



COVID-19
**Catching PIPEs in the wave
of COVID-19 capital raisings**

March 2020

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The commercial impact of COVID-19 is causing many businesses to experience decreasing revenues (in some cases, due to mandated shutdowns) or higher costs. As a result of dwindling cash flows, ASX-listed companies have started to seek to raise capital to shore up their balance sheets – and in worsening economic times, this trend is likely to increase.

This economic reality does, however, provide opportunities for cashed up institutions and sponsors with appropriate mandates, to invest in private investment in public entities (PIPE) transactions. PIPEs can take various forms, including:

- placements of ordinary shares to a 'cornerstone' investor;
- pro rata entitlement offers of ordinary shares to existing shareholders (EOs), underwritten (or sub-underwritten) by a 'cornerstone' investor – these are often combined with placements;

- issues of preferred securities or convertible notes to a 'cornerstone' investor. Sometimes, these are combined with entitlement offers or placements of ordinary shares.

If you are an ASX-listed company needing to raise capital, or an investor considering participating in such a transaction, this guide provides an overview of PIPEs and their different forms, and the key matters to consider in undertaking them.



Pros and cons of the forms of PIPES

The most common forms of PIPES in the Australian market, and their advantages and disadvantages, are:

	Institutional placements	Entitlement offers	Preferred security issues	Convertible note issues
Advantages	<p>Speed of execution (generally T+4 to completion)</p> <p>Low documentation / cleansing notice (assuming eligibility criteria satisfied)</p>	<p>Can be accelerated (so that institutional offer completed on a placement timetable)</p> <p>Low documentation / cleansing notice (assuming eligibility criteria satisfied)</p> <p>Does not require ASX LR 7.1 shareholder approval</p>	<p>Provides investors with debt-style returns</p> <p>Flexible payment terms</p> <p>Tend to be perpetual or long-dated</p>	<p>Provides investors with debt-style returns with potential for equity upside</p> <p>Minimises dilution of equity (prior to conversion)</p>
Disadvantages	<p>Capped at 15% (or 25% for SMEs with annual approval) without shareholder approval</p> <p>Related parties excluded without shareholder approval</p> <p>Potential control implications</p> <p>Criticism from shareholder groups for favouring institutional investors over retail investors</p>	<p>Length of timetable (for a traditional offer or retail component of an accelerated offer)</p> <p>Constrained by demand from existing holders unless underwritten or combined with a placement</p> <p>Potential control implications unless unacceptable circumstances factors taken into account</p>	<p>Prospectus required</p> <p>Shareholder approval may be required if issuer's constitution does not specifically permit the issue of the preference shares or if issue would be deemed a variation to rights of ordinary shareholders</p>	<p>Prospectus or long form cleansing notice required</p> <p>Shareholder approval required if conversion could exceed 15% placement capacity</p> <p>Corporations Act may require appointment of debenture trustee</p> <p>Dilution of shareholder equity (if converted)</p>
Forms	<p>Unconditional</p> <p>Conditional on member approval</p>	<p>Traditional (renounceable or non)</p> <p>Accelerated:</p> <ul style="list-style-type: none"> - ANREO: non-renounceable - AREO: renounceable, with dual bookbuild - SAREO: renounceable, with dual bookbuild - PAITREO: renounceable, with dual bookbuild and retail rights trading 	<p>With or without 'step-up' rights</p> <p>Cumulative or non-cumulative distributions</p>	<p>Public market offering</p> <p>Bilateral or private offering to cornerstone investor(s)</p>

Assisting your decision – key commercial considerations

Some of the key commercial considerations in selecting the form of PIPE and its terms are as follows:

Issue	Observations
<p>Risk / return trade off</p> <p>For more further information, see below under 'Security type comparison' below.</p>	<p>The balancing of the investor's expected rate of return and risk tolerance on the one hand, and the issuer's cost of capital on the other, will influence the form of security selected:</p> <ul style="list-style-type: none"> • Ords: least complex, provide investors with unlimited upside (but no downside protection), expensive for issuer (deep discount to the last traded share price) • Prefs: provide investors with debt-style returns (which can be PIK or accumulating), rank higher than ordinary, are deeply subordinated to debt, have limited voting rights • Con notes: as for prefs, but provide equity upside (conversion), rank higher, can be secured (though query the value of security where there are senior lenders with first ranking security), no votes until converted. Conversion ratio can be VWAP or fixed ratio (but not a percentage of shares on issue)
<p>Decision making control</p>	<p>PIPEs in the Australian market are usually for less than a 20% equity interest, and would rarely approach levels required to control the listed company. With such a sized stake, while cornerstone investors will not necessarily be in a position to exercise the level of control they would ideally like to have, governance rights and covenants which provide a measure of control are typical. These might include rights to a board seat(s), information rights and negative controls over particular matters (eg debt incurrence, undertaking corporate transactions etc.). Depending on the nature and location (eg constitution v note deed) of the rights, there may be constraints on their scope and enforceability (eg if they fetter director's discretion).</p>
<p>Exit considerations</p>	<p>Cornerstone investors must not to deal in shares of the company whilst in possession of non-public material price sensitive information (which it may obtain from its information and board seat rights). This may affect the timing or governance structures associated with exits.</p> <p>Aside from a takeover bid, disposal of cornerstone stakes can be complex given the public context. Depending on the size of the stake and the identity of the buyer(s), such disposals as one block may require shareholder or regulatory approval or a cleansing notice (or prospectus).</p>
<p>Timing</p> <p>For more further information, see below under 'PIPE forms pros and cons' below.</p>	<p>PIPE issuers typically require funds quickly. Structuring the PIPE so that it does not require shareholder approval and funds can be received quickly may be possible. Some PIPEs (eg two-tranche placements (with the second conditional on shareholder approval) and accelerated EOs) require the cornerstone to fund part of its investment without certainty of shareholder approval for the latter portion. Terms of the transaction should not coerce shareholders to approve.</p>

Selecting the right form of PIPE – key legal considerations

Australian PIPEs are complex, with many Corporations Act (CA) and ASX listing rule (ASX LR) constraints (among others) to navigate, including:

Issue	Observations																		
<p>20% takeovers rule For more further information, see below under 'Unacceptable circumstances factors' below.</p>	<p>Chapter 6 of the CA prohibits a person increasing their voting power in a listed company to more than 20%, or if already above 20%, any increase above that level, other than under a takeover bid or an exception. One of the exceptions to this prohibition is where a shareholder increases its stake by taking up its entitlements under, or through underwriting or sub-underwriting, an EO.</p> <p>In order to access this exception, the issuer must appoint an ASIC-approved nominee to sell the securities that would otherwise be offered to ineligible foreign shareholders under the EO. ASIC uses this approval right to examine the EO offer structure to assess its effect on control and whether there are 'unacceptable circumstances' (ie the EO is contrary to the principles of fairness and access underlying the 20% rule exemptions). If it has concerns on this front, ASIC will withhold approval or may apply to the Takeovers Panel for a declaration of unacceptable circumstances. Other stakeholders, such as shareholders, can also apply to the Panel.</p> <p>Critically, an EO may give rise to unacceptable circumstances even if it falls within the technical legal requirements of the CA. The key is structuring the EO to take into account the factors that ASIC and the Takeovers Panel take into account (see below) so that the effects on control are mitigated.</p> <p>Unacceptable circumstances factors more relevant if a party goes above 20%:</p> <table border="1" data-bbox="504 943 2047 1469"> <thead> <tr> <th data-bbox="504 943 1274 983">Acceptable indicia</th> <th data-bbox="1274 943 2047 983">Unacceptable indicia</th> </tr> </thead> <tbody> <tr> <td data-bbox="504 983 1274 1023">Pressing need for funds</td> <td data-bbox="1274 983 2047 1023">No readily discernible need for funds</td> </tr> <tr> <td data-bbox="504 1023 1274 1062">Amount to be raise reasonable compared to value of company</td> <td data-bbox="1274 1023 2047 1062">Large issue ratio</td> </tr> <tr> <td data-bbox="504 1062 1274 1134">No alternative method for raising funds</td> <td data-bbox="1274 1062 2047 1134">Alternative method for raising funds (eg asset sales, debt finance or equity finance which would not breach the 20% rule)</td> </tr> <tr> <td data-bbox="504 1134 1274 1206">Professional underwriter (or relate party underwriter is the only available alternative)</td> <td data-bbox="1274 1134 2047 1206">Related party underwriter (or sub-underwriter) with a failure to canvass alternatives</td> </tr> <tr> <td data-bbox="504 1206 1274 1246">Large discount to market price</td> <td data-bbox="1274 1206 2047 1246">Low discount to market price</td> </tr> <tr> <td data-bbox="504 1246 1274 1318">Renounceability or non-renounceable if there is no reasonable prospect of a market for the entitlements due to low liquidity</td> <td data-bbox="1274 1246 2047 1318">Non-renounceable where there would likely be a market for the rights</td> </tr> <tr> <td data-bbox="504 1318 1274 1358">Full disclosure of the effect on control</td> <td data-bbox="1274 1318 2047 1358">Minimal disclosure of the effect on control</td> </tr> <tr> <td data-bbox="504 1358 1274 1469">Shortfall dispersion strategies (eg oversubscription for retail, canvassing of professional sub-underwriters, related party sub-underwriting with 'last resort' provisions)</td> <td data-bbox="1274 1358 2047 1469">No shortfall dispersion strategies in place</td> </tr> </tbody> </table>	Acceptable indicia	Unacceptable indicia	Pressing need for funds	No readily discernible need for funds	Amount to be raise reasonable compared to value of company	Large issue ratio	No alternative method for raising funds	Alternative method for raising funds (eg asset sales, debt finance or equity finance which would not breach the 20% rule)	Professional underwriter (or relate party underwriter is the only available alternative)	Related party underwriter (or sub-underwriter) with a failure to canvass alternatives	Large discount to market price	Low discount to market price	Renounceability or non-renounceable if there is no reasonable prospect of a market for the entitlements due to low liquidity	Non-renounceable where there would likely be a market for the rights	Full disclosure of the effect on control	Minimal disclosure of the effect on control	Shortfall dispersion strategies (eg oversubscription for retail, canvassing of professional sub-underwriters, related party sub-underwriting with 'last resort' provisions)	No shortfall dispersion strategies in place
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Selecting the right form of PIPE – key legal considerations (cont.)

Issue	Observations
<p>15 / 25% placement capacity cap</p>	<p>The ASX LRs limit issuances of equity securities by ASX-listed companies to 15% of their issued capital in any 12-month period, unless shareholder approval is obtained or an exception applies. PIPEs often rely on one of the below to avoid the need for shareholder approval:</p> <ul style="list-style-type: none"> • SMEs: certain SMEs can have 25% capacity if they obtain approval at their AGMs • EOs: pro rata EOs are an exception to this rule, as is underwriting and sub-underwriting of them. If an underwritten EO is combined with a placement, ASX will grant relief to upsize the placement so that the 15% is calculated counting in the base shares issued in the EO. EOs that are greater than 1:1 must be renounceable • SPPs: share purchase plans (enabling shareholders to each acquire up to \$30,000 worth of shares) are also an exception. These often follow after placements to mitigate the perception of unfairness • Conditional placements: PIPEs are often structured as two-tranche placements (with the second tranche conditional on shareholder approval) • Prefs and con notes: these securities are considered to be equity securities and their issue comes out of placement capacity (unless issued by way of EO). Calculating the extent of their consumption of the capacity depends on the conversion formula. Structuring convertible securities such that conversion is subject to later shareholder approval is now viewed dimly by ASX. ASX should be consulted in relation to the terms of non-ordinary securities.
<p>Related parties and substantial holders</p>	<p>If the PIPE investor is a related party, or a substantial shareholder, of the listed company additional restrictions may apply that may limit the investor's ability to acquire a further interest in the listed company without shareholder approval.</p> <p>ASX LR 10.11 provides that issues of equity securities to related parties and a substantial shareholder holding 30% or more in the previous 6 months or a substantial shareholder holding more than 10% at any time in the last 6 months who has nominated a director to the board or has a right to (10.11 parties) require shareholder approval unless an exception applies.</p> <p>Chapter 2E of the CA requires shareholder approval for related party transactions unless an exception applies.</p> <ul style="list-style-type: none"> • Placements, prefs and con notes: 10.11 parties may not participate in placements (including placements (but not EOs) of preference shares and con notes) without shareholder approval • EOs: EOs which are underwritten or sub-underwritten by 10.11 parties are more carefully scrutinised by ASIC (and the Panel, if an application is made) from the 'unacceptable circumstances' perspective described above • Chapter 2E: the arm's length exception may be available if the price is agreed with an independent underwriter and usual related party protocols are applied

Selecting the right form of PIPE – key legal considerations (cont.)

Issue	Observations
Disclosure	<p>Placements and EOs of ordinary shares can be undertaken with a prospectus if the low doc / cleansing notice eligibility criteria (eg no more than 5 days' of suspension in the last 12 months, no orders under CA accounting and continuous disclosure provisions etc.) are met.</p> <p>ASIC may provide relief in certain cases if these criteria are not met. Otherwise a prospectus will generally be required. Preparing a prospectus can add to the time needed to execute a transaction.</p> <p>We are in discussions with ASIC about the terms of the relief in the context of Coronavirus (COVID-19) crisis, as it is anticipated more companies will be suspended for more than 5 trading days in the last 12 months.</p> <p>Preference shares and convertible notes need a prospectus if offers are made to retail shareholders. For convertible notes, a long form cleansing notice can be used if issued to institutions.</p> <p>If neither a prospectus nor a long form cleansing notice is used, issues to institutions can still occur – it will require a later prospectus to ensure shares issued on conversion are freely tradable.</p>
Amendments to constitutions	<p>Issuing preference shares may necessitate an amendment to the issuer's constitution (75% shareholder approval threshold) and / or shareholder approval for variation of class rights. This can add to the time needed to execute a transaction.</p>
Appropriate and equitable terms of securities	<p>Issuers must ensure that the terms of preferred or convertible securities are appropriate and equitable in ASX's view (per ASX LR 6.1). ASX should be consulted in relation to the terms of non-ordinary securities. It will pay close attention to the anti-dilution rights (it being noted that convertible securities may not convert into a percentage of the issuer's capital, per ASX LR 6.18) and the effect on placement capacity. Indeed, as noted above, structuring convertible securities such that conversion is subject to later shareholder approval if necessary (to take advantage of later refreshes or the passing of time) is now viewed dimly by ASX.</p>
Appropriateness of structure and operations	<p>Care must be taken to ensure that any governance measures which increase the cornerstone investor's level of control do not render the issuer's structure and operations inappropriate for the purposes of ASX LR 12.5. Novel measures may require ASX consultation.</p>
FIRB etc	<p>If a cornerstone investor is foreign, or ownership of the issuer is subject to some other legislative constraint – eg airlines, certain financial institutions etc.), approval of FIRB (or the relevant regulator) may be required. Obtaining this approval can add to the time needed to execute a transaction.</p>

Security type – a snapshot comparison

	Ordinary	Preferred equity	Convertible note
Ranking	Lowest ranking	Rank above ordinary	Highest ranking and can be secured
Votes	Full voting rights	Limited voting rights	Generally no voting rights
Covenants	Subscription agreement can contain covenants and consent rights. Difficult to embed in constitution (which presents recovery issues in any event)	Terms or subscription agreement can contain covenants and consent rights. Difficult to embed in constitution (which presents recovery issues in any event)	Can include covenants or consent rights in note terms or subscription agreement
Change of control clause trigger risk	May trigger	Less likely to trigger	Less likely to trigger
Tax, accounting, ratings	Equity	May be debt or equity	May be debt or equity

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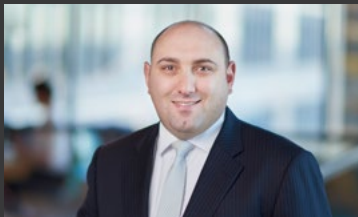
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