LOS ANGELES & SAN FRANCISCO
Daily Journal
www.dailyjournal.com

THURSDAY, APRIL 16, 2020

PERSPECTIVE

Raising capital in uncertain times

By Sara L. Terheggen

Given the rise of the coronavirus disease 2019 pandemic, it is safe to assume the world as we know it has changed and even a return to some level of normal is likely to be a very different type of normal than what existed pre-COVID-19. Individuals scramble to ensure the safety of themselves and their families. Businesses are struggling to ensure their place in the list of priorities of their employees while also managing a number of pressing stakeholder needs. It is no wonder that capital markets are struggling to stabilize.

While all companies, both private and public, and private funds, may have calculated certain contingencies into their budget and overall cash flow plan, it is safe to say that no company or fund was adequately prepared for this type of disaster on this scale. At this juncture, companies and funds will need to analyze and strategically assess all possible avenues of funding to optimize cash flow and prepare themselves to maximize their ability to take advantage of any upswings in the market as those transaction execution windows become available.

Shutterstock

Strategies for Raising Capital

Public Companies

For public companies, executing any kind of capital markets transaction in the current environment is a difficult challenge. Some companies have seen their stock price hit hard and the violent turbulence in the market would make it difficult to effectively price a transaction. Depending on when a company filed their 10-K, the baby shelf rules may also impose caps on the amount a company can raise thereby increasing the difficulty in executing a transaction. To maximize opportunities, companies can undertake several steps now to prepare.

File an S-3 (if needed). Companies have historically been concerned about filing an S-3 for fear that their stock price would take a hit. Now is the best time to file an S-3 since the market is currently preoccupied. The SEC has provided some relief with respect to deadlines for public company periodic filings. Subject to certain requirements and the filing of an 8-K or 6-K to communicate the company is relying on the relief, companies have an additional 45 days from their original due date to make their filings. That said, many companies will need their 10-K filed in order to get an S-3 effective so companies should be focused on forging ahead with their 10-K filings as quickly as feasible keeping in mind the important disclosure concerns discussed below that will need to be addressed for their 10-K and 10-Q filings and will also need to be addressed in the context of an offering document.

Review risk factor and MD&A disclosure carefully. Companies are wise to use the preparation time to expand their risk factor and MD&A disclosures. The impact and exposure of COVID-19 for companies is much broader and widespread than initially envisioned. Given the pervasiveness of the pandemic, it is critical that companies evaluate how their business will be impacted and disclose such risks. While many companies are still very uncertain about the magnitude of the impact, it is rare for there to be no impact regardless of industry.

Consider whether guidance needs to be updated. No public company likes to revise its earnings guidance downward, but the COVID-19 pandemic has certainly created a material development for several companies. Companies should consider whether earnings guidance should be updated or withdrawn in light of the new development, as well as the appropriate time to do so. In addition to continuous monitoring of the impact, keeping abreast of one's competitors is also a helpful guide.

Diligence. Regardless of what kind of capital raising transaction is intended, underwriters and placement agents are going to need to conduct standard due diligence. Companies can use the preparation time to request from their own legal counsel a standard due diligence request list and organize a data room for use by underwriters (or investors if a company is contemplating some type of private placement).

To the extent a public company is able to find a palatable window to get a deal done, it is best to be as prepared as possible, including vetting all disclosure issues now, preparing the necessary offering documents and getting ready generally to execute on a transaction as soon as a window presents itself.

Private Companies

For private companies, this is a pretty critical period. Rarely do small private companies, especially startups, have cash on hand to weather a crisis of this nature. Many are just flat running out of cash. They are also concerned about valuation when seeking to raise their next round of capital. For these companies, the preparation strategies are a bit different although disclosure is still a key consideration.

Runway. Before seeking to do any fundraising activity, the key is to get a handle on the runway and make appropriate operating budget cuts where possible to lengthen the runway as long as possible. It will be important to show potential investors that they are taking a disciplined and appropriate response. Further, it may take longer to get a financing done so it is important to be able to survive as long as possible to maximize success.

Disclosure and Diligence. Similar to public companies, private companies are going to need to be prepared to be candid with investors about the impacts of COVID-19 and provide appropriate diligence. Disclosure is a really difficult task for these companies who are weary of showing any signs of weakness or slowdown in their businesses. Investors are likely to be more focused on diligence than they were previously for start-ups as they will want to ensure business models are shored up, financials are solid, and budgets are intact and responsive to the situation. It is important to be transparent and accurate when communicating with investors.

Existing Investors. For private companies, it will be helpful to reach out to existing investors who have been large supporters to see whether they can get an additional investment to provide some additional runway before raising their next round.

For companies who are pre-IPO, COVID-19 has put a damper on IPO debuts forcing many companies to delay. However, depending on the company and the industry, it is possible to get an IPO done in this market with virtual roadshows. Companies should recognize that the pricing may be more discounted than in a typical market so they may be more likely to price at the lower end of their pricing range. Even start-ups who are just raising another round of financing should be prepared for investors to request larger discounts to invest and this may force many private companies to have a down round but having capital during this time should take precedent over concerns about a down round if survival is at stake.

Private Funds

For funds, there has definitely been an impact on fundraising but COVID-19 has not completely stopped these activities. Thus far, it seems that it is just taking longer due to a variety of things, including bans on travel, rescheduling of meetings and delays in finishing diligence. First time funds may have a more difficult time due to the lack of in-person meetings, but strategy can help to maximize success.

Disclosure. Similar to public and private companies, fund have to ensure their private placement memorandum is updated to reflect appropriate risk factors. For funds, disclosure can be more nuanced as funds are one level removed from the frontline in certain respects because it is ultimately their portfolio of companies who are experiencing the direct impact of COVID-19. However, funds have the unique challenge of having to obtain financials from their portfolio of companies and aggregate to report results to their own stakeholders, their limited partners. Limited partners are seeking feedback on how COVID-19 will impact portfolio company valuation marks and overall fund performance. Appropriate disclosure around the risks of these impacts and ultimate potential impact on valuation should be front and center in any fund offering document.

Diligence. Funds can ease diligence processes by preparing responses to standard investor diligence questions, setting up electronic data rooms, scheduling phone calls and video meetings and setting up electronic subscription documents to facilitate and hopefully speed up the investment process.

As with private companies, funds may need to submit to more diligence inquiries, and it may take longer to close an investor commitment. Investors may also be more prone to ask for lower management fees, better economics on carry and other economic concessions as investors see this time as an opportunity to get better terms on all of their investments and funds are no exception to that. Generally speaking, depending on investment strategy, funds are faring better in this turbulent market due to a plethora of investment opportunities at discounted rates with much potential future upside.

Be Strategic, Be Prepared to Execute: Keys to Survival

Regardless of whether you are a public company, private company or private fund, it is likely that COVID-19 is impacting your business and bringing forth questions of how best to maximize capital in an uncertain environment. It is important to not be paralyzed by the current events but rather think creatively about how best to approach your respective business, communicate with honesty and transparency to key stakeholders and maintain as much momentum as is possible on your capital raising efforts. Being strategic, vigilant and focusing on preparing for execution while maintaining an open line of communication with key stakeholders are strategies that never go out of style regardless of what may come. ■

Sara L. Terheggen, Ph.D., J.D. ("Dr. T") *is the founder and Managing Director of The NBD Group, Inc., a leading legal and business solutions firm. Dr. T has advised on transactions with an aggregate value of more than $100 billion and she has been recognized more than 40 times for her professional expertise and leadership.*