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Financial Services

Providing Strategic Legal Guidance to the Global Financial Services Industry

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Private Over Public? An Emerging Markets Perspective

The private placement of debt securities, compared to the more common public issuances, has grown in popularity in recent years, particularly in emerging markets such as those in the Middle East. Whilst there is little publicly available data on the volume of such issuances, they have certainly been on the rise. Numerous issuers have opted to issue on a private placement basis rather than, or in addition to, a public offering, particularly against a backdrop of reduced bank liquidity in most emerging markets, and particularly in the Middle East. We have considered some of the key factors that have recently contributed and influenced the growth of private placement issuances.

PRIVATE PLACEMENT – DEFINED

In a typical public issuance of debt securities, the issuer markets the issue widely, either on a retail basis or to institutional investors only. Following the offering, the securities are typically admitted to listing and trading on a particular stock exchange. In contrast, in the private placement context, an issuer markets its debt instruments to a small pool of investors only, with no subsequent listing of the securities on a stock exchange.

WHY ISSUE AS A PRIVATE PLACEMENT?

Light Touch Regulation

One of the key features of a private placement issuance is the comparatively light regulation applying to such an offering. For a public issuance, an offer document or prospectus which complies with various regulatory requirements is generally required to be prepared. The content will require, amongst other things, certain disclosure on the issuer's business, inclusion of financial statements and certain other prescribed requirements promulgated by the relevant regulatory and/or listing authorities. On the other hand, in a private placement issuance, the securities laws of most jurisdictions contain applicable private placement exemptions, under which, provided certain conditions are complied with, a full prospectus or offer document complying with public issuance disclosure standards may not need to be prepared. The applicable exemptions/conditions vary, but could include the minimum ticket size for each relevant investor being above a certain threshold, the investors being sufficiently sophisticated or where the issuer is otherwise offering to a limited pool of investors. Such relatively light regulatory requirements allow debut issuers to, essentially, take small steps in the debt capital markets space in order to better understand the process and mechanics before dipping into the more onerous public issuance arena.

Quick off the Mark

Another primary advantage of a private placement issuance is, in comparison to a public issuance, the speed of execution. The fact that a prospectus or offer document may not be required greatly expedites the transaction execution process and timeline in a private placement issuance. While most issuers will elect to produce a short form private placement memorandum for marketing purposes, this would not typically require regulator review and approval. The fact that such a process is not required to be factored into a transaction execution timetable results in a comparatively expedited execution time line.

Cost Efficiencies

With reduced disclosure requirements and further reduced regulatory interaction in most jurisdictions for a private placement issuance, the work streams undertaken by various advisors, particularly lawyers may, all things being equal, be significantly streamlined resulting in cost efficiencies in respect of such issuances.

It's Private Please

Private placement issuances also allow issuers that value privacy to remain private. In contrast to public offerings, which require a public filing, disclosure of company information and commercial/pricing terms, private placement transactions are negotiated confidentially and require minimal public disclosure. A private placement issuance also affords issuers with existing public debt securities the opportunity to undertake an issuance without affecting their existing "yield curve"; that is, the historic record of the pricing achieved on their public securities, which may be a significant advantage to frequent issuers.

Commercial Considerations

In a public issuance, a typical book-building process, with price discovery being based on market conditions and investor appetite, affords issuers little to no room for negotiations with their prospective investors. However, in a private placement offering, the investor base is limited to a small handful of interested parties, which is more conducive to commercial terms being negotiated, particularly around pricing and tenor.

Additionally, from our experience, many issuers have used private placement issuances as a stepping stone to issuing an ultimate benchmark public security. The private placement approach affords issuers some profile building benefits while at the same time limiting the cost and time expense associated with a full public issuance.

WHAT ARE THE LIMITATIONS OF A PRIVATE PLACEMENT?

Given the limited number of subscribers, privately placed debt securities are generally considered to be less liquid and not easily tradeable in the secondary market compared to public debt securities. Whilst the lack of a liquid secondary market may be a limitation, this is offset by the fact that, numerous investors of privately placed securities are "buy-to-hold" investors.

Further, the deal size in a private placement issuance is generally limited to US$150 million (or its equivalent in another currency), rather than the benchmark size of US$300 to US$500 million, or more. The tenor is also typically limited to 3 years. A private placement also has limitations as far as publicity is concerned, which presents a disadvantage to prospective issuers looking to raise their profile.

Most notably, however, privately placed debt securities are often priced at a premium, to compensate investors for the perceived greater risk and lack of secondary market liquidity. This is arguably one of the most significant limitations of a privately placed debt instrument.

CONCLUSION

Whilst there are certain limitations with any private placement issuance (as noted above), such mode of offering does also present significant advantages for both buy side and sell side market participants. From a sell side point of view, issuers would need to principally weigh the execution time and cost efficiencies against the potential negative pricing implications of issuing privately. From a buy side point of view, investors would need to consider the pricing upside against the reduced level of liquidity and tradability afforded by private placed instruments.