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PERSPECTIVE

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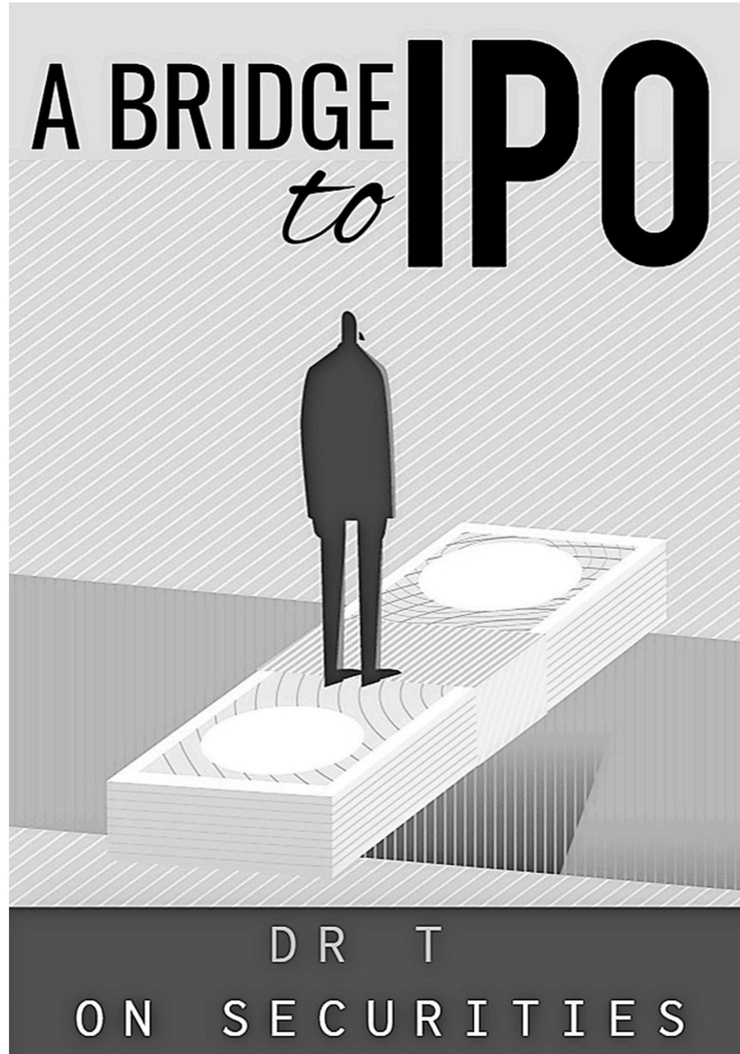
Because many companies are waiting longer to go public, it is becoming increasingly common to conduct a private bridge financing in advance of an initial public offering.

There can be many reasons why a company needs or wants to do a private bridge financing before their public IPO. These reasons can include cleaning up the cap table if this was not otherwise accomplished during a company's prior series rounds. It may simply be a path to padding the company coffers to help pay for expenses, such as bringing in key and necessary hires prior to the IPO and paying for advisor costs. It can also be a strategic move to identify key investors who would be crossover investors for the IPO; or allow a company to really hone their story to identify key investor concern areas that can be shored up prior to their debut.

Bridge financings can also be a lucrative opportunity for investors, providing investor friendly terms, access to the hottest upcoming IPOs and opportunities to explore new sectors to get educated prior to making similar investments in public companies. As more companies participating in bridge financings has increased, so has the potential investor base interested in such opportunities. Investors see the bridge financing as a less risky investment than traditional venture capital because the prospective time horizon for a return is much shorter and more certain.

Recent Securities and Exchange Commission rules around integration have also eased concern around conducting a private bridge prior to an IPO. New rules in late 2020 eliminated the six-month window that used to be required to avoid integration of two offerings and now a company can execute a private bridge all the way up until 30 days prior to the commencement of their registered IPO without fear that their private bridge will be integrated with their public IPO.



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Breaking Down the Bridge

Generally speaking, and compared to other types of capital raising options, a bridge financing before an IPO is straightforward. The rights and privileges can differ from company to company but there is generally one consistent theme: The terms tend to be investor-favorable which can make these investment opportunities quite attractive. Let's break down the typical terms.

Form and Issuance: It is typical for the shares issued in a private bridge financing to be preferred stock, most often with a redemption quality and a conversion quality. An alternative can be to structure as debt that looks like equity although this type of instrument generally provides less upside potential in the context of an IPO.

Conversion Rights: Most bridge financing instruments will contain an automatic conversion feature whereby the preferred stock automatically converts to common stock in connection with the IPO or other exit event, such as a merger.

Liquidation Preference: The liquidation preference is typically senior to other preferred stock as well as common stock and generally includes all the accrued and unpaid dividends as part of the liquidation value.

Dividends: Preferred stock issued in connection with a bridge financing commonly accrues a fixed dividend. Dividends in these late-stage financings are often cumulative and compounding allowing investors to effectively earn a dividend on the accrued. If not paid out in cash, it is common to have a convertible feature allowing the dividends to also convert to shares. In some cases, bridge financing terms can include PIK dividends which are special and often punitive dividends paid when certain obligations are not met, such as a requirement to go public, provide a resale registration statement or list on a national securities exchange, in each case, by a certain date.

Redemption Rights: Redemption rights are often seen as a backstop protection. Effectively, these provisions typically provide investors with the right to request redemption

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of their preferred stock if the IPO does not happen (or some other exit event) within a specified period of time (often 12-24 months).

Preemptive Rights: Investors will often want preemptive rights to avoid dilution especially in any financings leading up to the IPO.

Board Representation: In a bridge financing, it is not common for an investor to seek or get board representation although standard minority protective provisions built into the preferred stock rights is often seen.

Lock-Ups: It is important for investors in a bridge to understand that there is a high likelihood that they will be subject to a lock-up following the IPO (typically six to 12 months). A lock-up is intended to provide some level of stability in the company's stock following an IPO by avoiding a scenario where multiple early and late-stage investors are dumping their stock as soon as able. It is quite common for bridge financing investors to obligate themselves to sign such a lock-up. Although not on its face an investor friendly term, it is common and very typical in the context of bridge financings.

Executing a Bridge

Executing a bridge can be pretty straightforward and many companies will enlist the assistance of an investment bank as a placement agent. Once a banker is engaged, diligence and marketing efforts ensue. Companies will be required to put together a data room with diligence materials and the company and banking team will prepare marketing materials for the bridge (which typically include a teaser and a presentation very similar to a roadshow deck). While companies may view this added work as challenging especially in a time they are ramping up to their public debut, the work done for a bridge is not duplicative from a diligence or marketing perspective so executing a bridge can actually give a company a head start on these key IPO tasks.

While data room is set up and marketing materials are prepared, counsel on both sides will work to prepare a term sheet outlining the contemplated transaction structure for the bridge including determining which of the rights outlined herein will be included and the parameters for each. The bankers will then generally begin outreach utilizing the marketing teaser. Interested investors will execute a confidentiality agreement and then be given access to diligence materials as well as an opportunity to review the presentation and transaction term sheet.

As the investor engagement process continues, feedback on the term sheet will naturally occur and investors will have the opportunity to voice their requests on deal terms. Depending upon the size of their contemplated investment, these comments may be entertained. Once the pool of investors is identified and term sheet finalized, counsel will then draft the definitive agreements and close the bridge.

Bridge to the Big Leagues

Bridge financings offer companies and investors several advantages. For companies, a bridge may be a vital strategic and financial tool that provides both critical feedback and dollars. A bridge is also a great preparation technique for an IPO as it provides companies with a practice run of sorts prior to an IPO. For investors, a bridge can be a great investment opportunity albeit not without risk. In the path towards a public IPO, a bridge provides companies with a golden opportunity to see if they are cut out for the big leagues.

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