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PIPE Transactions for Acquisition Finance in Swiss Listed Companies – Recent Cases and Structuring Considerations

In the last year, several Swiss listed companies conducted PIPE (private investment in public entity) transactions to finance an M&A deal. PIPE transactions may be structured in many different ways. Existing authorizations, timing, conditionality to the M&A deal and dilution of existing shareholders play a role in the structuring of a PIPE instrument. This edition of Advestra Insights looks at recent PIPE transactions and discusses the main structuring options.

Introduction and Recent Cases

Large acquisitions often involve or even require the issuance of equity in order to keep the acquiror's debt to equity ratio in a solid territory. This has been the case in a number of large acquisitions by Swiss listed companies. Dufry, for example, conducted a capital increase by way of a rights offering to finance the acquisition of the remaining stake that it did not already own in Hudson, a NYSE listed US company. Peach Property acquired a large real estate portfolio in Germany and issued mandatory convertible bonds to partly finance the acquisition. Siegfried issued a perpetual convertible instrument to finance its purchase of a pharmaceutical production facility in Spain. In all these transactions, anchor investors were involved to facilitate the success of the acquisition financing, and all investments had an equity component. However, the commonalities end there. The instruments used range from straight equity to a perpetual convertible instrument. Some of the transactions involved a public offering including pre-emptive rights while others were conducted on a private placement basis only, excluding pre-emptive rights.

Overview of recent cases

The below table gives an overview over the main characteristics of some Swiss equity transactions involving anchor investor.

Feature	Advent Int. and Alibaba Group / Dufry	Ares / Peach Property	EGS / Siegfried
Target	Hudson	Real estate portfolio	Production facility
Instrument	Shares in Dufry (i.e., equity)	Mandatory convertible bond	Perpetual convertible notes
Pre-emptive rights granted to shareholders	Yes	No	No
Public Offering / prospectus	Yes	Yes	No
Pricing / timing thereof	Both commitments were entered into prior to shareholder meeting, but after the announcement of the M&A deal	Pricing after announcement of M&A deal	Pricing after announcement of M&A deal
Conditionality to M&A deal	No (no conditionality)	Yes (after signing of M&A deal and consummation reasonably likely to occur)	Yes (after consummation of the M&A deal)

Structuring Considerations

Analysis of existing authorizations

Swiss listed corporates intending to finance an acquisition by issuing equity or equity-linked instruments will first look at their existing capital authorizations in their articles of association to assess whether they are sufficient to proceed with a transaction (in rare cases, if applicable, companies may also assess whether they have sufficient treasury shares to place with investors). More specifically, they will look at the level of authorized capital and of conditional capital – the latter is a specific capital authorization designed for equity-linked instruments. If these existing authorizations are not sufficient to fund the equity piece of the acquisition, a shareholder meeting approving additional capital authorizations will be required. This was the case in Dufry, where shareholders approved an ordinary capital increase that served as basis for an at-market rights issue. It was also the case in Peach Property, where shareholders approved additional authorized capital (as the company was "maxed out" on conditional capital, which is usually used as underlying) to source the shares needed for the mandatory convertible instrument.

Sometimes, existing authorizations are limited to either conditional capital or authorized capital (but not both). If only conditional capital is available and the company does not intend to hold a shareholder meeting, the company may issue only equity-linked instruments. Existing authorizations may also include restrictions as to how and to whom such equity-linked instruments can be issued, particularly if pre-emptive rights are excluded. Hence, depending on the wording of the clause on conditional capital in the articles of association, there is limited flexibility in structuring PIPE instruments and/or non-preemptive issuances to a selected group of investors only may not be permitted. Where there is only authorized capital available, the spectrum of instruments that can be issued ranges from common equity to equity-linked instruments. However, equity-linked instruments are only rarely issued on the basis of authorized capital as the conversion mechanics would be cumbersome and share issuance upon conversion requires a board resolution and notarial deed.

Equity vs. equity-linked instruments

PIPE investors often look for some sort of equivalent of redeemable preferred stock issued by companies in the United States. However, mandatory provisions of Swiss corporate law do not allow for an enforceable right of redemption of shareholders (irrespective of whether holders of common or preferred stock). In addition, redemption rights of investors usually disqualify the investment instrument from being recognized as equity under applicable accounting standards or for rating agency purposes. Such recognition as "equity" is, however, usually a requirement for issuers of PIPEs in the context of an acquisition.

For Swiss incorporated entities, the "equity" constraint usually leaves a limited set of investment instruments. Luckily, not only securities that are by their legal nature equity securities such as shares (stock; *Aktien*) or non-voting shares (so called "participation certificates"; *Partizipationsscheine*) meet the "equity" recognition criteria of accounting or rating standards. Instruments that qualify as debt instruments under statutory accounting rules can meet these criteria if they carry certain features such as subordination, coupon (interest) deferral and absence of redemption rights of the investor. Equity-linked instruments such as mandatory or perpetual convertible bonds or notes can therefore also pass the "equity" test and are frequently used in PIPE transactions.

Equity-linked instruments have certain advantages compared to straight equity instruments. From a tax point of view, for example, equity-linked instruments do not trigger issuance tax of currently 1% (even if qualifying as equity for accounting purposes) contrary to an issuance of shares. Such issuance tax would only be triggered if and when the host instrument converts into common equity (shares or participation certificates). Furthermore, the exclusion of pre-emptive rights tends to be more acceptable and accepted in practice (see below) and – relevant for larger stakes – the subscription of convertible instruments does not trigger anti-trust clearance until a conversion into shares, which gives the investor time to make the necessary filings with the competent authorities.

Pre-emptive vs. non-preemptive issuances

Companies will have to decide whether equity instruments should be issued on a pre-emptive or non-preemptive basis, i.e. whether existing shareholders are allowed to participate *pro rata* to their existing shareholding in the issuance of shares or other equity instruments. Obviously, allowing shareholders to participate in a pre-emptive issuance will generally be considered more shareholder friendly, but comes with a price tag: Such a transaction will be considered a "public offering" and typically trigger the duty to publish a prospectus, which is time consuming, costly and increases liability risks. In addition, the company cannot make guaranteed allocations to PIPE investors as the extent to which existing shareholders will exercise their subscription rights is not known from the outset.

Hence, while investors in PIPE instruments will generally prefer a non-preemptive issuance in order to receive a guaranteed allocation and therefore a guaranteed stake in the target, issuers may prefer to grant pre-emptive (subscription) rights to their shareholders to avoid exposure to criticism from existing investors.

Decision criteria: pro and contra pre-emptive structures

The decision whether or not to grant pre-emptive (subscription) rights will usually be driven by the following considerations:

(1) *Size*: The larger the equity issuance, the more likely pre-emptive rights should and, in practice, will be granted. Non-pre-emptive issuances of shares below 10% of the existing share capital have been very frequent. Such new shares are usually issued out of authorized capital in an accelerated book-building procedure and sold to institutional investors in a private placement. Beyond 10%, exclusions of pre-emptive rights in case of issuance of new shares for financing purposes (i.e. against cash) have not been very frequent in Switzerland. The reason may often be found in the limitations in the authorized capital used for such new share issuance, which is typically capped at 10% in light of the guidelines of the leading proxy advisers (for example, ISS, Glass Lewis). Also, under the past listing regime of SIX Exchange Regulation, an issuer was not required to produce a listing prospectus if the new shares (together with any other issuances of new shares without a prospectus during the last twelve months) did not exceed 10% of the shares already in issue. This threshold has been increased to 20% under the new Swiss Financial Services Act.

(2) *Existing authorizations*: If the PIPE transaction envisages only the use of existing capital authorizations (authorized or conditional capital), the existing authorization must provide for an exclusion of pre-emptive rights (and in the case of equity-linked instruments the advance subscription rights) and the company is bound by the structural requirements that such authorizations impose. If, for example, pre-emptive rights may only be excluded for a very limited set of reasons under existing capital authorizations, the PIPE will have to be structured around these limitations.

(3) *Timing*: The more compressed a timetable for an acquisition, the more likely rights will be excluded to enable private placements and avoid a costly and lengthy public offering (see above). However, often the acquiror has a (debt) bridge financing in place to address timing and certainty of funds considerations. In such a scenario, there is more time and a rights offering can be conducted, the proceeds of which can be used to repay the banks under the bridge financing. Another way to bridge the financing is a volume underwriting. A banking syndicate commits to underwrite a not yet defined number of shares which will result in gross proceeds of a certain amount. As banks will charge fees for a bridge financing or a volume underwriting, it is attractive for a company to bring in an anchor investor early because anchor investors regularly do not request a fee for their commitment. In addition, an early announcement of an anchor investor is also a signal of confidence to the market.

(4) *Equity-linked vs. equity instrument*: It is generally considered easier to exclude pre-emptive rights if an equity-linked instrument (e.g. convertible bond) is issued rather than shares. While there is no "logic" rationale for this conclusion, the following reasons are usually invoked to support it: (1) It is a different and new class of instrument that is being issued, (2) pricing is not comparable to stock due to coupon, embedded call and/or put options etc. which makes it more difficult for existing shareholders to claim that they have been disadvantaged, (3) the revised Swiss corporate law also imposes a lower standard on exclusion of (advance) subscription rights for equity-linked instruments compared to shares.

Conditionality with M&A transaction

Issuers typically want certainty on the investor commitment to subscribe to a PIPE at the time a binding agreement to acquire the target is entered into (which is usually also the time the acquisition is announced). Of course, the issuer may also rely on bridge financing or a volume underwriting by banks (the latter is not ideal as it will typically only be available with some "outs" in favor of the banks) to fund the acquisition, in which case there tends to be less of a need to secure a PIPE investor commitment upfront. Investors are often fine with an upfront commitment concurrent with the signing of the M&A transaction and therefore prior to the announcement of the M&A transaction.

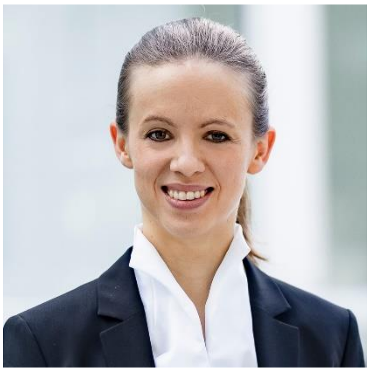
Issuers and investors typically want the funding under the PIPE to only occur if the M&A transaction closes. However, the closing of the PIPE investment cannot be conditional on the closing of the M&A transaction if the issuer (acquirer) needs the funding from the PIPE investment for the closing of the M&A deal. Nevertheless, both the investor and the issuer will want to still have mechanisms in place in order to avoid an undesired "overfunding" in case of a PIPE closing without the M&A deal being closed. This may be addressed in various ways. If the instrument is redeemable, which is the case for equity-linked instruments, it can simply be redeemed if closing of the M&A transaction does not occur. If redemption is not possible or desired (which often is the case for shares due to, among other things, restrictions on share repurchases under Swiss law), the closing of the PIPE investment needs to be interlinked with the M&A deal, for example by requiring evidence that all or certain conditions precedent of the M&A transaction have been satisfied before the closing of the PIPE will occur.

Insider trading considerations

In order to increase transaction certainty, issuers and investors typically want to enter into a binding commitment prior to the announcement of the M&A deal. Before doing so, the issuer will have to inform the PIPE investor about the M&A deal (as the PIPE investor will want to know at least the identity of the target prior to investing) and the PIPE investor becomes an insider as a result thereof. PIPE investors typically want to fix the price for their investment on the basis of the share price prior to the announcement (for example, a VWAP over the last 30 days) as a PIPE commitment is seen as a positive signal to the market and is likely to move the share price up. Even though both the investor and the issuer are privy to inside information, Swiss law does not contain a safe harbor for this type of situation. Hence, if the M&A transaction is not publicly announced prior to entering into a binding investment or similar agreement, there is a risk that both parties commit insider trading. This risk can usually be eliminated if the purchase price for the securities (or any relevant conversion price in case of equity linked securities) is fixed only after the announcement when the M&A transaction is "priced in", which has become somewhat of a market practice. However, this solution is not entirely satisfactory from the investor's perspective who would like to benefit from an anticipated stock price appreciation as a result of its own investment becoming publicly known. Other structuring possibilities are available, but tend to be less established and do not provide for a legally recognized safe harbor.

As outlined herein, the structure of a PIPE may vary significantly and depends very much on the transaction specific needs and the authorizations available to the issuer. Prior to each PIPE transaction, the board of directors should carefully assess the possibilities and try to find structuring solutions that accommodate both the interest of PIPE investors and those of the issuer's shareholders thus minimizing its own exposure.

Contacts



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