

“In the pipeline ...”

PIPE transactions are a useful way for small to mid cap listed companies raise new funding. In this article, Corporate partner Andrew Collins looks at how these transactions work in practice.

Raising new funding over the last year has not always been straightforward. The secondary offering market (eg for rights issues and placings) has been quiet, and the cash surplus in the private equity industry has meant that traditional opportunities in that market have also been limited. As a result a number of small to mid-cap listed companies have been looking to the private sector to meet their funding requirements.

One particular form of fund raising which has migrated to the UK, following its more widespread use in the United States, is the “PIPE” (private investment in public equity). This involves investors taking a minority stake in a listed company as part of a private transaction. The investors (typically a syndicate) may be either existing shareholders of the listed company or new investors, and the syndicate is put together by an investment bank or broker.

Few PIPE transactions have completed in the UK to date. However, there are structures available which can raise funds for the listed company, whilst also offering *any level* of shareholding in the company for the investors, together with appropriate investor protection, board representation and the opportunity to subscribe *to* listed securities at a discount to market price.

A win-win situation

For the company, PIPE transactions can offer a more immediate and efficient source of capital than secondary offerings, which tend to be more time consuming and expensive. A PIPE offering also gives credibility to the company’s status and performance, through the involvement of high profile institutional investors. For the investors, PIPE transactions offer an opportunity to invest capital, usually at a discount, and with the prospect of an easier route to exit (because the equity to be issued either is or will become freely tradeable).

The mechanics

On PIPE transactions, it is usual to agree a “term sheet” or “heads of terms” at the outset. This is then encapsulated into a subscription or investment agreement. After

agreeing the heads of terms, the investors’ due diligence process will commence. To maintain secrecy and avoid the need to announce the proposed transaction, the information made available by the company is likely to be much more restricted than that in relation to a “straight” investment in a private company.

The next step is the negotiation of the subscription agreement which contains the terms of the subscription, limited investor protections, and limited warranties from the company. The transaction will need to be announced to the market as soon as the subscription agreement has been signed. The subscription agreement may be conditional on, for example, shareholder approval (in which case the company will not receive the funds until that condition is satisfied). Alternatively, if convertible loan stock is issued, the company can receive the funds on exchange, with the company undertaking to create, allot and list the shares in due course.

The usual corporate procedures for an issue of new shares will need to be followed. For example, an ordinary resolution may be needed to increase the authorised share capital of the listed company or to grant authority to the directors to allot shares pursuant to Section 80 Companies Act 1985. A special resolution (21 days’ notice and 75% approval) may also be required to disapply the statutory pre-emption rights or to amend the company’s articles of association (eg. to create a new class of convertible preference shares).

Convertible loan stock

PIPE transactions are usually structured as an issue of ordinary shares or contingently convertible loan stock or preference shares (the underlying equity being issued on conversion of the loan stock or preference shares). Where convertible loan stock is used (perhaps because the company needs, and therefore undertakes, to increase its share capital and / or obtain a Rule 9 City Takeover Code “whitewash”), the conversion rates are usually fixed at the outset, whether by reference to a formula or a discount to market value at the date of conversion. Gone are the days

of the “toxic PIPE” and “death spiral” (ie where there is no floor price to the issue of shares or conversion, driving down the share price and considerably diluting the listed company’s shareholding).

Conversion rights usually start shortly after the stock is issued and last until it is redeemed. The conversion price may be at the present market price of the shares or at a small discount, normally not more than 10%. The holder converts by completing a form at the back of the loan stock certificate and the number of shares it receives is calculated by dividing the nominal values of the loan stock it tenders by the conversion price, ie the stockholder pays no cash, but simply exchanges its stock for shares. Likewise, the company receives no cash on conversion. However, its outstanding debt is reduced by the nominal amount of stock redeemed and its issued share capital (and share premium account, if appropriate) increases by the same amount. The conversion therefore has a doubly beneficial effect on gearing, reducing debt at the same time as equity is increased.

Larger transactions

On larger transactions, it may be worth considering having the investors subscribe for preference shares in, say, a wholly-owned Jersey subsidiary of the UK listed company, and then arranging for the subsidiary to lend the subscription proceeds up to the parent pursuant to a deep discount bond. The conversion right is still into the UK listed company’s equity. The listed company should then be able to deduct the financial cost of the borrowing (the discount) for corporation tax purposes (at the end of the life of the bond). A deep discount, as opposed to the payment or accrual of interest, is used to avoid withholding tax issues.

Investment rights

Institutions undertaking a PIPE transaction do not tend to obtain the same investment rights usually afforded to them by a typical private equity investment. Part of the reason for this is that veto rights would not be permitted under the Listing Rules or AIM Rules. However, their absence can be addressed by the company and the investors agreeing a list of matters in the subscription agreement. For example, the investors may be entitled to receive certain financial information on a regular basis; and there may be

matters requiring additional shareholder approval (eg beyond those contained in the Listing Rules with regard to borrowings and expenditure, undertaking matters outside the ordinary course of business, or creating encumbrances). There is also typically a provision that any loan stock will be immediately redeemed upon the happening of certain standard events of default.

The size of the subscription and the discount applied will also dictate what other legal and regulatory considerations are involved. For example,

- whether listing particulars are required
- whether a “whitewash” will be required under the Takeover Code to avoid a mandatory bid for the whole of the company by the investors acquiring 30% or more of the shares
- whether the Association of British Insurers’ (ABI) guidelines on discounts and shareholder approvals will need to be considered.
- approvals will need to be considered.

An experienced team

Speechly Bircham has recently advised on two PIPE transactions. In the first we advised a syndicate of investors on the PIPE transaction and refinancing of AIM-listed AIT Group plc, a customer interaction software company. Investors included Quester Capital Management and Bessemer Venture Partners and £5 million of new funding was injected by way of convertible loan stock into the company. We subsequently advised AIM-listed Adval Group plc, a learning solutions provider to the corporate and government sectors, on its PIPE transaction and placing by the issue of contingently convertible loan stock and new shares to a syndicate of leading VCT investors and individuals.

If you would like to discuss a possible PIPE transaction, please contact

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