Weil

Weil, Gotshal & Manges
2023 PIPE Survey

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Introduction

Welcome to the 17th survey of U.S. sponsor-backed PIPE transactions prepared by Weil, Gotshal & Manges LLP. The focus of this study is on U.S. sponsor-backed PIPEs that signed in 2023 and had an aggregate placement amount of at least $100 million (and not the PIPE market generally).

In 2023, the U.S. sponsor-backed PIPE market experienced a complex interplay of market dynamics, reflecting broader economic trends and sponsor sentiments. This report delves into the intricacies of these transactions, offering insights as to the factors that have influenced the sponsor-backed PIPE market over the year. From shifting interest rates to evolving sector-specific M&A trends, we explore how these elements have shaped sponsor strategies and the strategic importance of sponsor-backed PIPE transactions in today's market. We also consider PIPE data from the past decade and offer insights into future trends and the PIPE market's trajectory. As we have done annually for 17 years, this study also focuses on the key terms of those U.S. sponsor-backed PIPEs that signed throughout the year, including financial terms, liquidity mechanisms and governance rights.

We are happy to discuss the detailed findings and analyses underlying this survey.

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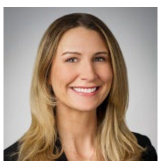

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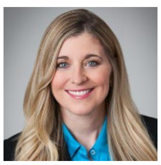

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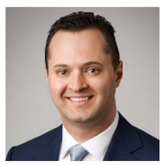

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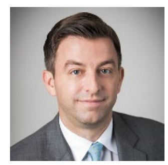

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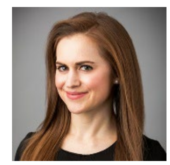

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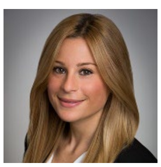

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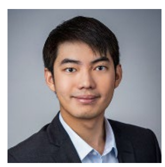

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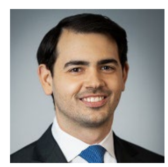

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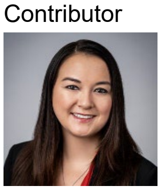

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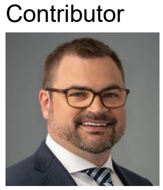

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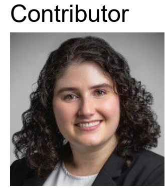

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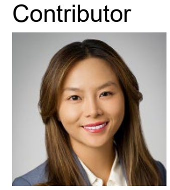


Research Methodology

We identified and surveyed eight U.S. sponsor-backed PIPE transactions that signed between January 1, 2023 and December 31, 2023 involving investments ranging from $150 million to $1,250 million.

The eight surveyed transactions involved the following issuers:

BrightView

Cengage

evolent

KIMBELL ROYALTY PARTNERS

KORE

VERTEX

Western Digital

Wolfspeed

All dollar (or other) amounts and percentages referenced in this survey are approximate amounts and percentages. Unless otherwise noted, such amounts and percentages are based on the eight surveyed transactions listed above.

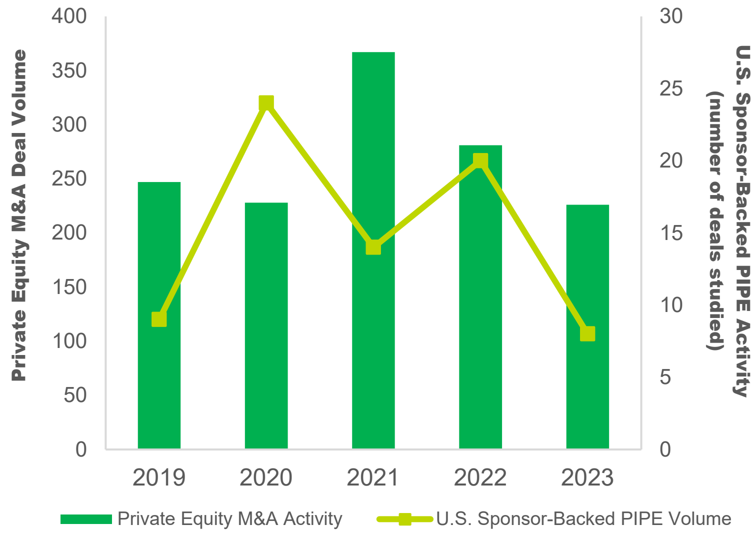
General Market Observations

U.S. Sponsor M&A activity slowed in 2023 and sponsor-backed PIPE activity followed. Nonetheless, despite the year of smaller volume, deals reflected bigger bets.

2023 represented a continuation of the slowing M&A market from 2022, with announced transaction volumes falling for the second straight calendar year. Private equity and venture capital deal activity took an outsized hit in 2023 due to several factors, including rapidly rising interest rates, tighter availability of traditional financing sources, prospective sellers that did not feel pressure to sell at lower valuations (commensurate with higher borrowing costs), and relatedly, persistent valuation gaps between buyers and sellers. U.S. sponsor deal-making finished 2023 similar to how it started, with volume and value of sponsor-backed deals continuing to fall year-over-year and generally quarter-over-quarter.

This slowdown in sponsor transaction activity was also reflected in the 2023 U.S. sponsor-backed PIPE market, which moderated further from its 2020 peak. Not only are the same M&A headwinds present in the context of sponsor-backed PIPEs, but public company trading multiples have generally not yielded unique opportunities compared to other investments sponsors consider.

Private Equity M&A Activity versus U.S. Sponsor-Backed PIPE Activity



Source: Pitchbook, Weil PIPE Studies (2021, 2022, 2023)

This 2023 study includes fewer deals than were surveyed by Weil in 2022 (12 fewer transactions, although our 2022 study also included PIPE transactions by financial investors, not just sponsors), which represents a nearly 40% decline in aggregate dollars raised (falling to $4.28 billion, down from $6.95 billion) by transactions falling within the scope of the survey. However, average placement amount rose by over 50% to just over $535 million per deal (reaching $535.50 million in 2023, up from $348.25 million).[1]

The increase in average placement amount for sponsor-backed PIPEs is likely attributable to record levels of dry powder piling up, which reached $2.59 trillion by December.[2] In addition, mandates to deploy cash have coincided with a lethargic deal market, meaning that sponsors have seized on sizable opportunities, when available, to invest in public companies or to provide privately placed equity financing. In other words, those sponsors who found and executed PIPE opportunities truly acted by "*taking the bull by its horns*" and leaned into those opportunities with increased scale.

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[1] Source: Weil 2022 and 2023 PIPE Studies.

[2] Source: S&P Global.

A Decade of PIPEs in Review: A Retrospective on Trends and Drivers

Sponsor-backed PIPEs are a strategic financing opportunity for public companies. Yet, over the past few years, sponsors have cooled to the idea of investing in public companies through PIPEs. We discuss below certain macro environment factors that have been driving this trend.

Strategic Financing Opportunity. PIPE financings are one of a number of sources of financing options for public companies. Management teams balance the cost and availability of capital among various potential sources, ranging from equity financings (i.e., public offerings or PIPEs), to private credit providers, to traditional bank and bond offerings. When some financing options become harder or more expensive to execute (for example, if traditional lenders slow loan originations in the face of rapid changes to interest rates), PIPEs become more attractive and executable with the ability for public companies to obtain financing quickly and opportunistically from private investors outside of public markets. This speed is crucial in environments where market conditions can shift rapidly, providing a competitive edge to companies that can secure funding when others cannot. PIPEs also provide public companies with the flexibility to capitalize in uncertain economic markets and act quickly.

Sponsor-backed PIPEs often involve negotiations with one financial investor (or a small group of institutional investors), leading to more tailored terms that can include specific rights or covenants favorable to the issuer or its investors. Such terms are described in more detail in the sections below. This negotiated approach can be particularly advantageous for sponsors and public company issuers in sectors where strategic alignment, sector expertise and partnerships are key to navigating market dynamics and capturing value. Additionally, sponsor-backed PIPE transactions can serve as a vital lifeline for public company issuers seeking not just capital, but also strategic partners that can offer expertise and guidance. Private equity firms (and other financial/institutional investors) often bring to the table a wealth of industry knowledge, operational expertise and a vast network of contacts that can be leveraged to foster growth and operational efficiencies – in many ways, similar dynamics to the value propositions of private buyouts and consortium investments. This aspect of sponsor-backed PIPE financing underscores its value beyond mere capital infusion, highlighting its role in strategic corporate development.

As noted above, the focus on this study is limited to U.S. sponsor-backed PIPEs, where private equity sponsors negotiate minority protections, governance and often conversion rights for securities purchased as part of a strategic investment. In many cases, as we discuss below in later sections of this study, the U.S. sponsor-backed PIPE transactions we review generally resemble platform ventures, co-investments and private company minority investments. It is not necessarily the case that overall PIPE activity is correlated to U.S. sponsor-backed PIPE activity – sponsors and their investment committees need to be willing and able to deploy capital. The trend has been clear that over the past few years, private equity sponsors have cooled to the idea of investing through PIPEs.

Sector Trends; Use of Proceeds. Of the eight deals we studied in 2023, technology and healthcare sectors accounted for six transactions. This reflects broader industry trends such as rapid innovation and opportunity in both sectors, however, given the market saturation, increased regulatory scrutiny, slower M&A and general scarcity of capital in those sectors throughout 2023, management teams have had to rely more on fundraising equity from sponsors in those sectors. The dynamic nature of tech and healthcare underscores the value of U.S. sponsor-backed PIPEs in providing necessary strategy, agility and flexibility in capital structure management, particularly in sectors with more complexity and challenge.

Generally, proceeds from the U.S. sponsor-backed PIPE financings surveyed were used for (i) working capital and other general corporate purposes, (ii) acquisition financing and transaction expenses and (iii) to repay or refinance debt, with more than half of the deals using the financing obtained for a combination of these purposes. This supports the notion that U.S. sponsor-backed PIPE transactions are one of many strategic financing sources public company management teams look to as they support their long term capital planning and needs and seek partners to accelerate growth. Lastly, the strategic deployment of PIPE proceeds can significantly enhance a company's competitive positioning, not only by bolstering its balance sheet but also by enabling strategic initiatives such as M&A, market expansion and technological advancements – all with the support of sector expert sponsors, deal teams and sophisticated managers of capital.

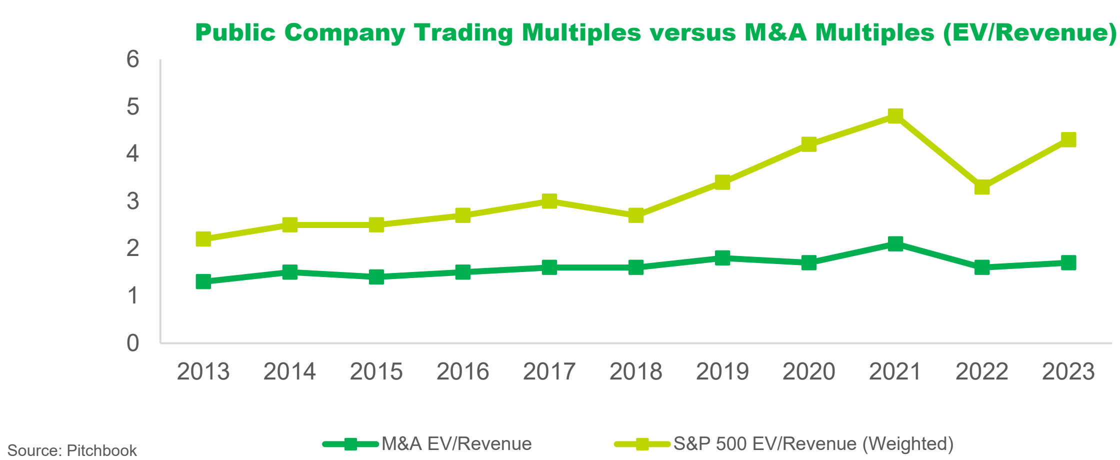
Macro Environment Trends in PIPEs. Notwithstanding the moderation in U.S. sponsor-backed PIPE activity, the overall PIPE market has remained elevated from pre-COVID levels.

From 2018 to 2023, overall PIPE volume, including those transactions outside the scope of this study, has increased by 51%, total dollars raised has increased by 72% and average deal size has increased by 13%.[3] From a capital markets standpoint, public companies have been proficient in using PIPE offerings.

We discuss below some of the key drivers of PIPE activity over the past decade and consider whether some macroeconomic factors are correlated more to PIPE activity than others. In short, higher interest rates (by themselves) do not drive sponsor PIPE activity, but the rise of private credit and the increasing spread in multiples between private M&A transactions and public trading multiples are taking sponsor-backed PIPEs further out of the strike zone. For there to be a dramatic uptick in sponsor-backed PIPEs, we would look for an uptick in sponsor-backed M&A and a moderation of trading multiples of public companies.

- ***SPACs drove PIPEs in 2020-2021.*** The high volume of de-SPAC transactions drove U.S. sponsor-backed PIPE volume in 2020 and 2021, both of which have tapered off precipitously since. In those two years alone, there were more than 250 PIPE transactions in connection with de-SPAC transactions.[4] By mid-2022, the SPAC PIPE market was struggling, in part, because substantial capital was already committed to announced or closed de-SPAC transactions, SPAC redemptions had skyrocketed and regulatory headwinds picked up. By the end of 2023, the SPAC transaction craze had officially ended, with transactions falling over 95%.[5] Needless to say however, SPAC transactions were a major driver of sponsor-backed PIPE activity over the past decade and those fundamentals have come and gone.

- ***Public Market Performance Putting Sponsor-backed PIPEs Further Out of Reach.*** With the S&P 500 rising over 2023 and now at all-time-highs, public company multiples are seemingly further out of reach for the many sponsors reticent to deploy capital. This point is most strikingly made comparing M&A multiples to public company trading multiples (on an EV/revenue basis) over the past 10 years, as shown in the chart below. As sponsors start to deploy more capital, investment committees will look at both public and private opportunities. If sponsors can complete transactions and acquire revenue and EBITDA at lower multiples in private M&A, there will be few reasons to pay more to transact with a public target. We therefore consider the increasing gap between public company trading multiples compared to M&A multiples as a notable headwind on sponsor-backed PIPEs.

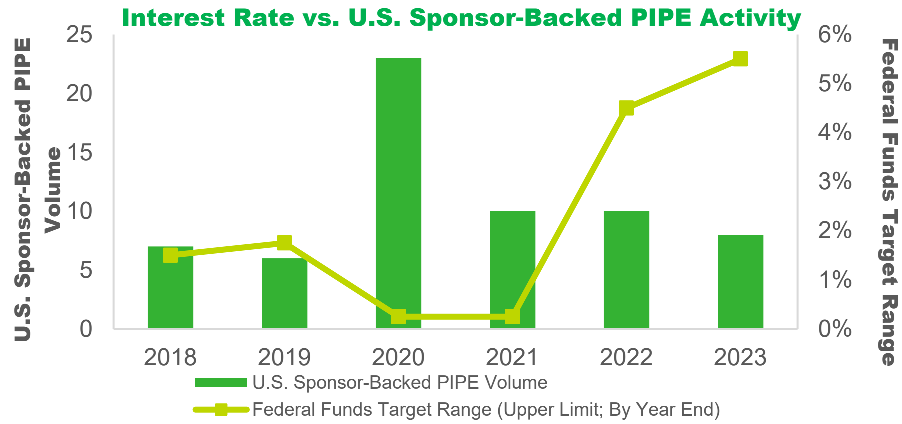


[3] Source: PrivateRaise.

[4] Source: Houlihan Lokey SPAC Pipe Study.

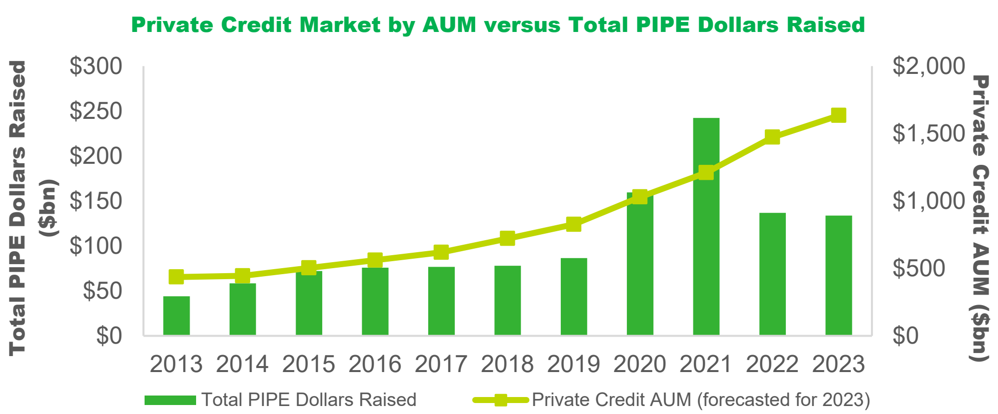
[5] Source: PrivateRaise.

- ***Interest Rates Are Not Directly Correlated with Sponsor PIPE Activity.*** It is widely understood that high interest rates, coupled with accelerated rate hiking cycles, lead to tighter credit markets. When these headwinds are present, it can be difficult for public companies to tap familiar sources of debt capital. We considered that U.S. sponsor-backed PIPEs, being one such alternative source of capital, may naturally become more prevalent in higher interest rate environments. And in the case of the wider PIPE market (factoring in smaller and non-sponsor backed deals), that is true. 2006 was the last year the Overnight Federal Funds Rate peaked at 5.25% (the same high for 2023) and through 2007 (a period of elevated interest rates), PIPE activity increased significantly year-over-year. However, the same phenomenon of rising interest rates we have lived through from 2022 into 2023 did not yield the same result of more U.S. sponsor-backed PIPE transactions. In fact, U.S. sponsors' interest in PIPEs has fallen. It follows that upward movement in interest rates does not necessarily correspond to increased sponsor activity or interest in PIPE transactions.



Source: Federal Reserve Bank of St. Louis, Weil PIPE Studies (2018, 2019, 2020, 2021, 2022, 2023)

- ***Private Credit is Gaining Airtime At the Expense of Equity Transactions.*** The unpredictable nature of the credit market in 2023 caused traditional financing sources to pull back, paving the way for further momentum in private credit to fill the void. This continuing development in the market for private credit financing has also come at the expense of equity transactions, including U.S. sponsor-backed PIPE deal volume. In today's economic climate, private credit providers serve as a lower cost and viable financing source for public companies to obtain capital, and from the investors' standpoint, offer better risk-adjusted returns (why not earn equity-like returns with debt). Compounding this trend, private equity firms themselves are expanding their strategies to include, in some cases, private credit. Some U.S. sponsor-backed PIPE activity and public company capital need has been clearly diverted (both in attention and capital) to private credit. The private credit market is expected to continue to grow exponentially – by 2027, some estimates are that private credit will reach well over $2 trillion of AUM, up from $1.4 trillion at the start of 2023.[6] We expect U.S. sponsor-backed PIPE activity to remain lukewarm and face a challenging competitor in private credit deployments, unless private credit funds themselves lean into leading PIPEs (which we would expect, all else equal, would be more in the form of convertible notes). The exponential growth of private credit AUM and slower growth of sponsor-backed PIPE dollars deployed over the past 10 years visualizes this point well. For the time being, until risk-adjusted returns swing back to favor equity investors, private credit appears to be eating sponsor-backed PIPE transactions' lunch.



Source: Deal Point Data, PrivateRaise

[6] Source: Morgan Stanley.

2023 Survey Results; Looking Ahead

As discussed below in the remainder of this study, while some of the key financial terms of the surveyed transactions (for example, those relating to security type and coupon rate and payment) deviated from the terms we observed in 2022, terms relating to sponsor liquidity (for example, redemption and conversion) and sponsor governance (board designation rights and investor consent rights) remained largely consistent with the terms we observed in prior recent years.

As for what the future holds, considering the fall of SPACs, movement of interest rates, performance of public equity markets and growth of private credit, U.S. sponsor-backed PIPEs have a long way to go before they are back on the main stage. Based on the trends studied above, our view is that availability (not necessarily cost) of alternative capital sources, and investment committees' appetite for equity investing generally, are what primarily spills over as key drivers of U.S. sponsor-backed PIPE activity.

As leading indicators for a reinvigoration of sponsor-backed PIPE activity, we will be looking for a few factors for the stars to align:

- First, positive market sentiment on investment committees deploying equity capital and executing on M&A;
- Second, a narrowing between public company trading multiples and M&A multiples; and
- Third, opportunities, tailwinds and strategic capital needs in certain sectors that will generate targeted opportunities.

Overall, the rising tide of private equity deployment will naturally land in public companies too, through U.S. sponsor-backed PIPEs.

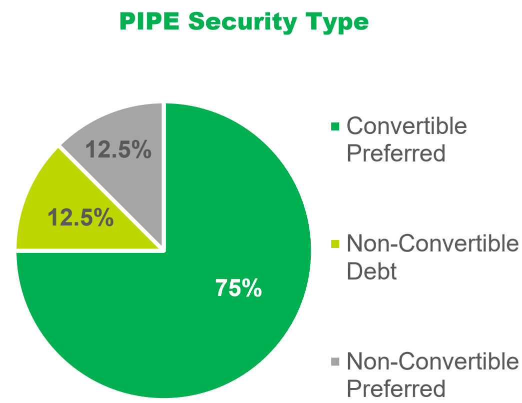
We expect to see an increase in M&A activity in 2024, presenting sponsors with more opportunities to deploy capital. Couple that with the inevitable cooling of the public markets from their record highs, we foresee a rebound in U.S. sponsor-backed PIPE transactions in the coming period, with private credit providers also participating in PIPE transactions with greater frequency.

2023 Surveyed PIPEs: Key Financial Terms

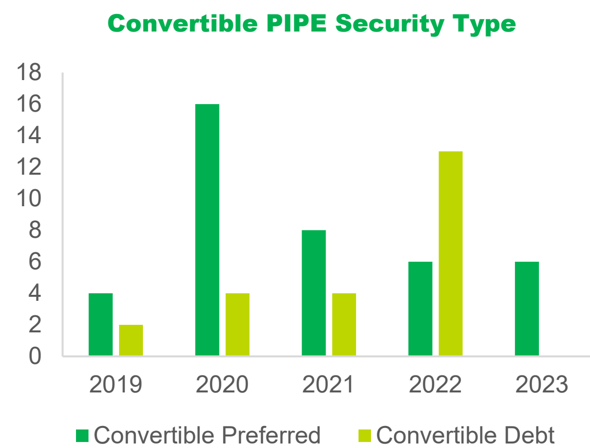
Security Type.

Of the PIPEs surveyed in 2023, all but two were structured with a convertible preferred security (those two involved non-convertible PIPE securities – one with non-convertible debt (senior notes) and one with non-convertible preferred equity and warrants).

The prevalent use of convertible preferred securities for sponsor-backed PIPEs in 2023 marked a sharp turnaround from 2022 (when, for the first time in recent years, the number of surveyed PIPE transactions that were structured with convertible debt instruments (excluding any form of preferred security) exceeded the number of transactions that involved convertible preferred securities), but was largely in line with historical ratios. In fact, and as shown in the chart to the right below, over the past five years (excluding 2022) we have consistently observed a higher prevalence of convertible preferred securities as compared to convertible debt securities (and in all cases across recent years, a higher prevalence of convertible PIPE securities (equity or debt) as compared to non-convertible PIPE securities (equity or debt)).



So why did we see more sponsor-backed PIPEs involving the issuance convertible preferred securities (as compared to convertible debt securities) in 2023?



- Given the greater upside that convertible preferred securities generally offer investors as compared to convertible debt securities, we surmise that the return of convertible preferred securities among the surveyed transactions may reflect broader normalization across the sponsor-backed PIPE market despite overall market skepticism and decreased M&A activity in 2023.
- In addition, the observed trend may have been a result of increased issuer demand for greater payment flexibility (relating to payment of preferred dividends as compared to mandatorily scheduled payment of debt interest) during the challenging and unpredictable market conditions of 2023.
- Issuers may have also favored issuing convertible preferred securities over convertible debt securities to benefit from the generally longer maturities of convertible preferred securities compared to convertible debt securities (and notably, all of the surveyed transactions with convertible preferred securities involved perpetual preferred (i.e., no maturity)). Longer maturities permit issuers to use the capital raised in the PIPE transactions over a longer time horizon, which is a useful feature for issuers during times of economic uncertainty and unpredictable credit markets (as was the case in 2023).
- Additionally, issuing convertible preferred securities may have been more palatable to issuers that were already leveraged or that planned to take on additional debt as the credit markets opened up.

Notably, the issuance of convertible PIPE securities involves certain structural considerations – including with respect to obtaining requisite shareholder approval and/or regulatory approval – as discussed in more detail below in this study.

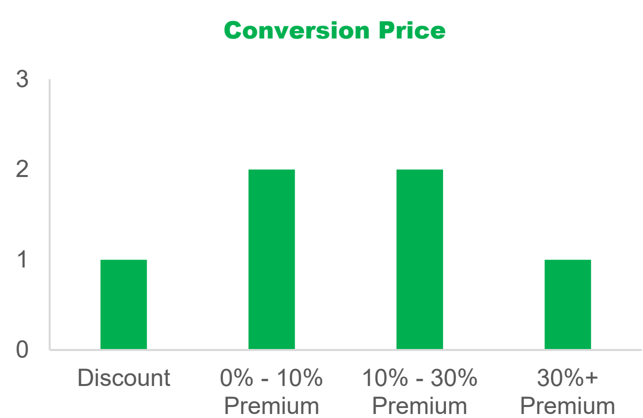
<u>Conversion Price</u>.

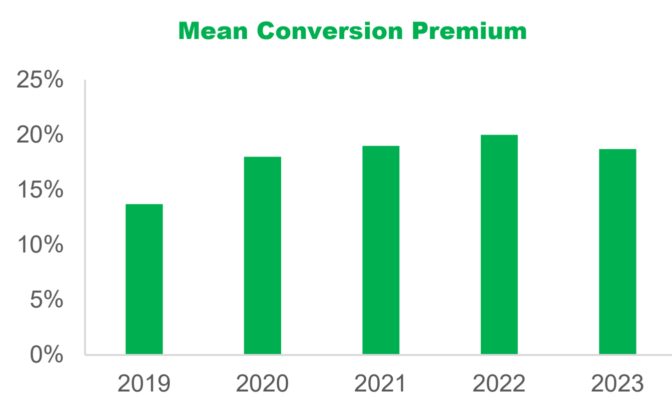
Among the surveyed transactions involving convertible securities, all except one contemplated a fixed conversion price (subject to adjustment) and almost all of the conversion prices reflected a premium to the closing stock price as of the signing of the definitive investment agreement.

Adjustment. Unsurprisingly, in a handful of the surveyed transactions, conversion prices were subject to adjustment based upon the occurrence of certain events (including, for example, certain make-whole fundamental change transactions).[7] In addition, and as expected, the conversion prices in all of the applicable surveyed transactions were subject to customary anti-dilution protections.

Premium/Discount. In all but one of the applicable surveyed transactions, the conversion price reflected a premium to the closing stock price as of the signing of the definitive investment agreement. Such premiums ranged from 8% to 38%, which represents a narrower range compared to the 2022 and 2021 premium ranges.[8] We suspect that the narrower premium range in 2023 is due in part to the overall market instability and volatility that persisted throughout the year. We also surmise that the prevalence of conversion premiums (as compared to conversion discounts) reflects overall sentiment that convertible PIPE securities (preferred or debt) should remain as such until the requisite level of issuer's performance is achieved.

Yet, despite the narrower range of conversion premiums, the mean and median conversion premium (19% and 20%, respectively) was largely unchanged from last year's mean and median amounts (20% and 22%, respectively). We expect such amounts to continue to remain relatively steady in the near future (consistent with prior years).





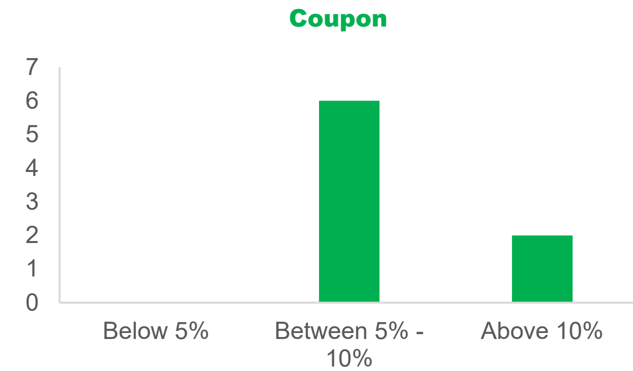
[7] In one transaction involving perpetual convertible preferred securities, the issuer could, at any time, decrease the conversion price by any amount for a period of 20 business days if its board of directors (which has fiduciary duties) determines that such decrease is in the issuer's best interest.

[8] Premium ranges of 7% to 62% and 1% to 67%, respectively.

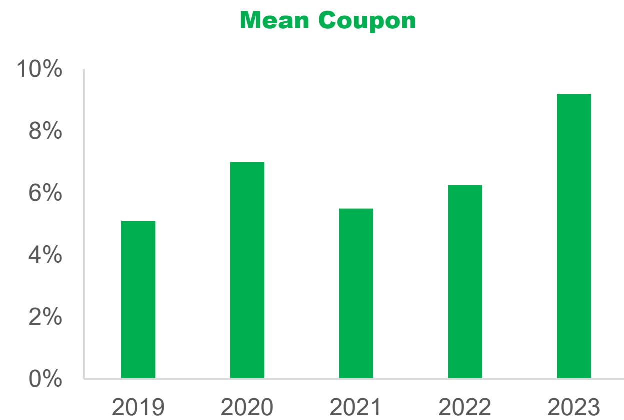
Coupons.

As predicted in last year's survey, coupons increased meaningfully in 2023, averaging at 9.2% – the highest average across surveyed deals over the past five years and a 46% increase from last year's average coupon. We also saw an uptick in issuer optionality to pay coupons in cash or in-kind (PIK).

The increase in coupon rates is a consequence of the high interest rate environment in 2023. Prevailing sentiments are that interest rate cuts are on the horizon, and we would expect trends in U.S. sponsor-backed PIPE transaction coupons to follow the direction of the Federal Reserve. Assuming 2024 is the year we see a lower rate environment, PIPE coupons will naturally reflect that.



Not surprisingly, sponsors continued to negotiate coupon adjustments upon the occurrence of certain events of non-compliance or default by issuer or the failure of issuer to redeem the PIPE securities when required. In fact, in all except one of the surveyed transactions, the coupon was subject to increase (often by 1 to 2%, subject to a cap) in such circumstances.



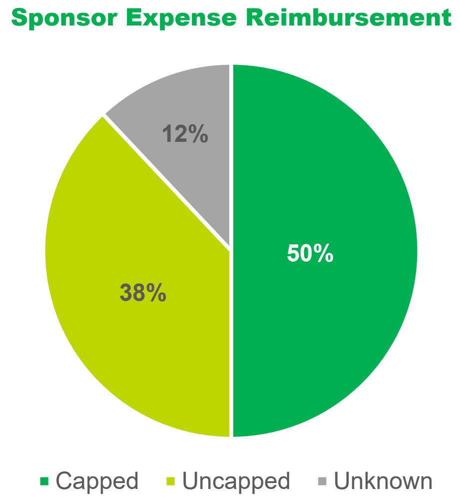
Notably, all except two of the surveyed transactions involved coupons that were payable in cash or payment-in-kind (PIK) (one transaction contemplated cash-only interest payments and the other transaction contemplated PIK-only dividends). In addition, all except two of the surveyed transactions involving convertible preferred securities explicitly entitled sponsors to participate in dividends paid on issuer's common stock on an as-converted basis.[9]

This shift away from coupons payable in cash only (which constituted 42% of surveyed PIPEs in 2022 and 43% in 2021) is likely attributable to higher market volatility and uncertainty in 2023, which enhanced the value of payment flexibility for issuers (with PIK optionality, issuers can adapt to changing market conditions by paying cash during periods of financial strength and conserving cash during periods of tight liquidity). Sponsors also may benefit from PIK coupon payment optionality, as PIK coupons can offer higher returns and mitigate the risk of default or financial distress that an issuer may face from mandatory cash coupons. While only one surveyed transaction specified a higher coupon for PIK payment than cash payment, PIK coupons can offer a higher return to investors even at the same rate as cash coupons due to the cumulative and often compounding nature of PIK coupons.

[9] In the one transaction that did not involve such participation, the convertible preferred securities offered the right to share in special, one-time distributions on the common but not regular distributions on the common. In the other, the investment documentation was silent on such participation.

Sponsor Expense Reimbursement; Other Sponsor Fees.

Sponsor expense reimbursement remained common and even more prevalent as compared to other prior recent years.



In an increase from last year (and other prior recent years), sponsors received expense reimbursements by the applicable issuer in 88% of the surveyed transactions (compared to 70% in 2022, 50% in 2021, 80% in 2020 and 79% in 2019).

The value of these sponsor expense reimbursements ranged from up to $1.5 million to 100% of sponsor's expenses (i.e., uncapped). Where a capped amount was contemplated, the mean expense reimbursement amount was up to $3.9 million (representing a mean of 0.8% of the aggregate investment amount across surveyed transactions that included expense reimbursement caps, which is substantially similar to the mean percentage amount last year).

In addition to expense reimbursement, in two of the surveyed transactions there were additional fees payable by the issuer to sponsor[10] in connection with the transactions – such fees were described as structuring fees or arrangement fees and were equal to 1% of the aggregate investment amount. These additional one-time fees appear to be deal specific.

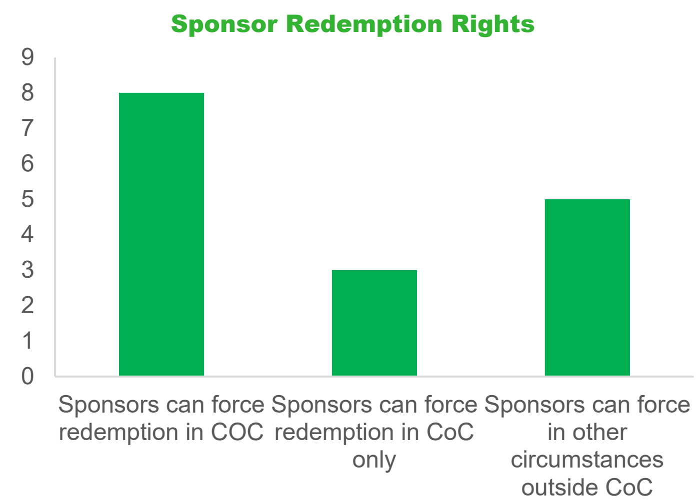
[10] Both transactions involved investments made by Apollo.

2023 Surveyed PIPEs: Liquidity

Despite the significant drop in the number of U.S. sponsor-backed PIPEs in 2023, deal terms related to sponsor liquidity have generally remained consistent over recent years. However, as compared to the more sponsor-friendly 2022 PIPE market, sponsors received less favorable liquidity terms in 2023.

Sponsor Redemption.

Redemption Triggers. All of the surveyed transactions allowed sponsors to force a redemption of their PIPE securities upon certain trigger events, either mandatorily or at the sponsor's option.



- Change of Control. Consistent with prior years, all of the surveyed transactions contained triggers for redemption upon a change of control of issuer.
  - *Mandatory*: In 63% (five of eight) of the transactions, a change of control results in automatic redemption of all of the outstanding PIPE securities (no election by sponsor or issuer required, and partial redemption is not permitted). In three of those transactions, a change of control is the only trigger for mandatory redemption.
  - *Optional*: In the other three transactions, upon a change of control, sponsor may elect for issuer to redeem all or part of its PIPE securities. We note there is little substantive difference nor trend between mandatory redemptions on a change of control compared to optional redemptions on a change of control, other than some sponsors may prefer optionality and may consider the possibility to roll-over into potential take-private transactions as a choice worth holding onto (though in practice, that rarely happens).
- Lapse of Time.
  - *Mandatory*: Two of the surveyed transactions involved PIPE securities with a fixed term (seven years following the original date of issuance in the transaction involving non-convertible debt and ten years in another transaction involving non-convertible preferred securities), where the PIPE securities will be automatically redeemable by the issuer when the applicable term expires. The reason why only a minority of the surveyed transactions involved fixed-term PIPE securities in 2023 may have been because the capital raised through such PIPE securities is subject to a more limited term for use (and thus expose issuers to greater risks in the credit market once such term expires) as compared to longer standing capital raised through perpetual convertible PIPE securities.
  - *Optional*: While most (six of eight) of the surveyed transactions involved perpetual preferred securities, only half (three) of those perpetual preferred transactions (and 38% of all surveyed transactions) provided sponsors with the option to redeem their PIPE securities following the lapse of a certain period of time (six years post-issuance for one transaction and seven years for the other two transactions).[11] The other half of the transactions involving perpetual preferred securities did not include any time-based redemption triggers. The trend of sponsors more commonly having rights to redeem PIPE securities after pasage of time marks a significant increase from last year in which sponsors only had the right to force redemption after a certain period of time in 10% of the surveyed transactons (and somewhat more consistent with 2021 in which 70% of the surveyed transactions granted sponsors such right).
- Other Trigger Events. Three of the surveyed transactions provided for redemption upon certain other events which in most cases were unique to the circumstances of the applicable transaction, including mandatory redemption (1) upon

[11] In one such transaction, in addition to the seven-year term, the sponsor is limited to exercise its redemption right once per calendar quarter during the term, with a minimum redemption of $20 million.

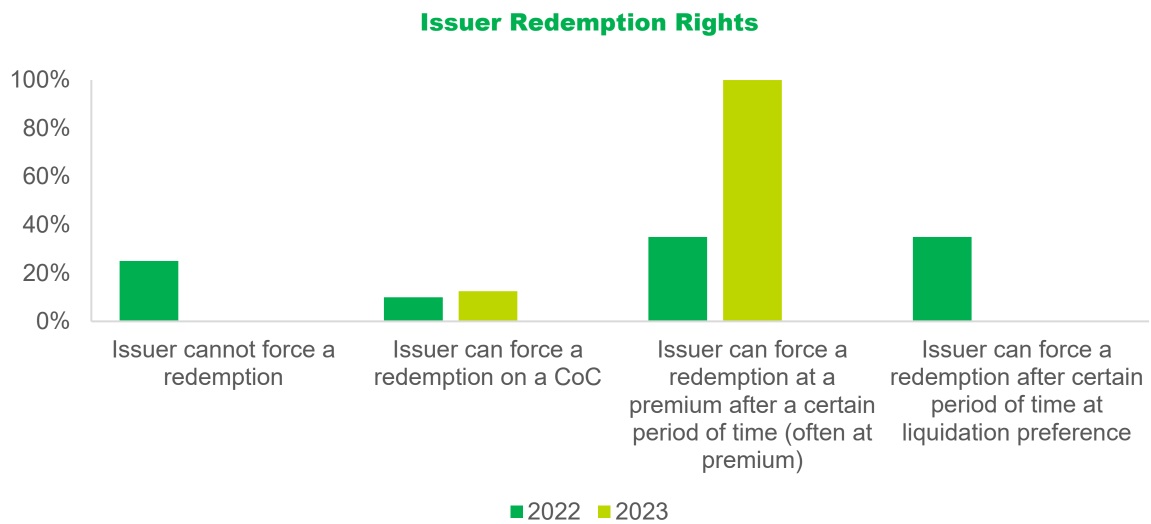
a refinancing or replacement of the issuer's existing credit agreement with unaffiliated lenders prior to maturity, (2) upon certain insolvency events relating to bankruptcy, liquidation or dissolution (as was common in previous years), (3) if a particular acquisition by the issuer did not close within 10 business days of the issuance of the PIPE securities or if the issuer terminated the tender offer anticipated to precede such acquisition[12] and (4) upon certain non-ordinary course asset sales and casualty events.[13]

Redemption Price. Upon redemption (whether mandatory or optional), as is customary, sponsors in each of the applicable surveyed transactions can choose to receive, in addition to any accrued and unpaid dividends, the greater of (1) the fair market value of their PIPE securities on an as-converted basis (determined immediately prior to the time of the trigger event and based on the applicable trading price of the issuer's common stock over a specified period prior to the applicable trigger event) or (2) a multiple of their liquidation preference, ranging from 100% to 165%. This mechanism for the calculation of the redemption price and the multiple range are consistent with past years. In all but two surveyed transactions (six of eight), the liquidation preference multiple used to calculate the redemption price did not vary based on the trigger event. In one exception, such multiple varied between 135% and 165% depending on the applicable trigger event.[14] In the other exception, such multiple varied between 100% and roughly 110% depending on the timing of the trigger event.[15]

Issuer Redemption. All of the surveyed PIPEs (as compared to 75%, 71% and 92% in 2022, 2021 and 2020, respectively) allowed issuer to force a redemption of sponsor's securities in certain circumstances, including in the following scenarios:

- 12.5% (one of eight) of the surveyed transactions permitted redemption at the issuer's option in the event of a sale or other change of control of issuer (sometimes at a multiple); and/or
- 100% of the surveyed transactions permitted redemption at the issuer's option following a certain period of time (most commonly two to seven years) or at any time, often at a redemption premium.

While issuers more commonly negotiated redemption rights in 2023, sponsors were able to mitigate against such issuer-forced redemptions with redemption premium payments in many cases.



[12] In this transaction, the transaction proceeds were used specifically to finance such acquisition by issuer. As such, this redemption trigger is deal specific.

[13] In this transaction, sponsor may reinvest the proceeds received from such casualty events and asset sales in issuer so long as no event of default exists under the related indenture agreement entered into between issuer and sponsor.

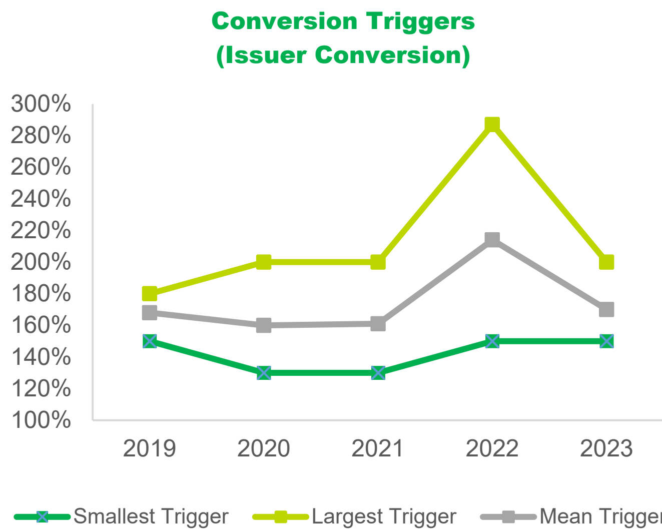
[14] In this transaction, sponsor may elect to receive (i) 150% of its liquidation preference upon a change of control within two years post-issuance, (ii) 135% of its liquidation preference upon a change of control on or after two years post-issuance and (iii) 165% of its liquidation preference upon refinancing or replacement of its existing credit agreement with unaffiliated lenders prior to maturity.

[15] In this transaction, sponsor will receive the lesser of (i) 109.875% of the liquidation preference or (ii) (A) 109.406%, 104.938% or 100% of the liquidation preference if the trigger event happens within four, five or six years of the issuance date, respectively.

Conversion.

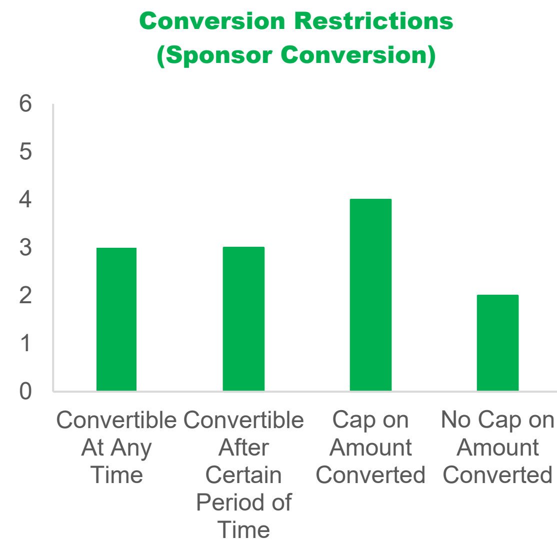
Issuer Conversion. Of the six surveyed transactions involving convertible securities, 50% (as compared to 42% and 67% in 2022 and 2021, respectively) provided for conversion at issuer's option upon certain triggering events (typically if, after a certain period of time, issuer's common stock trades above a specified price for a specified time period). While such issuer-forced conversion triggers may provide increased liquidity for sponsors upon certain milestone events, they can also cap upside.

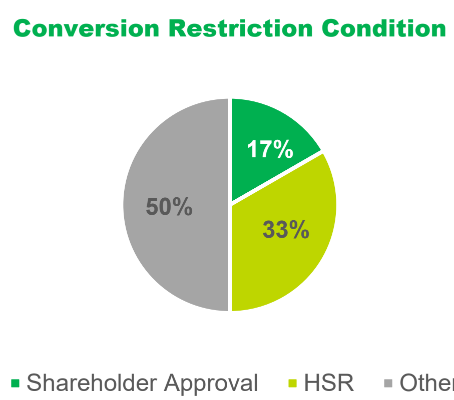
All three of those transactions provided for such conversion if issuer's common stock traded above a specified price (expressed as a percentage of the conversion price) for a specified period of time, with the mean average trading price trigger being equal to 170% of the conversion price (this is generally consistent with the mean amounts over the last five years). Of those transactions, issuer's optional conversion right did not vest until the second (one of three) or third (two of three) anniversary of the PIPE closing.



Sponsor Conversion. While sponsors continued to negotiate sponsor-initiated conversion rights, in 2023 we saw tighter restrictions around such sponsor-initiated conversion.

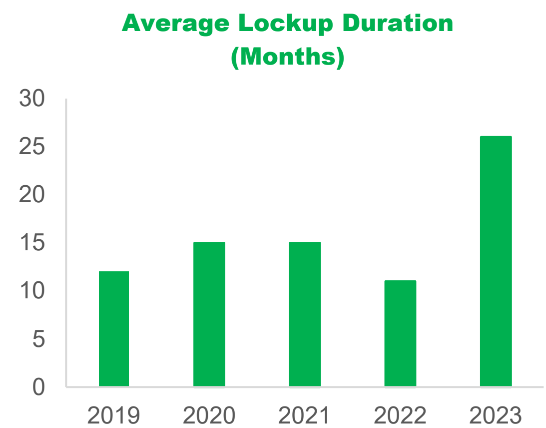
- Time Restrictions. 50% (three of six) of the transactions only allowed for conversion by sponsor after a period of time (one or two years) following the original issuance or upon completion of certain deal specific corporate actions.[16]
- Other Conversion Restrictions. 75% (four of six) of the transactions imposed a cap on the amount of preferred securities that a sponsor may convert, where one such transaction capped conversion by reference to the aggregate dollar value of the post-conversion common stock (i.e., the converted common stock may not exceed $10 million in aggregate value), one transaction capped conversion in accordance with NASDAQ shareholder approval requirements (discussed in more detail below in this survey), and two transactions capped conversion by reference to the sponsor's aggregate ownership percentage of common stock post-conversion (at 9.99% to 49% respectively). Neither of the other two transactions involving convertible preferred securities included a cap (the PIPE securities can be converted by sponsor at any time), although one of such transactions required the sponsor to convert a minimum amount of the PIPE securities, while the other PIPE transaction imposed no minimum or maximum.





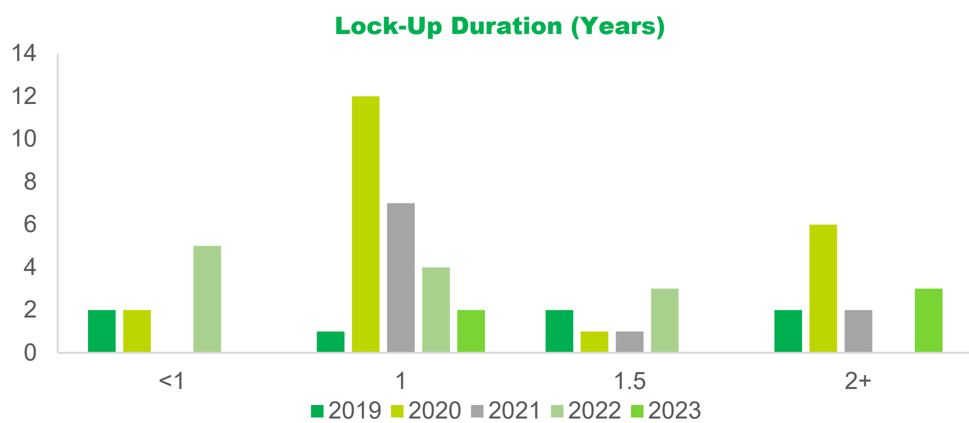
[16] Among these three transactions, one transaction allows conversion at the later to occur of: (i) the expiration of the HSR waiting period (that applied to an underlying pending acquisition (for which the proceeds of the PIPE issuance were used to finance)) and (ii) the 20th calendar day following the mailing of the information statement relating to the issuance of the PIPE securities to the holders of common stock (which represented the expiration of the acceptance period in the tender offer in the deal). One transaction allows for conversion (i) 12 months after the date of issuance of the PIPE securities or (ii) upon the consummation of a spin-off transaction of part of the issuer's business. The other transaction allows for conversion (i) two years after the date of issuance of the PIPE securities or (ii) immediately prior to a liquidation of the issuer.

Lock-ups. Unsurprisingly, lock-ups remained prevalent in 2023, with all of the surveyed PIPEs containing provisions restricting sponsor's ability to transfer its securities (as compared to 70% in 2022). Lock-up provisions provide issuers with greater certainty that holders of the PIPE investment security remain committed to the issuer and its strategy for deploying the newly invested capital for a greater period of time. In 63% of the surveyed transactions, the PIPE securities were subject to the lock-up for a specified period of time (compared to 60% in 2022) and, in the remaining 37% of the surveyed transactions, the PIPE securities were subject to the lock-up for an indefinite duration (compared to 5% in 2022).



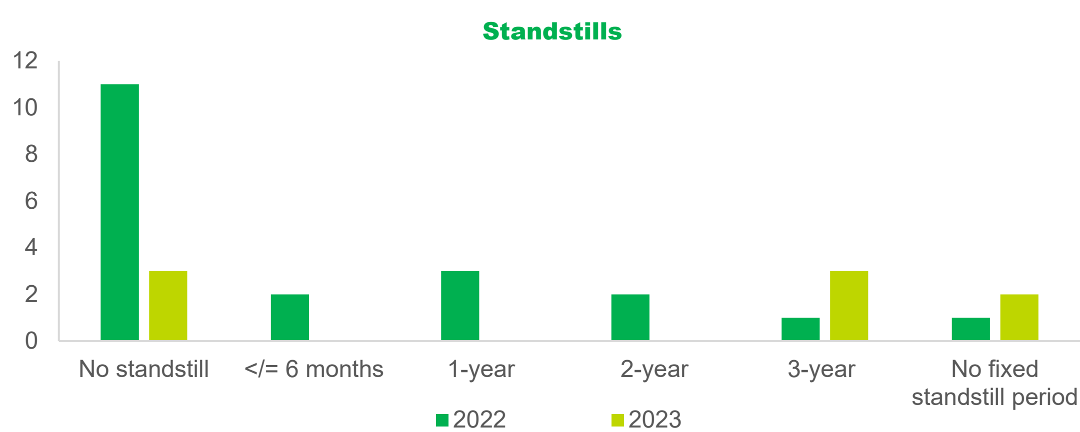
*Note: Does not include lock-ups of an indefinite duration

With respect to lock-ups for a specified period, 2023 also saw a significant increase in the average length of the lock-up period (from 11 months in 2022 to 26 months in 2023). As issuers faced greater economic uncertainty in 2023 (particularly in the credit markets), and reflecting perhaps greater leverage of issuers given the dearth of PIPE investment opportunities, it is not surprising that issuers sought increased certainty through use of longer lock-up periods.



*Note: Does not include lock-ups of an indefinite duration

Standstills. 63% (five of eight) of the surveyed transactions contained standstill provisions restricting sponsor from purchasing additional securities of issuer for a fixed period of time (as compared to 45% and 71% of 2022 and 2021 PIPEs, respectively), with the longest standstill lasting until the third anniversary of the issuance. The median standstill was three years (compared to one year, three years and two years in 2022, 2021 and 2020, respectively). In 38% (three of eight) of the surveyed PIPEs, the standstill provision could fall away upon a step down of the applicable sponsor's right to designate directors to the issuer's board (typically upon ceasing to hold a minimum number of issuer's securities).



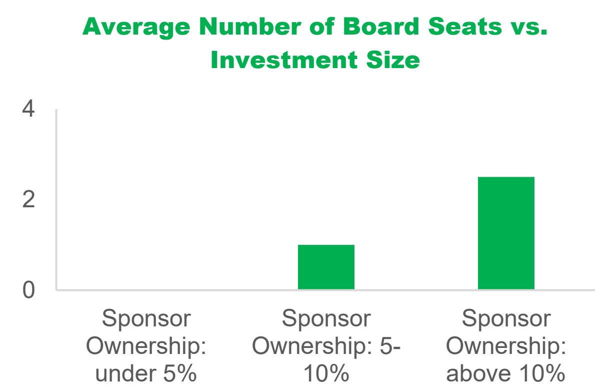
*Note: In 2 transactions there was no fixed standstill period, but rather it was tied to either sponsors holding a certain equity ownership threshold or continuing to hold their board appointment rights.

2023 Surveyed PIPEs: Governance

In terms of governance rights, sponsors have generally negotiated slightly greater board representation (although still roughly in proportion to investment size) and have continued to negotiate robust investor consent rights.

Board Representation. 75% (six of eight) of the surveyed PIPEs provided sponsors with board designation rights, which represents an increase as compared to 2022 (where only 55% of the surveyed PIPEs granted sponsors board seats, though last year a majority of U.S. sponsor-backed PIPEs were convertible debt securities), but is more consistent with prior years. Expectedly, the number of board members that a sponsor may designate was roughly proportional to the size of sponsor's investment:

- For the one transaction in which sponsor ownership was under 5% (i.e., 4%), the sponsor was not granted any board designation right;
- For the two transactions where sponsor ownership was between 5% and 10% (i.e., 6% and 8%, respectively), the sponsors were entitled to designate one director to the board;
- For the two transactions where sponsor ownership was above 10% (i.e., 25% and 36%, respectively), the sponsors had the right to designate up to three directors[17] and in the case of one such transaction, one board observer; and



- For the other three transactions where sponsor ownership was unconfirmed, in one such transaction,[18] the sponsor may designate up to three directors (including at least one independent director) and one board observer. In the other two transactions, the sponsor that received non-convertible senior secured notes was not granted any board seat while the sponsor that received non-convertible preferred stock and warrants was granted the right to designate two directors.

Consistent with prior years, in 75% of the surveyed transactions (six of eight), sponsors were required to maintain a minimum ownership percentage of the applicable security or number of PIPE securities acquired at the original issuance (ranging from 20% to 50%) in order to maintain their board designation rights. A failure to meet such continued ownership requirement would generally result in a reduction in the number of board seats a sponsor is entitled to. In one surveyed transaction, the sponsor designee would be downgraded from a board member to a board observer when the sponsor's ownership of issuer's common stock drops below 50% on an as-converted basis; and the sponsor will further lose such right to designate a board observer when its ownership of issuer's common stock drops below 25% on an as-converted basis. In another surveyed transaction, the sponsor will lose one of its three board seats when its ownership of the PIPE securities issued at closing drops below 50% and lose the other two board seats when such ownership drops below 20%. In the same transaction, the sponsor is also entitled to designate one board observer as long as it owns 7.5% or more of the issuer's common stock on an as-converted basis. Interestingly, one surveyed transaction imposes a vesting period on the sponsor's board designation right, where the sponsor is entitled to designate (i) one board member upon six years after the closing or, if earlier, an event of default by the issuer (i.e., a material breach of the governance document by the issuer or failure to pay dividends on the preferred when due) and (ii) two *additional* board members (for a total of three board seats) seven years after the original closing.[19]

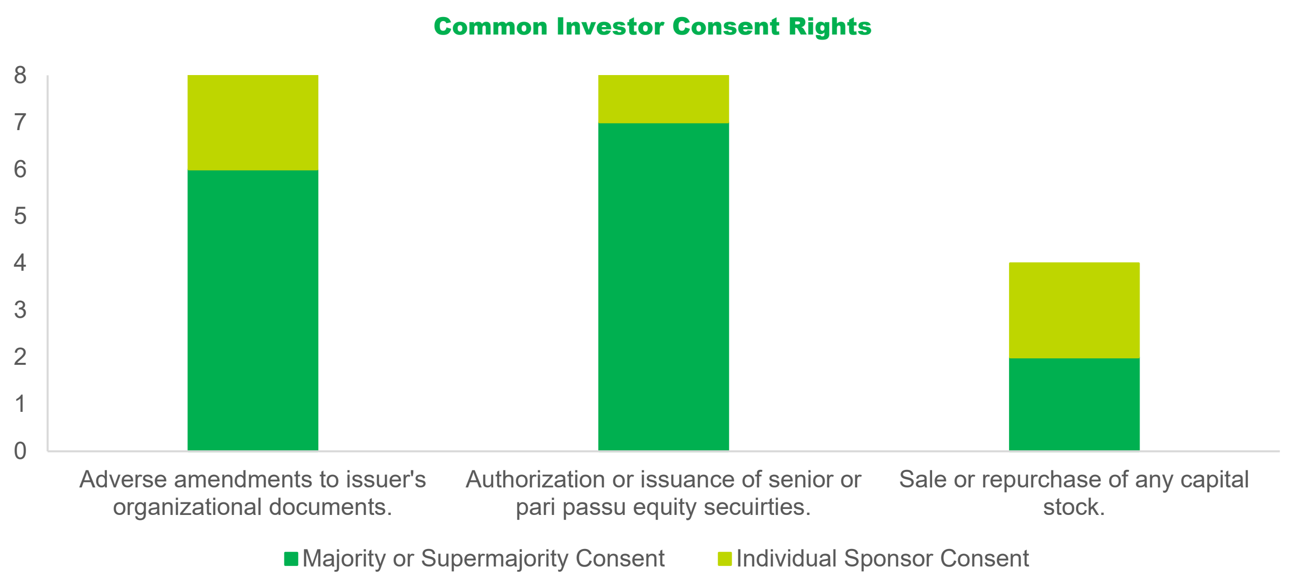
[17] In one of such transactions, one director is required to be independent.

[18] The investment documents for this transaction have not been made publicly available. As such, we were unable to confirm sponsor's ownership percentage.

[19] In such transaction, the sponsor had 8% of total ownership as of signing.

Investor Consent Rights.[20] Following the trend from recent years, in which sponsors have had robust investor consent rights, all of the surveyed PIPEs in 2023 provided sponsors with consent rights over certain corporate actions.[21] Depending on the nature of the corporate action under approval, some corporate actions required majority or supermajority (i.e., 66.67% approval, in the case of just one surveyed transaction) consent from the PIPE security class and the others require consent from each individual sponsor within the PIPE security class. Surprisingly, the surveyed transactions do not suggest a strong correlation between the number and type of investor consent rights granted to a sponsor and the size of investment.

Certain common issuer actions that required either majority, supermajority, or individual sponsor consent include: (i) adverse amendments to issuer's organization documents, (ii) authorization or issuance of senior or pari passu equity securities and (iii) sale or repurchase of any capital stock. Other common issuer corporate actions that require a majority or supermajority consent from the PIPE security class include: incurrence or assumption of indebtedness (five of eight), incurrence of certain liquidation events (four of six) or any consolidation, combination or merger with or into another person (three of eight).



[20] While sponsor consent rights remain robust in the surveyed PIPE transactions, some of these consent rights may run the risk of litigation given recent developments in Delaware case law. Certain consent rights granted to stockholders of public companies have been invalidated under Delaware law on the basis of "unduly interfer[ing] with directors' management prerogatives" (*Gorman v. Salamone, C.A. No. 10183-VCN (Del. Ch. July 31, 2015)*) or breaching the implied covenant of not withholding consent "solely for the purpose of harming [a] counterparty" (*Tamarix Restaurant Group, Inc. v. Value Opulence I LLC, C.A. No. 2023-1145-JTL (Dec. 8, 2023)*). As of February 2024, there were six similar lawsuits filed in the Delaware Court of Chancery challenging stockholder consent rights over replacement of the CEO, charter amendments, mergers or dissolutions and the appointment of board members in public company settings. In one such litigation (*West Palm Beach Firefighters' Pension Fund v. Moelis & Company, C.A. No. 2021-0309-JTL (Del. Ch. Feb. 23, 2024)*), the Delaware Court of Chancery invalidated certain provisions of a stockholders agreement providing stockholders with consent rights over specified corporate actions and other rights as to board and committee representation on the basis that such provisions imposed significant governance constraints on the board's ability to exercise its authority under the Delaware General Corporation Law. While none of the cases discussed above involve consent rights granted to PIPE investors specifically, each surveyed PIPE transaction involves at least one such consent right currently being challenged in the Delaware Court of Chancery and the outcome of these cases could affect the future validity of such rights and whether similar consent rights will be granted to investors in public deals going forward, including future PIPE transactions.

[21] In one transaction, the holders of at least a majority of outstanding voting power of PIPE securities must also include investors that owned at least 25% of the common shares (as converted) as of the date of the original issuance. In another transaction, the investors only have such consent rights if the investor continues to have the right to nominate a director.

Structural Considerations Relating to the Issuance of Convertible Preferred PIPE Securities

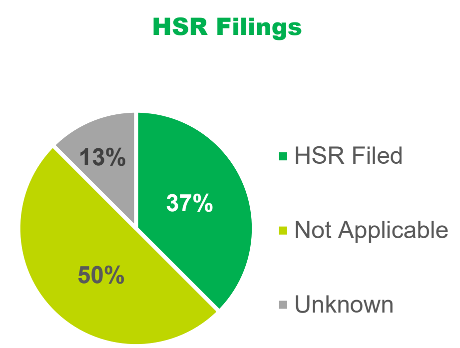
The issuance of convertible PIPE securities may require approval by issuer's shareholders and/or applicable regulatory authorities.

Shareholder Approval. NASDAQ and the NYSE require, subject to certain exceptions, listed issuers to obtain shareholder approval for issuances of securities convertible or exchangeable into common stock in excess of 20% of the common stock or voting power outstanding prior to the issuance (the "20% rule").[22]

Given the potential delay that obtaining shareholder approvals can create, investors and issuers commonly structure PIPE transactions in a manner that limits the issuance to less than 20% of the pre-transaction common stock or with caps on the number of shares that may be issued upon conversion until the requisite shareholder approval is obtained.[23] Any such share cap must apply for the life of the transaction unless shareholder approval is obtained. Interestingly, only one of the surveyed transactions involving convertible PIPE securities included such a share cap.

Transaction terms for convertible PIPE securities may also contain "penalties" or "sweeteners" (to the extent not coercive) that are triggered if the requisite shareholder approval is or is not obtained (e.g., changes to the conversion ratio or coupon or other economic consequences). In fact, the one surveyed transaction with a 20% share cap noted above included a sweetener provision, pursuant to which the issuer would be required to redeem the shares that could not be converted (i.e., the shares that, if converted, would exceed the 20% cap) and pay sponsor cash at the then-prevailing market price for such redeemed shares.

Antitrust Filings. A PIPE transaction involving the issuance of convertible securities can trigger an HSR filing at the time of the initial issuance if the transaction provides the sponsor with board designation (as opposed to nomination) rights (which, as discussed above, is quite common in sponsor-backed PIPEs). In addition, a filing could be triggered in the future (following the closing of the issuance) if and when the convertible PIPE securities will be converted to voting securities. In these scenarios, a filing may be triggered if the total fair market value of the securities acquired (or converted), combined with any securities already held by the sponsor, exceeds $119.5M (this threshold is adjusted annually). Among the surveyed transactions involving convertible PIPE securities, 50% (three of six) involved an HSR filing at the time of issuance, all of which exceeded the $119.5M threshold.



Even though PIPE transactions typically involve the acquisition of minority and largely passive ownership interests, they can still raise substantive questions or concerns from the FTC or DOJ if the sponsor has investments in, board seats or information rights relating to other companies that compete with or operate in closely adjacent product areas to the issuer.[24] Notably, the FTC and DOJ have pursued an exceedingly aggressive enforcement agenda over the last few years, which has included a focus on, and close scrutiny of, private equity firms. This risk is reduced if a PIPE transaction does not require an HSR filing, but investigations and enforcement actions could be brought against non-reportable transactions (pre- or post-closing), so sponsors should still conduct a thorough risk assessment to identify and evaluate any potential horizontal or vertical overlaps with the issuer.

[22] Shareholder approval is also required where the issuance of securities may result in a "change of control" of the issuer. NASDAQ generally considers a "change of control" as a transaction that results in an investor or group of affiliated investors owning, or having the right to acquire, 20% or more of an issuer's common stock or voting power, and such ownership or voting power would be the largest ownership in the issuer.

[23] If an issuer determines to defer a shareholder vote in this manner, NASDAQ interpretations provide that shares issuable under the cap (in the first part of the transaction) would not be eligible to vote to approve the remainder of the transaction.

[24] Sponsors should carefully consider whether any board designation right obtained as part of a PIPE transaction raises interlocking directorate concerns under Section 8 of the Clayton Act, which prohibits a "person" from simultaneously serving as an officer or director of two competing corporations.

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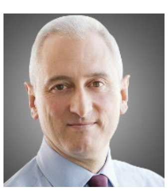
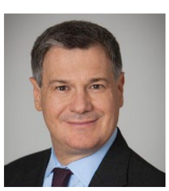


Marco Compagnoni
Co-Head of Global Private Equity



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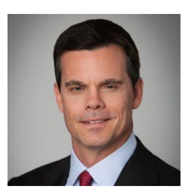

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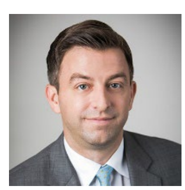

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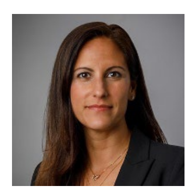

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