White Paper

Methods to Raise Capital in the Current Environment

In today's turbulent capital markets and sluggish global economy, many companies are evaluating different methods to raise capital. The following summary highlights some of the advantages and disadvantages associated with various types of capital-raising alternatives that create freely transferable securities for the ultimate holder.

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Overview

At-The-Market, PIPE, Registered Direct and classic underwritten offerings, as well as rights offerings and equity line facilities are effective vehicles through which companies can raise capital. However, in today's uncertain capital markets and sluggish global economy, some options may be more attractive than others for a variety of reasons. The following summary reviews the potential risks and benefits associated with each of these types of offerings.

Underwritten Offerings

An initial public offering (IPO) is the first sale of registered stock by a company. The number of IPOs has increased recently as equity markets improved in 2010 and private equity firms seek to exit from older investments. In addition, public companies have traditionally used follow-on underwritten offerings (off-the-shelf or separately registered) to raise equity, debt or a combination such as convertible debt.

Advantages

- Because it is one of the most commonly used methods to raise capital, it is also trusted and well understood.
- The discount to the trading price is low.
- The investor road show that accompanies IPOs and underwritten offerings helps increase public awareness of the company.

Disadvantages

- The market overhang created by the registration announcement and corresponding increase in the number of shares that can be sold typically depresses the market price, but the price often recovers during the road show.
- The process can be time-consuming if the offering is selected for SEC review, which large cap, well-known seasoned issuers (WKSIs) can avoid.
- IPOs and underwritten offerings of small and middle market companies require an extensive investor road show – typically 1 to 2 weeks.

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At-The-Market, Dribble-Out or Continuous Offerings

An At-the-Market (ATM) offering is a registered offering by a public company of its listed equity securities directly into the market at other than fixed prices. Typically, the issuer uses a broker-dealer as a placement agent to sell the stock in the market using standard broker's transactions on a "best efforts" basis at the then-prevailing market price. The issuer determines the quantity and timing of the issuances, a floor price and the duration of the selling period, which can cover an extended period of time in some cases.

Advantages

- ATM offerings can be initiated quickly (often within 2 to 3 weeks) without a special selling effort or road show.
- The overall cost and commissions are often lower than firm commitment underwritings (transaction costs generally range from 2 to 5 percent as compared to 5 to 7 percent for an underwritten offering).
- Sales can be extended over two years, giving issuers the flexibility to raise capital incrementally based on short or long-term needs.
- Issuers have flexibility to control the timing, number of sales and minimum acceptable price and do not have to continuously renegotiate the terms for an equity offering.
- The issuer's instructions to the placement agent can be reassessed or revoked at any time, even intraday.
- Issuers are able to act quickly when favorable market conditions arise.
- The complete anonymity of the sales transactions maintains transparency within the market and limits the potential decrease in stock prices.
- Issuers are able to manage market and investor expectations.
- Because issuers can sell newly-issued shares into the market's natural trading flow at any time:
  - the offering is less dilutive on existing shares than PIPEs, registered direct offerings and equity lines of credit; and
  - investors cannot short the shares in advance of the offering.

Disadvantages

- The broker-dealer administering the offering will require periodic due diligence (comfort letters from the issuer's auditors and negative assurance from the issuer's counsel), which increases the costs.
- Applicable anti-fraud provisions restrict sales during blackout periods and necessitate monitoring for insider trading activity.
- The trading price is often depressed when the offering is announced.
- The offering provides a signal to the market that the stock is fairly traded.

- Distribution agreements typically limit the number of shares to be sold on any given day.
- Issuer must be Form S-3 eligible for primary offerings (limited to 1/3 of the issuer's public float if the total public float is less than $75 million).
- FINRA approval is required for issuers with less than $150 million in market capitalization held by non-affiliates.
- Regulation M and other anti-manipulation regulations apply, and prohibit stabilization and passive market making.
- National listing exchanges require shareholder approval before selling voting securities that constitute 20 percent or more of the issuer's pre-transaction outstanding shares at a discount, absent shareholder approval.

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PIPEs

A PIPE is a private investment in a publicly traded entity that usually provides registration rights so that the securities can be freely resold, involves a placement agent, and is offered to a small number of targeted institutional investors. The offering may either be registered with the SEC or issued as an unregistered private placement, the sale of which is conditioned on its subsequent registration with the SEC. A PIPE's flexibility allows it to be structured as debt, equity or a combination of each, but their custom terms and varying leverage structures can lead to extensive negotiations. A company's plan to issue a PIPE or Registered Direct Offering (RDO) qualifies as material, nonpublic information and therefore, issuers should enter into confidentiality agreements with potential investors. The aggregate proceeds raised in the 50 largest PIPE transactions in 2009 exceeded $15 billion.

Advantages

- PIPE offerings are flexible – they can be structured as debt, equity or a combination.
- Standstill provisions within the investor agreement may prevent large holders from increasing their ownership.
- Companies without existing shelf registration statements may benefit from the timing that a PIPE offers.
- Companies will generally pursue PIPEs when other capital markets are not available to raise debt or equity.
- The SEC generally gives less scrutiny to PIPE offerings as compared to conventional underwritten offerings.
- Rule 144A allows qualified institutional buyers to resell securities issued in a PIPE to other qualified institutional investors, which provides a measure of transferability at the outset.

Disadvantages

- General solicitation is prohibited in PIPE offerings.
- Certain restrictions apply to transfers prior to registration.
- Public markets tend to react negatively to the discounted sale price, which increases the potential for dilution particularly when conversion into equity or warrants is included as an equity kicker.
- Because they are illiquid at the time of the initial private placement, investors typically demand higher discounts – usually 8 to 12 percent for stable, established companies and up to 50 percent for other companies in dire need of capital (all-in cost can exceed 20 percent).
- Companies need to factor dividends or interest into the cost of the securities.
- The structure gives rise to opportunities for investors to negotiate covenants and board positions such as:
  - Approval rights at the board and/or stockholder level, which may allow them to block certain transactions or the issuance of additional equity;
  - Preemptive and tag along rights, which, if granted, can make subsequent financing more difficult; or
  - Restrictive covenants that can impose operating limitations.
- The offering is subject to the same shareholder approval limitation — sales must involve less than 20 percent of the pre-transaction shares outstanding at the time of the transaction — applied to ATM's.

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Registered Direct Offerings

A registered direct offering is similar to a PIPE except that it is registered with the SEC before its initial placement, thus providing the targeted marketing appeal and speed advantages of a PIPE without the high discounts demanded by PIPE investors in return for unregistered shares. If the registrant has an effective shelf registration statement in place, the transaction can be completed quickly and discreetly when market conditions are ideal by filing a prospectus supplement immediately before the offering is priced. The securities are typically sold through a placement agent to a select group of institutional buyers on a "best efforts" basis, and can be structured as "Any-or-All," "Minimum-Maximum" (minimum dollar amount that must be raised before the issuer is required to close), or "All-or-None." H&R Block raised $145 million through an RDO in October 2008.

Advantages

- The offering can be issued quickly (generally within one to two weeks) and discreetly to targeted investors.
- Issuers can test the market without attracting publicity because investors sign confidentiality agreements.
- Using an existing registration statement avoids issues with market overhang and generally helps secure a better price than the traditional PIPE.
- The securities are immediately transferable because they are already registered.
- There are fewer expenses associated with drafting and due diligence because the RDO is marketed on the issuer's existing public disclosure with fewer negotiated provisions.
- The marketing period is brief and does not require a road show.
- WKSIs enjoy the following additional benefits:
  - S-3s are not reviewed by the SEC,
  - They can pay as you go, and
  - They are generally not subject to gun jumping rules.

Disadvantages

- RDO's are typically not marketed to retail investors, which means that they are not as widely distributed as other public offerings.
- The price is often discounted 4 to 8 percent off of the trading price (all-in cost can be 15 percent or more).
- The offering may result in greater dilution to the company's existing stockholders than ATM's or Rights Offerings.
- In some cases, warrants in addition to standard commissions are required to entice investors.
- Only Form S-3 eligible issuers may utilize the RDO structure.
- An issuer with a market cap under $75 million must limit its offerings to less than one-third of its public float over any 12-month period.
- Issuers with less than $150 million in market capitalization are subject to FINRA approval.
- Regulation M and other anti-manipulation regulations apply and prohibit stabilization to be used for this type of "best efforts" offering.
- Under certain circumstance, securities exchanges require shareholder approval if they do not consider the offering a "public offering."
- The placement agent will have underwriter's liability, which will require some level of due diligence and similar protections to those in an underwriting agreement.
- The offering is subject to the same shareholder approval limitation — sales must involve less than 20 percent of the pre-transaction shares outstanding at the time of the transaction — applied to ATM's and PIPE's.

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Rights Offerings

A company may choose to raise capital by issuing rights to existing shareholders to participate ratably in new equity through a rights offering. Typically, shareholders are given the right to purchase newly issued shares at a discount from the recent trading price during a specified period of time, generally 15 to 30 days. Some structures allow the rights to be transferred immediately and traded on the same exchange as the underlying common stock. If the issuer has an effective registration statement on file, rights offerings can be executed quickly without diluting the value of existing stock and are not subject to the national listing exchange's shareholder approval rules if more than 20 percent of the company's outstanding shares are offered at a discount.

Advantages

- Directing the offering to existing shareholders prevents dilution of existing share value.
- Sometimes the rights may be transferable and can be traded during the offering period.
- Permitted backstop agreements help to ensure that the company will raise the needed capital.
- There is no shareholder approval required, even if the rights offering results in an issuance of common stock representing 20 percent or more of the voting power outstanding prior to issuance.
- If the issuer already has an effective registration statement on file, the offering can be quickly executed at lower costs than other capital raising alternatives because it is marketed to existing shareholders.

Disadvantages

- The offering price is based upon a discount to the current or recent market price.
- Offering new equity to existing shareholders creates the potential for more concentrated investor positions.
- The total funding amount is uncertain under this method unless a backstop commitment arrangement is included in the plan.

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Equity Line Facilities

For companies that are having trouble obtaining traditional sources of capital, an equity line facility may present a viable alternative. To obtain this financing facility, the issuer will enter a registration rights agreement and an investment agreement with an investor who is willing to purchase the issuer's stock at a discount (typically 5 to 8 percent) over time at the issuer's request. Typically, the stock is priced based on the lowest closing price over the five trading days after the issuer provides notice of a draw to the investors.

Advantages

- The cost of capital is low relative to other alternatives.
- The company has control over the timing and amounts of draws.
- The process is less time consuming.
- The issuer sets a floor price for every draw.
- Commitments can extend for up to three years.

Disadvantages

- SEC review may delay the registration statement.
- The capital is raised over time rather than in one lump sum.
- The total funding amount is uncertain.
- Warrants and commitment shares can be dilutive.
- Operating and financial covenants may be imposed.
- Companies must vet the investor carefully to ensure that funding will be available throughout the term of the program.

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Comparison

The following table compares a number of the key characteristics of these methods of raising capital:

Type of Offering	Registered	Road Show	Immediate Liquidity for Investor	Confidential Marketing	Use of Existing Public Documents	Low Transaction Costs	Low Discount to Trading Price	Higher Dilutive Effect	Proceeds over Extended Period of Time
Traditional Underwritten Offerings	X	X	X		Possibly		X		
ATM Offerings	X (S-3 eligible)		X		X	X	X		X
PIPEs	Not initially[1]	X	X[2]	X	Possibly			X	
RDOs	X (S-3 eligible)		X	X	X	X	X[3]	X	
Rights Offerings	X		X		X	X			
Equity Line Facilities	X		X		X	X		X[4]	X

[1] Some PIPE offerings require registration very soon after the private placement.
[2] Typically liquid within 3-12 months after the private placement.
[3] Discounts are typically 4-8% below market.
[4] The ability to raise capital at higher prices in the future can reduce the amount of dilution.

For more information on methods to raise capital in the current environment, contact:

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