“PIPE” TRANSACTIONS

Thursday, May 7, 2020

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WHAT IS A PIPE?

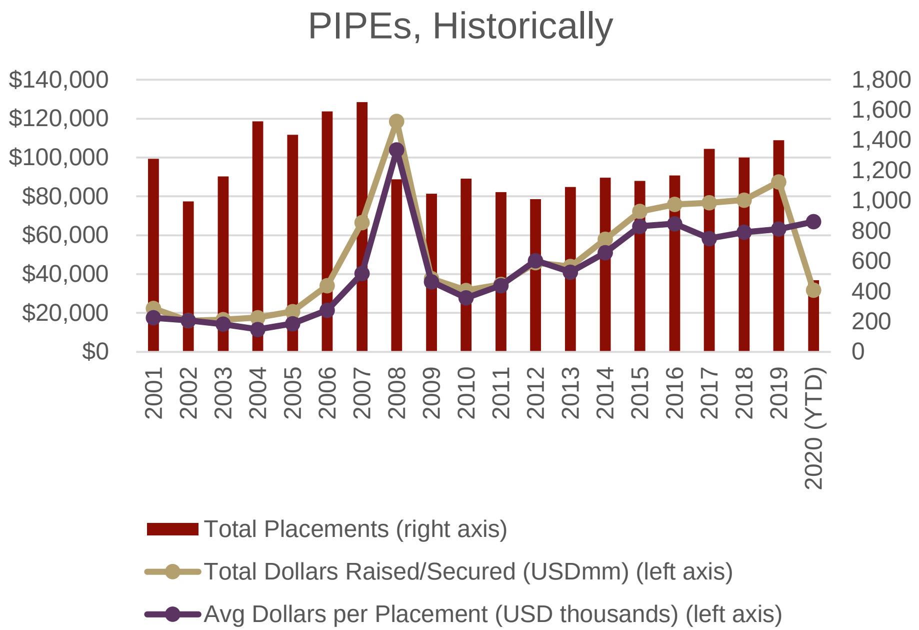
- A "PIPE" transaction (**p**rivate **i**nvestment in **p**ublic **e**quity or "PIPE")
  - a **private placement of securities of a public company** that typically is **made to selected accredited investors** (usually to selected institutional accredited investors, such as mutual funds, pension funds, hedge funds and private equity funds).
- In a traditional PIPE
  - investors irrevocably commit to purchase a fixed number of securities at a fixed price, not subject to volume adjustments or market price fluctuations.
  - Issuer commits to file a resale registration statement covering the securities with the SEC
- In a non-traditional PIPE
  - One or more investors enter into highly-negotiated private purchase agreements
  - Investor granted registration rights for the securities
  - In exchange for Board seats, anti-dilution provisions, preemptive rights, etc., Issuers in non-traditional PIPEs often impose restrictions on the investor and the securities purchased in the transaction

WHY PIPES IN A DISTRESSED MARKET?

- **Issuers and investors that typically would not consider a PIPE are more amenable to this type of transaction in difficult macroeconomic environments/recessions**
  - Especially true during periods of heightened market volatility, when public offerings are not viable
  - Particularly attractive when even healthy companies cannot access the credit markets to increase liquidity or shore up working capital needs
- **For many Issuers**, a PIPE transaction has multiple advantages
  - Faster to complete than a registered public offering (with no SEC review process)
  - Ability to tap market when traditional capital raising options are not available
  - Flexibility in timing and structure to meet the Issuer's needs
  - Subject to minimal market volatility
  - Gain credibility in an acquisition context
  - Gain a "friendly," experienced investor that may hold a large portion of equity, deterring unsolicited bids and potentially furthering management's strategy at the board level
- **For investors**, a PIPE transaction can be an attractive way of deploying capital
  - While traditional PIPE investors include hedge funds, private equity investors turn to the PIPE market when they have capital to deploy but access to the credit markets makes LBOs unattractive

PIPE investor base in the current economic cycle expected to include even more private equity and other mainstream institutional investors than other recent downturns

HISTORICAL PIPE TRENDS



Note: In 2008, U.S. listed companies raised $118.6 billion through PIPE transactions. Since then, the average has been $56.2 billion annually. In 2020YTD, U.S. listed companies have already closed or announced $31.7 billion in PIPE transactions.

Source: Private Raise (as of April 6, 2020)

- PIPEs in the U.S. market have historically been countercyclical, increasing during times of reduced credit availability and lower stock market performance
  - Increase following dot.com bust
  - Increase during 2008/2009 financial crisis
  - Expected to increase as a result of COVID-19 pandemic
- Issuers typically shift the use of proceeds from the PIPE transaction from acquisitions and other growth plans to distressed strategies, such as stock buybacks, restructuring programs, working capital or general corporate purposes

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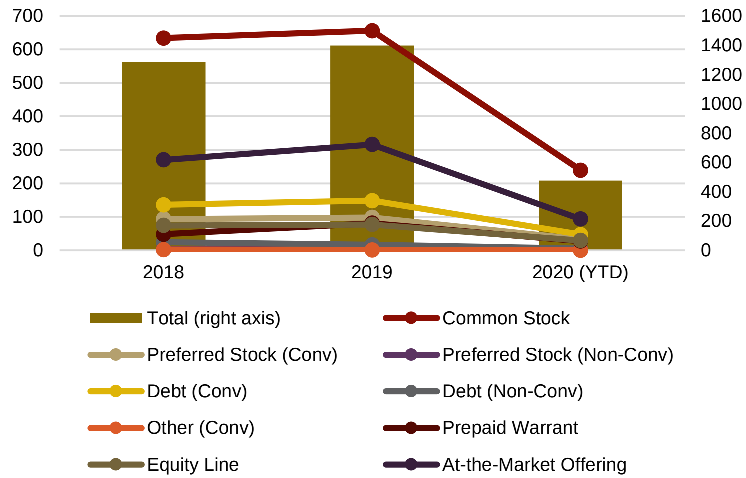
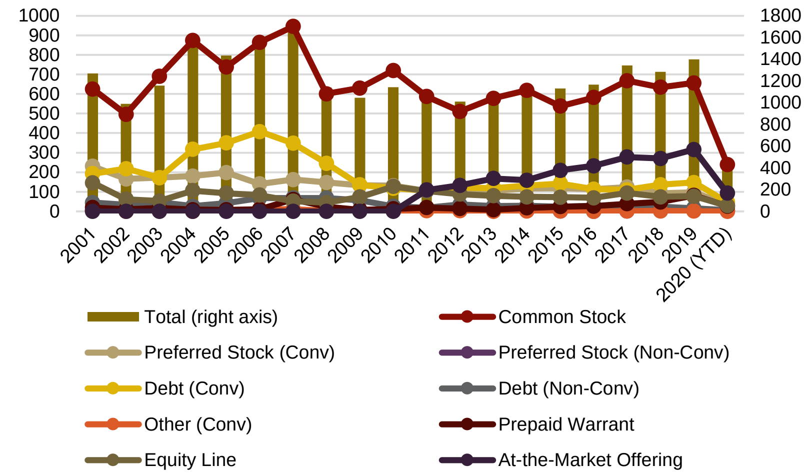
PIPES IN DISTRESSED MARKETS

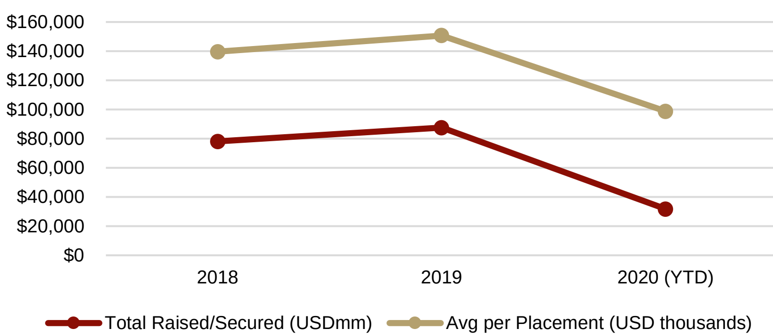
Deal Count, Recent Years



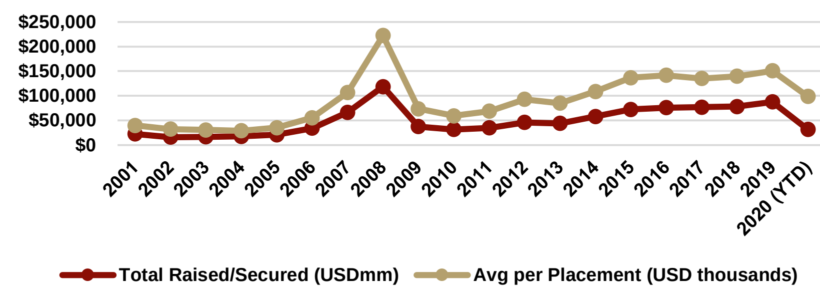
Deal Count, since 2001



Transaction Value, Recent Years



Transaction Value, Since 2001



Source: Private Raise (as of April 6, 2020). Charts include At-the-Market Offerings which Private Raise counts in their PIPE category

TYPES OF PIPE STRUCTURES

- Frequent structures:
  - Common stock sold at fixed price
    - Can also be sold along with fixed price warrants
    - Can also be sold along with resettable or variable priced warrants
  - Common stock sold at variable price
  - Convertible preferred stock or convertible debt
  - Non-convertible debt

	Common Stock	Preferred Stock (Conv)	Preferred Stock (Non-Conv)	Debt (Conv)	Debt (Non-Conv)	Other (Conv)	Prepaid Warrant	Equity Line
2020 (YTD)	239	33	2	47	5	-	27	29
2019	656	98	6	148	16	1	81	77
2018	634	93	3	136	24	2	48	74
2017	668	124	2	110	26	1	39	94
2016	582	113	-	113	28	-	27	69
2015	538	119	1	142	24	1	24	72

Source: Private Raise (as of April 6, 2020).

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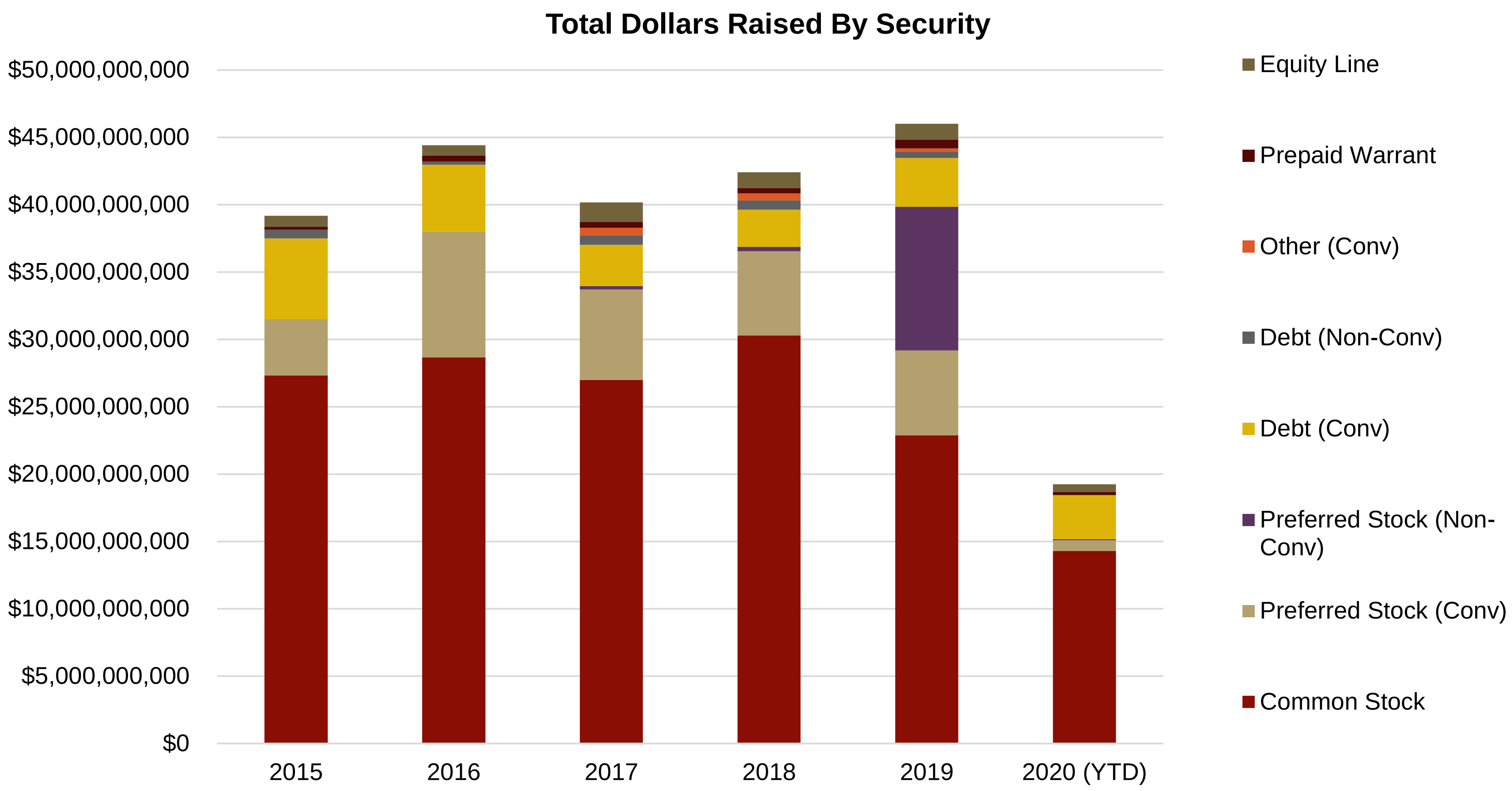
TRENDS IN DOLLAR AMOUNT RAISED BY TYPE OF SECURITY



Source: Private Raise (as of April 6, 2020)

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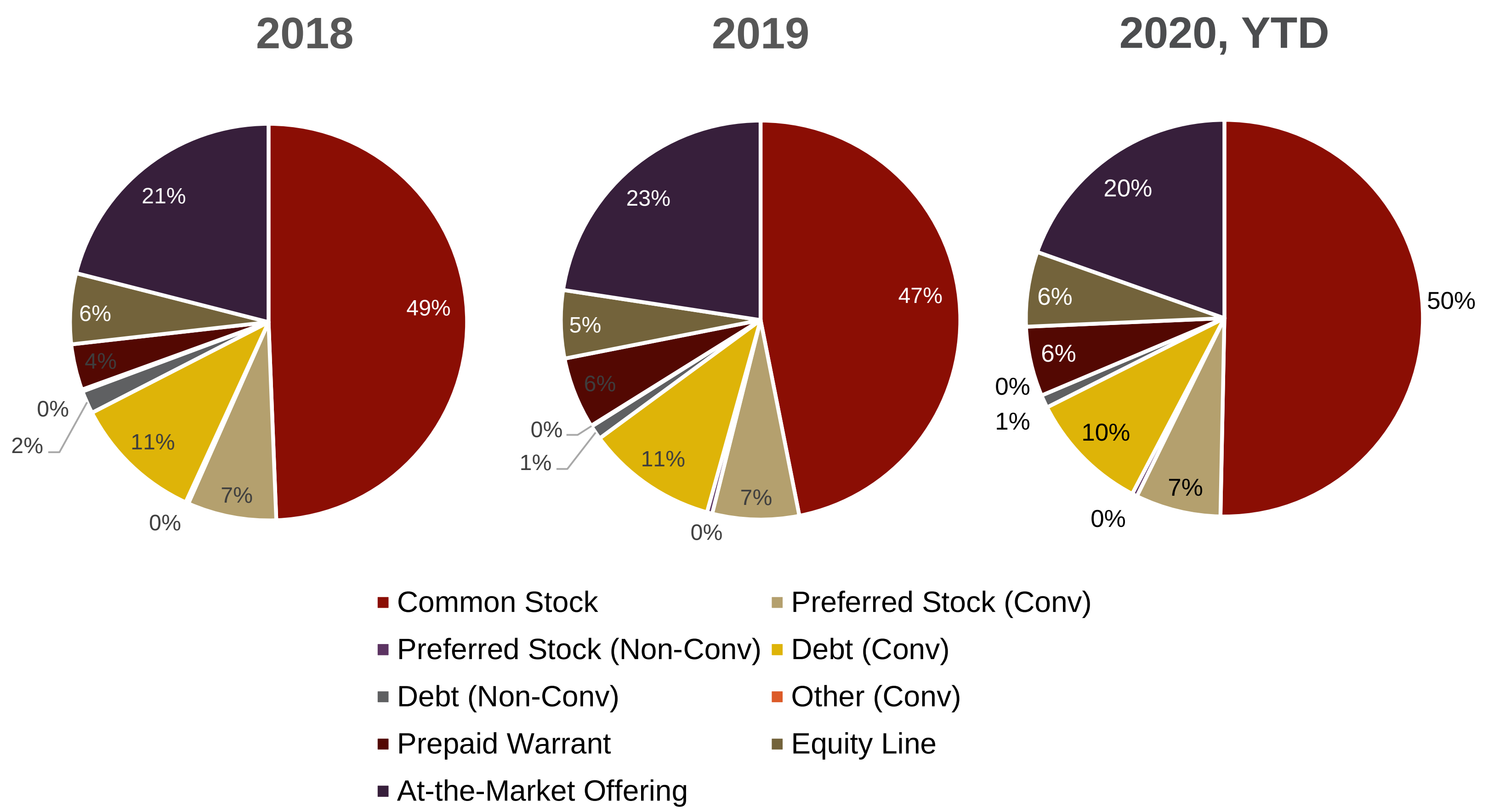
RECENT TRENDS IN DEAL STRUCTURES



Source: Private Raise (as of April 6, 2020)

TYPES OF PIPE STRUCTURES

- A variety of types of securities can be involved in PIPE transactions, such as:
  - Common stock
  - Convertible preferred stock
  - Non-convertible preferred stock
  - Convertible debt
  - Non-convertible debt (issued with warrants)
- Private equity investors typically prefer convertible preferred stock or convertible debt
  - Convertible into shares of common stock of the issuer
  - Typically better to protect their equity investments for the long term
  - Offer better down-side protection to an investor relative to common stock, especially debt
- Common stock is most prevalent, but why consider convertible preferred stock?
  - Above the common stock in the equity structure
  - Fixed income stream through the dividend on the preferred stock until the conversion occurs
  - Investors can try to lessen the conversion premium when negotiating price

PARTICIPANTS IN A PIPE TRANSACTION

- Public company issuer
- Founders/sponsors
- Placement agent (investment banks)
- Investors
  - Hedge funds (historically active)
  - Private equity funds and sponsors
  - Other “accredited investors”
- Auditors
- Legal counsel
- Trustees (convertible debt)

GENERAL FEATURES OF A PIPE—TRADITIONAL PIPE

- A traditional PIPE involves investors entering into private purchase agreements with a public company issuer to acquire a fixed amount of securities at a fixed price
- Made through a placement agent that facilitates the investment process
- Securities are restricted and cannot be immediately resold in the public market without SEC registration
  - Investor is granted registration rights and the public company issuer commits to file a resale registration statement allowing the investor to resell its securities into the public market
  - Investor's obligation to purchase is typically conditioned on the resale registration statement being declared effective by the SEC soon after the purchase of the securities
    - Investor does not pay issuer for the securities until the resale registration statement is declared effective

This type of PIPE transaction is now less common than in the pre-2008 marketplace

NON-TRADITIONAL PIPEs

- One or more investors entering into highly-negotiated private purchase agreements
  - Most prevalent post-2008 crisis
  - Typically no placement agent
  - Lead investor controls the investment process
- While highly-structured, these investments generally involve the following features:
  - Consent rights over major corporate actions of the issuer
  - Anti-dilution provisions
  - Optional conversion and redemption features
  - Preemptive rights
- Investor is granted registration rights
- Often rights to nominate members to the board of directors of the issuer
  - Investors in these non-traditional PIPEs often acquire large percentages of the issuer's common equity securities (from 5% to more than 20% of the outstanding securities)
- In return for granting these rights, issuers in non-traditional PIPEs often impose restrictions on the investor and the securities purchased in the transaction, including:
  - Transfer restrictions, or lock-ups
  - Prohibitions on hedging transactions involving the issuer's stock
  - Standstill restrictions that prevent an investor from proxy fights or asserting or taking control of the issuer for a period of time without prior board approval

DOCUMENTATION FOR A PIPE TRANSACTION

- Engagement Letter between issuer and placement agent
- Confidentiality agreement (or Wall Cross confidentiality undertaking) with potential investor, covering due diligence access
- Private placement memorandum (incorporating Exchange Act reports) or investor presentation
- Purchase Agreement
- Registration Rights Agreement
- Instrument Governing Rights of Securityholder
  - Certificate of Designation
  - Convertible Note
- Investor Rights Agreement (for governance rights)
- Resale Registration Statement
- Legal opinions
- Closing documents (legended securities)
- Press release/Form 8-K to announce and file material agreements

TERMS OF THE PURCHASE AGREEMENT

- Agreement between the issuer and the investors
- Contains issuer representations and warranties
  - Issuer reps about its business
  - Reps about private placement status (Section 4(a)(2) and/or Rule 506(b))
  - Investor will not have material non-public information once the transaction is announced
- Issuer covenants to promptly make the transaction public (cleanses MNPI)
- Investor representations are limited
  - Private placement reps; “accredited investor” status rep
  - No violation of trading restrictions
- May contain ongoing covenants relating to corporate governance (board representation or observer rights, blocking rights, veto rights, etc.) or information requirements
- Closing conditions customarily include: bring down of reps/warranties; no occurrence of Material Adverse Change and delivery of legal opinions

PRICING TERMS AND CONVERSION

- The pricing of PIPE securities is a subject of significant negotiation
- Common stock PIPEs
  - Can be issued at, above or below the market value
  - Often issued at lower valuations as compared to convertible preferred stock or convertible debt PIPEs due to the less attractive legal and downside economic protections
- Convertible preferred stock PIPEs
  - Typically convertible into common stock
  - Can also be issued at different implied common stock prices~~.~~
  - Value is reflected in its "conversion price"
  - The conversion price of a preferred stock PIPE is generally set at a premium to the market price of the common stock immediately before deal announcement, but can also be set at a discount
- Dividend the investor receives on the amount initially invested
  - Preferred stock PIPEs often include a dividend which accrues at an annual percentage of the original issue price and is payable quarterly (or semi-annually or annually)
  - Private equity investors typically want a cumulative dividend, requiring a cash payout of the dividend or a PIK dividend

Note: The premium or discount embedded in the conversion price and the amount of accrued and unpaid dividends added to the liquidation preference are major valuation drivers and can offset one another

ANTI-DILUTION, PREEMPTIVE RIGHTS AND REDEMPTION

- Investors seek to minimize potential dilutive effect of future issuances on more favorable terms, against stock splits and similar dilutive corporate actions by the issuer
  - Protection typically covers issuances of common stock or convertible securities at prices below fair market value or below the price paid by the PIPE investor
    - May only last for a specified period of time after closing
    - May require the new issuance exceed a certain minimum dollar threshold
  - "Broad-based weighted average" (common protection)
    - Adjusts the investor's purchase or conversion price by taking into account the weighted average dilutive impact of the new issuance based on the size and aggregated value of the new offering
  - "Full ratchet" (aggressive protection)
    - Re-sets the PIPE issuance or conversion price to the level of the new dilutive issuance
  - Almost all anti-dilution protections also include a mechanism to make proportional adjustments to the PIPE security, on conversion or otherwise, to account for stock splits, reverse stock splits, or similar corporate events
- Preemptive rights also protect PIPE investors from future dilutive issuances
- Issuers often have the right to redeem PIPE securities on the occurrence of specified events, including:
  - When the issuer's common stock trades in excess of a specified price threshold for an agreed period of time
  - After the expiration of a no-call period

GOVERNANCE RIGHTS

- Key negotiating terms may include robust governance rights
- Levels and types of control and governance features vary
- Control and governance features may change based on certain triggers:
  - Additional voting rights on the receipt of shareholder approval
  - More or fewer board appointment rights based on the holder’s ownership percentage
  - Additional board appointment rights if dividends are not paid for a period of time
- Despite typically being minority investments of less than one-third of an issuer’s capital stock, the aggregate amount of the investments typically support robust governance rights for the investor
- Larger investment amounts typically grant investors:
  - Representation on the issuer’s board of directors;
    - Investors acquiring more than 10% of an issuer’s common stock typically get 1+ seat on the board, and that member can participate on important board committees
  - Veto rights over major corporate actions (sometimes)

CONSENT AND VOTING RIGHTS

- Investors can sometimes negotiate consent or veto rights over major corporate actions
- Consent rights typically include actions such as:
  - Amendments to the certificate of incorporation
  - Issuances of new senior equity securities
  - Dividends on the common stock
  - The entrance into new business lines or approval of the annual business plan
  - Major acquisitions or dispositions
  - Affiliate transactions
  - The incurrence of debt
- Investors who receive securities other than common stock typically get the right to vote on corporate matters requiring a shareholder vote
  - May vote together with the common stock on an "as-converted basis"

ISSUER PROTECTIONS

- Standstill provisions
  - Restrict investor ability to acquire any additional securities of the issuer (or, alternatively, additional securities above a specified percentage cap)
  - Restrict investor ability to engage in actions that a board may consider hostile, such as:
    - Proxy contests involving the replacement of directors
    - Unsolicited takeover offers potentially forcing a sale of the issuer
  - Restrictions typically lapse after a period of time (1-4 years) or when the investor owns less than a specified percentage of the issuer's outstanding voting stock (e.g., 5%)
- Lock-ups
  - Issuers also seek to impose transfer restrictions on investors to protect against downward pressure on an issuer's stock price (often 1-3 years)
    - Lock-up agreement
    - Caps on amount of securities transferred over a period of time
    - Restrictions on sales to large shareholders, competitors or activist investors
  - May also limit hedging transactions involving the issuer's stock

REGISTRATION RIGHTS CONSIDERATIONS

- Almost all PIPEs give the investor the opportunity to obtain liquidity through registration rights
- Typical registration rights allow the PIPE investor to exercise:
  - **Demand registration rights:** investor can require the issuer to register the investor's securities
    - Typically only a specified number of demands may be exercised by the investor
    - Typically registration must include enough securities for the investor to receive a minimum threshold amount of expected proceeds from the sale of securities
  - **Piggy-back registration rights:** investor can piggy-back on the company's primary offering or another stockholder's secondary offering to sell its securities in that registered offering
    - Typically get unlimited piggy-back registration rights, but is often subject to limitations. For instance, underwriters often have the power to limit the number of shares that an investor can register if registering a greater amount of shares would negatively impact the offering
- Is Form S-3 available (current and timely filer requirements)?
  - Issuer may be able to use Form S-3 on a resale basis (does not need to be primary eligible)
    - SEC position: PIPEs equal to 33% of market capitalization may be deemed to be a disguised primary offering (CD&I Question 612.09 (Jan. 26, 2009))
  - WKSIs may add resales to an existing automatic shelf Form S-3 (automatically effective)
  - Issuer can also use a Form S-1 (with benefit of retro-incorporation) for resales

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SECURITIES LAW CONSIDERATIONS FOR PIPE TRANSACTIONS

- Generally structured to comply with the Section 4(a)(2) exemption and Rule 506(b) of Regulation D to selected “accredited investors”
- Private placements (including PIPEs) are subject to:
  - Section 17(a) (the antifraud provision) of the Securities Act
  - Section 10(b) (the antifraud provision), Section 16(b) (short swing profit rule) and Section 20(a) (the “control person” provision) of the Exchange Act
  - State securities (“blue sky”) laws
  - State common law of fraud and negligent misrepresentation
  - FINRA suitability, advertising and supervisory rules
  - Transfer restrictions - securities are restricted and cannot be immediately resold in the public market without registration (or subsequent exemption therefrom)
- Schedule 13D or 13G filings (if common stock, or common stock underlying convertible preferred stock, acquired puts aggregate holdings at 5% or more. Section 16 filings for holders of 10% or more and officers and directors)

SECURITIES LAW CONSIDERATIONS FOR PIPE TRANSACTIONS (CONT'D)

- Regulation M (market manipulation rules) Compliance
- Disclosure Concerns and Regulation FD Compliance
  - Is any MNPI being shared?
  - A PIPE transaction may be commenced and privately marketed with customary confidentiality provisions without public disclosure
  - Rule 135c press release announcing the PIPE only when definitive purchase agreements have been executed
  - Rule 10b-5 Liability
    - Under Rule 10b-5, it is unlawful for “any person, directly or indirectly, . . .[t]o make any untrue statement of material fact” in connection with the purchase or sale of a security”
    - Scienter standard (higher standard than in registered public offerings)
  - Potential HSR Filing
  - Transaction size threshold for 2020 is $94 million
  - If required, there is a 30-day statutory waiting period to consummate the transaction, unless early termination is granted
  - Confidentiality concerns: the FTC must publish a notice of any early termination in the Federal Register and on the FTC website

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STOCK EXCHANGE CONSIDERATIONS

- Board Appointment Rights
  - Board rights granted should not be greater than an investor's proportional economic interest
  - Board nomination rights decline pro rata with the decline of the investor's economic interest in the issuer
    - NYSE rules do permit preferred stockholders to have the right to appoint up to two additional directors after default of six quarterly dividends
- Consent Rights
  - NYSE and Nasdaq exchange rules require any veto rights granted to an investor to be **reasonable** considering the investor's economic interest in the issuer
- Voting Rights
  - NYSE and Nasdaq exchange rules require that any voting rights granted in a PIPE transaction not be greater than the investor's economic interest in the issuer
    - Restrict voting of PIPE securities that convert at a discount to the market value of common stock
  - Voting rights are sometimes capped in a PIPE transaction at 19.99% of the issuer's outstanding capital stock to avoid or delay the need for shareholder approval under NYSE/ Nasdaq rules (for the issuance of 20% or more of the issuer's capital stock (subject to potential waivers during the COVID-19 pandemic))
  - FPIs are not bound by the 20% threshold for shareholder approval under the NYSE or Nasdaq rules, but may be bound by the shareholder approval requirements in their home country

RECENT CHANGES TO NYSE SHAREHOLDER APPROVAL RULES

- NYSE has waived the application of certain of the shareholder approval requirements through and including June 30, 2020, subject to certain conditions
  - **Issuances to Related Parties Do Not Need Shareholder Approval**. Would suspend the rule requiring shareholder approval of any issuance to a director, officer or substantial security holder of the company (each a "Related Party") or to an affiliate of a Related Party if the number of shares of common stock to be issued, or if the number of shares of common stock into which the securities may be convertible or exercisable, exceeds either 1% of the number of shares of common stock or the voting power outstanding before the issuance.
    - Limited to transactions that involve the sale of the Company's securities for cash at a price that meets the "Minimum Price" requirement set forth in Section 312.04 of the Manual.
    - To qualify, transaction must be reviewed and approved by the company's audit committee or comparable committee composed solely of independent directors.
  - **Bona Fide Private Financings Can Be Made to Only One Investor Without Obtaining Shareholder Approval**. Any bona fide private financing was historically permitted to exceed the 20% threshold for shareholder approval, subject to certain requirements regarding the Minimum Price, and subject to the purchaser not acquiring or having the right to acquire, more than 5% of the shares of the issuer's common stock or voting power before the sale (the "5% Limitation"). The NYSE proposed rule filing suspends the 5% limitation.
    - Must be a sale of the company's securities for cash at a price that meets the Minimum Price requirement.
    - Transaction must be reviewed/approved by the company's audit committee or a comparable committee comprised solely of independent directors if purchaser is a Related Party or other person subject to Section 312.03(b).
    - NYSE noted "as a result of the proposed waiver, the Exchange's application of Section 312.03(c) will be consistent with the application of NASDAQ Marketplace Rule 5635(c) with respect to private placements relating to 20% or more of a company's common stock or voting power outstanding before such transaction."

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SHAREHOLDER APPROVAL CONSIDERATIONS

- Generally there are several reasons why a PIPE issuance will require shareholder approval:
  - State Law Considerations: If the issuer does not have enough authorized stock or needs to amend its charter to provide for the creation of a new type of security, shareholder approval is required under most state corporate statutes
  - Stock Exchange Rules: Both the NYSE and Nasdaq require shareholder approval before a stock (common or convertible) issuance that will either:
    - result in a "change of control" of the issuer; or
    - represents more than 20% of the issuer's outstanding common stock or voting power
- Structures used to avoid shareholder approval under 20% test include:
  - Multiple classes of securities, one of which is voting to the extent permissible and the other non-voting
  - Bridge preferred—preferred stock that converts automatically when shareholder approval obtained or into 19.99% of outstanding common stock and permanent preferred stock with relatively onerous terms
  - Sweeteners and penalties that incentivize issuer to obtain shareholder approval

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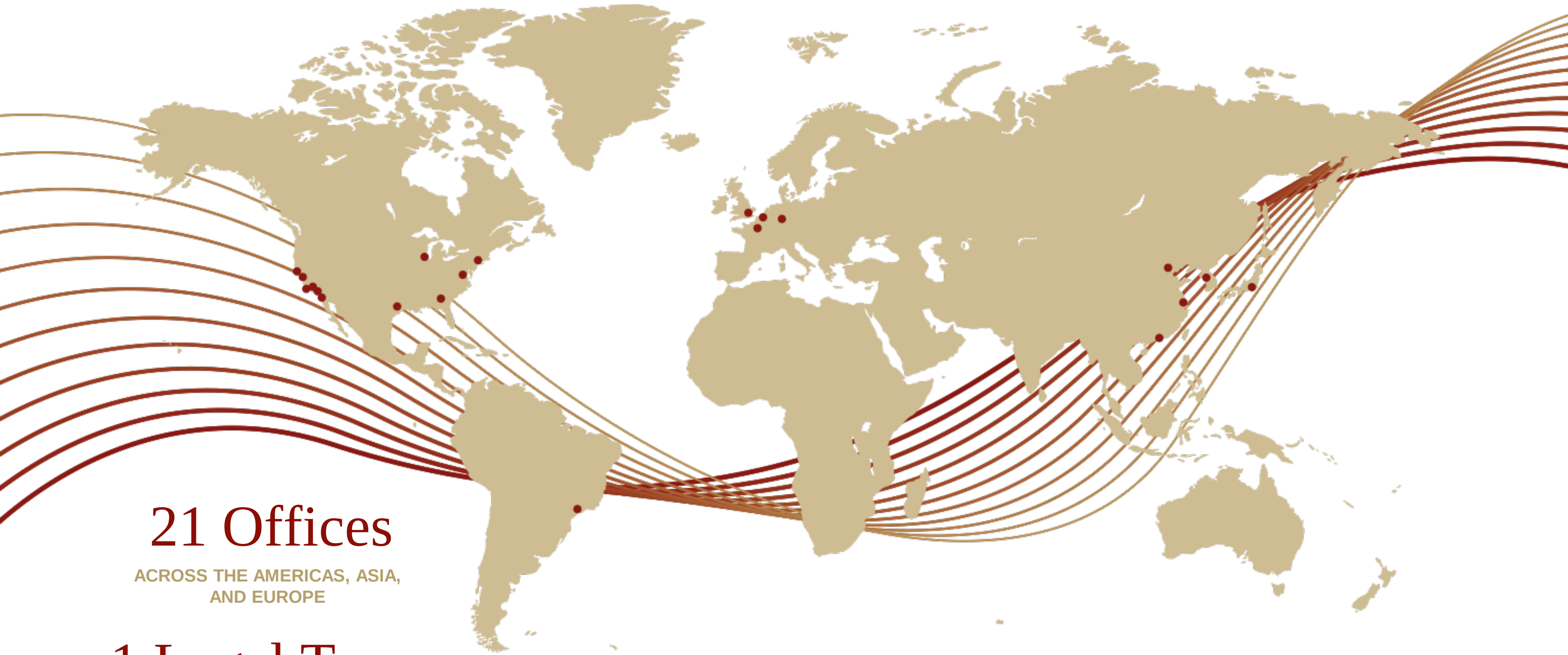

21 Offices

ACROSS THE AMERICAS, ASIA, AND EUROPE

1 Legal Team

TO INTEGRATE WITH THE STRATEGIC GOALS OF YOUR BUSINESS

PAUL HASTINGS

OUR OFFICES

THE AMERICAS

Atlanta
1170 Peachtree Street, N.E.
Suite 100
Atlanta, GA 30309
t: +1.404.815.2400
f: +1.404.815.2424

Century City
1999 Avenue of the Stars
Los Angeles, CA 90067
t: +1.310.620.5700
f: +1.310.620.5899

Chicago
71 S. Wacker Drive
Forty-fifth Floor
Chicago, IL 60606
t: +1.312.499.6000
f: +1.312.499.6100

Houston
600 Travis Street
Fifty-Eighth Floor
Houston, TX 77002
t: +1.713.860.7300
f: +1.713.353.3100

Los Angeles
515 South Flower Street
Twenty-Fifth Floor
Los Angeles, CA 90071
t: +1.213.683.6000
f: +1.213.627.0705

New York
200 Park Avenue
New York, NY 10166
t: +1.212.318.6000
f: +1.212.319.4090

Orange County
695 Town Center Drive
Seventeenth Floor
Costa Mesa, CA 92626
t: +1.714.668.6200
f: +1.714.979.1921

Palo Alto
1117 S. California Ave.
Palo Alto, CA 94304
t: +1.650.320.1800
f: +1.650.320.1900

San Diego
4747 Executive Drive
Twelfth Floor
San Diego, CA 92121
t: +1.858.458.3000
f: +1.858.458.3005

San Francisco
101 California Street
Forty-Eighth Floor
San Francisco, CA 94111
t: +1.415.856.7000
f: +1.415.856.7100

São Paulo
Av. Presidente Juscelino Kubitschek, 2041
Torre D, 21º andar
Sao Paulo, SP
04543-011
Brazil
t: +55.11.4765.3000
f: +55.11.4765.3050

Washington, D.C.
875 15th Street, N.W.
Washington, D.C. 20005
t: +1.202.551.1700
f: +1.202.551.1705

ASIA

Beijing
Suite 2601, 26/F
Yintai Center Office Tower
2 Jianguomenwai Avenue
Chaoyang District
Beijing 100022 PRC
t: +86.10.8567.5300
f: +86.10.8567.5400

Hong Kong
21-22/F Bank of China Tower
1 Garden Road
Central Hong Kong
t: +852.2867.1288
f: +852.2526.2119

Seoul
33/F West Tower
Mirae Asset Center1
26, Eulji-ro 5-gil, Jung-gu
Seoul, 04539, Korea
t: +82.2.6321.3800
f: +82.2.6321.3900

Shanghai
43/F Jing An Kerry Center Tower II
1539 Nanjing West Road
Shanghai 200040, PRC
t: +86.21.6103.2900
f: +86.21.6103.2990

Tokyo
Ark Hills Sengokuyama Mori Tower
40th Floor, 1-9-10 Roppongi
Minato-ku, Tokyo 106-0032
Japan
t: +81.3.6229.6100
f: +81.3.6229.7100

EUROPE

Brussels
Avenue Louise 222
1050 Brussels
Belgium
t: +32.2.641.7460
f: +32.2.641.7461

Frankfurt
TaunusTurm
Taunustor 1
60310 Frankfurt am Main
Germany
t: +49.69.907485.000
f: +49.69.907485.499

London
100 Bishopsgate
London EC2N 4AG
United Kingdom
t: +44.20.3023.5100
f: +44.20.3023.5109

Paris
32, rue de Monceau
75008 Paris
France
t: +33.1.42.99.04.50
f: +33.1.45.63.91.49

For further information, you may visit our home page at
www.paulhastings.com or email us at info@paulhastings.com

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