Frequently Asked Questions About PIPE Transactions

What is a PIPE transaction?
A PIPE (Private Investment in Public Equity) refers to the purchase of newly issued securities in an already public company by a select number of accredited investors in a private placement transaction. In a traditional PIPE newly issued common stock is sold at a discount to the current market price and the transaction's closing is conditioned on the issuer receiving indication from the SEC that it is prepared to declare the registration statement effective.

What are the primary advantages of a PIPE?

- In many cases a transaction can go from contemplation to completion within a matter of weeks;
- Transaction expenses are significantly lower than a public offering and the expenses are incurred until after investor proceeds are not received;
- The issuer expands its base of institutional investors;
- For investors, the advantages include receiving securities at a discount to current market price and having liquidity.

What are the primary disadvantages of a PIPE transaction?

- The offering can only be marketed to accredited investors;
- An issuer cannot sell more than 20% of its outstanding stock at a discount without receiving prior shareholder approval
- PIPE investors, often hedge funds, sell the shares short in the open market to lock-in the discount premium or hedge their holdings often creating significant downward pressures on the common shares;
- There is a limit to the number of blackout periods for the issuer while the resale registration statement is effective (See "what is a black-out period?"?)

What types of securities are sold in a PIPE?
A variety of securities can be offered in PIPE transactions including convertible debt, preferred stock, common stocks and warrants. Often warrants are sold along with common stock to sweeten the deal which allows the investor to buy additional shares if the price of the common stock increases in value. In select cases, especially in turnaround transactions, prospective investors may seek, for a fixed period of time, provisions such as the following:

- 'Re-set' provisions to protect against a price drop;
- Veto rights to major transactions or preemption or anti-diulation rights on sales of new equity;
- Bonus provisions for liquidity events

An issuer, on the other hand, often seeks protection against manipulation of its stock price such as limitations on the volume of re-sales and representations and warranties by purchasers that they have not engaged in short selling.

What is a non- traditional PIPE transaction?
In a traditional PIPE investors commit to purchase securities at a fixed price for a specified period of time but do not fund the transaction when they enter into the purchase agreement. The Issuer, in turn, is not obliged to deliver the securities if the price declines. Instead the issuer files a resale registration statement covering the resale and the transaction closes when the SEC declares its preparedness to deem the resale registration effective. As consequence, investors in a traditional PIPE have the assurance at closing that a resale registration will be declared effective for their shares. Additionally, money is not exchanged at closing. Investors only pay the purchase price when the SEC declares the resale registration effective.

Non-traditional PIPEs are structured with follow-on or trailing registration rights. Rather than closing with an declaration from the SEC that it is prepared to declare the resale registration effective, the issuer is required to use its best efforts to obtain a resale registration rights posting closing. In the event the filing of the registration statement or its effectiveness is delayed past the deadline set by the deal documents, the issuer is subject to liquidated damages (typically 1-1.5% per month of the gross offering amount). The investors will not have the benefit of a resale registration statement for some time, usually 45-90 days following closing, during which period the investor will hold restricted securities.

A traditional PIPE transaction involves less uncertainty, market risk and illiquidity than a non-traditional PIPE.

What are PIPE "black-out" periods?

In a typical PIPE the issuer is required to the keep the resale registration statement effective for an agreed upon period of time so the securities may be freely sold without reliance on Rule 144. During a black-out period an issuer may suspend the use of the resale statement to amend or remedy a material misstatement or omission. During these periods PIPE investors have limited liquidity and will typically negotiate a limited number of permissible black-out periods.

What are common closing conditions for a traditional PIPE?

- The Issuer must update the representations and warranties sections of the purchase agreement and deliver a comfort letter and legal opinions to the placement agent;
- No material adverse change shall have occurred since execution of the purchase agreement;
- The SEC must have indicated its willingness to declare the resale registration statement effective.

Does a PIPE require prior approval from a regulatory body or an exchange?

Prior approval may be required by the exchange on which the issuer's common shares are traded if the transaction will be completed at a discount and results in the issuance of more than 20% of the issuer's total outstanding shares.

How does an equity line of credit differ from a traditional PIPE?

Under an equity line of credit the issuer enters into an agency agreement with the investor under which the issuer has the right, for a specified period of time, to put a certain number of securities to the investor, rather than an agreement to purchase an aggregate amount of shares at a fixed price as in a traditional PIPE.