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Companies Forced To Get Creative As Public Markets Stall

By **Tom Zanki**

Law360 (March 30, 2020, 6:01 PM EDT) -- With equity capital markets largely shut amid uncertainty generated by the coronavirus pandemic, companies eager for funding will be forced to consider costlier alternatives than traditional public offerings to survive tumultuous times.

Capital markets lawyers say they are discussing various options with their public company clients, ranging from cash management and cost-cutting practices that could help weather the downturn to exploring short-term financing options outside of conventional capital raises.

"All on the table," Goodwin Procter LLP partner Rick Kline said. "We have been having a ton of those discussions with our clients."

The sober outlook reflects a plunge in equity-raising transactions over the past month. Initial public offerings, a bellwether of public equity markets activity, have all but dried up. Two operating companies went public this month and none since March 11, marking a steep drop after a busy start to 2020. The tepid pace has thrown the typically robust spring IPO season into doubt.

Accounting giant EY said last week that renewed IPO activity on a global basis may not occur until the third quarter of 2020, given that dicey conditions make it hard for issuers to price offerings.

"That market is going to be nonexistent for the near term, Stradling Yocca Carlson & Rauth PC shareholder Christopher Ivey said. "With the exception maybe of companies that might fit within the specific space that aligns well with the current crisis, such as medical device or diagnostics companies, or something like Zoom," a video communications company.

Existing public companies can continue capital raising after their IPO through what are called follow-on offerings, but such activity is also declining. Only 17 companies completed follow-on deals in March, raising $2.6 billion, compared with 64 companies that raised $15.5 billion last month, according to Dealogic.

One less-used option that could become more common in the coming months is what is known as an at-the-market, or ATM, offering.

ATMs are similar to follow-on offerings, but rather than selling a large number of shares once at a fixed price, ATMs sell smaller increments of shares gradually based on prevailing market prices. ATMs don't raise nearly as much money as ordinary follow-on offerings, although they provide companies the flexibility of only selling shares when markets rise to desired levels.

"The ability to be opportunistic on days with less volatility and generate smaller amounts of cash on a more frequent basis through ATM programs is very relevant right now," said Covington & Burling LLP partner Brian Rosenzweig, who co-chairs the firm's capital markets and securities practice.

Another tool in the capital-raising box are PIPE — or private investment in public equity — offerings in which public companies sell shares to private investors. These deals come with trade-offs, however. PIPEs are typically sold at discounts and contain other restrictive terms favoring private investors. One advantage is that PIPEs can be completed quicker and cost companies less than a fully registered offering with the U.S. Securities and Exchange Commission.

Given falling stock prices of many public companies after recent sell-offs, PIPE deals could appeal to private investors. Kline said public companies may consider PIPEs if the downturn persists and issuers get "closer to desperation." Shares in PIPE deals are often sold below their market price and increase dilution — results that companies would rather avoid.

"If the public window stays shut and companies need money, then absolutely we will start seeing PIPEs," Kline said.

While traditional follow-on offerings have declined, capital markets lawyers say opportunities are not closed. Cooley LLP partner Robert Phillips notes that many life sciences companies need funds to pay for clinical trials. Many early stage drug developers have yet to generate revenue from product sales, making fundraising more urgent, regardless of market volatility or news cycles.

"They are a lot more press agnostic, so I think we will continue to see some follow-ons," Phillips said, noting that companies that report positive trial data and are followed by investors and analysts will be best positioned to raise capital.

Borrowing is an alternative to raising equity, but one that is largely limited to large companies with the best credit. The debt market for investment-grade companies has soared in recent weeks, aided by rescue measures announced by the Federal Reserve.

Intel Corp., General Dynamics Corp., Nike Inc., Viacom Inc. and other companies last week priced multibillion-dollar debt offerings after the Fed took emergency actions to stabilize markets, including an unprecedented commitment to buy corporate bonds with investment-grade ratings. That followed earlier Fed actions to slash interest rates to near zero.

"Companies that can do high-quality debt deals are going to raise a ton of money because the money is almost free," Cooley LLP partner Eric Jensen said. "And why not stock away some billions for a rainy day?"

Current trends favor investment-grade companies, which are considered the most creditworthy issuers. The market for high-yield bonds, issued by companies with higher risks of defaulting, is less friendly.

Dealogic data show that only three corporations completed high-yield debt offerings in March, raising $3.6 billion, compared with 89 investment-grade companies who netted $151 billion. This month's paltry showing in high-yield debt offerings compared with a stronger February, when 40 companies raised $29 billion in high-yield debt.

Companies in need of short-term financing are taking additional steps besides debt offerings, such as drawing down credit lines. The Kraft Heinz Co. this month said it tapped a credit line worth up to $4 billion, one of several companies that has taken similar measures to build their cash cushion.

Companies may also look to convertible bonds, which are hybrid investments that can convert from debt to equity. Kline noted that convertible bonds have declined recently as well, although they may bounce back quicker than equity markets, which are typically riskier.

"The equity market is likely going to stay closed until the volatility calms down," Kline said.

--Editing by Orlando Lorenzo.

This story is the second in a two-part series about funding for public and private companies. The first story examined how startups are dealing with dried-up funding.