Market Trends 2020/21: Registered Direct Offerings

A Practical Guidance® Practice Note by Anna T. Pinedo, Mayer Brown LLP

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This practice note discusses recent market trends regarding registered direct offerings. It begins by discussing the advantages these offerings provide to issuers and continues with a review of current deal structure and process and applicable shareholder approval requirements. It concludes with an overview of market trends for registered direct offerings, including recent notable transactions, activity level, and industry insights.

A registered direct offering is a type of hybrid securities offering that has characteristics of both public offerings and private placements. Generically, the term describes an offering made under an effective registration statement (which is usually a shelf registration statement) filed with the Securities and Exchange Commission (SEC) under the Securities Act of 1933, as amended (Securities Act), that is sold on a best efforts, or agency, basis by a placement agent and is target marketed principally to institutional investors.

For additional information on registered direct offerings, see Registered Direct Offerings and Top 10 Practice Tips: Registered Direct Offerings.

Notable Transactions

In 2020, there were nine registered direct offerings that raised at least $100 million, the largest being the BeiGene, Ltd. offering, which raised $2.1 billion directly from investors without a placement agent. In 2021, through June 30th, at least 15 offerings of at least $100 million have been completed. For example, Nano Dimension Ltd. raised over $500 million and approximately $332 million in two separate offerings, and Gevo Inc. raised $350 million.

Level of Activity

From 2015 to 2019, the numbers of registered direct offerings were relatively constant. However, in 2020, there was a sharp increase in registered direct offerings, and this trend has continued through June 30, 2021.

In 2015, 2016, 2017, 2018, and 2019, there were 139, 167, 224, 166, and 190 completed registered direct offerings, respectively, for aggregate proceeds of approximately $2.5 billion, $2.2 billion, $3.5 billion, $3.5 billion, and $1.7 billion, respectively. The average proceeds raised in an offering in 2015, 2016, 2017, 2018, and 2019 were $15.5 million, $12.9 million, $17.3 million, $20.7 million, and $8.9 million, respectively. In 2020, however, there were 356 registered direct offerings raising aggregate proceeds of approximately $9 billion and average proceeds per offering of approximately $22.3 million. This increased activity has continued in 2021, and as of June 30, 2021, there were 187 offerings for aggregate proceeds of approximately $7.1 billion and average proceeds per offering of approximately $34.5 million.

Included in the registered direct offering totals for 2020 and 2021 are offerings made by companies directly to a small number of institutional investors without a placement agent. In 2020, there were 48 offerings made directly to investors; through June 30, 2021, there were 23 offerings made directly to investors without a placement agent. Many of these offerings were made to hedge funds, pension

funds, private equity funds, venture capital funds, and mutual funds.

Industry Insights

Issuers in the healthcare, industrial, and technology sectors conducted the most registered direct offerings in recent years. In 2020, amidst the COVID-19 pandemic, healthcare companies were the most active, with 210 offerings raising an aggregate of approximately $5 billion. Industrial companies accounted for 61 offerings raising aggregate proceeds of approximately $1.9 billion, and technology companies completed 39 offerings for aggregate proceeds of approximately $970 million.

Through June 30, 2021, healthcare companies continue to be the leaders in registered direct offerings, having completed 70 offerings for proceeds of approximately $2.7 billion.

Advantages over Alternative Transactions

An issuer may choose a registered direct offering instead of a confidentially marketed firm commitment underwritten public offering if it anticipates the offering will be relatively small or will be sold to a limited number of investors. The investment bank engaged by the issuer may also prefer a registered direct offering because, as a placement agent, it will not undertake any principal risk and will not incur any cost of capital for its participation. Given that registered direct offerings are "best efforts" offerings, there will be no over-allotment option, or "green shoe," and the placement agent cannot undertake stabilization activities.

For further information on confidentially marketed public offerings, see Market Trends 2020/21: Confidentially Marketed Public Offerings and Confidentially Marketed Public Offerings.

An issuer may prefer a registered direct offering over a private placement or a private investment in public equity (PIPE) transaction if the issuer has an effective shelf registration statement and believes, or is advised that, it will obtain better pricing by undertaking a registered offering rather than a private placement. Institutional investors may prefer to purchase shares issued under 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 under a registration statement, the placement agent may include retail, or non-accredited, investors in the offering, unlike in a PIPE transaction, where participation is usually limited to accredited investors.

For further information on PIPEs, see Market Trends 2020/21: PIPEs, and PIPE Transactions. For information and resources generally about private placements, see Private Placements Resource Kit.

Deal Structure and Process

A registered direct offering may be structured in several ways. Most registered direct offerings completed in recent years have involved offerings of only common stock or, less often, common stock and warrants.

Shelf Registration

Most issuers undertaking registered direct offerings in recent years have structured them as "takedowns" from effective shelf registration statements. Issuers will usually (but not always) retain a financial intermediary (typically an investment banking firm) to act as placement agent.

The placement agent will usually "wall cross" a few prospective investors (e.g., institutional investors, such as hedge funds, mutual funds, and private equity funds, as well as an issuer's principal shareholders), that is, provide them with limited information about the contemplated offering. This enables the issuer and the placement agent to gauge investor interest before announcing an offering, thus limiting the issuer's risk of having to withdraw an announced offering due to insufficient investor interest. Because the fact that the issuer is contemplating an offering may constitute material nonpublic information about the issuer, the placement agent will obtain confidentiality undertakings from investors that will also obligate them to refrain from trading the company's securities for a brief, usually two- to three-day, period. The issuer and its counsel will also prepare a prospectus supplement that provides the terms of the offering during this period.

For more information on shelf takedowns, see Shelf Registration, Top 10 Practice Tips: Shelf Registration Statements and Takedowns, and Registered Securities Offerings Post-IPO. For a form of script relating to wall-crossing, see Investor Wall-Crossing Script and E-mail Confirmations. For more information on prospectus supplements, see Rule 424 Prospectus Supplements Filing.

Non-shelf Registration

Although almost all registered direct offerings completed in recent years have been conducted as shelf takedowns and marketed on a wall-crossed basis, it is possible, although

unusual, to conduct an initial public offering as a registered direct offering. A registered direct offering may also be conducted by filing a non-shelf or "bullet" registration statement (i.e., a one-time use single-purpose registration statement), rather than a shelf registration statement. Due to concerns about market volatility and possible shorting activity (made more likely by the time necessary to have a non-shelf registration statement declared effective by the SEC), an issuer may be reluctant to file a single-purpose registration statement for a registered direct offering.

All or None Offerings

In the past, registered direct offerings were usually conducted as "all or none" offerings. The prospectus for the offering would specify the number of shares or the dollar amount to be raised, and the offering would close only if the entire amount was raised. Rule 15c2-4 (17 C.F.R. § 240.15c2-4) under the Securities Exchange Act of 1934, as amended (Exchange Act), requires that an escrow account be used to hold investors' funds in an all or none offering (and in a "minimum/maximum offering," discussed below) and that the funds be released to the issuer only if all the shares are sold. Otherwise, the escrow agent, which must be a national bank, must promptly return the funds to the investors.

It has become more common to structure registered direct offerings as "any or all" offerings, in which the offering will close if any securities are sold. An escrow account is not required for this type of offering.

Minimum/Maximum Offerings

Occasionally, especially in offerings by micro-cap and small-cap companies, registered direct offerings will be structured as "minimum-maximum" offerings that require a stipulated minimum amount be raised for the offering to close. This structure is usually used to ensure that the issuer receives funds at least sufficient for its stated use of proceeds. The maximum offering amount is often provided to illustrate the maximum dilution investors may incur from purchasing the offered securities. Because this type of offering is subject to a contingency (i.e., the minimum amount specified being raised), an escrow account is required by Rule 15c2-4.

Use of a Placement Agent

Most registered direct offerings are conducted by placement agents. The engagement letter for the offering will require the placement agent to use its best efforts or commercially reasonable efforts to introduce the issuer to investors interested in purchasing the offered securities. Unlike an underwriter in a traditional firm commitment offering, a placement agent is not obligated to, and will not, purchase any of the offered securities.

The engagement letter for a registered direct offering will obligate the issuer to 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 may also contain representations and warranties from the issuer to the placement agent and will obligate the issuer to indemnify the placement agent for breaches of such representations and warranties and for any material misstatements or omissions in the offering materials provided to investors.

The issuer will enter into a placement agency agreement with the placement agent at pricing, which will supersede the engagement letter. The agreement will contain representations, warranties, and covenants like those contained in an underwriting agreement for a registered offering. The placement agency agreement also will contain requirements to deliver a comfort letter, legal opinions, a negative assurance letter from issuer's counsel (also known as a 10b-5 letter), and other closing deliverables. Additionally, investors in some registered direct offerings will insist that the issuer make the same representations and warranties directly to them, which may be contained in a side letter executed on the pricing date.

The fees typically paid to a placement agent in a registered direct offering will be lower than those paid to an underwriter in a firm commitment offering. 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 cash compensation. In 2020 offerings, placement agency fees ranged from 0.9% to 8.25%. Placement agency fees in 2021 through June 30th have ranged from approximately 3.0% to 9.3%. Placement agent fees in 2020 and 2021 averaged about 7% of offering amounts, slightly higher than in prior years.

An issuer may conduct a registered direct offering directly to one or more institutional investors without the services of a placement agent. And from time to time, an existing investor may indicate to an issuer its interest in purchasing the issuer's securities, or a new investor may approach the issuer or an investment bank that works with the issuer desiring to purchase the issuer's securities of the issuer (a reverse inquiry).

Regulation M

A registered direct transaction will usually constitute a "distribution" for Regulation M purposes. This means that the placement agent should take the appropriate steps

to comply with Regulation M, including observing the applicable Regulation M restricted period and making the Regulation M notice filing with the Financial Industry Regulatory Authority, Inc. (FINRA). For further information on Regulation M, see Regulation M.

Stock Exchange Requirements

Both the New York Stock Exchange (NYSE) and The Nasdaq Stock Market (Nasdaq) rules (NYSE Listed Company Manual § 312.03 and NASDAQ Equity Rule 5635) require listed companies to obtain shareholder approval for offerings, other than public offerings, that result in shares being issued in amounts equal to or greater than 20% of the issuer's outstanding pre-transaction shares at prices below the market price (as defined) of the shares. Although registered direct offerings are registered with the SEC, they are usually not considered public offerings under these rules because they are mostly made to a very limited number of institutional investors.

Note that both the NYSE and Nasdaq recently amended their shareholder vote rules to eliminate the use of book value in determining whether shares were being offered at a below market price. Consequently, the closing price of an issuer's shares, either on the day before, or averaged over the five days before, the signing of a definitive agreement for the offering is now the sole determinant of whether shares are being issued below market price. NASDAQ IM 5635-3 provides that Nasdaq will consider the following factors in determining whether an offering is a public offering for purposes of its 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 almost all 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 investors rather than through the economics of price discovery attendant to an underwriter's book building process and is indicative of a nonpublic offering.

An issuer should thus determine whether it needs (or desires) to offer such number of shares that will exceed 20% of its pre-transaction total voting shares outstanding and whether the shares will be sold at a discount to the minimum price (market price) under the rules of the applicable securities exchange. If so, it must obtain the required shareholder approval for the offering.

Alternatively, an issuer may undertake a firm commitment underwritten public offering or limit the number of shares it offers in the registered direct offering to less than the 20% threshold. An issuer and its placement agent might also structure an offering of common stock and warrants exercisable for common stock that is deemed priced at the market price.

For more information about the NYSE and Nasdaq shareholder approval rules, see 20% Rule and Other NYSE and Nasdaq Shareholder Approval Requirements, Shareholder Approval Rules Compliance Checklist (NYSE), Shareholder Approval Rules Compliance Checklist (Nasdaq), and SEC Approves NYSE Shareholder Approval Amendments.

Master Limited Partnerships

An issuer organized as a master limited partnership should consider that it will be treated as an "ineligible issuer" (as defined in Securities Act Rule 405 (17 C.F.R. § 230.405)) if it undertakes a best efforts offering. This may limit a master limited partnership's ability to use certain free writing prospectuses for a registered direct offering. For additional information on master limited partnerships, see Market Trends 2019/20: Master Limited Partnerships and Top 10 Practice Tips: Master Limited Partnerships. For further

information on free writing prospectuses, see Free Writing Prospectus Checklist.

Market Outlook

Offering activity in 2020 and through June 30, 2021, reflects an increase in the number of registered direct offerings. The total number of offerings, the aggregate offering proceeds, and the average proceeds by offering were substantially higher in 2020 and, through June 30, 2021, are nearing yearly totals for prior years.

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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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