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Will the impact of COVID-19 trigger an increased volume of PIPE investments in the UK?

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Whilst the COVID-19 global pandemic (and the widely predicted economic downturn to follow) will inevitably require investors to be more creative in sourcing investments, there are some areas – such as minority investments in public companies at discounted values – which could provide a more readily available form of investment than has historically been the case. Recent developments in the UK public markets show encouraging signs for UK PIPE deals during the pandemic period.

Private investments in public equity, often colloquially referred to as "PIPEs" – can take many forms, but typically involve an investor acquiring a non-controlling stake in a listed company through the issuance of convertible bonds or shares or listed ordinary shares (or a combination), at a discounted equity price to the current market. It enables the investor to be protected in a downside scenario whilst also being able to participate in the equity upside. The form of investment and the accompanying rights sought will be influenced by the investors' strategy for wanting to participate in the PIPE and the issuer's financial situation and capital structure.

Whilst PIPEs are more common in the U.S. and volumes continue to increase there as a result of public companies looking to raise capital to see them through the effects of the pandemic (with public companies reported to have raised over $60bn YTD 2020) and investor appetite to make similar investments in UK public companies definitely exists too, for a number of reasons volumes in the UK have historically been much lower. Some of the regulatory challenges are summarised below.

Regulation and guidance relevant to PIPEs in the UK	
Shareholder approval requirements for non-preemptive issues	Listed companies arrange annual pre-approvals at their AGMs to issue up to a certain percentage of their current issued share capital on a non pre-emptive basis. The IPC guidelines suggest that this threshold should not exceed 5%. Whilst Main Market companies tend to adhere to these guidelines, AIM companies often seek authorisation to issue up to 20% on a non-pre-emptive basis. If a company wished to issue additional 'equity securities' (which includes shares, warrants, options and convertible instruments) above the pre-authorised threshold, it would need majority approval of 75% to disapply pre-emption rights prior to offering such equity securities to new shareholders.
Restrictions on discounts	With respect to Main Market companies, the Listing Rules restrict issuances at a price representing more than a 10% discount unless shareholders approve by a simple majority. IPC Guidelines further restrict this threshold to a maximum of a 5% discount if shares are being issued on a non-pre-emptive basis. Again, an ordinary resolution would be required to issue in excess of the threshold.

Prospectus requirement	Companies listed on the Main Market are limited to issues of 19.9% of their share capital without an FCA-approved prospectus being produced (note this restriction does not apply to AIM although any offer which is considered to be an offer to the public will still require a prospectus). Preparation of a prospectus can be a long and costly process.
Takeover Code	Investments which may result in the investor holding 30% or more of the voting rights of the issuer require the investor and issuer to release a circular to shareholders and get their and the Takeover Panel's consent to the issuance to avoid the need to make a mandatory cash offer for all the remaining shares when the shares are issued (a 'Code whitewash'). If the transaction does require a Code whitewash, the Takeover Code restricts the obligations an issuer can be subject to in the context of that transaction.
Lock-up & Standstill and other restrictions on trading	Investors are often required to agree to a lock-up and standstill terms for a period of time. Lock-up periods are typically six to 12 months depending on the size of the stake. An investor will need to consider whether any nominee it appoints to the board of the issuer is walled off to ensure it does not receive material non-public price sensitive information such that it is restricted from trading. Any nominee appointed to the board will also be subject to the issuer's share dealing code and will be under an obligation to procure its PCAs (persons closely associated) also do not deal. Issuers' share dealing codes often go beyond what the market abuse regulation requires but in any event the PCA definition under the market abuse regulation is broad and may capture the investor itself.
Information	Restrictions on dissemination of inside information means limited detailed due diligence can be conducted without a delay to the investment. Also, once in receipt of material non-public information, the investor cannot trade until the information is cleansed by the issuer by release to the market.
Fund constitutional restrictions	Significant minority investments in publicly traded companies outside of a P2P strategy are not always permitted by a fund's investment mandate. The fund documents should be reviewed for any restrictions.
Limited governance rights	A board seat is typically only awarded if an investor's shareholding is greater than 15%. Consent rights are rarely granted. In addition, depending on the percentage held, the investor may be required to enter into a relationship agreement with the issuer to ensure the issuer is able to continue to operate independently notwithstanding the significant shareholding of the investor.

UK issuers have therefore instead been largely to date reliant on underwritten general offers to its existing shareholder base

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and/or private placements within the limits of the permitted non-preemptive issue authorities when in need of capital. Whilst there is more flexibility on the AIM market, the opportunities to deploy sizeable cheques are more limited.

There are signs however that the UK market is opening up to PIPE deals if issuers can also manage existing shareholders' concerns about dilution.

In recognition of the need for capital to see out the effects of the pandemic and the limitations of the UK regulatory regime, the FCA and investor guidance groups have both announced measures to facilitate issuers' easier access to capital:

Shareholder approvals encouraged	PEG (the Pre-Emption Group, an institutional shareholder guidance group) has recommended that shareholders should consider supporting issuances by companies of up to 20% of their issued share capital rather than the usual 5%, however it continues to expect issuers to consult with major shareholders and for pre-emptive issues to be made where possible. The guidance will be renewed on 1 October 2020.
Prospectus requirement relaxed	The FCA has encouraged the use of a shorter form prospectus with its simplified disclosure regime when possible to limit the time and cost of preparation.

Until very recently, UK public companies have raised capital from a subset of existing shareholders rather than new investors. Notwithstanding the regard had to limiting the dilution suffered by at least larger shareholders, taking advantage of the new regulatory guidance does still come with market scrutiny. Both Foxtons and The Restaurant Group were still criticised by the investor guidance group ISS for taking advantage of the relaxed guidance and using it to raise capital on a non-pre-emptive basis despite, in their view, there being no immediate liquidity concerns. The suggestion is these measures are available to avoid imminent distress rather than to enable an issuer to take proactive preemptive steps to shore up its balance sheet. In the last few days, SIG has announced a PIPE whereby Clayton Dubillier & Rice will invest in new ordinary shares alongside a general offer to existing shareholders. CD&R are guaranteed a minimum investment amount which should deliver a shareholding in the region of 25% of the enlarged capital. It will be able to appoint 2 directors and will be subject to a relationship agreement with SIG. The transaction remains subject to shareholder consent. The SIG/CD&R transaction represents as close to a traditional US PIPE transaction as has been seen in the UK market for some time and may represent a wave of distressed companies impacted by COVID-19 accessing strategic capital in this way.

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