Convertible Bond Offerings: Replacing Outstanding Converts, Convert Exchanges and other Developments

February 20, 2025

Claude DeSouza-Lawrence
Managing Director, Equity Linked Strategies
Raymond James
+1 727 567 2563
claude.desouzalawrence@raymondjames.com

Peter Pergola
Managing Director, Equity Linked Strategies
Raymond James
+1 727 567 2421
peter.pergola@raymondjames.com

Ryan Castillo
Partner
Mayer Brown LLP
+1 212 506 2645
rcastillo@mayerbrown.com

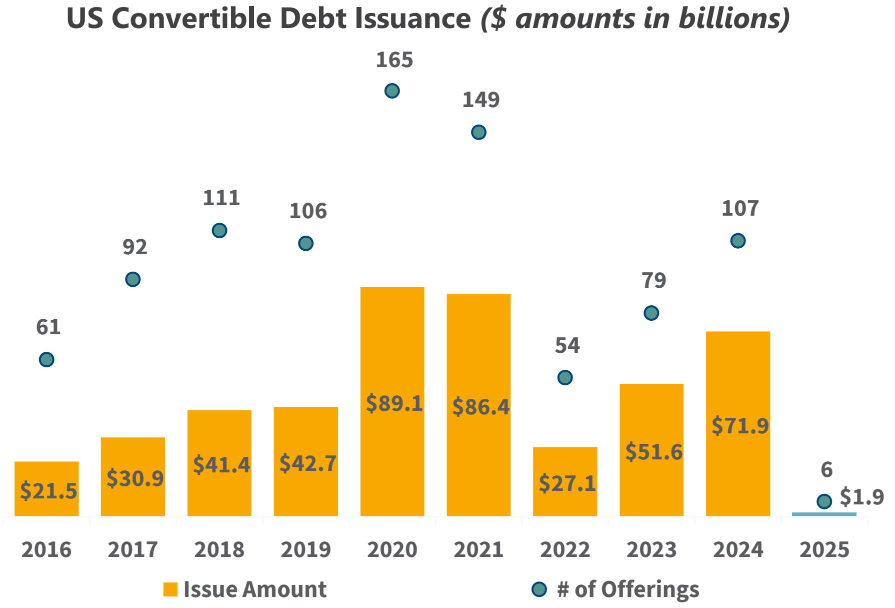
Remmelt Reigersman
Partner
Mayer Brown LLP
+1 415 874 4259
rreigersman@mayerbrown.com

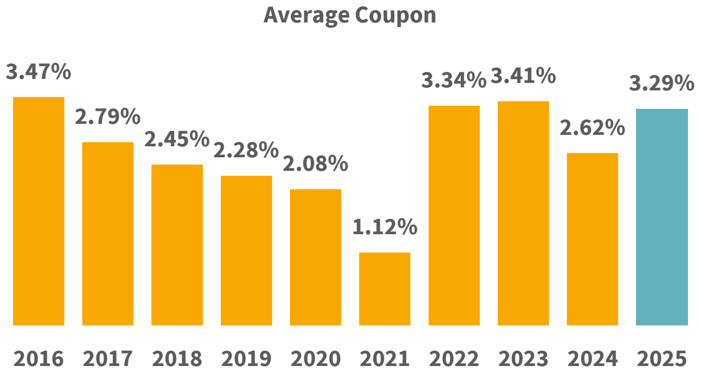
Agenda

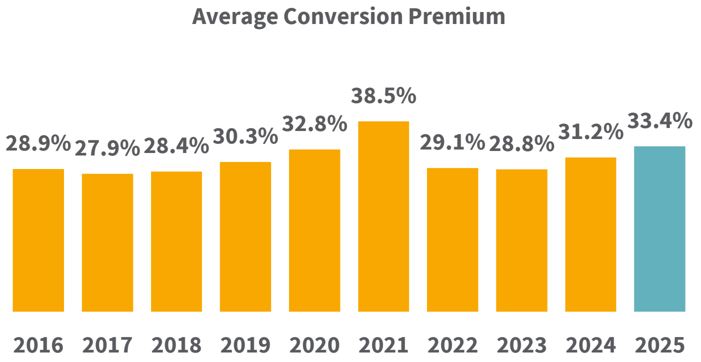
- Understanding Convertible Bonds and the Market
- Tax Considerations
- Securities Offering and Disclosure Considerations

Understanding Converts

Convertible Debt Issuance in 2024 Was Up Meaningfully after Nearly Doubling in 2023







Convertible Structures Available to Companies

- While Plain Vanilla Convertible Debt is the most commonly issued security, some companies also have access to structured solutions and convertible preferred options

	Typical Characteristics
Plain Vanilla Convertible Debt	• Senior unsecured • No financial covenants • Cash coupon below comparable maturity non-convertible debt • Conversion price set at a premium to market (option to buy-up premium via “call spread” or “capped calls”) • 3 – 7 year maturities; 5-years most common • Flexible settlement upon conversion (cash or shares) to minimize dilution • Issued as private placement via Rule 144A and marketed publicly to Qualified Institutional Buyers (“QIBs”) only
Structured Convertibles	• Similar to traditional convertible debt • 3 – 5 years maturities • Likely to contain conditions and structural features that enhance investor protections
True Private Placement Convertible Debt	• Highly structured agented private placement • Structure and terms determined by investors through a competitive process • Typically placed with small group of investors including dedicated convertible, fixed-income cross over funds, and/or private capital providers
Plain Vanilla or Debt-backed Mandatory Preferred Securities	• Equity substitute • Cumulative dividends higher than convertible debt • 3 year automatic conversion into shares

Convertible Debt Allows Companies to Minimize Interest Expense and Dilution

Bond + **Call Option** = **Convertible Bond**

Issuer agrees to…

- Pay periodic cash coupons
- Repay principal in cash at maturity

Issuer agrees to…

- Sell an embedded call option struck at a fixed price set at a premium to the stock price when the bond is issued issue

Result…

- Debt security with lower coupon cost relative to straight debt
- Ability to issue common stock at a premium to minimize dilution
- Principal amount issued must be repaid in cash at maturity if not converted

Straight Debt Cost = X
(Example: 7.50%)

Option Value = Y
(Example: 5.00%)

Convertible Coupon = X – Y
(7.50% - 5.00% = 2.50%)

Reasons For and Against Issuing Converts

RATIONALE & ADVANTAGES

- Unsecured debt; no incurrence or maintenance covenants
- Lower coupon cost relative to straight (non-convertible) debt
- Ability to issue equity at a premium
- Option to “buy up” premium and minimize dilution via derivative purchase
- Maxed out on senior leverage
- Lack of rating prohibits access to the high-yield market
- “All-in” cost of capital including purchase of the derivative compares favorably to high-yield debt
- Sizing and structure provide more flexibility than other debt alternatives
- Time to market / management marketing commitment is minimal
- Fixed coupon rate eliminates interest rate risk
- Settlement flexibility and conversion premium minimizes dilution
- Typically structured with issuer call option after 3 or 4 years
- Commonly issued via Rule 144A (no prospectus filing with the SEC)
- Broadens long term investor base (long-only convertible investors, income funds, sector buyers, arbitrage investors)

CONSIDERATIONS

- Classified as long-term debt on the balance sheet
- Periodic cash interest payments
- Principal amount must be repaid in cash if not converted prior to maturity
- Potential for share dilution upon conversion
- GAAP accounting
- No increase in the public share float / liquidity prior to conversion
- No equity credit provided by credit rating agencies (mandatory convertible preferred is an exception)

When to Consider Issuing Convertibles

Criteria	Comment / Recent Examples
Company seeking to refinance debt	• Refinancing higher cost debt is easily understood and a common use of proceeds
Company has a funding need for an acquisition	• Companies with acquisitions that have already been announced (audited financials on the target preferred) can use convertibles to repay any bridge financing
Company with history of successfully integrating acquisitions is building a "war chest" – growth capital	• A Company with a history of successful acquisitions can raise opportunistic capital with a "general corporate purposes" use of proceeds to "pre-fund" potential acquisitions
Company would like to complete a large block share repurchase	• Convertibles provide an efficient means to execute a meaningful block share repurchase at a fixed price
Company is trading near a 52-week or all-time high	• Companies with high valuations can sell stock even higher through a convertible
Company is trading near a 52-week or all-time low	• See share buyback comment above
Company has high-cost, floating rate, senior secured bank debt that can be prepaid	• Locking in fixed-rate, covenant free debt with low cash costs
Company has a funding need that can't be efficiently satisfied by one (equity or high-yield) offering	• When a Company's funding need exceeds the amount that one investor group can digest efficiently, it can combine a high-yield or equity offering with a convertible

Factors Impacting Pricing and Feasibility

- Size of offering, and therefore, expected liquidity of the new convertible, as well as liquidity of the underlying common stock are important factors investors consider when evaluating new issues

Factor	Note
Public Equity Float	• A larger public equity float benefits pricing because convertible investors perceive better common stock liquidity
Registration Statement	• Companies with an effective shelf or with WKSI status will get better pricing on the margin
Average Daily Trading Volume	• Average daily trading volume in the common stock is a measure of liquidity—which as noted above is a positive for convertible buyers. Convertible investors want to know, “how many days will it take to trade the stock underlying this convertible?”
Short Interest as a % of the Public Float	• Higher short interest as a percentage of the public float reduces the number of shares that can be lent to investors and increases the cost to borrow shares
Borrow Cost	• Higher borrow cost impacts pricing terms negatively
Common Stock Volatility	• Higher stock volatility increases the value of the embedded conversion option allowing issuers to get a higher conversion premium at pricing
Common Stock Dividend	• A higher dividend negatively impacts convertible pricing
Credit Profile	• A longer history as a financially sound growth company leads to better pricing • A stronger credit profile lowers the credit risk premium and leads to lower interest rate (coupon) on a convertible note
Offering Size	• Noticeable breakpoints exist in the convertible market as the deal size moves above $100 million – $150 million to $200 million deal size opens the transaction to ~100% of potential investors • Smaller deals are possible, but the universe of investors is smaller and pricing terms are higher (i.e. higher coupon and lower conversion premium) – additional investor protections or credit enhancements may be required
Use of Proceeds	• For a first-time issuer with no history in the public credit markets, a clearly defined use of proceeds, such as senior debt repayment, leads to better pricing

Many Convertible Debt Issuers use Capped Calls or a "Call Spread" to Increase the Premium

- A separate, over-the-counter derivative transaction that synthetically increases the conversion price of a convertible security
- The Issuer's pays for the derivative at issuance; the net cost is treated as an immediate reduction to shareholders' equity and is not periodically marked-to-market
- The derivative is worthless at maturity if the common stock is not trading above the conversion price
- Sale of the derivative is commonly conducted via a competitive auction

	Bond Hedge + Warrant ("Call Spread")	**Capped Calls**
# of Contracts	• 2 (purchased call option, sold warrant)	• 1
Cost	• Cheaper than Capped Calls due to longer-dated expiration of warrants	• More expensive than "Call Spread" because entire contract expires at the same time
Tax Deductibility	• <u>Entire</u> cost of the purchased calls ("Bond Hedge") is treated as Original Issue Discount ("OID") for tax purposes and deductible over the life of the security	• <u>Net</u> cost of the Capped Calls ("Bond Hedge") may be treated as Original Issue Discount ("OID") for tax purposes and deductible over the life of the security
GAAP Dilution during Reporting Periods Prior to Conversion	• Dilution benefit is ignored for the calculation of GAAP diluted shares • Additional dilution above the warrant strike price calculated using the Treasury Stock method	• Dilution benefit is ignored for the calculation of GAAP diluted shares • No additional dilution above the "Cap Price"

Mid and Large Cap Companies Have Been the Most Active Issuers 2024-2025YTD

Convertible Debt Issuance (in millions)

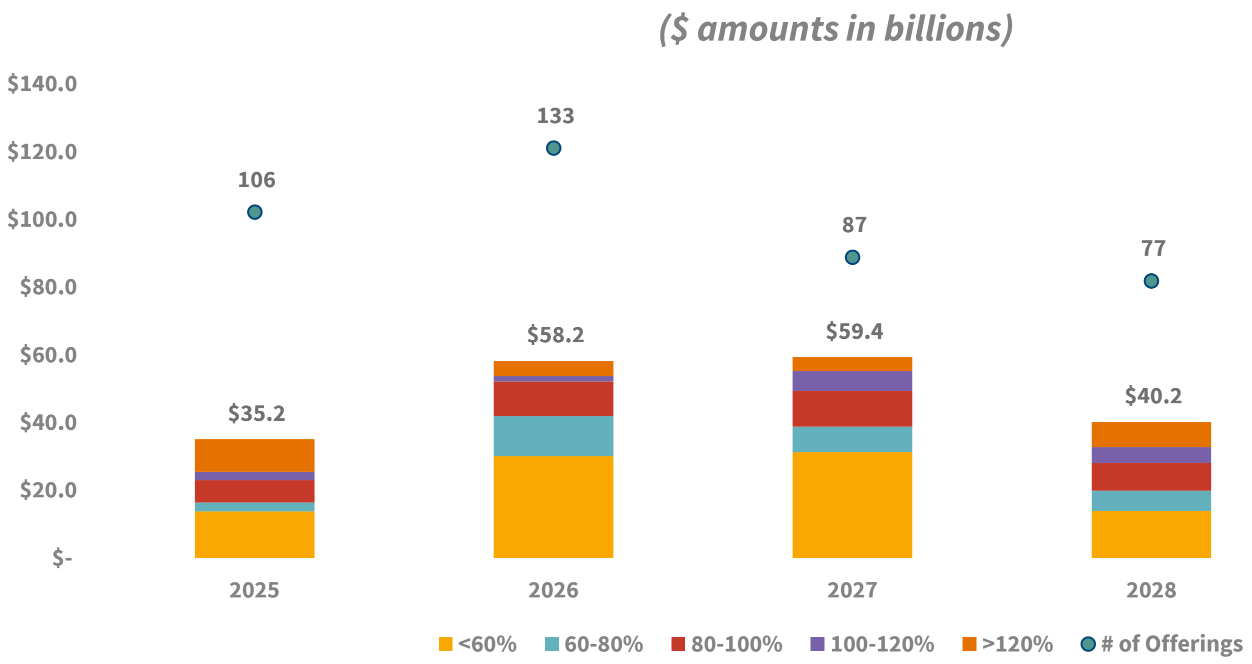
	Total			Average						
	# Deals	Amount Raised	# Deals with Hedge	Market Cap	Stock Impact (%)	Deal Size	Maturity	Coupon (%)	Premium (%)	Premium with Hedge
2024 -2025YTD	113	$ 73,806	55	$ 14,558	(6.65)	$ 653	5.1 Years	2.66	31.30	90.55
Market Cap Range:										
Greater than $10 B	30	$ 37,696	11	$ 46,008	(1.19)	$ 1,257	4.4 Years	1.65	33.40	88.64
$5 B - $10 B	15	11,353	9	7,452	(5.77)	757	4.9 Years	1.83	31.34	87.78
$2.5 B - $5 B	28	13,959	18	3,507	(5.42)	499	6.1 Years	2.19	30.27	93.06
$1 B - $2.5 B	28	8,976	14	1,676	(10.47)	321	5.2 Years	3.47	30.94	90.36
$500 MM - $1 B	10	1,568	2	707	(24.79)	157	4.9 Years	5.57	29.55	87.50
$250 MM - $500 MM	2	254	1	453	(35.14)	127	5.1 Years	4.75	27.50	100.00
Sub $250 MM	-	-	-	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Offering Size Range:										
Greater than $1 B	21	$ 32,635	11	$ 52,993	(0.62)	$ 1,554	4.4 Years	1.16	33.23	88.64
$500 MM - $1 B	33	23,004	14	12,145	(5.11)	697	5.4 Years	2.13	32.02	94.64
$250 MM - $500 MM	38	14,755	25	2,854	(7.43)	388	5.3 Years	2.92	31.22	88.20
$175MM - $250 MM	6	1,295	2	1,105	(17.28)	216	5.2 Years	4.31	23.97	100.00
$100MM - $175 MM	14	2,076	3	1,096	(14.90)	148	5.1 Years	4.37	29.53	91.67
Sub $100 MM	-	-	-	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.

Technology and Health Care Companies Have Been the Most Active Issuers 2024-2025YTD

($ amounts in millions)

	Total				Average					
Sector	**# of Deals**	**Deals with Hedge**	**Amount Raised**	**% of 2024 - 2025YTD Issuance**	**Deal Size**	**Market Cap**	**Coupon (%)**	**Premium (%)**	**Hedge (%)**	**Maturity (Years)**
Information Technology	45	25	$ 30,991	42.0%	$ 689	$ 13,273	1.75	33.70	89.06	4.76
Consumer Discretionary	6	3	9,775	13.2%	1,629	48,422	2.00	32.75	100.00	4.44
Financials	11	5	7,098	9.6%	645	12,667	3.11	27.54	95.00	5.18
Utilities	7	1	6,000	8.1%	857	37,716	4.54	20.36	50.00	7.31
Health Care	15	8	5,694	7.7%	380	2,900	2.88	31.14	87.00	5.23
Industrials	10	6	4,149	5.6%	415	3,163	3.60	35.13	87.50	5.30
Real Estate	5	1	3,820	5.2%	764	30,116	3.35	24.50	40.00	4.60
Communication Services	6	2	3,486	4.7%	581	18,842	3.21	31.25	100.00	5.39
Materials	5	2	1,640	2.2%	328	1,728	3.90	33.00	100.00	5.33
Energy	2	1	803	1.1%	401	1,913	2.69	27.50	100.00	6.01
Consumer Staples	1	1	350	0.5%	350	2,733	3.38	30.00	70.00	5.03
Telecommunication Services	-	-	-	0.0%	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Average / Total	**113**	**55**	**$73,806**	**100.0%**	**$ 653**	**$14,558**	**2.66**	**31.30**	**90.54**	**5.13**

Yearly Convertible Maturities by "Money-ness"



Refinancing "Busted Convertibles"

	Least Common	More Common		Most Common
	Registered Exchange	**Privately 4(a)(2) Exchange**	**Privately 3(a)(9) Exchange**	**"Modified" Amend and Extend**
Description	• Publicly announced exchange offering that allows the Issuer to exchange new registered convertible (and/or common stock or non-convertible) securities for existing convertibles o Registration statement filed on form S4 o Exchange offer is made to investors by prospectus o Offer is kept open for 20 days after it is announced publicly	• Confidentially negotiated and marketed transaction that allows the Issuer to exchange new unregistered convertible securities for outstanding convertibles held by a small group of existing investors.	• A transaction direct between the issuer and existing security holders that allows the Issuer to exchange outstanding securities for new securities without registration requirements **Requirements** o New and old securities are issued by the same issuer o Holder cannot be asked to give anything of value other than outstanding securities o Exchange must be done with existing holders only o No commission can be paid for soliciting the exchange o Exchange must be done in good faith	• Confidentially or publicly negotiated and marketed transaction that allows the issuer to repurchase outstanding convertibles while simultaneously issuing new registered or unregistered securities
Benefits	• Targets all current Note holders • Potential to maximize the amount of debt refinanced • Ability to incentivize investors to participate in the exchange	• Stock price not impacted during confidential marketing and negotiations • Transaction can be terminated without public disclosure • Minimal disclosure and documentation required given private placement	• No registration requirements • Stock price not impacted during confidential marketing and investor negotiations • Low transaction fees and expenses • Potential to price on an overnight basis	• Potential to increase size of offering and repurchase after public announcement
Considerations	• Common stock price is exposed to impact of exchange announcement • Must be kept open for minimum of 20 days, exposing stock price to market risk • No guarantee that investors will participate in the exchange • S4 filing subject to SEC review	• Cannot target the entire class of investors given tender offer rules • No broad marketing effort • Investors may need to buy/sell stock to adjust existing hedges • Some holders may not agree to negotiated "over the wall"	• Cannot target the entire class of investors given tender offer rules • Investors may need to buy/sell stock to adjust hedges • Issuer negotiates terms and conditions directly with investors	• Cannot target the entire class of investors given tender offer rules • Repurchase price and amount • Some investors may need to buy/sell stock to adjust hedges • Some investors may not agree to NDAs

Refinancing Deep In-the-Money Convertibles

- Instead of facing a conversion event at maturity, many companies with deep in-the-money convertibles elect to refinance with a new convertible
  - Doing so allows the issuer to:
    - Set a new, higher conversion price;
    - Set a new interest rate based on current market conditions; and
    - Push the maturity date out into the future.
  - Can be structured as an underwriting with a simultaneous cash repurchase of the old convertibles or as an exchange with or without a new money tranche
    - Investor outreach must be carefully orchestrated to avoid triggering a “creeping tender”
  - In addition to new bonds, the issuer can deliver a portion of the value owed to investors in cash, shares, or a combination thereof
    - Due to hedging dynamics amongst convertible arbitrage investors, the issuer’s stock price is likely to rise during the public marketing period (typically 1-day)
    - If the issuer is interested in raising equity capital, it can do so simultaneously with this offering, often on an overnight basis at no discount to last trade
  - Typically, the notional amount of the convertible bond increases, thus the issuer’s balance sheet must be able to tolerate the additional leverage

~21 Months

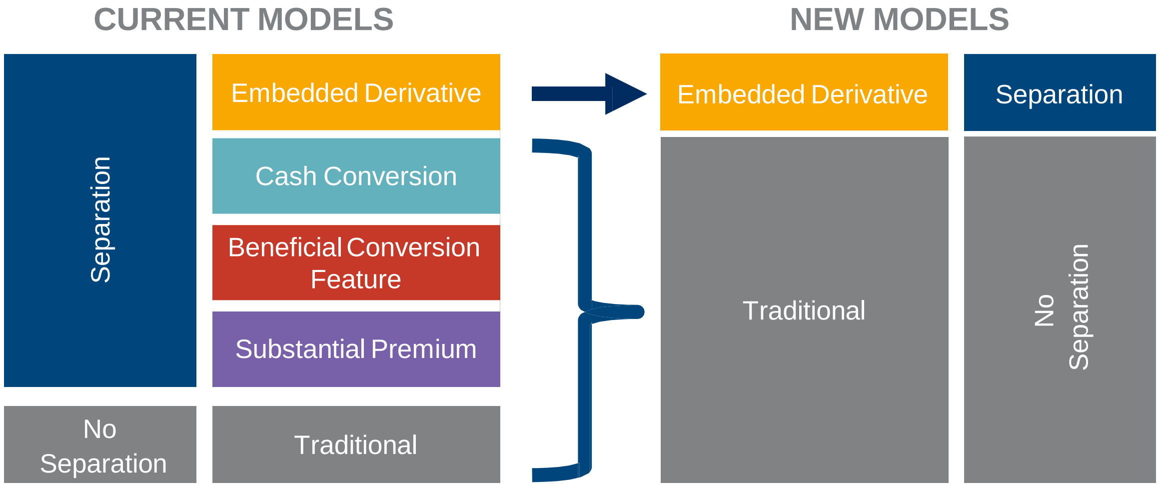
average time prior to maturity for in-the-money amend and extend transactions

20

In-the-money amend and extend transactions over the last 24 months

Convertible Accounting was Simplified

- The FASB voted unanimously to proceed with a simplified model for convertible debt accounting and has provided a final Accounting Standards Update (Debt—Debt with Conversion and Other Options (Subtopic 470-20) to formalize the change
- The effective date was for filers with fiscal years beginning after December 15, 2021



Accounting Treatment Summary

	Current Accounting	Old Regime
Net Share Settlement - Issuer agrees to settle the principal amount in cash; premium over par can be settled in cash or shares at the issuer's option		
Balance Sheet	**Not bifurcated**	Bifurcated into debt and equity
EPS	Treasury stock method	Treasury stock method
May become a current liability if conversion conditions met	Yes	Yes
"Instrument X" - Converions can be settled in cash, shares or any combination; Issuer does not specify how conversions will be settled		
Balance Sheet	**Not bifurcated**	Bifurcated into debt and equity
EPS	If-converted method	Treasury stock method
May become a current liability if conversion conditions met	No	Yes
"Plain Vanilla" - Converions settled entirely in shares		
Balance Sheet	**Not bifurcated**	Not bifurcated
EPS	If-converted method	If-converted method
May become a current liability if conversion conditions met	NA	NA

Definitions of “provisional call” and “fundamental change”

Provisional Call

- Feature that allows an issuer to redeem convertible notes for par ($1,000) prior to maturity after two conditions are satisfied:
    1. Passage of time - typically 3-years (Non-Call Period) for a bond that matures in 5-years; and
    2. Stock price trades at or above a predefined price (the “Provisional Call Trigger Price”)
        - Typically set at a 30% premium to the conversion price
- At the Provisional Call Trigger Price, intrinsic (equity) value of the notes is substantially above par value ($1,000)
- If/when the issuer exercises its call option, all rationale holders will elect to convert to receive maximum value
- Since calling the bonds prior to maturity results in early termination of the conversion option, investors are entitled to a make-whole payment (in cash or shares) to compensate for lost option value

Fundamental Change

- Events that qualify as a fundamental change include (1) a person or group acquiring 50% of the issuer’s voting common stock, (2) a consolidation or merger that results in the issuer’s stock being converted into cash, (3) liquidation or dissolution of the issuer, or (4) a delisting of the issuer’s stock from the major US exchanges
- When a fundamental change occurs prior to maturity, it results in early termination of the conversion option, entitling investors to a make-whole payment (in cash or shares) to compensate for lost option value
- Lost option value at different stock prices and points in time is estimated using an option pricing model and set out in a table (the “Make-whole Table”) when the notes are issued
    - The exact number of additional shares is determined by reference to the Make-whole Table and depends on the date of the fundamental change and the then-current stock price
    - If the stock price is below the stock price when the convertible notes were issued, holders have the right to require the issuer to repurchase the notes at par value

Make-whole example

Assumptions		
Issue Size	$	100,000,000
Reference Stock Price	$	10.00
Conversion Premium		30.00%
Conversion Price	$	13.00
Call Trigger Price	$	14.95

- If there is a fundamental change or the issuer exercises its provisional call option, convertible note holders are entitled to a make-whole as compensation for the remaining option value that is lost because of the early extinguishment of the security
- The value of the make-whole declines as time advances and as the stock price increases
- The maximum value of the make-whole occurs if a fundamental change occurs immediately after pricing of the convertible notes at a stock price that is equal to the conversion price
  - This maximum make-whole amount is the equivalent of the issuer selling shares at the reference stock price

Additional Value Owed to Convertible Holders by Virtue of the Make-Whole Table *(in millions)*

	Stock Price									
Year	$10.00	$13.00	$14.95	$15.00	$20.00	$25.00	$30.00	$40.00	$50.00	$75.00
0	$ -	$ 17.2	$ 14.7	$ 14.6	$ 10.8	$ 8.8	$ 7.5	$ 5.9	$ 4.7	$ 2.5
1	-	15.8	13.1	13.0	9.1	7.2	6.2	4.9	3.9	2.0
2	-	14.5	11.4	11.3	7.3	5.6	4.8	3.9	3.1	1.6
3	-	12.5	9.0	8.9	5.0	3.8	3.3	2.7	2.2	1.2
4	-	9.4	5.5	5.4	2.4	1.9	1.7	1.4	1.2	0.6
5	-	-	-	0.0	-	-	0.0	-	-	-

Tax Considerations

Convertible Debt

- Interest deduction for issuer, holder includes interest income
- Conversion is not a taxable event. Rev. Rul. 72-265
- The right to convert into the stock of the issuer (or an affiliate) is not a "contingency" within the meaning of Reg. Section 1.1275-4. Reg. Section 1.1275-4(a)(4). So, not a contingent payment debt instrument.
- The holder does not allocate any of its purchase price to the conversion feature. Reg. Section 1.1273-2(j).
- Issuer does not recognize gain or loss when stock is issued upon conversion. Section 1032.
- Issuer cannot deduct repurchase premium to the extent it exceeds adjusted issue price plus a normal call premium. Section 249.

Section 163(l)

- No deduction for interest on disqualified debt
- Disqualified debt
  - Payable in equity of issuer, related party or equity held by issuer (or related party)
- Payable in equity?
  - Substantial amount of principal or interest required
    - To be paid or converted, or at issuer's option is payable or convertible in such equity
    - To be determined, or at issuer's option is determined by reference to value in such equity
  - Part of an arrangement reasonably expected to result in foregoing
- Holder option?
  - Is there "substantial certainty" option will be exercised?
  - Answer: No, if "traditional" convertible bond

Convertible Bond Call Spread

- Integration Election: Reg. Section 1.1275-6 – The convertible bond and only the purchased call are integrated
  - Hedge identification requirement
- Creates a synthetic debt comprised of the convertible bond and the purchased call
  - Face: $125 mm
  - Cost of the call option: $25 mm
  - Issue Price for tax purposes: $100 mm
  - OID: $25 mm
  - Warrant price: $10 mm
- The written warrant is not integrated with the convertible bond or the purchased call
  - Warrant price
  - Section 1032
- AM 2007-014

Convertible Bond Capped Call

- Integration Election: Reg. Section 1.1275-6 – The convertible bond and the capped call are integrated
- Creates a synthetic debt comprised of the convertible bond and the capped call
  - Face: $125 mm
  - Cost of the capped call option: $15 mm
  - Issue Price for tax purposes: $110 mm
  - OID: $15 mm

Securities Offering and Disclosure Considerations in Convert Issuances and Exchanges

Offering Methodology – Convertible Issuances

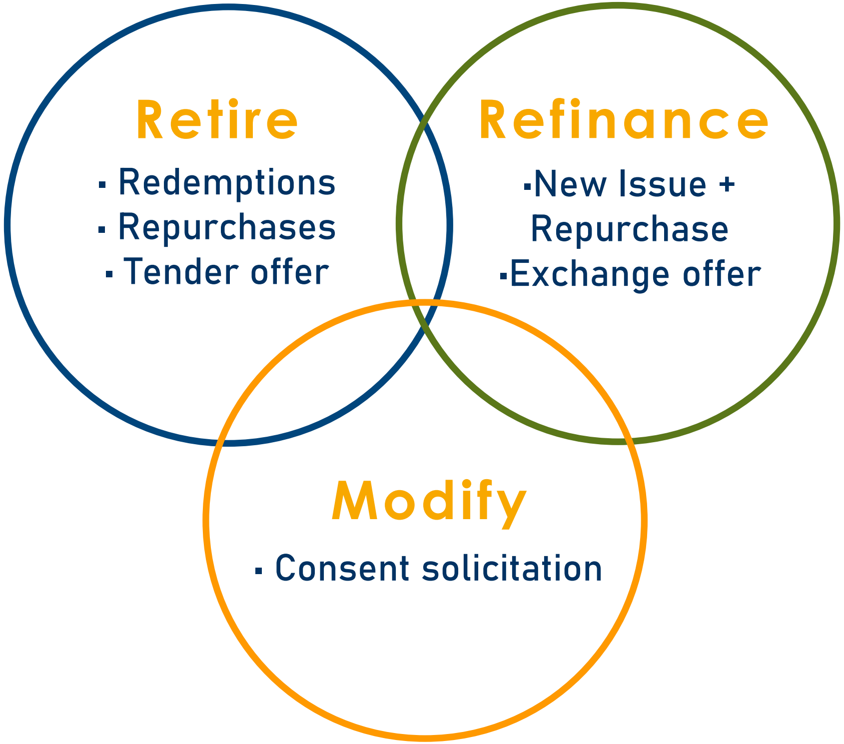
- Convertible bonds can be issued:
  - In a traditional Rule 144A offering – issuer sells notes to initial purchasers in a Section 4(a)(2) private placement, who then resell to QIBs pursuant to Rule 144A
  - In a Rule 144A-qualifying transaction - in certain instances, for example, in the event the issuer is offering the convert to finance an acquisition, it may not be possible to structure the transaction as a traditional Rule 144A offering. The investment bank may act as placement agent and introduce issuer to QIBs that will purchase directly from issuer in a Section 4(a)(2) private placement; however, the transaction will be a Rule 144A-qualifying transaction. Notes will settle through DTC and bear a Rule 144A CUSIP. Placement agent may act as settlement agent to facilitate closing.
  - In an SEC-registered offering

Offering Methodology *(cont'd)*

- More often than not, convertible notes will be issued in a Rule 144A offering
  - Rule 144A market is deep and active, route allows quick access to funding vs SEC-registered
  - Of course, for Rule 144A, the convert must have a conversion premium (to avoid fungibility issues)
  - The repurchase strategies can be executed without Regulation M concerns arising
  - Registration rights generally are not required because of shorter holding periods under Rule 144
    - Issuer will covenant to provide "current information" and indenture will provide for the Rule 144A "restricted" CUSIP to be moved to an "unrestricted" CUSIP on the one-year anniversary of issuance
    - Failure by issuer to perform such covenants would result in payment by issuer of additional interest under the convertible notes indenture: "Additional Interest;" "Special Interest" for "Reporting Event of Default"

Retiring, Replacing or Refinancing Outstanding Convertible Bonds – Options for Issuers

- Liability management/debt restructuring options are available. Consider:
  - Issuer objective: retire, refinance, modify or mix
    - Repay debt in whole or part to delever
    - Manage upcoming maturity dates
    - Reduce interest expense; modify restrictive covenant
  - Consideration to pay holders: Cash, new shares, new convertible debt, or a mix
  - Participation of existing holders vs. new investors in new deal
  - Economics: price/premium for old bonds, new coupon rate, premium for new convert
  - Timing and execution, securities and disclosure items e.g. offer of new debt implicates federal securities laws, so must be registered or exempt; sufficient authorized shares



Retiring Existing Convertible Notes: Redemption

- **Redemption**: enables issuer to shorten life of convertible bonds directly (repurchasing for cash on specified redemption date) or indirectly (forcing early conversion by holders)
- Look at terms of indenture/bond to see if redemption is allowed, conditions and mechanics
  - Issuer's ability to redeem usually subject to conditions or triggers, for instance, a certain non-call period, coupled with a provisional call trigger price is quite common (*e.g.* 5NC3)
    - Can call beginning year 3, if stock price is at least 130% above conversion price during specified trading period
  - Comply with required minimum notice periods; pay redemption price and any make-whole
- Holder in turn can choose to convert, usually at a make-whole, rather than being redeemed
  - Redemption cuts interest payment stream, reduces time value in embedded option
  - Sending by issuer of optional redemption notice usually considered a "make-whole fundamental change", which entitles holder to convert and receive a make-whole payment (*e.g.* additional shares in MW table); this leads to a higher conversion rate
- In turn, issuer may elect method of conversion settlement: physical (shares), cash or combination settlement

Retiring Existing Converts: Cash tender offers and open market repurchases

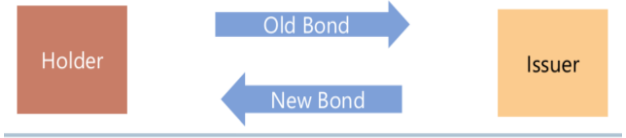
- **Cash Repurchases:** open market or privately negotiated purchases of outstanding debt for cash
  - Can negotiate purchase price directly or engage a financial intermediary to negotiate and effect open market repurchases
  - Structure so that offers to repurchase are made: for a limited amount of securities; to a limited number of holders (preferably sophisticated investors); with no pressure for holders to sell and over an extended period of time; at prices privately and individually negotiated; and with offers and acceptances independent of one another.
- **Tender offers:** offer made to holders to purchase outstanding debt securities for cash
  - Offer may be for "any and all" of the outstanding securities of one or more series or may be for a maximum principal or purchase amount
  - Must generally be held open for 20 business days
  - Note: 5-day Abbreviated Tender offer process under SEC Staff's January 2015 no-action letter guidance is for <u>non-convertible </u>debt, not convertible debt

Modifying Existing Convertible Notes: Consent Solicitations

- **Consent Solicitation** – Issuer solicits consent to amend the terms of the indenture governing outstanding debt securities
  - Issuer seeks consent of a specified threshold/number of holders of notes, which consent would allow issuer to amend the notes
  - Usually, consent of 100% of holders is required to reduce principal or interest rate or amend maturity date
  - Stand-alone consent solicitation/indenture amendment usually not sufficient
  - But can use in conjunction with other refinancing options.
    - E.g. Exit consent to a covenant strip – in conjunction with a debt for debt or debt for equity exchange or swap
      - Usual threshold is just majority consent, instead of unanimous consent
      - Consent given by tendering holders (who are about to give up securities) and bind non-tendering holders; avoids the "hold-out" problem

Refinancing Existing Convertible Notes

- **New Issue plus Repurchase**
  - For instance, a Rule 144A convertible bond issuance, the proceeds of which will be used to fund cash consideration payable to existing holders to repurchase existing convertible bonds
  - 144A piece can be open to new investors as well as old/existing investors being repurchased
- **Private Exchange Offer** – Issuer offers investors to exchange their existing securities for a new series of securities (e.g. debt: for debt, for shares, or for debt, shares and cash, etc.)
  - Can be conducted pursuant to Section 4(a)(2) and made to sophisticated investors, usually QIBS; private placement with no "general solicitation"
  - Can also do under Section 3(a)(9): "any securities exchanged by the *issuer* with its *existing securityholders exclusively* where *no commission* or other remuneration is paid or given directly or indirectly *for soliciting such exchange*." 3(a)(9) exchange requires:
    - Same issuer
    - No additional consideration from holders
    - Offer only to existing holders
    - No remuneration or commission for solicitation of the exchange



Refinancing Existing Converts: Additional Considerations

- **Tacking holding period from old to new convert**
  - New securities assume character of old securities exchanged in a 3(a)(9) exchange.
  - So if old are restricted securities, then new are also restricted but tacking of holding period of old to new is allowed. See C&DI Question 125.08
- **More on 3(a)(9) exchange offers**
  - Note the *no remuneration for solicitation* prong; but SEC has allowed fixed financial advisory fees for services (not contingent on success of exchange) under certain conditions
  - Indenture not exempt from Trust Indenture Act qualification requirement; may required a Form T-3 filing; consider if other exemption available (*e.g.* 4(a)(2))
- **Logistics and Funding in Private Exchanges**
  - Wall-Cross Procedures and Confidential Marketing
  - Closely coordinate with old and new trustees, transfer agent for shares, custodians/brokers
  - Funds and securities flow memo: wires for cash, DWACs for securities etc.

Securities Exchange Listing Rules

- 20% Rule: NYSE and Nasdaq listing rules require prior shareholder approval of transactions that may result in issuance or sale of 20% or more of a listed company's common stock or voting power (including equity-linked securities such as convertible notes)
- NYSE has exemptions for (1) "any public offering for cash" and (2) non-public offering issuances made for cash, and at least at the "Minimum Price". Nasdaq has substantially similar exemptions.
  - "Minimum Price" is defined as the lower of: (i) the official closing price of issuer's common stock immediately before the execution of the transaction agreement and (ii) the average official closing price of issuer's common stock during the five days immediately preceding the transaction agreement.
- Generally, initial issuance will not require shareholder approval given that convert will be issued at a premium to common stock closing price, so will satisfy "Minimum Price".
- Both exchanges consider as well the potential, in the case of exchangeable securities, for shares to be issued in excess of the 20% threshold. As such, a blocker provision may be required to be included in connection with certain conversion adjustments.

Fundamental Change and Make-Whole Fundamental Change

- Converts have "fundamental change" and "make-whole fundamental change" provisions
  - *E.g.* Fundamental Change: (1) a person or group acquires more than 50% of issuer's voting common stock, (2) sale of all or substantially all of issuer's assets to any person, (3) consolidation, merger or transaction resulting in all of issuer's stock being exchanged or converted into securities, cash or other property and there is a change of control, (4) issuer liquidation or dissolution, or (5) delisting of issuer's stock from US exchanges
    - Exception: for 1 and 2, if at least 90% consideration received by shareholders is in the form of common stock listed on US major exchange
- The occurrence of a fundamental change gives noteholders a put right
  - Holders can require issuer to repurchase their notes for cash at 100% principal amount, plus accrued and unpaid interest up to the repurchase date

Fundamental Change and Make-Whole Fundamental Change *(cont'd)*

- Almost always, a "fundamental change" is also a "make-whole fundamental change" that entitles a noteholder to convert the notes at a higher adjusted conversion rate based on the make-whole table in indenture
  - "Make-Whole Fundamental Change" is generally defined to include a "fundamental change"
  - Sending by issuer of an optional redemption notice for the notes also considered a "make-whole fundamental change" in most indentures
- So the noteholder has the option either to (1) exercise the put (and require issuer to pay cash at the principal amount of notes), or alternatively, (2) convert the notes at the make-whole fundamental change adjusted conversion rate
  - Issuer may in turn, elect the method of conversion settlement: physical, cash or combination settlement

Conversion Price, Conversion Rate and Conversion Rate Adjustments

- Conversion Price = dollar amount needed to receive one common share upon conversion; effective dollar price paid per underlying common share
- Conversion Rate = number of shares into which each $1,000 principal amount of notes is convertible
- Example:
  - Reference price: $20 per share
  - Initial Conversion Price at *e.g.*, 25% premium over reference = $25 per share
  - Initial Conversion Rate = $1,000 principal amount of notes divided by conversion price
    - = $1,000 divided by $25 per share = 40 shares per $1,000 principal amount of notes

Conversion Rate Adjustments *(cont'd)*

Initial Conversion Rate is adjusted (and hence conversion price too) as a result of specified corporate events during life of notes. Indenture will have formulas for:

- Anti-dilution adjustments
  - *E.g.*, Stock splits, stock dividends, stock combination
- Adjustments to compensate noteholders for distributions of value to others
  - Adjustments for cash dividends, spin-offs
  - Adjustments for the issuance of rights, warrants
  - Adjustments for other in-kind distributions
  - Adjustments for issuer self-tenders
- Make-whole adjustments

Additional Resources

VISIT OUR BLOG

SCAN HERE!

OUR FREE WRITINGS & PERSPECTIVES BLOG PROVIDES NEWS AND VIEWS ON SECURITIES REGULATION AND CAPITAL FORMATION.

The blog provides up-to-the-minute information regarding securities law developments and commentary on developments relating to private placements, IPOs, and other securities related topics.

ALSO VISIT OUR ILLUSTRATED SECURITIES GLOSSARY

CLICK HERE!