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On the Road to Recovery: "At-the-Market" Offerings in an Improving but Volatile Market

Introduction

While the capital markets have started to recover in the last few quarters, they remain volatile. Issuers are still somewhat hesitant to commit to traditional, fully marketed follow-on public offerings due to concerns about whether the offering will price in a favorable range or a given offering size is realistic or achievable, as well as concerns relating to the negative implications of downsizing or terminating a public offering after it is announced. Even where a traditional, fully marketed follow-on offering is a realistic possibility, many issuers find that "at-the-market" ("ATM") equity offerings are a useful supplement to traditional offerings, as they offer the ability to raise capital quickly at favorable market prices, while providing some protection from arbitrage opportunities and avoiding pronounced disruptions in trading. While some alternative public offering structures (such as registered direct offerings) are more commonly used for smaller offerings or associated with specific industry sectors, over the past year issuers of varying sizes in a range of industries (including energy, real estate, life sciences, banking, mining and resources, technology and transportation) have successfully raised significant amounts of capital using ATM offerings. This advisory summarizes some characteristics of ATM offerings, as well as certain legal and practical developments since January 2009, when we previously published a client advisory on ATM (as well as registered direct) offerings. Since January 2009, over 60 issuers, including Citi and Ford Motor Company, have entered into ATM programs.

Basic Characteristics

- An ATM offering involves the sale of equity securities into the market at prevailing market prices under SEC Rule 415(a)(4), rather than at a fixed price, pursuant to an effective shelf registration statement. In certain ways, each issuance under an ATM offering functions like an ordinary brokerage sale, except the issuer, rather than a shareholder, is the party placing an order to sell and can specify minimum prices and trade parameters. Issuers must be eligible to use Form S-3 for primary offerings to take advantage of ATM offerings, whether pursuant to General Instruction I.B.1 (issuers that have a public float of at least $75 million), or I.B.6 (for an issuer listed on a national securities exchange, but does not satisfy the market capitalization requirement, so long as not more than one-third of its market capitalization is sold on Form S-3 in any 12-month period).

For additional information about at-the-market offerings, contact one of the members of Katten's Securities Practice listed below.

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- In practical terms, an ATM offering is usually conducted by a registered broker-dealer as placement agent on behalf of an issuer. Regardless of whether such placement agent conducts the offering or any individual trade as agent or principal, the placement agent or distribution agreement provides for customary underwriter protections such as comfort letters and opinions of counsel. Occasionally certain types of equity line products, including arrangements where a single purchaser commits to purchase shares issued under a shelf registration statement from time to time at a specified discount to prevailing market prices, are referred to as "at-the-market" programs, and such programs are also subject to SEC Rule 415(a)(4).
- ATM offerings can be for any type of equity securities, but in practice usually involve common stock of a class traded on a national securities exchange.

Practical Considerations

- The initial costs of establishing an ATM program are usually lower than those associated with traditional, underwritten public offerings. The principal initial cost for the issuer (assuming it already has an effective shelf registration statement) relates to the negotiation of the distribution agreement (and related documents including a comfort letter and opinion of counsel) and the preparation of the prospectus supplement (which customarily incorporates most relevant information by reference). Placement agents will also incur initial costs (principally legal fees) to perform initial due diligence and negotiate the distribution agreement, comfort letter and opinion of counsel. So long as the placement agent maintains an ongoing dialogue with the issuer's management (to avoid the need to rapidly conduct significant additional due diligence), the incremental costs of each drawdown to both the placement agent and issuer under the ATM program should be relatively low, although the placement agent will need to bring down its due diligence, comfort letter and other protections periodically.
- Because placement agents do not engage in full marketing efforts, placement agent fees and commissions are typically lower than underwriting discounts, fees and commissions for traditional offerings (and usually lower than discounts associated with equity lines as well, though there is no commitment to buy in an ATM program), and are usually in a range of 2–5 percent of gross proceeds (although generally higher for smaller issuers or smaller offerings).
- ATM programs are increasingly being used as a supplement to, not a replacement for, fully marketed, underwritten follow-on public offerings or other capital raising efforts. Issuers have successfully negotiated carve-outs to lock-up provisions in placement agent or underwriting agreements covering fully marketed offerings permitting them to continue drawdowns under an existing ATM program after the closing of a fully marketed offering.
- Under current market conditions, investors in many traditional public offerings still attempt to negotiate a discount from the market price of an issuer's stock or a warrant or other "sweetener" in order to participate in the financing. The only discount to market price in an ATM program is the placement agent's fee, which is negotiated in advance.
- Broadly speaking, the more liquid the market for an issuer's common stock, the more flexibility such issuer will have raising capital in an ATM offering. Some issuers have found that the announcement of, and initial drawdowns under, ATM offerings can have a beneficial effect on the price or liquidity of their stock, while others have seen initial or temporary drops in stock price until the extent or timing of any drawdowns (and therefore any dilutive effect on existing shareholders) become apparent.
- Although some issuers with actively traded stock have been able to raise significant amounts of capital in a relatively short time with ATM offerings, the most practical use of an ATM program for most issuers is to raise modest amounts of capital in quick but repeated drawdowns over time when market prices are at attractive levels.
- As with any public offering conducted pursuant to a shelf registration statement, both the issuer and the placement agent must be confident that the registration statement, including all information incorporated by reference into the registration statement, contains sufficient and accurate disclosure about the issuer and its operations. However, with respect to information about the ATM offering itself, apart from the initial prospectus supplement and Form 8-K describing the terms of the distribution agreement and possible maximum size of the offering, disclosure about completed sales under an ATM program is typically limited to quarterly or annual reports, unless some material threshold of proceeds is raised. This greatly limits arbitrage or speculation concerning the size or pricing of the offering.

- ATM offerings are considered public offerings under NASDAQ Rule 5635 and therefore, a NASDAQ issuer can sell in excess of 20 percent of an issuer's outstanding shares in an ATM offering without shareholder approval. It is also possible to sell in excess of 20 percent of an issuer's outstanding shares in an ATM offering without shareholder approval under NYSE or NYSE Amex rules.
- Drawdown instructions from an issuer to a placement agent typically are similar to a limit order to sell shares, with a minimum price, maximum number of shares and specified expiration date, and can be given, modified or terminated very quickly (even in the same trading day), whereas terminating or modifying a traditional public offering involves a host of legal and business concerns and additional disclosure.
- Regulation M and other applicable regulations prohibit special selling efforts, stabilization or passive market making in ATM offerings; and both the placement agent and the issuer need to be mindful of these restrictions.

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