Market Trends 2017/18: Registered Direct Offerings

A Lexis Practice Advisor® Practice Note by
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OVERVIEW

A registered direct offering is a type of hybrid securities offering, meaning that the offering methodology has certain characteristics associated with a public offering and certain characteristics associated with a private placement. Generically, the term describes an offering made pursuant to an effective registration statement (which may be a shelf registration statement) that is sold on a best efforts, or agency, basis by a placement agent and is marketed in a more targeted manner principally to institutional investors.

In recent years, most issuers that have undertaken registered direct offerings have structured these offerings as "takedowns" made pursuant to effective shelf registration statements. For more information on takedowns, see Market Trends 2017/18: Shelf Registrations and Takedowns and Top 10 Practice Tips: Shelf Registration Statements and Takedowns. Generally, the issuer will retain a financial intermediary to act as the placement agent and enter into an engagement letter. The engagement letter for a registered direct offering will provide that the placement agent will use its best efforts or commercially reasonable efforts to introduce the issuer to investors in order to purchase the offered securities. Unlike the underwriter in a traditional offering, the placement agent has no obligation to, and will not, purchase any of the offered securities. The engagement letter for a registered direct offering also will provide that the issuer will reimburse certain of the placement agent's expenses, including the fees and expenses of its counsel, usually up to a specified cap. The engagement letter will contain standard representations and warranties of the issuer to the placement agent, as well as provide that the issuer will indemnify the placement agent for certain breaches of such representations and warranties, as well as for disclosure-related misstatements and omissions. For more information, see Registered Direct Offerings.

The placement agent generally will wall-cross investors (i.e., inform them of the potential offering, which may constitute material nonpublic information) by obtaining certain confidentiality undertakings from them as well as agreements to refrain from trading in the company's securities for a brief, usually two- to three-day, period. The issuer and its counsel will prepare a prospectus supplement that describes the terms of the registered direct offering. For a form of script relating to wall-crossing, see Investor Wall-Crossing Script and Email Confirmations. For more information on prospectus supplements, see Rule 424 Prospectus Supplements Filing.

NOTABLE TRANSACTIONS

In 2017, there were a number of registered direct offerings that raised over $100 million in offering proceeds. For example, in 2017, Fortis Inc. raised approximately $382 million in offering proceeds, Agnico Eagle Mines Limited raised approximately $220 million, and Urban Edge Properties raised approximately $155 million. To date, in 2018, there have been a few large registered direct offerings, including an offering undertaken by Wynn Resorts, Limited raising approximately $928 million, and an offering by Algonquin Power & Utilities Corp. raising approximately $353 million in offering proceeds.

DEAL STRUCTURE AND PROCESS

A registered direct offering may be structured in a variety of different ways. In the past, it was common to structure registered direct offerings as “all or none” offerings. This means that the issuer would set forth in the prospectus the number of shares or the dollar amount to be raised in the proposed offering and the offering would only proceed to a closing if the specified amounts had been raised. In an all or none offering, the securities laws require that an escrow account be used to collect investor funds and such investor funds can be released only if the contingency (the threshold amount) has been met. Otherwise, the escrow agent, which must be a national bank, must promptly return the investor funds.

It has become more common to structure registered direct offerings as “any or all” offerings. This means that the transaction will proceed to close even if the proposed maximum offered amount identified in the prospectus has not been sold. In this type of offering, no escrow account is required to be used.

Occasionally, especially in the case of offerings by micro-cap and small-cap companies, registered direct offerings will be structured as “minimum-maximum” offerings, with a stipulated minimum amount that must be raised in order for the transaction to proceed to a closing. This usually is meant to ensure that the issuer has raised the proceeds necessary for its stated use of proceeds. The maximum amount often is identified so that investors understand the total overall dilution that may result from the transaction. In this type of offering, which also is subject to a contingency (i.e., the minimum amount specified being raised), an escrow account also must be used. For a comparison of various types of equity offerings, see Equity Offerings Comparison Charts.

As noted above, almost all of the registered direct offerings completed in recent years have been follow-on offerings, completed as shelf takedowns and marketed on a wall-crossed basis. It is possible to conduct an initial public offering as a registered direct offering, although it is unusual. Similarly, it is possible to conduct a registered direct offering by filing a non-shelf registration statement for the offering, or a bullet registration statement (i.e., a one-time use or single-purpose registration statement), rather than a shelf registration statement. Due to concerns regarding market volatility and possible shorting activity, issuers may be reluctant to file a single-purpose registration statement for a registered direct offering. For forms, checklists, and further information regarding follow-on offerings and shelf offerings, see Follow-On Offerings Resource Kit, Market Trends 2017/18: Follow-On Offerings, Registered Securities Offerings Post-IPO, Top 10 Practice Tips: Follow-on Offerings, and Shelf Offerings.

An issuer may elect to undertake a registered direct offering instead of a private placement or a private investment in public equity (PIPE) transaction if the issuer has an effective shelf registration statement and the issuer believes, or is advised that, it will be able to obtain better pricing by undertaking a registered offering rather than a private placement. Institutional investors may prefer to purchase shares issued pursuant to a registration statement, which will be freely transferable, rather than acquiring restricted securities in a private placement. In addition, since the securities offered in a registered direct transaction are sold pursuant to a registration statement, it is possible for the placement agent to include retail, or non-accredited, investors in the transaction. Usually, participation in a PIPE transaction will be limited to accredited investors. For further information on PIPEs, see Market Trends 2017/18: PIPEs, PIPEs: Drafting Key Documents, Raising Capital Using a PIPE, and Steps for Conducting a PIPE.

An issuer may choose a registered direct offering instead of a firm commitment underwritten public offering that is confidentially marketed if the issuer anticipates that the offering will be relatively small or will be sold to a limited number of investors. The financial intermediary may prefer a registered direct offering, since, in a registered direct offering, it will not undertake any principal risk and there will be no cost of capital associated with its participation in the transaction. Given that a registered direct offering is a best efforts offering, there will be no over-allotment option, or “green shoe,” and the placement agent cannot undertake any stabilization activities.

For further information on confidentially marketed public offerings, see Market Trends 2017/18: Confidentially Marketed Public Offerings, Confidentially Marketed Public Offerings: Questions to Ask Before Proceeding, and Confidentially Marketed Public Offerings.

A registered direct transaction will usually constitute a "distribution" for purposes of Regulation M. This means that the placement agent should consider taking the appropriate steps required for compliance with Regulation M restrictions, including observing the applicable Regulation M restricted period, and making the appropriate Regulation M notice filing with FINRA. For further information on Regulation M, see Regulation M.

Offered Securities

Most registered direct offerings completed in recent years have involved offerings only of shares of common stock and, to a lesser extent, common stock and warrants.

Use of a Financial Intermediary

Most registered direct offerings have been completed using a placement agent. An issuer also may sell securities directly to one or more institutional investors pursuant to a registration statement without the services of a placement agent. From time to time, an existing investor may indicate to an issuer its interest in purchasing additional securities of the issuer, or a new investor may approach the issuer or a placement agent on a reverse inquiry basis, desiring to purchase securities of the issuer.

Level of Activity

In recent years, according to a data provider, the level of offering activity has been fairly consistent, generally with a slight upward trend in activity. In 2015, 2016, and 2017, there were 139, 167, and 224 registered direct offerings completed, raising proceeds of approximately $2.47 billion, $2.15 billion, and $3.47 billion, respectively. The average proceeds raised in each offering in 2015, 2016, and 2017 were $15.49 million, $12.88 million, and $17.29 million, respectively.

INDUSTRY INSIGHTS

The issuers that relied most on registered direct offerings for capital-raising were companies in the healthcare, technology, energy, and industrial sectors. These are sectors in which companies need to access the capital markets frequently and in which companies may face stock price volatility that may cause them to consider relying on registered direct offerings. The market capitalization of the companies that relied on registered direct offerings for their funding varied significantly on a year-to-year basis from 2015 to 2017.

LEGAL AND REGULATORY TRENDS

The issuer will enter into a placement agency agreement with the placement agent at pricing. The agreement will contain representations, warranties, and covenants similar to those that would be contained in an underwriting agreement. The placement agency agreement also will contain requirements to deliver a comfort letter, legal opinions, a negative assurance letter from the issuer's counsel (also known as a 10b-5 letter), and other closing deliverables.

Some investors in registered direct offerings will insist that the issuer make the same representations and warranties directly to the investors. These may be contained in a side letter executed on the pricing date. However, investors cannot enter into a binding commitment to purchase securities from the issuer until a preliminary prospectus with a price range has been delivered to them.

The issuer should consider whether it intends to offer shares in excess of 20% of its pre-transaction total voting shares outstanding and whether the shares to be sold in the registered direct offering will be sold at a discount to the greater of the book value of the issuer's shares or its market price, based on the rules of the securities exchange on which its equity securities are listed or quoted.

Both the New York Stock Exchange and the Nasdaq Stock Market (Nasdaq) rules require that listed companies obtain shareholder approval in the case of certain private placements completed at a discount resulting in the issuance of 20% or more of the issuer's pre-transaction shares outstanding. See 20% Rule and Other NYSE and NASDAQ Shareholder Approval Requirements. Although a registered direct offering is a public offering, for purposes of the securities exchanges' shareholder voting requirements, given the targeted nature of the offering, it usually is not considered a "public offering."

In interpretative guidance contained in IM 5635-3, Nasdaq has indicated that it will consider the following factors in determining whether an offering is a "public offering" for purposes of the shareholder vote requirement:

- The type of offering, including whether the offering is conducted by an underwriter on a firm commitment basis (generally Nasdaq considers a registered firm commitment offering to be a public offering), or an underwriter or placement agent on a best-efforts basis or whether the offering is conducted by the company without an underwriter or placement agent
- The manner in which the offering is marketed, including the number of investors offered securities, how those investors were chosen, and the scope of the marketing effort
- The extent of the offering's distribution, including the number and identity of the investors who participate in the offering and whether there is any prior relationship between the company and those investors
- The offering price, including the extent of any discount to the market price of the securities offered
- The extent to which the company controls the offering and its distribution

Nasdaq will also consider:

- Whether the offering was announced to the public before it was priced
- Whether the offering was marketed to retail investors
- The portion of the offering allocated to the largest purchaser

Nasdaq takes the view that if the vast majority of the securities offered were allocated to one investor (or to a group of affiliated investors), it is more likely that the offering price was derived through direct negotiation with the investor rather than through the economics of price discovery attendant to an underwriter's book building process.

In February 2018, Nasdaq proposed amendments to its shareholder approval rule to delete the reference to book value (which feedback from investors suggested was an outmoded accounting concept that did not reflect a security's true value). Instead, an issuer would have to consider whether the proposed offering would be undertaken at a discount to the market price. In addition, the amendments would change the definition of market price for the purposes of the rule from the closing bid price (as the rule currently stands) to the lower of (i) the closing price on Nasdaq.com and (ii) the average of the closing price for the five trading days before the execution of the agreement to sell the shares. The proposed amendments are currently under consideration by the Securities and Exchange Commission.

As a result of the Nasdaq and New York Stock Exchange rules regarding shareholder approval, the issuer may opt to undertake a firm commitment underwritten public offering. The issuer also might choose to limit the number of shares it offers in the registered direct offering to an amount below the 20% threshold. Finally, the issuer might work with the placement agent to structure an offering of common stock and warrants exercisable for common stock that is considered to be priced at the market price and not at a discount.

An issuer that is organized as a master limited partnership should consider that it will be treated as an "ineligible issuer" when it undertakes a best efforts offering (under the definition of ineligible issuer in Rule 405 (17 C.F.R. § 230.405)). This may limit a master limited partnership's ability to use certain free writing prospectuses in connection with a registered direct offering. For additional information on master limited partnerships, see Market Trends 2017/18: Master Limited Partnerships and Top 10 Practice Tips: Master Limited Partnerships. For further information on free writing prospectuses, see Free Writing Prospectus Checklist, Using a Free Writing Prospectus Flowchart, and Timing for Filing a Free Writing Prospectus Checklist.

OTHER KEY MARKET TRENDS

Typically, the fees paid to a placement agent in a registered direct offering will be lower than the fees paid to an underwriter in a firm commitment offering. In recent transactions, the placement agency fees have varied from 2% to 6% of the total proceeds raised. In transactions involving micro-cap and small-cap issuers, the placement agent's compensation may include warrants to purchase shares of common stock in addition to the cash compensation.

Many of the recently completed registered direct offerings have been sold to a small number of institutional investors, including hedge funds, pension funds, private equity funds, venture capital funds, and mutual funds.

MARKET OUTLOOK

During 2018, it is likely that the companies in the same industries (e.g., healthcare, technology, and energy) will continue to rely on registered direct offerings. To date, many of the registered direct offerings completed in 2018 were undertaken by healthcare companies. Given the number of healthcare companies that have completed IPOs in recent years, and the research and development budgets of many healthcare companies, it is reasonable to anticipate that companies in this sector may prove to be the most active users of registered direct offerings as follow-on offerings.

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Anna Pinedo is a partner in Mayer Brown's New York office and a member of the Corporate & Securities practice. She concentrates her practice on securities and derivatives. Anna represents issuers, investment banks/financial intermediaries and investors in financing transactions, including public offerings and private placements of equity and debt securities, as well as structured notes and other hybrid and structured products.

She works closely with financial institutions to create and structure innovative financing techniques, including new securities distribution methodologies and financial products. She has particular financing experience in certain industries, including technology, telecommunications, healthcare, financial institutions, REITs and consumer finance. Anna has worked closely with foreign private issuers in their securities offerings in the United States and in the Euro markets. She also works with financial institutions in connection with international offerings of equity and debt securities, equity- and credit-linked notes, and hybrid and structured products, as well as medium term note and other continuous offering programs.

In the derivatives area, Anna counsels a number of major financial institutions acting as dealers and participants in the commodities and derivatives markets. She advises on structuring issues as well as on regulatory issues, including those arising under the Dodd-Frank Act. Her work focuses on foreign exchange, equity and credit derivatives products, and structured derivatives transactions. Anna has experience with a wide range of transactions and structures, including collars, swaps, forward and accelerated repurchases, forward sales, hybrid preferred stock and off-balance sheet structures. She also has advised derivatives dealers regarding their Internet sites and other Internet and electronic signature/delivery issues, as well as on compliance matters.

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