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UPDATE

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Summary of Post COVID-19 PIPE Deals

Since the onset of the COVID-19 pandemic and the resulting social distancing guidelines and business shutdowns throughout the U.S., global markets have experienced volatility not seen since the 2008 financial crisis. Beyond the turbulence in public markets, businesses throughout the country and globally are feeling an increasing strain as they grapple with declining revenues, cash flow crunches and, in some cases, the need to increase capital expenditures as work-places implement social distancing practices and/or encourage employees to work from home. As public issuers seek to raise capital to weather the current storm, financial sponsors are increasingly viewing private investments in public equity (PIPEs) as an attractive means to achieve returns in an uncertain environment, and we are seeing a corresponding increase in the number of announced structured equity investments in public issuers.

We have reviewed a selection of seventeen PIPE transactions announced in April through June in which a private equity sponsor made an investment in convertible preferred stock (twelve deals), convertible debt (two deals), non-convertible preferred stock and warrants (two deals) and non-convertible debt and warrants (one deal). Below we highlight certain recurring key points resulting from our review of the PIPE transactions announced since the onset of the COVID-19 crisis:

- **Conversion Prices**: Conversion prices ranged from a discount of 21% to a premium of 65% to the closing stock price as of the signing date, with a mean conversion premium of 13.5%. In the instances where the conversion price represented a discount to the closing price as of the signing date, the conversion price calculation in the transaction documents was based on a volume weighted average price (VWAP) for a period between five and thirty days prior to signing, and when calculated on a VWAP-basis represented a significant premium.
- **Dividends**: Dividend rates ranged from 2.5% to 16% per annum, with a mean of approximately 8% per annum. In one case the structured equity did not accrue a dividend and instead only participated in dividends declared on the issuer's common stock. Presumably as a response to the desire on the part of the issuers to conserve cash in the current climate, in surveyed deals the issuer was generally provided with flexibility to make dividend payments in cash or in-kind at the issuer's option. In fourteen of the seventeen reviewed transactions the issuer was permitted to pay all or a portion of the accrued dividends in-kind for a period of time following the closing of the investment, after which the issuer was required to pay the

accrued dividends in cash. In just over half of the reviewed transactions (nine of seventeen deals), the structured equity participated in ordinary dividends on common stock on an as-converted basis, in addition to receiving the structured equity's dividend. In addition, four of the reviewed transactions featured a dividend rate which increased after a set period of time (after the fifth, seventh, eighth and tenth anniversaries in the examples), typically structured to increase by 0.75% or 1% per year after the applicable anniversary. Interestingly, dividend rates have generally declined since the beginning of April, likely reflecting an increasingly issuer friendly market, with a mean of approximately 8% for deals announced in April and May and a mean of approximately 7% for deals announced in June.

- **Automatic Conversion**: Eleven of the fourteen convertible preferred stock and convertible debt transactions we reviewed contained an automatic conversion feature, typically providing the issuer with the right to force the conversion of the structured equity in the event the underlying common stock traded at a threshold premium in excess of the conversion price for a certain period of time (e.g., 20 trading days in any 30 trading day period). Generally speaking, issuers push for this provision on the theory that once a sponsor has achieved a high enough implied return based upon the price of the underlying common stock, the sponsor should no longer also benefit from the preferred dividends. In the transactions where automatic conversion was contingent on a trading premium, the threshold premium ranged from 150% to 200% of the conversion price, with a median threshold premium of approximately 180%. Two of the reviewed transactions featured declining threshold premiums whereby the required threshold declined on successive anniversaries of the investment closing. In a minority of the reviewed transactions the structured equity could not be converted for a certain set period of time after the closing of the investment, usually two to three years, even if the conversion premium condition was met (thus allowing sponsors a minimum return based upon the dividends).
- **Redemptions**:
  - *Holder Redemption / Change of Control*: In the majority of the reviewed transactions, structured equity holders do not have the right to force the issuer to redeem their securities, other than in the case of a change of control of the issuer (not only are issuers reluctant to give sponsors this right from a purely economic perspective, a put right can be dispositive in the analysis as to whether the investment will be treated as debt for accounting purposes). Upon a change of control, holders typically have the option (i) to receive the amount of transaction consideration they would be entitled to if the structured equity was converted immediately prior to the closing of the change of control or (ii) to receive a redemption amount equal to a multiple (usually capped at 110%) of the structured equity's liquidation preference (plus accrued but unpaid dividends). In the latter case where the holder is entitled to a multiple of the liquidation preference, it is common for the multiple to decline on certain successive anniversaries of the closing of the investment. The multiples and decline rates vary greatly among the reviewed transactions, however, the most common framework seen in the reviewed transactions is a redemption price equal to 105% to 110% if the change of control occurs prior to the fifth or sixth anniversary, with a redemption price equal to 100% to 105% thereafter. A less common structure is a redemption price equal to the liquidation preference of the structured equity (plus accrued but unpaid dividends), with a separate make-whole payment equal to the amount of dividends payable by the issuer between the date of the change of control and an agreed anniversary of closing.
  - *Issuer Redemption*: An issuer's right to force the redemption of the structured equity commonly mirrored the holder's redemption right upon a change of control, with the issuer permitted to force the redemption of the structured equity at a redemption price equal to a multiple of the structured equity's liquidation preference (plus accrued but unpaid dividends), which would decline on successive anniversaries of the investment closing. However, in a majority of the transactions, issuers also had a redemption right outside of the context of a change of control. The issuer redemption rights differed from change of control redemptions in that issuers typically were not permitted to force a redemption for some period of time after the closing of the investment (usually only after the fifth or sixth

anniversary) and the issuer's redemption right was typically based on a higher multiple as compared to the holder's redemption right in a change of control as of a given anniversary of closing (e.g., the multiple payable by the issuer may be 5% to 10% higher for the same redemption date as compared to a change of control redemption by the holder) or the redemption multiple may only be effective from a later anniversary as compared to a change of control redemption (e.g., the multiple in a change of control redemption may be 110% if after the fifth anniversary, but the issuer can only force redemption at 110% if after the sixth anniversary).

- Warrants: Each of the three non-convertible preferred stock and debt investments we reviewed benefitted from warrants. Warrant coverage on the investments were 21%, 40% and 51% of the respective investment amounts, and had exercise prices equal to, in one case, the closing price of the underlying common stock as of the signing date, and in the other two cases, equal to a 10% discount and a 17% premium to the respective closing prices of the underlying common stock as of the signing date. The warrants had terms of five, seven and ten years. These equity kickers can be particularly valuable for equity funds, whose investment mandate may otherwise preclude them from investing in a lower return debt or debt-like instrument.

- Liquidation Preferences: Liquidation preferences were nearly universally equal to the issue price of the security (plus accrued but unpaid dividends) in the reviewed transactions, without including a minimum return feature (which was more commonly addressed in the conversion and redemption features noted above). In certain private deals sponsors are able to negotiate a liquidation preference over 100% but it is very rare in PIPEs.

- Board Representation: In fifteen of the seventeen reviewed transactions the purchaser received either a full director or a non-voting observer seat on the issuer's board. As would be expected, the number of board seats granted to a purchaser strongly correlated with the percentage of the issuer's total equity represented by the structured equity investment. Most commonly, purchasers acquiring over 25% of the equity (on an as-converted basis) received two full board seats (or one board seat and one observer seat), purchasers acquiring more than 15% received one board seat and purchasers acquiring less than 15% received only an observer seat or the right to receive board materials. The step-down rights varied among the reviewed transactions, but most commonly the appointment right expired once the purchaser had sold down in excess of 50% or 75% of its investment (with the 50% threshold being the more common of the two).

- Veto Rights: In nearly all of the transactions we reviewed the consent of a majority or super majority of the structured equity was required for the issuer to (i) make adverse changes to the rights and preferences of the structured equity, including any amendments to the issuer's organizational documents that would have an adverse impact on the structured equity, (ii) increase or decrease the number of structured equity securities and/or issue any additional structured equity securities and (iii) issue securities ranking on a parity basis or senior to the structured equity. Less commonly holders were provided with veto rights over: (i) dividends on or redemptions of junior or parity stock (four deals), in some cases only to the extent dividends on the structured equity are not fully-paid or if the structured equity does not participate in the dividend, (ii) incurrences of indebtedness, subject to a leverage ratio but excepting draw-downs of existing facilities (five deals), (iii) M&A transactions, subject to a materiality threshold (three deals) and (iv) liquidations or dissolutions of the issuer (four deals). In certain of the reviewed transactions the purchasers were also able to negotiate business-level veto rights over hiring/firing the CEO, capital expenditures and affiliate transactions, but these were rare. In no instance did a purchaser receive a veto right over the issuer's budget or business plan. Interestingly, the breadth of a purchaser's veto rights package was only modestly correlated with the percentage of the issuer' total equity (on an as-converted basis) represented by the structured equity, and purchasers acquiring in excess of 20% of the issuer's total equity did not necessarily result in a broader set of veto rights as compared to a purchaser acquiring between 10% and 20% of the equity. The breadth of a purchaser's veto rights package has, however, correlated with the date

of announcement, with broader rights packages tending to occur in deals announced in April and May as compared to deals announced in June, again likely reflecting a more issuer favorable market.

- **Transfer Restrictions**: Thirteen of the seventeen transactions we reviewed contained a restriction on transfer of the structured equity, with terms ranging from 3 months from the closing of the investment to indefinite restrictions on transfer, with a median term of approximately 15 months. The as-converted equity was commonly subject to the same restricted period as the structured equity, though in some cases the as-converted equity was freely tradeable or was subject to a shorter restricted period than the structured equity. In one instance the holder was permitted to transfer no more than 25% of the structured or as-converted equity prior to the first anniversary, but otherwise caps and other carve-outs to the transfer restrictions were not a common feature of the reviewed transactions.
- **Standstills**: Fourteen of the seventeen reviewed transactions contained an explicit standstill provision preventing the holder from purchasing other securities of the issuer (though the remaining three deals may have included a standstill pursuant to the confidentiality agreement between the issuer and purchaser, which are not publicly available), with initial terms ranging from one to three years, with a median term of approximately two years. The terms of the standstill were also typically extended for so long as the purchaser has a representative on the issuer's board (to the extent that right was negotiated by the purchaser), and in other cases extended for so long as the purchaser retained information rights with respect to the issuer or until the purchaser had sold-down a significant portion of its investment (e.g., below 50% or 25% of the structured or as-converted equity issued to it at closing).
- **Transaction Fees**: Expense reimbursement was a common feature of the reviewed transactions, with thirteen of the seventeen deals containing either a transaction fee or expense reimbursement (or both) payable by the issuer to the purchaser. For deals containing a reimbursement by the issuer, reimbursement amounts ranged from $500,000 to $5.5 million, with an average of approximately $2.25 million. As a percentage of the invested amount, reimbursement amounts had a modest negative correlation to the size of the investment (i.e., reimbursement in larger deals represented a smaller percentage of the invested amount), and ranged from 0.2% to 3% of the investment amount, with an average of 0.8% of the investment amount.
- **vs. Private Debt Offerings**: In addition to PIPE offerings, issuers have also looked to access capital since the onset of the COVID-19 crisis from the private debt markets, including from first and second lien syndicated and direct loan markets and from 144A debt offerings. While PIPE offerings can result in bespoke provisions depending on the particular investors and situation involved, accessing these other deep capital markets with established customary terms and conditions can be more attractive in certain circumstances. Practice, terms, size and conditionality vary amongst these markets, which have made one or more of them a potential better option than a PIPE in certain situations.

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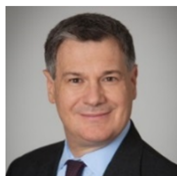

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