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Financing Alternatives for Life Sciences Companies

PLI One-Hour Briefing

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Agenda

- During today's session, we will address:
  - Pre-IPO financing alternatives
    - Debt financing
    - The late-stage (or "crossover") private placement market
  - Alternatives to traditional IPOs
  - Post-IPO financing alternatives
    - Follow-on offerings
    - PIPE transactions
    - Registered direct offerings
    - Confidentially marketed public offerings
    - At-the-market offerings
  - Sequencing financings in light of clinical and strategic announcements

- We hope to be able to highlight during the course of our session today the very different dynamics that affect life sciences companies and the particular industry considerations that strongly influence the financing strategies for life sciences companies

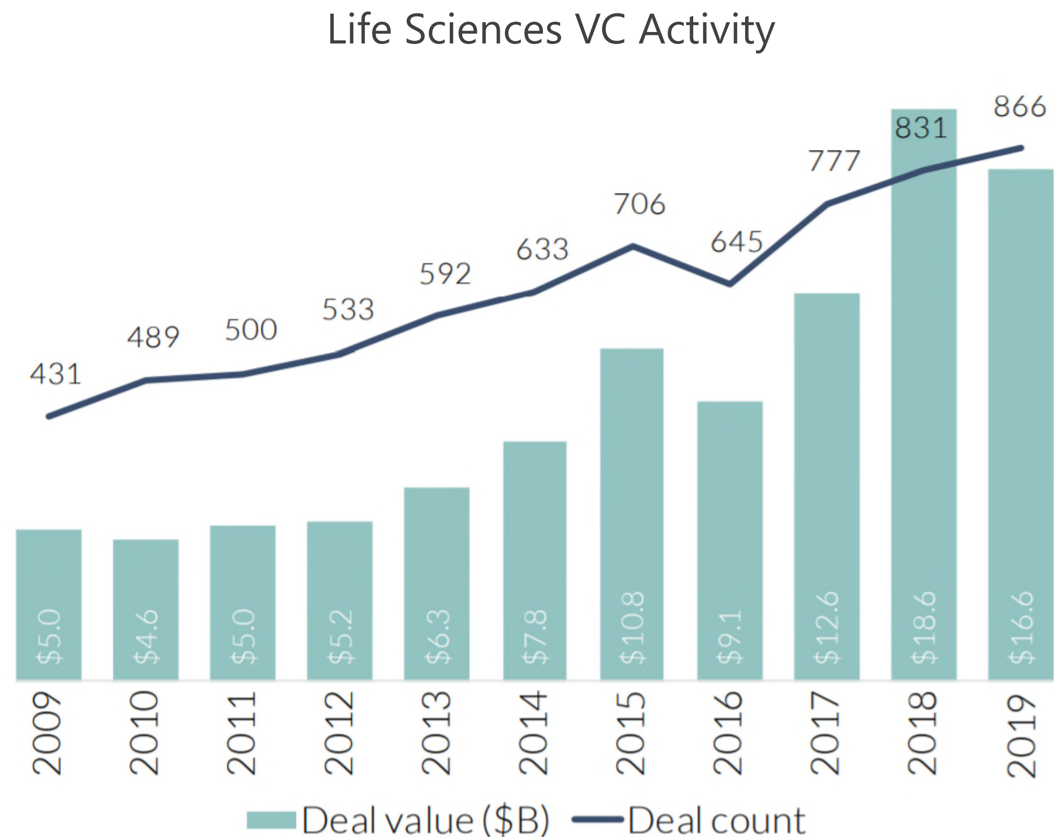
Pre-IPO Financing Alternatives

Pre-IPO Financing Trends and Alternatives

- Outside of the life sciences sector, a lot has been written regarding the increased availability of private capital for pre-IPO companies and the increase in the number of “mega” financing rounds
- Private capital sources have improved for the life sciences sector but not to the same extent as for tech. Life sciences has a continued dependence on committed sector investors and the prospects for success are less predictable
- While tech and fintech companies may have the opportunity to stay private longer and defer their IPOs , or no longer see IPOs principally as financing opportunities, the same cannot be said of life sciences companies
- Life sciences companies still need to undertake IPOs, and in most cases need to establish strong existing investor sponsorship prior to a public listing

Life Sciences VC Activity

- US venture capital deal value in 2019 totaled $136.5 billion, in aggregate
- Life sciences and healthcare deals accounted for approximately 12% of venture capital activity, by dollars raised in 2019



Source: PitchBook/NVCA

Debt Financing

- A notable trend in recent years has been the growth in alternative lenders that are prepared to finance life sciences companies
- Participants in this market include:
  - Some commercial banks
  - Alternative, or direct, lenders
  - Royalty-based financing sources
  - Business development companies
- These transactions may take various forms, from secured notes to bank-style draw-down financing commitments subject to repayment upon the occurrence of specified milestones or liquidity events
- Often this debt-like piece will be accompanied by warrants or an equity kicker
- Particularly in the case of companies with in-licensed IP, granting security interests may give rise to burdensome diligence and documentation issues

Pre-IPO (or Crossover) Financings

- For companies that are 12 to 24 months away from an IPO, pre-IPO private placements have become an important stepping stone
  - While this is generally true of most IPO issuers, for life sciences companies, it is particularly significant
  - The pre-IPO round not only serves to provide much-needed capital but more importantly provides validation from sector specialist investors
  - Also, the understanding is that pre-IPO crossover fund investors will be anchor investors in the IPO
- IPO companies that complete at least one crossover round with public institutional investors tend to perform better at pricing and in the aftermarket
- 27 of the last 40 biopharma IPOs completed a pre-IPO crossover financing within 365 days of IPO, according to a William Blair report.

Pre-IPO Financings

- Considerations
  - Finding the "lead"
  - Deal structure and terms can be highly variable
    - Common stock, preferred stock, convertible preferred stock (most typical)
    - Board representation
    - Affirmative and negative covenants
    - Information rights
    - Financial statement requirements
    - IPO/Qualified IPO provisions
    - M&A and IPO ratchet provisions
  - Time horizon
    - Pre-IPO investors may have a specific timeline in mind for the IPO and a target valuation

Pre-IPO Financings *(cont'd)*

- By their nature, these investments may require more extensive and complex due diligence
  - Current capitalization and issued/outstanding securities (accredited vs. non-accredited former employees)
  - Existing shareholder rights
  - Liabilities – credit facilities or royalty financing arrangements
  - FDA/clinical pathway
- Especially for life sciences companies, addressing diligence requests requires careful consideration of the timing of future financings
  - Regulatory communications
  - Discussions with key opinion leaders, investigators
  - Detailed trial results

Pre-IPO Financings *(cont'd)*

- Unlike the pre-IPO rounds for unicorns, generally valuations for life sciences company pre-IPO rounds have not been as rich
  - Crossover funds expect a bump from pre-IPO round to IPO
  - For the company, it is essential to understand the milestones or other value creation events that will transpire between the pre-IPO round and the IPO
- Timing between the private placement and the IPO
  - Are expectations aligned between the late stage investors and the company?
  - What if the timeline for the IPO is extended?
  - Will the late stage investors need liquidity? Will other existing stockholders of the company or employees require liquidity?

Pre-IPO Financings *(cont'd)*

- Will crossover investors participate in the IPO?
  - Ideally, the pre-IPO round investors will be the "anchor orders" in the IPO
  - No ability in the U.S. to obtain and secure cornerstone investors
  - Only two options: either obtain an indication of interest from the crossover investor that can be disclosed in the IPO prospectus, or do a concurrent private placement to the crossover investor at the IPO price concurrent with the IPO
  - Maybe more uncertainty with the indication of interest option if the market remains volatile and IPOs price below stated ranges
- Did the crossover investors receive confidential information during the pre-IPO process? Has that information been disclosed in the IPO prospectus? Are they cleansed of material nonpublic information?

The IPO Market

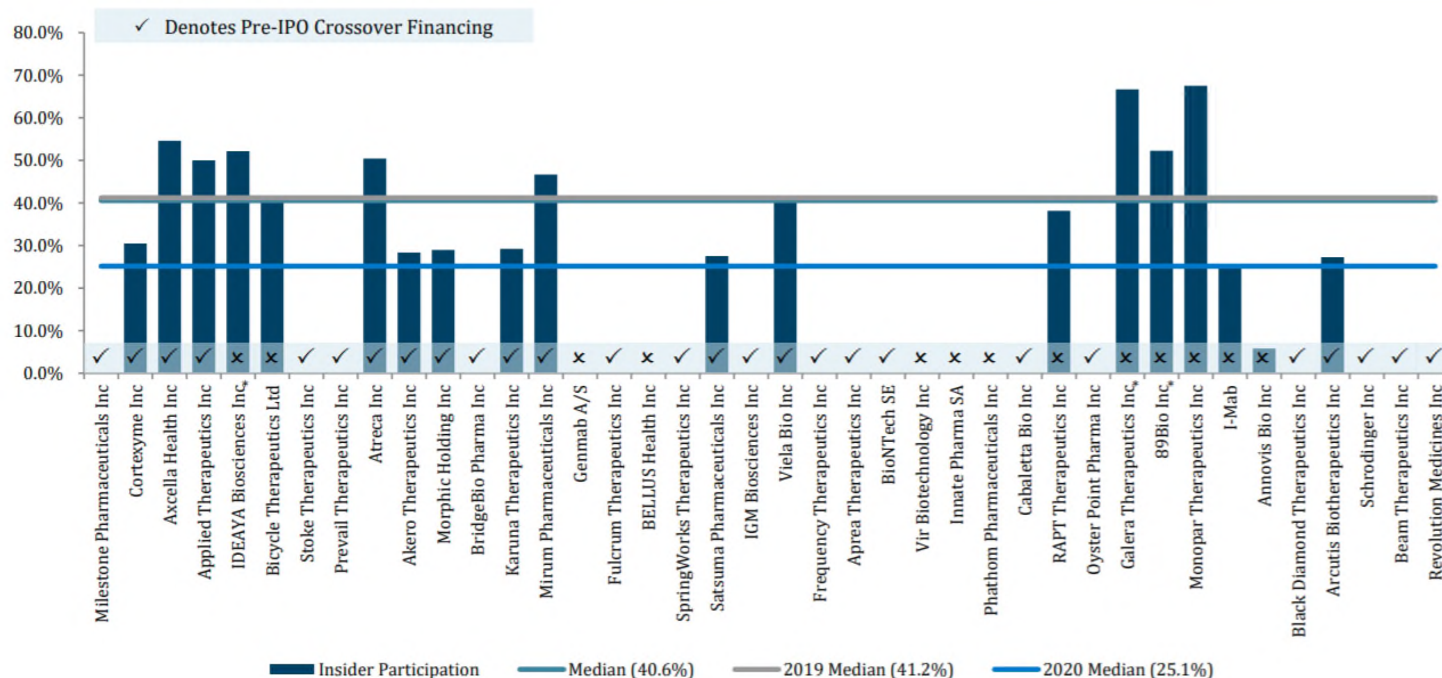
The IPO Market

- A total of 72 life sciences and healthcare IPOs were completed in 2019, raising over $12 billion in aggregate.

Source: IPO Vital Signs

Insider Participation in IPOs

- Insider participation only accounts for capital committed by affiliates at pricing; excludes broader participation from "existing" investors
- Of the seven biotech IPOs that have priced in 2020, five have completed crossover financings, but only three have filed/priced with disclosed insider participation



Legal Considerations

- Insiders may only provide indications of interest; there is no guarantee of their ultimate orders
- Both FINRA and the SEC expect to see disclosures relating to insider participation in the IPO
- Depending on the percentage of the IPO that will be allocated to insiders additional disclosures may be advisable
  - Insider or affiliate holdings may have the effect of reducing public float, negatively impacting liquidity
  - Future sales by insiders may have a disproportionately negative effect on stock price

Alternatives to Traditional IPOs

SPACs

- Historically, some companies have considered mergers into already public special purpose acquisition vehicles (a "SPAC"), also known as a blank check company, as an alternative to the traditional IPO
- Within a specified time period, usually 24 months, a SPAC that has undertaken an IPO must identify an operating company to merge into that meets the selection criteria disclosed in the SPAC's IPO prospectus
- The number of SPACs that have gone public and initiated a search for operating company targets increased from 13 SPAC IPOs in 2016, which raised over $3.2 billion, to 59 in 2019, which raised over $12.1 billion

Source: IPO Vital Signs

SPACs *(cont'd)*

- Companies from a variety of industries completed mergers into SPACs in 2019
- A total of 26 mergers were finalized, with an aggregate enterprise value of $20.3 billion
- Recently, more life sciences companies have elected to merge with SPACs. In 2019, life sciences company mergers into SPACs accounted for 23% of all SPAC mergers

Source: Rothschild & Co

SPACs *(cont'd)*

- For many privately held companies, merging with and into a SPAC provides deal certainty
- To the extent that the capital markets have experienced volatility and IPO windows open and close, a merger into a SPAC is not subject to these vicissitudes
- The privately held company and the SPAC can negotiate a valuation subject only to receipt of SPAC stockholder approval for the merger
- However, over half of the companies that have emerged from a merger with a SPAC have experienced poor aftermarket performance, as measured by the percent change in stock price, with one company trading at 84% below its price at the time its merger

Reverse Mergers

- Life sciences IPO candidates may have other alternatives, including a merger with and into a struggling public company (that is not a blank check company or SPAC)
- Instead of liquidating and distributing its capital to stockholders, these public companies may be interested in reverse merger opportunities
- A private company that has commenced IPO preparations but found its IPO delayed may consider a reverse merger into an already public company
- Unlike “reverse mergers” into shell companies, which raise a number of concerns, a reverse merger into an operating company may be a worthwhile alternative

Reverse Mergers *(cont'd)*

- Historically, some companies considered "backdoor IPOs," including reverse mergers into public shell companies
- Mergers into operating companies are different than reverse mergers into shell companies
  - Admission to trading
  - Greater transparency
  - Not a "shell company" for SEC purposes
  - Market perception

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Reverse Mergers *(cont'd)*

- Basic structuring options – generally two alternatives
- Merger with and into existing public company
  - Existing public company issues stock in a private placement to private company holders in exchange for their existing private company stock; combined company will change its name to private company; and application will be made to Nasdaq (generally requires new listing)
  - Existing public company files proxy or information statement to seek shareholder approval for the transaction. An information statement may be less time-consuming than a proxy/prospectus on Form S-4
- Newco subsidiary is formed and merges with existing public company
  - Requires a proxy/prospectus on Form S-4 and securities are issued in the merger transaction pursuant to the proxy/prospectus
  - Existing public company will seek shareholder approval for the transaction

Reverse Mergers *(cont'd)*

- Consider how the proposed transaction will impact:
  - Existing employment agreements; option and other comp plans
  - Lease agreements and other commercial arrangements
  - Financing agreements, such as bank lending or outstanding venture debt
  - Warrants and other convertible, exchangeable or equity-linked securities
  - License or collaboration agreements
  - Net operating losses
- Diligence of the public company will take into account:
  - Assets, liabilities triggered by transaction
  - Contractual commitments
  - Litigation, D&O insurance

Reverse Mergers *(cont'd)*

- Public company will expect robust representations and warranties from private company
- Consider differing interests of private company securities holders
- Does private company have audited and interim financial statements?
- As with other M&A transactions, the parties will focus on:
  - Definition of Material Adverse Effect
  - Knowledge qualifiers and persons identified as having knowledge
  - Fundamental representations and their survival
  - Conditions to closing
  - Regulatory approvals
  - Non-solicitation provisions
  - Termination rights and break-up fees

Reverse Mergers *(cont'd)*

- Transaction costs (production of an information statement or a proxy/ prospectus, which will require pro forma financials and other SEC disclosures)
- New public company costs and regulations
- Lack of investment bank sponsorship that follows an IPO (research and analyst coverage and market making) and resultant stock volatility
- Distraction: depending on whether the public company has any remaining viable clinical programs, the combined company's management may be distracted from concentrating on the private company's product pipeline
- Concurrent and subsequent financings: consider the availability of required financial information as well as a number of issues related to how investors are contacted, at what point investors are contacted, information that can be shared with investors, and related matters.

Post-IPO Financing Alternatives

Publics More Private

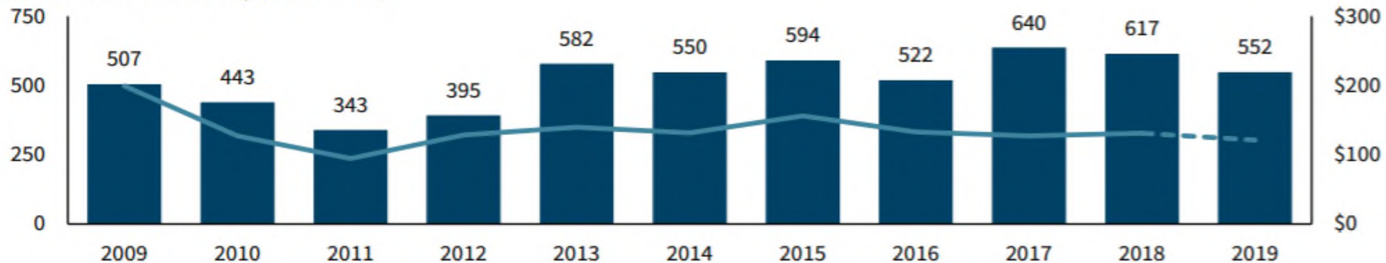
- The most important change in recent years in the United States is that public offerings have become less "public"
  - Due to market developments, such as broadened shelf filing regulations, heightened volatility and concerns about investor front-running
  - Most follow-on offerings begin as confidentially marketed offerings, which may include:
    - PIPE transactions (private)
    - Confidentially marketed offerings
    - Registered direct offerings
  - At-the-market offerings, though "announced" have some of the same attributes as these financing alternatives, including the ability to avoid investor front-running

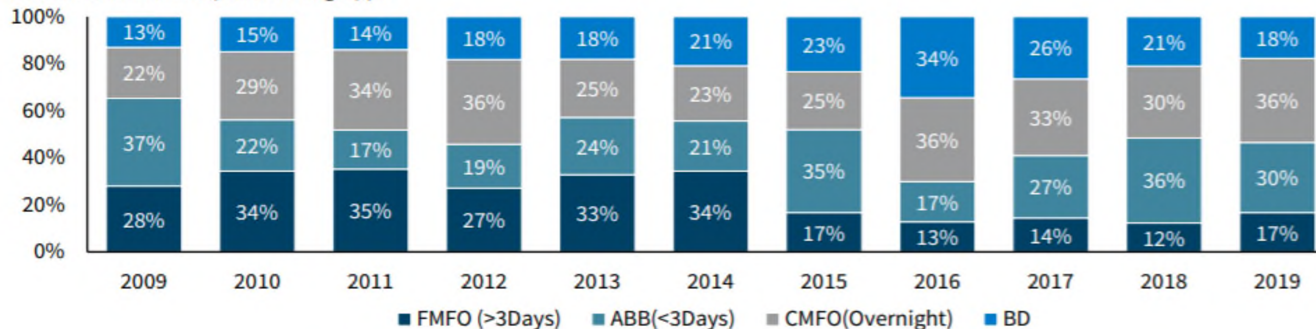
Follow-on Offerings

- Overall, companies that are eligible to file and maintain a shelf registration statement do so, and we were all reminded of the value of a shelf registration statement during the 2019 SEC shut-down
- Having an effective shelf registration statement facilitates financings and increases issuer optionality
- Most follow-on offerings are now completed off of shelf registrations
- Among deal formats, generally reliance on PIPE transactions has declined significantly, although for the life sciences sector, PIPE transactions remain important

Follow-on Offerings *(cont'd)*

- There were 552 follow-on offerings completed in 2019, down approximately 10% from 2018 by number of deals
- Healthcare remained the most active industry for follow-ons, accounting for 54% of the 2019's deals





Source: William Blair & Company LLC

What Is a PIPE?

- A PIPE (Private Investment in Public Equity) is the privately negotiated sale (i.e., a private placement) of a public issuer's equity or equity-linked securities to selected accredited investors, where the sale is conditioned upon a resale registration statement being filed with, and declared effective by, the SEC (permitting immediate or prompt resale)
- Investors enter into a purchase agreement to buy securities. The purchase agreement, or a separate registration rights agreement, provides that the issuer is required to file a resale registration statement covering the resale of the purchased securities (or the shares of common stock underlying the purchased securities)
- Designed to enable a public company to issue equity or equity-like securities to investors more rapidly than a typical registered offering
- Usually consists of "primary shares," but may also be in the form of a "secondary offering" or a "primary/secondary" offering

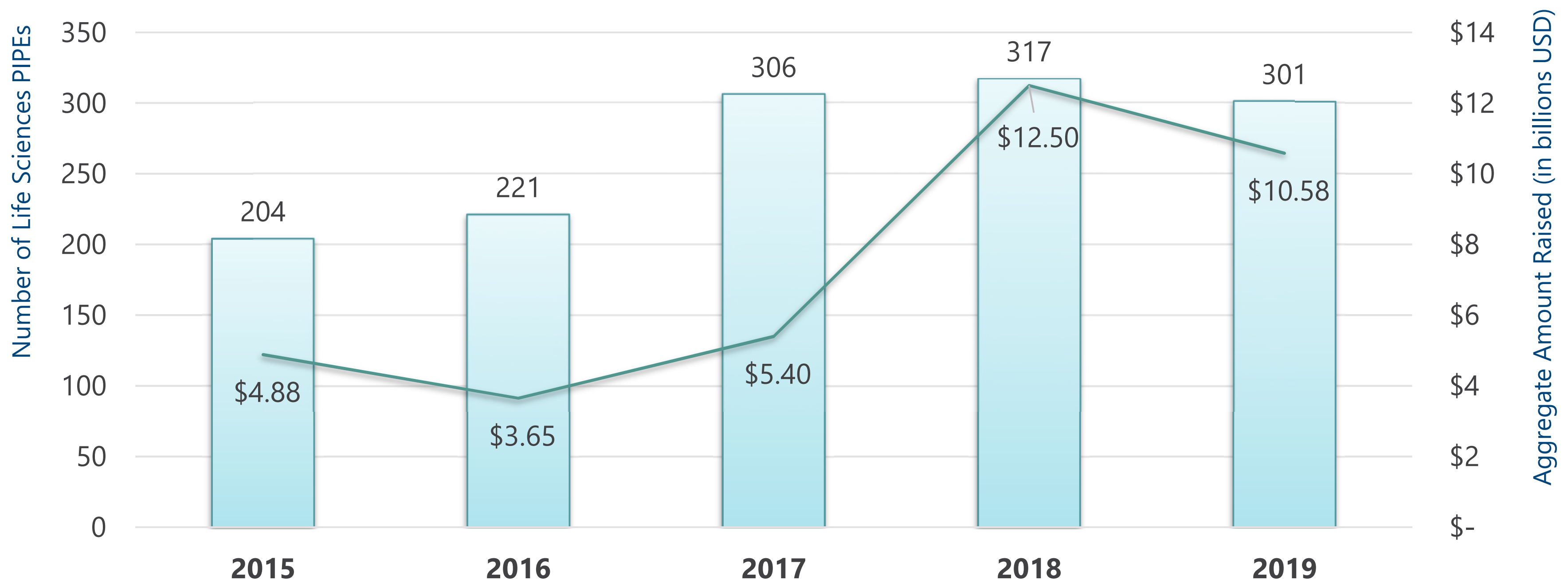
PIPE Market Trends

Year	Number of Deals	Dollars Raised
2019	1077	$41.3 billion
2018	1171	$46.6 billion
2017	1445	$44.8 billion
2016	1179	$48.9 billion
2015	1057	$41.1 billion

Source: PrivateRaise.com

Life Sciences PIPE Trends

- Over the past five years, the life sciences industry has raised over $37 billion through 1,349 PIPEs
- In 2019, there were 301 PIPEs completed by life sciences companies, raising $10.6 billion



Source: PrivateRaise.com

Considerations for Life Sciences Companies

- There may be strategic uses for a PIPE transaction, such as:
  - To finance an acquisition
  - To facilitate a VC investment or recapitalization transaction
  - When a baby shelf issuer needs to raise in excess of the permitted one-third primary offering threshold
- There may be instances where a PIPE transaction simply accomplishes a better result, such as:
  - A selling stockholder PIPE to effect the sale of a VC stake to new sector buyers
  - Enables the execution of NDAs to foster extensive due diligence

Registered Direct Offerings

Registered directs allow an issuer to achieve public style pricing while maintaining the relative confidentiality of a private placement

- A registered direct offering is a “best efforts” placement of registered common stock off an issuer’s existing effective shelf registration statement, generally, to a limited number of institutional investors; the securities are immediately eligible for resale
- Registered direct offerings have characteristics of both public and private offerings; thus, they are governed by the rules, regulations and market practices specific to each type of offering
- A registered direct is a “private style” public offering which is, in some ways, an extension of the PIPE; the number of registered direct offerings has been trending upwards in the last several years
- Registered directs are sometimes being marketed and sold by placement agents as “registered PIPEs” or “strategic publics”
- For many life sciences companies with a shelf registration statement, a sale to one or more existing holders may be easily structured as a registered direct offering

Why Choose a Registered Direct?

- Over a PIPE transaction?
  - Same efficient marketing: If an issuer has an effective shelf registration statement, a registered direct offering can be marketed akin to a PIPE transaction — on a "stealth" basis
    - Often a preliminary prospectus is filed, making the offering known to the public. However, the issuer and placement agent may agree not to file a preliminary prospectus supplement until late in the process
  - Often better pricing: Investors receive registered, freely transferable securities, thus, no 'liquidity' discount
  - Prompt pricing and closing: If the issuer has an effective shelf registration statement (or is a WKSI that can file an automatically effective shelf) the offering can be priced and closed promptly. In some cases, pricing can occur overnight or in a few days
  - Not limited to accredited investors: Because these transactions are registered, offerings can be made to any potential investor, subject to suitability requirements

Why Choose a Registered Direct? *(cont'd)*

- Over a traditional underwritten follow-on offering?
  - Advance selling: In a fully marketed underwritten offering, the market has some advance notice of the potential offering, and market participants may begin selling the issuer's common stock in anticipation of the offering
  - Potentially better pricing: Depending on the length of the marketing period and general market conditions, selling activity (or lack of buying) in the issuer 's securities may cause the market price of the issuer 's stock to decline (sometimes significantly) by the pricing date. As a result, the pricing in a marketed follow-on generally may be lower than the price in a registered direct offering
  - Speed and targeted allocation: well-suited for follow-on offerings with a small number of investors
  - No capital commitment: From the placement agent's perspective, a registered direct offering does not require any capital

Confidentially Marketed Public Offerings

- Given extreme market volatility, focus on speed of execution has intensified
- Important for issuers to be able to avoid shorting activity or other aberrational trading that may result from a "launch" announcement or from a broad-based marketing effort
- As a result, recent offerings have been marketed on an overnight or one-day basis to shorten exposure to price/market risk
- Additionally, issuers and underwriters have confidentially pre-marketed their offerings prior to the public announcement

Why Choose a CMPO?

- Over a PIPE transaction or a registered direct offering? In general, many of the advantages of a registered direct offering also apply in the context of a Confidentially Marketed Public Offering (a "CMPO")
  - Wider distribution: An advantage of a PIPE and of a registered direct offering is that it is marketed in a targeted manner. However, that often means that the offering is not as widely distributed as other public offerings, in which case a CMPO may be attractive (it can be opened up to retail investors)
  - 20% rule: If an issuer anticipates offering and selling a number of shares that exceeds 20% of the total shares outstanding prior to the offering, and those shares will be sold at a discount, a registered direct offering may not be considered a "public offering" under the rules of the applicable exchange; thus presenting shareholder vote issues under the 20% rule. A CMPO may be an attractive alternative because it is underwritten (important for NASDAQ) and in the second (public) stage can be opened up to a broader universe of offerees
  - Perceived better pricing: Many issuers still view an underwritten offering to be the most desirable financing alternative
  - Underwriter can stabilize or over-allot (if it chooses to do so): Depending on market conditions, this may be important

What is an At-the-Market Offering?

- An offering of securities into an existing trading market at publicly available bid prices
- Commonly referred to as “equity distribution” or “equity dribble out” programs
- Shares are “dribbled out” to the market over a period of time at prices based on the then-prevailing market price of the securities
- Generally, sales do not involve special selling efforts
- Can be helpful in facilitating block trades of primary shares for large institutional investors
- For life sciences companies, ATMs may pose special challenges:
  - Some ATM distribution agents only will offer securities of actively-traded companies
  - The volume in the stock may not allow for significant capital raises
  - For baby shelf issuers, an ATM “uses up” the one-third primary offering capacity

Compare to Traditional Follow-on

At-the-Market Offering

- A continuous offering
- Shares are dribbled out
- Sold on an agency basis through one or more distribution agents; may be sold on a principal basis
- Issuer determines amount, floor price, and duration of any issuance
- Amounts, floor prices, and duration of placements may vary over the life of the program and may be changed at any time

Follow-on Offering

- A "bullet" or single offering
- Shares are sold all at once
- Sold as principal through a syndicate of underwriters

- The clearing price and size of issuance is based on investor demand at a specific point in time

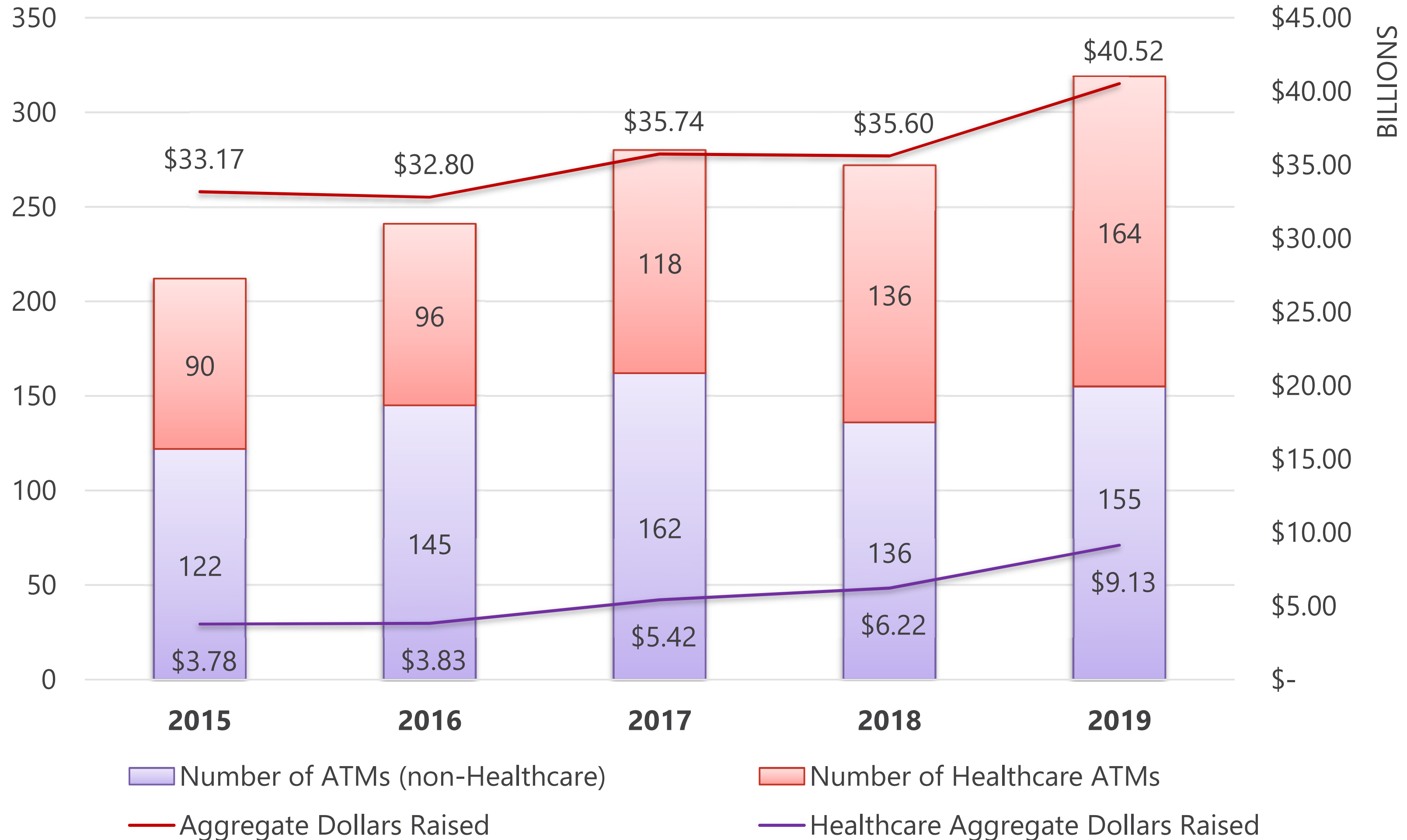
Why Use an ATM?

- Raise equity by selling stock into the natural trading flow of market
- Minimal market impact
- Requires no commitment of any kind; sales may be executed on an agency basis
- Increases the issuer's ability to better time its issuances and match offering proceeds to specific uses
- Often effective whether or not the market is receptive to other types of offerings

ATM Market Overview

- ATMs have become more prevalent as issuers seek easy access to capital
- A total of $40.5 billion was raised across 319 ATMs in 2019
- ATMs by healthcare companies accounted for over half of ATMs in 2019 by deal volume, however, they raised less than a quarter of total proceeds in 2019

ATM Market Overview *(cont'd)*



Sequencing Your Financings

Sequencing Your Financings

- IP-based companies must consider the timing of their financings in light of their announcements, such as, new clinical trial data, new strategic relationships and other corporate events, as well as burn rates
- Considerations:
  - How well has the company articulated its clinical trial milestones and when the market can expect news?
  - In the company's public disclosures, including, for example, its MD&A, has it identified major milestones?
  - Market participants and the research analyst community will keep a close eye on burn rate, upcoming milestones, etc. and anticipate that the company likely will consider these factors as part of its financing plan
  - Public investors will not give credit for future partnerships and license agreements

Sequencing Your Financings *(cont'd)*

- Biotech and life science companies
  - Often must balance their cash needs against the difficulties associated with financing when there is no news or at least no significant news
  - Considerations in undertaking dilutive financings versus financing when financing is available

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