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RAYMOND JAMES

Convertible Bonds

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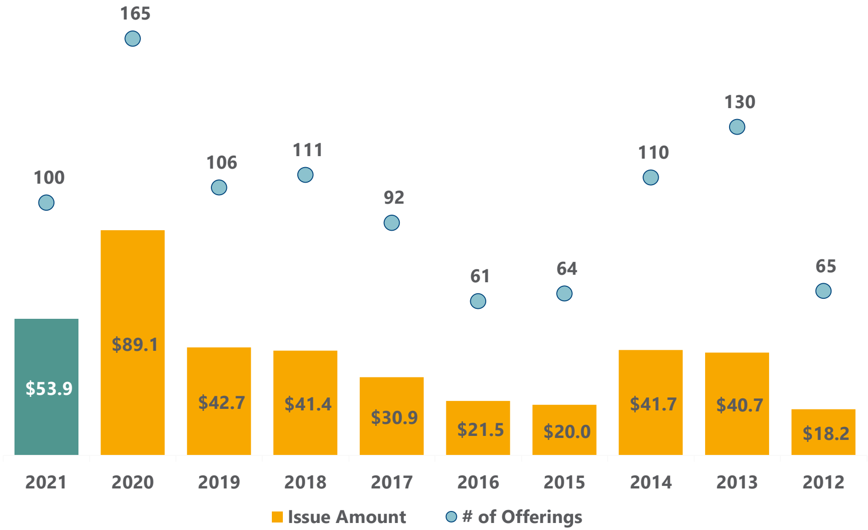
Agenda

- Understanding Converts and the Convert Market
- Tax Considerations
- Securities Considerations

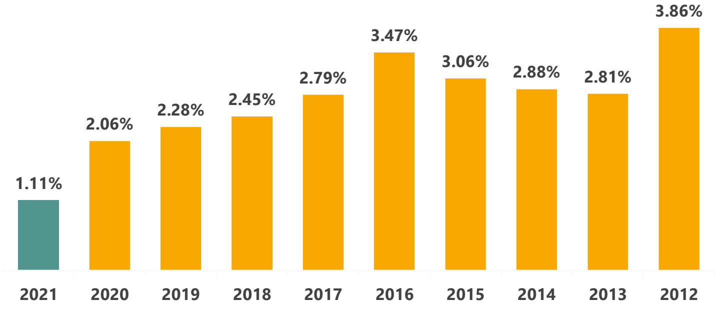
Understanding Converts

Convertible Debt Issuance in 2021 is on pace to set a new 10+Year High

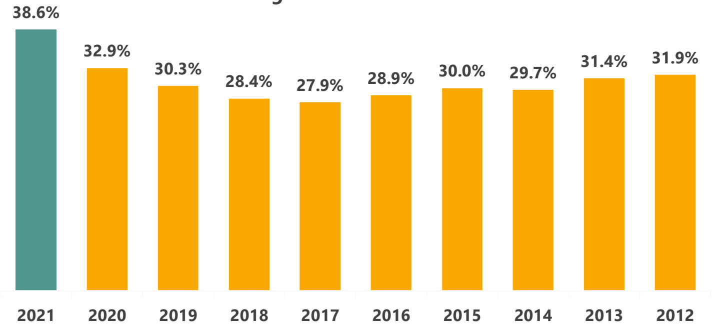
US Convertible Debt Issuance *($ amounts in billions)*



Average Coupon



Average Conversion Premium



Convertible Structures Available to Companies

- While Plain Vanilla Convertible Debt is the most popular security of choice, companies may also have access to structured solutions and convertible preferred options

	Typical Characteristics
Plain Vanilla Convertible Debt	• Senior unsecured • No financial covenants • Cash coupon below comparable maturity non-convertible debt • Conversion price set at a premium to market (option to buy-up premium via "call spread" or "capped calls") • 3 – 7 year maturities; 5-years most common • Flexible settlement upon conversion (cash or shares) to minimize dilution • Issued as private placement via Rule 144A and marketed publicly to Qualified Institutional Buyers ("QIBs") only
Structured Convertibles	• Similar to traditional convertible debt • 3 – 5 years maturities • Likely to contain conditions and structural features that enhance investor protections
True Private Placement Convertible Debt	• Highly structured agented private placement • Structure and terms determined by investors through a competitive process • Typically placed with small group of investors including dedicated convertible, fixed-income cross over funds, and/or private capital providers
Plain Vanilla or Debt-backed Mandatory Preferred Securities	• Equity substitute • Cumulative dividends higher than convertible debt • 3 year automatic conversion into shares

Convertible Debt Allows Companies to Minimize Interest Expense and Dilution

Bond + **Call Option** = **Convertible Bond**

Issuer agrees to…

- Pay periodic cash coupons
- Repay principal in cash at maturity

Straight Debt Cost = X
(Example: 7.50%)

Issuer agrees to…

- Sell an embedded call option struck at a fixed price set at a premium to the stock price when the bond is issued issue

Option Value = Y
(Example: 5.00%)

Result…

- Debt security with lower coupon cost relative to straight debt
- Ability to issue common stock at a premium to minimize dilution
- Principal amount issued must be repaid in cash at maturity if not converted

Convertible Coupon = X – Y
(7.50% - 5.00% = 2.50%)

Reasons For and Against Issuing Converts

RATIONALE & ADVANTAGES

- Unsecured debt; no incurrence or maintenance covenants
- Lower coupon cost relative to straight (non-convertible) debt
- Ability to issue equity at a premium
- Option to "buy up" premium and minimize dilution via derivative purchase
- Maxed out on senior leverage
- Lack of rating prohibits access to the high-yield market
- "All-in" cost of capital including purchase of the derivative compares favorably to high-yield debt
- Sizing and structure provide more flexibility than other debt alternatives
- Time to market / management marketing commitment is minimal
- Fixed coupon rate eliminates interest rate risk
- Settlement flexibility and conversion premium minimizes dilution
- Typically structured with issuer call option after 3 or 4 years
- Commonly issued via Rule 144A (no prospectus filing with the SEC)
- Broadens long term investor base (long-only convertible investors, income funds, sector buyers, arbitrage investors)

CONSIDERATIONS

- Classified as long-term debt on the balance sheet
- Periodic cash interest payments
- Principal amount must be repaid in cash if not converted prior to maturity
- Potential for share dilution upon conversion
- GAAP accounting
- No increase in the public share float / liquidity prior to conversion
- No equity credit provided by credit rating agencies (mandatory convertible preferred is an exception)

When to Consider Issuing Convertibles

Criteria	Comment / Recent Examples
Company seeking to refinance debt	• Refinancing higher cost debt is easily understood and a common use of proceeds
Company has a funding need for an acquisition	• Company's with acquisitions that have already been announced (audited financials on the target preferred) can use convertibles to repay any bridge financing
Company with history of successfully integrating acquisitions is building a "war chest" – growth capital	• A Company with a history of successful acquisitions can raise opportunistic capital with a "general corporate purposes" use of proceeds to "pre-fund" potential acquisitions
Company recently announced a share buyback program	• Convertibles provide an efficient means to execute a meaningful block share repurchase at a fixed price
Company is trading near a 52-week or all-time high	• Company's with high valuations can sell stock even higher through a convertible
Company is trading near a 52-week or all-time low	• See share buyback comment above
Company has high-cost, floating rate, senior secured bank debt that can be prepaid	• Locking in fixed-rate, covenant free debt with low cash costs
Company has a funding need that can't be efficiently satisfied by one (equity or high-yield) offering	• When a Company's funding need exceeds the amount that one investor group can digest efficiently, it can combine a high-yield or equity offering with a convertible

Factors Impacting Pricing and Feasibility

- Size of offering, and therefore, liquidity, has taken on increased importance to investors given the supply of new issuance

Factor	Note
Public Equity Float	• A larger public equity float benefits pricing because convertible investors perceive better common stock liquidity
Registration Statement	• Companies with an effective shelf or with WKSI status will get better pricing on the margin
Average Daily Trading Volume	• Average daily trading volume in the common stock is a measure of liquidity—which as noted above is a positive for convertible buyers. Convertible investors want to know, "how many days will it take to trade the stock underlying this convertible?"
Short Interest as a % of the Public Float	• Higher short interest as a percentage of the public float reduces the number of shares that can be lent to investors and increases the cost to borrow shares
Borrow Cost	• Higher borrow cost impacts pricing terms negatively
Common Stock Volatility	• Higher stock volatility increases the value of the embedded conversion option allowing issuers to get a higher conversion premium at pricing
Common Stock Dividend	• A higher dividend negatively impacts convertible pricing
Credit Profile	• A longer history as a financially sound growth company leads to better pricing • A stronger credit profile lowers the credit risk premium and leads to lower interest rate (coupon) on a convertible note
Offering Size	• Noticeable breakpoints exist in the convertible market as the deal size moves above $100 million – $150 million to $200 million deal size opens the transaction to ~100% of potential investors • Smaller deals are possible, but the universe of investors is smaller and pricing terms are higher (i.e. higher coupon and lower conversion premium) – additional investor protections or credit enhancements may be required
Use of Proceeds	• For a first-time issuer with no history in the public credit markets, a clearly defined use of proceeds, such as senior debt repayment, leads to better pricing

Many Convertible Debt Issuers use Capped Calls or a "Call Spread" to Increase the Premium

- A separate, over-the-counter derivative transaction that synthetically increases the conversion price of a convertible security
- The Issuer's pays for the derivative at issuance; the net cost is treated as an immediate reduction to shareholders' equity and is not periodically marked-to-market
- The derivative is worthless at maturity if the common stock is not trading above the conversion price
- Sale of the derivative is commonly conducted via a competitive auction

	Bond Hedge + Warrant ("Call Spread")	**Capped Calls**
# of Contracts	• 2 (purchased call option, sold warrant)	• 1
Cost	• Cheaper than Capped Calls due to longer-dated expiration of warrants	• More expensive than "Call Spread" because entire contract expires at the same time
Tax Deductibility	• Entire cost of the purchased calls ("Bond Hedge") is treated as Original Issue Discount ("OID") for tax purposes and deductible over the life of the security	• Net cost of the Capped Calls ("Bond Hedge") is treated as Original Issue Discount ("OID") for tax purposes and deductible over the life of the security
GAAP Dilution during Reporting Periods Prior to Conversion	• Dilution benefit is ignored for the calculation of GAAP diluted shares • Additional dilution above the warrant strike price calculated using the Treasury Stock method	• Dilution benefit is ignored for the calculation of GAAP diluted shares • No additional dilution above the "Cap Price"

Mid and Large Cap Companies Have Been the Most Active Issuers this Year

Convertible Debt Issuance *(in millions)*

	Total			Average						
	# Deals	Amount Raised	# Deals with Hedge	Market Cap	Stock Impact (%)	Deal Size	Maturity	Coupon (%)	Premium (%)	Premium with Hedge
2021	100	$ 53,894	59	$ 12,369	(6.93)	$ 539	5.3 Years	**1.11**	**38.64**	93.40
Market Cap Range:										
Sub $250 MM	1	$ 86	-	$ 243	(24.78)	$ 86	5.1 Years	**4.50**	**25.00**	
$250 MM - $500 MM	5	696	2	378	(22.25)	139	5.0 Years	**4.38**	**29.48**	87.50
$500 MM - $1 B	10	2,027	6	828	(14.16)	203	5.2 Years	**3.04**	**31.50**	91.67
$1 B - $2.5 B	18	4,462	11	1,652	(6.96)	248	5.5 Years	**1.87**	**30.58**	79.55
$2.5 B - $5 B	19	7,930	12	3,623	(6.71)	417	5.4 Years	**0.34**	**36.51**	97.11
$5 B - $10 B	21	14,183	12	6,848	(6.12)	675	5.3 Years	**0.40**	**41.40**	89.58
Greater than $10 B	26	24,510	16	37,848	(3.02)	943	5.3 Years	**0.21**	**48.58**	104.38
Offering Size Range:										
Greater than $1 B	13	$ 17,440	9	$ 42,940	(2.82)	$ 1,342	5.6 Years	**0.06**	**54.26**	106.67
$500 MM - $1 B	34	22,513	19	15,965	(4.84)	662	5.2 Years	**0.31**	**41.53**	96.61
$250 MM - $500 MM	27	9,511	17	4,041	(6.79)	352	5.5 Years	**1.04**	**35.04**	92.05
$175MM - $250 MM	12	2,658	7	1,321	(12.03)	221	5.2 Years	**2.26**	**31.87**	82.14
$100MM - $175 MM	10	1,455	6	755	(14.94)	145	5.2 Years	**3.05**	**31.07**	87.50
$75 MM - $100 MM	3	268	1	690	(18.04)	89	5.7 Years	**4.00**	**24.97**	50.00
$50 MM - $75 MM	1	50	-	1,245		50	3.8 Years	**1.88**	**32.29**	

Consumer Discretionary and Technology Companies are the Most Active Issuers in 2021

($ amounts in millions)

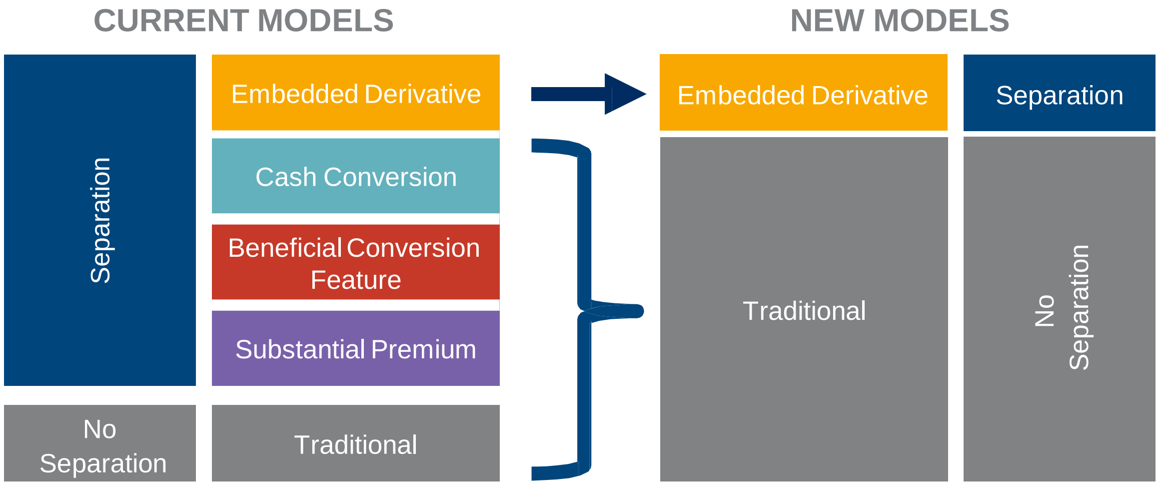
	Total				Average					
Sector	# of Deals	Deals with Hedge	Amount Raised	% of 2021 Issuance	Deal Size	Market Cap	Coupon (%)	Premium (%)	Hedge (%)	Maturity (Years)
Consumer Discretionary	20	10	$ 15,130	28.1%	$ 757	$ 26,601	0.63	41.89	102.50	5.06
Information Technology	26	17	14,811	27.5%	570	9,912	0.50	44.05	96.94	5.17
Health Care	19	13	7,270	13.5%	383	3,432	1.66	33.45	94.23	5.50
Communication Services	10	7	6,445	12.0%	645	25,279	0.34	41.50	94.29	5.58
Real Estate	7	5	2,006	3.7%	287	2,226	2.11	31.60	72.86	5.45
Industrials	5	2	2,426	4.5%	485	6,098	0.93	37.50	93.75	5.41
Financials	4	1	2,220	4.1%	555	13,608	3.88	37.50	100.00	5.01
Consumer Staples	2	1	1,200	2.2%	600	5,018	0.94	39.90	100.00	4.90
Utilities	2	2	1,075	2.0%	538	4,351	0.13	25.00	87.78	4.27
Materials	2	1	776	1.4%	388	3,839	1.50	24.50	50.00	6.05
Energy	3	1	535	1.0%	178	929	3.42	30.83	75.00	6.05
Total	**100**	**60**	**$ 53,894**	**100.0%**	**$ 539**	**$ 12,374**	**1.11**	**38.64**	**93.51**	**5.30**

Refinancing "Busted Convertibles"

	Least Common	More Common		Most Common
	Registered Exchange	**Privately 4(a)(2) Exchange**	**Privately 3(a)(9) Exchange**	**"Modified" Amend and Extend**
Description	• Publicly announced exchange offering that allows the Issuer to exchange new registered convertible (and/or common stock or non-convertible) securities for existing convertibles o Registration statement filed on form S4 o Exchange offer is made to investors by prospectus o Offer is kept open for 20 days after it is announced publicly	• Confidentially negotiated and marketed transaction that allows the Issuer to exchange new unregistered convertible securities for outstanding convertibles held by a small group of existing investors.	• A transaction direct between the issuer and existing security holders that allows the Issuer to exchange outstanding securities for new securities without registration requirements **Requirements** o New and old securities are issued by the same issuer o Holder cannot be asked to give anything of value other than outstanding securities o Exchange must be done with existing holders only o No commission can be paid for soliciting the exchange o Exchange must be done in good faith	• Confidentially or publicly negotiated and marketed transaction that allows the issuer to repurchase outstanding convertibles while simultaneously issuing new registered or unregistered securities
Benefits	• Targets all current Note holders • Potential to maximize the amount of debt refinanced • Ability to incentivize investors to participate in the exchange	• Stock price not impacted during confidential marketing and negotiations • Transaction can be terminated without public disclosure • Minimal disclosure and documentation required given private placement	• No registration requirements • Stock price not impacted during confidential marketing and investor negotiations • Low transaction fees and expenses • Potential to price on an overnight basis	• Potential to increase size of offering and repurchase after public announcement
Considerations	• Common stock price is exposed to impact of exchange announcement • Must be kept open for minimum of 20 days, exposing stock price to market risk • No guarantee that investors will participate in the exchange • S4 filing subject to SEC review	• Cannot target the entire class of investors given tender offer rules • No broad marketing effort • Investors may need to buy/sell stock to adjust existing hedges • Some holders may not agree to negotiated "over the wall"	• Cannot target the entire class of investors given tender offer rules • Investors may need to buy/sell stock to adjust hedges • Issuer negotiates terms and conditions directly with investors	• Cannot target the entire class of investors given tender offer rules • Repurchase price and amount • Some investors may need to buy/sell stock to adjust hedges • Some investors may not agree to NDAs

Convertible Accounting Getting Simpler

- The FASB voted unanimously to proceed with a simplified model for convertible debt accounting and has provided a final Accounting Standards Update (Debt—Debt with Conversion and Other Options (Subtopic 470-20) to formalize the change
- Early adoption is permitted, with some issuers already moving to the new guidance; the official effective date is for filers with fiscal years beginning after December 15, 2021



Other Import Accounting Treatment Changes

	Current Accounting	New Accounting
Net Share Settlement - Issuer agrees to settle the principal amount in cash; premium over par can be settled in cash or shares at the issuer's option		
Balance Sheet	Bifurcated into debt and equity	Not bifurcated
EPS	Treasury stock method	Treasury stock method
May become a current liability if conversion conditions met	Yes	Yes
"Instrument X" - Converions can be settled in cash, shares or any combination; Issuer does not specify how conversions will be settled		
Balance Sheet	Bifurcated into debt and equity	Not bifurcated
EPS	Treasury stock method	If-converted method
May become a current liability if conversion conditions met	Yes	No
"Plain Vanilla" - Converions settled entirely in shares		
Balance Sheet	Not bifurcated	Not bifurcated
EPS	If-converted method	If-converted method
May become a current liability if conversion conditions met	NA	NA

Tax Considerations

Convertible Debt

- Interest deduction for issuer, holder includes interest income
- Conversion is not a taxable event. Rev. Rul. 72-265
- The right to convert into the stock of the issuer (or an affiliate) is not a "contingency" within the meaning of Reg. Section 1.1275-4. Reg. Section 1.1275-4(a)(4). So, not a contingent payment debt instrument.
- The holder does not allocate any of its purchase price to the conversion feature. Reg. Section 1.1273-2(j).
- Issuer does not recognize gain or loss when stock is issued upon conversion. Section 1032.
- Issuer cannot deduct repurchase premium to the extent it exceeds adjusted issue price plus a normal call premium. Section 249.

Section 163(l)

- No deduction for interest on disqualified debt
- Disqualified debt
  - Payable in equity of issuer, related party or equity held by issuer (or related party)
- Payable in equity?
  - Substantial amount of principal or interest required
    - To be paid or converted, or at issuer's option is payable or convertible in such equity
    - To be determined, or at issuer's option is determined by reference to value in such equity
  - Part of an arrangement reasonably expected to result in foregoing
- Holder option?
  - Is there "substantial certainty" option will be exercised?
  - *Answer*: No, if "traditional" convertible bond

Convertible Bond Call Spread

- Integration Election: Reg. Section 1.1275-6 – The convertible bond and only the purchased call are integrated
  - Hedge identification requirement
- Creates a synthetic debt comprised of the convertible bond and the purchased call
  - Face: $125 mm
  - Cost of the call option: $25 mm
  - Issue Price for tax purposes: $100 mm
  - OID: $25 mm
  - Warrant price: $10 mm
- The written warrant is not integrated with the convertible bond or the purchased call
  - Warrant price
  - Section 1032
- AM 2007-014

Convertible Bond Capped Call

- Integration Election: Reg. Section 1.1275-6 – The convertible bond and the capped call are integrated
- Creates a synthetic debt comprised of the convertible bond and the capped call
  - Face: $125 mm
  - Cost of the capped call option: $15 mm
  - Issue Price for tax purposes: $110 mm
  - OID: $15 mm

Other Considerations for Issuers

Offering Methodology

- Converts can be issued:
  - Pursuant to Rule 144A, in a traditional Rule 144A offering to initial purchasers
  - In certain instances, such as, for example, in the event that the issuer is offering the convert to finance an acquisition, it may not be possible to structure the transaction as a traditional Rule 144A offering. The investment bank may act as placement agent and introduce the issuer to QIBs that will purchase directly from the issuer in a Section 4(a)(2) private placement; however, the transaction will be a Rule 144A-qualifying transaction. The notes will settle through DTC and bear a Rule 144A CUSIP. Either the placement agent or the trustee will act as settlement agent to facilitate the closing.
  - In a registered offering

Offering Methodology *(cont'd)*

- More often than not, convertible notes will be issued in a Rule 144A offering
  - The repurchase strategies can be executed without Regulation M concerns arising
  - Of course, for Rule 144A, the convert must have a conversion premium (to avoid fungibility issues)
  - Registration rights generally are not required; issuer will covenant to provide "current information" and the indenture will provide for the Rule 144A restricted CUSIP to be moved to a non-restricted CUSIP on the one-year anniversary of issuance

Conversion Price Adjustments

- Anti-dilution adjustments
- Adjustments for distributions like dividends, spin-offs
- Adjustments for other in-kind distributions
- Adjustments for the issuance of rights, warrants
- Adjustments for issuer self-tenders

Change of Control

- Converts will have a make-whole fundamental change provision
- The provision will adjust the conversion rate upon the occurrence of:
  - A merger
  - The delisting of the issuer's stock
- Typically, a merger in which the convert becomes convertible into the acquirer's listed stock may be excluded from the fundamental change provision
- An issuer redemption may also trigger the fundamental change provision

Redemption Features

- In certain instances, after a specified period, the notes may become redeemable at the issuer's option (with no make whole)
- The issuer redemption option also may be more limited—it may be available after a specified period, and in the event that the notes are trading above a specified premium to the conversion price
- Notes also may be structured as contingently convertible instruments

Securities Exchange Listing Rules

- Both the NYSE and the Nasdaq listing rules require shareholder approvals with respect to certain transactions
- Generally, the initial issuance will not require shareholder approval given that the convert will be issued at a premium (assuming, in the case of a Nasdaq issuer, it is not offered and sold in connection with an acquisition)
- The NYSE also has an exemption for "bona fide private financings"
  - Applicable to a sale in which either a registered broker-dealer purchases securities from the issuer with a view to the private sale of such securities to one or more purchasers, or the issuer sells the securities to multiple purchasers, and no one such purchaser has the right to acquire upon exercise or conversion of the securities, more than 5% of the shares of the issuer's common stock or more than 5% of the issuer's voting power before the sale
- Both exchanges consider as well the potential, in the case of exchangeable securities, for shares to be issued in excess of the 20% threshold. As such, a blocker provision may be required to be included in connection with certain conversion adjustments

Offsetting Anti-Dilutive Transaction

- The call overlay/call-warrant structures will be documented with standard ISDA style confirmation documents; often, frequent issuers will have a preferred starting point and dealers also have their preferred forms
- As is the case with the convert offering itself, the issuer will have to take care to consider disclosure matters, including potential material nonpublic information
- The dealer counterparty will expect representations from the issuer regarding no material nonpublic information ("MNPI")
- Depending on the repurchase alternative that the issuer is considering undertaking, there may be additional requirements to take into account

Offsetting Anti-Dilutive Transaction *(cont'd)*

- For example, if the issuer chooses to undertake open market repurchases, it will need to consider Rule 10b-18 conditions. Even an accelerated share repurchase ("ASR") will analogize to Rule 10b-18, and may be implemented with an issuer Rule 10b5-1 plan
- It will be useful for the issuer to understand how a dealer will approach its own hedging (in connection with any of the offsetting transactions, as discussed), as it affects the documentation and has potential to affect the issuer's stock

Additional Resources

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