public float limitation is applicable, and is required to be determined at time equity line is entered into.
- Reg M considerations in connection with draw downs.
- Issuers should seek to require anti-short sale and anti-hedging provisions in equity line agreement in an effort to minimize volatility and downward stock price pressure in connection with draw downs (although any selling activity by equity line provider may still result in downward pressure on stock).

Rights Offerings

– Overview

- Rights distributed to all shareholders, providing each shareholder opportunity to participate and maintain pro rata ownership
- Rights may be transferrable or non-transferrable
- May provide for over-subscription rights to allow for additional take-up of unexercised rights
- Rights offering may be backstopped by investor(s) (e.g., a significant existing investor or a new institutional investor) or one or more investment banks acting as standby underwriters

Rights Offerings

– Advantages

- Perceived as more democratic form of equity raising by permitting all existing stockholders to participate
- Can be used to raise large amount of capital (subject to availability on registration statement)
- Where rights are transferrable, non-participating shareholders may partially offset dilutive impact through sale of rights, and transferability can facilitate greater take up of offering
- Backstopped transactions assure issuer of raising minimum specified amount of capital

Rights Offerings

- Considerations
  - While more common outside the U.S. (where they are sometimes required by law), rights offerings are still relatively uncommon in the U.S. (although they are increasingly being seen)
  - Shares issuable upon exercise of rights are required to be registered under Securities Act (issuer can use existing primary shelf registration statement, if available and it contemplates the issuance of rights)
  - Subscription period usually lasts 16-30 days after rights are distributed; stock exchange rules require 10 days' advance public notice of record date. As a result, a rights offering typically takes about four to six weeks to complete from time of public announcement
  - In case of transferrable rights, rights will typically be listed on stock exchange for trading during subscription period
  - Backstop purchasers may require a backstop fee or other compensation; standby underwriters receive standby underwriting fees

Rights Offerings

– Selected Issues

- In addition to rights offering considerations, backstops can implicate many issues often seen with PIPEs (the backstop is effectively a contingent PIPE).
- While in most cases a rights offering can be completed without triggering stock exchange shareholder approval rules, in case of a backstopped rights offering, depending on the amount of shares involved and backstop structuring, stock exchange shareholder approval rules may be implicated.
- Backstop purchasers typically require resale registration rights (sales by standby underwriters, if any, are typically covered by rights offering prospectus, which will describe such activities).

Rights Offerings

- Selected Issues (Con't)
  - While rights offerings generally do not require the types of concessions to investors that are frequently seen in PIPEs (e.g. governance and minority investor rights), such issues may present themselves in connection with a backstop arrangement.
  - Terms of any outstanding convertible securities and warrants should be checked to determine whether rights offering may trigger anti-dilution adjustments or require that rights be distributed to holders of these securities.
  - Rights received by affiliates are restricted securities, and so cannot be transferred in connection with the rights offering unless registered.
  - Special rules may apply to foreign private issuers.

Convertible Note Offerings

– Overview
  - Convertible notes are typically sold in an SEC-registered or Rule 144A offering
  - Structure often provides for issuer to settle conversions in stock, cash or a combination of cash and stock, at issuer’s election
  - Often coupled with a stock repurchase and/or call spread or capped call to mitigate dilution

Convertible Note Offerings

- Advantages
  - Allows issuer to effectively sell stock at a premium relative to a straight sale of equity
  - Ability to settle conversions in cash or on a net settlement basis provides issuers with optionality to mitigate dilution, which can be further mitigated through call spread or capped call (as well as through a concurrent stock repurchase at time of offering)
  - Lower coupon and with far less in the way of covenants relative to straight debt
  - Rapid execution
  - Well accepted in marketplace, and particularly popular in periods of market volatility
  - Anti-dilution adjustments generally not implicated by future capital raising transactions

Convertible Note Offerings

– Considerations
  - Debt on balance sheet
  - Repayment/refinancing risk if underwater at maturity or at time of a fundamental change
  - Fundamental change put rights and conversion make-wholes
  - Anti-dilution adjustments include investor dividend protection and other customary adjustments
  - Ability to call bonds or otherwise refinance
  - Accounting and tax treatment and related considerations
  - Hedging activity by investors and, in case of call spread or capped call, derivatives counterparties

Convertible Note Offerings

- Selected Issues
  - Repayment/refinancing options in event stock price does not perform well
  - Ability to incur convertible debt under other existing debt agreements
  - Consider potential implications for future change of control transactions

Non-Convertible Debt Finance

– Venture Debt
  - Overview
    – Generally structured as term loans, often providing for tranches tied to milestones
    – Often provide for interest-only period before principal amortization commences
    – Borrowings are typically secured and guaranteed by subsidiaries, and loan agreement provides for covenants and events of default
    – Typically accompanied by warrants

Non-Convertible Debt Finance

– Venture Debt (Con’t)
  - Advantages
    – Less dilutive than equity financing
    – Committed source of capital (subject to achievement of applicable milestones and satisfaction of other conditions)
    – Lenders typically don’t take board seats, which is something a PIPE investor might require
    – Can extend cash runway position to increase time between equity investments or to bridge between equity rounds

Non-Convertible Debt Finance

- Venture Debt (Con't)
  - Considerations
    - Interest expense
    - Default risk
    - Collateral package
    - Covenants can restrict business (e.g., restrictions on incurrence of debt, restricted payments, investments, granting of liens, M&A activity, asset dispositions, etc., as well as any financial covenants)
    - Often provide for pre-payment premiums
    - As noted above, often requires issuance of warrants as an equity kicker
    - Implications, if any, for future debt or equity raises

Non-Convertible Debt Finance

– Venture Debt (Con’t)
  - Selected Issues
    - Intellectual property is often excluded from collateral
    - Limitations on entering into certain licensing arrangements without lender consent
    - Material Adverse Effect Default vs. Investor Support default
    - Some lenders will require all bank and other accounts to be maintained with them (deposit account, securities accounts, etc.)

Non-Convertible Debt Finance

– Venture Debt (Con’t)
  - Other Potential Debt Financing Options (generally for commercial stage companies)
    - Revolving Debt
    - Term Loans
    - Mezzanine Debt
    - Revenue and Royalty Sale Transactions
    - Hybrid Loans with Revenue/Royalty Participation Component
    - Receivables Financing

Conclusion and Questions & Answers

Questions

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