Practical Guidance

Market Trends 2019/20: Registered Direct Offerings

A Practical Guidance® Practice Note by
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This practice note focuses on recent market trends covering registered direct offerings, providing an overview of the market, recent notable transactions, deal structure and process, and legal and regulatory trends. A registered direct offering is a type of hybrid securities offering, meaning that the offering methodology has certain characteristics associated with a public offering and certain characteristics associated with a private placement. Generically, the term describes an offering made pursuant to an effective registration statement (which may be a shelf registration statement) that is sold on a best efforts, or agency, basis by a placement agent and is marketed in a more targeted manner principally to institutional investors.

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

In recent years, most issuers that have undertaken registered direct offerings have structured these offerings as "takedowns" made pursuant to effective shelf registration statements. For more information on takedowns, see Top 10 Practice Tips: Shelf Registration Statements and Takedowns. Generally, the issuer will retain a financial intermediary to act as the placement agent and enter into an engagement letter. The engagement letter for a registered direct offering will provide that the placement agent will use its best efforts or commercially reasonable efforts to introduce the issuer to investors in order to purchase the offered securities. Unlike an underwriter in a traditional firm commitment offering, the placement agent has no obligation to, and will not, purchase any of the offered securities. The engagement letter for a registered direct offering also will provide that the issuer will 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 will contain standard representations and warranties of the issuer to the placement agent, as well as provide that the issuer will indemnify the placement agent for certain breaches of such representations and warranties, as well as for disclosure-related misstatements and omissions.

The placement agent generally will wall-cross investors (i.e., inform them of the potential offering, which may constitute material nonpublic information) by obtaining certain confidentiality undertakings from them as well as agreements to refrain from trading in the company's securities for a brief, usually two- to three-day period. The issuer and its counsel will prepare a prospectus supplement that describes the terms of the offering. 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.

Notable Transactions

In 2019, there were three registered direct offerings that raised over $100 million in offering proceeds. Elbit Systems Ltd., raised approximately $186 million, PBF Logistics, LP, raised approximately $135 million, and Enviva Partners, LP, raised approximately $100 million in offering proceeds. In 2020, to date, there was one offering that raised over $100 million in offering proceeds, which was undertaken by Carvana Co. and raised nearly $600 million in offering proceeds.

Deal Structure and Process

A registered direct offering may be structured in a variety of different ways. In the past, it was common to structure registered direct offerings as "all or none" offerings. This means that the issuer would set forth in the prospectus the number of shares or the dollar amount to be raised in the proposed offering and the offering would only close if the specified amount had been raised. In an all or none offering, the securities laws require that an escrow account be used to collect investor funds and such funds can be released only if the contingency (the threshold amount) has been met. Otherwise, the escrow agent, which must be a national bank, must promptly return the investor funds.

It has become more common to structure registered direct offerings as "any or all" offerings. This means that the transaction will proceed to close even if the amount identified in the prospectus has not been sold. In this type of offering, no escrow account is required.

Occasionally, especially in the case of offerings by micro-cap and small-cap companies, registered direct offerings will be structured as "minimum-maximum" offerings, with a stipulated minimum amount that must be raised in order for the transaction to close. This usually is meant to ensure that the issuer has raised the proceeds necessary for its stated use of proceeds. The maximum amount often is identified so that investors understand the total dilution that may result from the transaction. In this type of offering, which also is subject to a contingency (i.e., the minimum amount specified being raised), an escrow account also must be used.

As noted above, almost all of the registered direct offerings completed in recent years have been follow-on offerings, completed as shelf takedowns and marketed on a wall-crossed basis. It is possible to conduct an initial public offering (IPO) as a registered direct offering, although it is unusual. Similarly, it is possible to conduct a registered direct offering by filing a non-shelf registration statement for the offering, or a bullet registration statement (i.e., a one-time use or single-purpose registration statement), rather than a shelf registration statement. Due to concerns regarding market volatility and possible shorting activity, issuers may be reluctant to file a single-purpose registration statement for a registered direct offering. For forms, checklists, and further information regarding follow-on offerings and shelf offerings, see Follow-On Offerings Resource Kit, Market Trends 2019/20: Follow-On Offerings, Registered Securities Offerings Post-IPO, Top 10 Practice Tips: Follow-on Offerings, and Shelf Registration.

An issuer may elect to undertake a registered direct offering instead of a private placement or a private investment in public equity (PIPE) transaction if the issuer has an effective shelf registration statement and the issuer believes, or is advised that, it will be able to obtain better pricing by undertaking a registered offering rather than a private placement. Institutional investors may prefer to purchase shares issued pursuant to 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 pursuant to a registration statement, it is possible for the placement agent to include retail, or nonaccredited, investors in the transaction. Usually, participation in a PIPE transaction will be limited to accredited investors. For further information on PIPEs, see Market Trends 2019/20: PIPEs, and PIPE Transactions.

An issuer may choose a registered direct offering instead of a firm commitment underwritten public offering that is confidentially marketed if the issuer anticipates that the offering will be relatively small or will be sold to a limited number of investors. The financial intermediary may prefer a registered direct offering, since, in a registered direct offering, it will not undertake any principal risk and there will be no cost of capital associated with its participation. Given that a registered direct offering is a best efforts offering, 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 2019/20: Confidentially Marketed Public Offerings and Confidentially Marketed Public Offerings.

A registered direct transaction will usually constitute a "distribution" for Regulation M purposes. This means that the placement agent should take the appropriate steps required for compliance with Regulation M restrictions, including observing the applicable Regulation M restricted period, and making the Regulation M notice filing with the Financial Industry Regulatory Authority (FINRA). For further information on Regulation M, see Regulation M.

Offered Securities

Most registered direct offerings completed in recent years have involved offerings only of shares of common stock and, to a lesser extent, common stock and warrants.

Use of a Financial Intermediary

Most registered direct offerings have been completed using a placement agent. An issuer also may sell securities directly to one or more institutional investors pursuant to a registration statement without the services of a placement agent. From time to time, an existing investor may indicate to an issuer its interest in purchasing additional securities of the issuer, or a new investor may approach the issuer or a placement agent on a reverse inquiry basis, desiring to purchase securities of the issuer.

Level of Activity

In recent years, according to a data provider, the level of offering activity has been fairly consistent, generally with a slight increase in activity. However, to date in 2020, there has been a sharp increase in registered direct offerings. In 2015, 2016, 2017, 2018, and 2019, there were 139, 167, 224, 166, and 190 completed registered direct offerings, respectively, raising 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 each 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, through July 9, 2020, there were 216 registered direct offerings, raising aggregate proceeds of approximately $2.3 billion and average proceeds raised in each offering of approximately $10.5 million. Accounting for only about half the year, the amount of offerings, proceeds, and average proceeds are already at yearly levels in excess of those in each of the prior five years.

Industry Insights

The issuers that relied most on registered direct offerings were healthcare, technology, and industrial companies. In 2019, companies in the healthcare sector were most active. There were 116 healthcare offerings in 2019 raising an aggregate of approximately $694.7 million. By contrast, technology companies accounted for 34 offerings raising aggregate proceeds of approximately $237.4 million. The market capitalization of the companies that relied on registered direct offerings varied significantly on a year-to-year basis from 2015 to 2019.

To date in 2020, the issuers that have relied on registered direct offerings were healthcare companies. Healthcare companies completed 147 offerings raising proceeds of approximately $1.1 billion. Industrial companies completed 29 offerings raising proceeds of approximately $232.2 million. Technology companies completed 19 offerings raising approximately $123.7 million.

Legal and Regulatory Trends

The issuer will enter into a placement agency agreement with the placement agent at pricing. The agreement will contain representations, warranties, and covenants similar to those that would be contained in an underwriting agreement. The placement agency agreement also will contain requirements to deliver a comfort letter, legal opinions, a negative assurance letter from the issuer's counsel (also known as a 10b-5 letter), and other closing deliverables.

Some investors in registered direct offerings will insist that the issuer make the same representations and warranties directly to the investors. These may be contained in a side letter executed on the pricing date. However, investors cannot enter into a binding commitment to purchase securities from the issuer until a preliminary prospectus with a price range has been delivered to them.

The issuer should consider whether it intends to offer shares in excess of 20% of its pre-transaction total voting shares outstanding and whether the shares to be sold in the registered direct offering will be sold at a discount to the minimum price (market price) based on the rules of the securities exchange on which its equity securities are listed or quoted.

Both the New York Stock Exchange (NYSE) and The Nasdaq Stock Market (Nasdaq) rules require that listed companies obtain shareholder approval in the case of certain private placements completed at a discount resulting in the issuance of 20% or more of the issuer's pre-transaction shares outstanding. Although a registered direct offering is a public offering, for purposes of the securities exchanges' shareholder voting requirements, given the targeted nature of the offering, it usually is not considered a "public offering."

In interpretative guidance contained in IM 5635–3, Nasdaq has indicated that it will consider the following factors in determining whether an offering is a public offering for purposes of the 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 the vast majority of 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 investor rather than through the economics of price discovery attendant to an underwriter's book building process.

Both the Nasdaq and the NYSE recently amended their shareholder vote rule provisions in order to eliminate references to book value in connection with assessing whether a proposed offering was to be completed at a discount and instead referencing solely the market price and to provide a definition of the price to be used in the determination.

As a result of the Nasdaq and NYSE rules regarding shareholder approval, the issuer may opt to undertake a firm commitment underwritten public offering. The issuer also might choose to limit the number of shares it offers in the registered direct offering to an amount below the 20% threshold. Finally, the issuer might work with the placement agent to structure an offering of common stock and warrants exercisable for common stock that is considered to be priced at the market price and not at a discount.

An issuer that is organized as a master limited partnership should consider that it will be treated as an "ineligible issuer" when it undertakes a best efforts offering (under the definition of ineligible issuer in Rule 405 (17 C.F.R. § 230.405)). This may limit a master limited partnership's ability to use certain free writing prospectuses in connection with 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 and Free Writing Prospectus Flowchart.

Other Key Market Trends

Typically, the fees paid to a placement agent in a registered direct offering will be lower than the fees 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 the cash compensation. In 2019 transactions, placement agency fees varied between 4%–9%. To date, 2020 transactions placement agency fees varied between 0.9%–8.25%. On average, most fees in 2019 and 2020 were about 7% of issuance amount, slightly higher than in previous years.

In 2019 and 2020, within the registered direct offering totals, there were some offerings sold by companies directly to a small number of institutional investors, without a placement agent. In 2019, there were approximately 46 offerings directly to investors; to date, in 2020, there were approximately 24 offerings directly to investors. Many of the recently completed registered direct offerings have been sold to a small number of institutional investors, including hedge funds, pension funds, private equity funds, venture capital funds, and mutual funds.

Market Outlook

Offering activity to date in 2020 indicates in increase in the number of registered direct offerings. The total number of offerings, the aggregate offering proceeds, and the average proceeds by offering are already hovering around the yearly totals for the past five years. The industries that will likely continue to utilize registered direct offerings include the healthcare, industrial, and technology sectors. Due to COVID-19, there may continue to be an increase in registered direct offerings, specifically in the healthcare sector.

For an overview of practical guidance on COVID-19 covering various practice areas, including capital markets, see Coronavirus (COVID-19) Resource Kit.

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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.