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ATM Offerings and Equity Lines:

Three Differences Issuers Need to Understand

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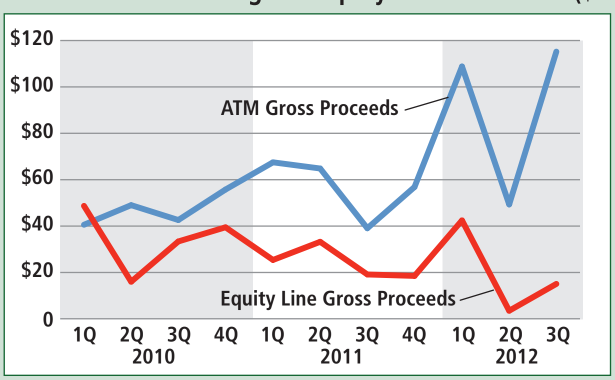
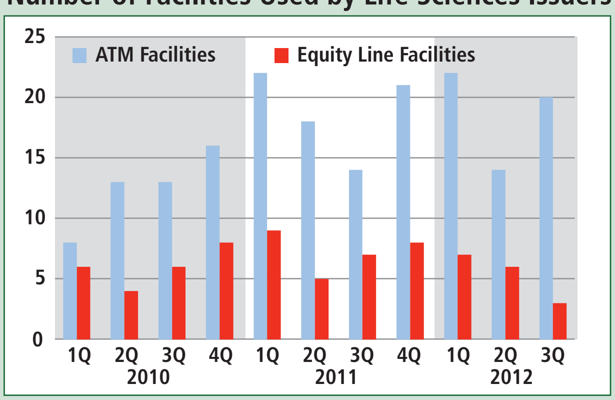
At-the-market (ATM) offerings and equity line facilities are methods of raising capital that publicly traded issuers in growth industries such as biotech have been using for a number of years. These issuers have been seeking additional ways, other than the traditional PIPE or registered direct offerings, to raise capital that lowers their cost of capital and gives them additional flexibility in accessing the capital markets. The following graphs illustrate the trends in usage of ATMs and equity lines over the last three years in the life sciences industry.

Life Sciences ATM Usage vs. Equity Line Drawdown ($M)



Source: Brinson Patrick Securities

Number of Facilities Used by Life Sciences Issuers



Source: Brinson Patrick Securities

At first glance, ATMs and equity lines appear to be very similar. People often confuse these two methods of raising capital. Not understanding the differences can have significant implications.

An ATM allows a publicly traded company to sell newly issued shares off of a registration statement directly into the existing trading market through a broker-dealer acting as an agent on behalf of the company. The amount and timing of sales into the existing trading market are determined by the company. For each share sold, the company receives the then-current market price at the time of each sale. These sales often take place over an extended period of time.

An equity line is an agreement between a publicly traded company and a capital provider that gives the company the ability to periodically sell shares to the capital provider at prices determined by a formula that usually references market prices. Sales under an equity line can occur during the term of the agreement – usually 18 to 36 months.

While the descriptions above of ATMs and equity lines sound similar. Let's take a closer look at the differences.

Conditions to use the facilities

The transaction documents for ATMs and equity lines contain the customary representations and warranties often found in underwriting agreements. Unlike ATMs, equity line facilities usually contain additional conditions that might limit their use for issuers. For example, equity line agreements usually contain a "floor price". If the company's stock price trades below the floor price then then the equity line facility is not available to the company. Equity line agreements also limit how much stock the company can sell to the capital provider in any given period. In a number of scenarios, stock exchange shareholder approval requirements (20% rule) can further limit a company's use of their equity line. Although equity lines are thought to be "committed" facilities, a number of issuers have learned over the years that their equity line facilities were not available when they wanted to utilize them.

Method for determining issuer's stock sales prices

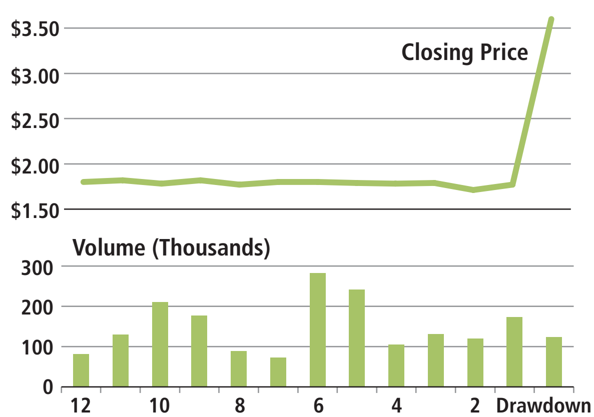
In an ATM, shares are sold at the current market price at the time of each sale. Issuers simply receive the market price for each share sold less a fixed commission from the ATM underwriter.

On the other hand, equity lines often have complicated pricing formulas. Sometimes these formulas mask the true cost of capital. The following is an example of a pricing formula that might be found in an equity line:

> "Purchase Price" means the lesser of (i) the lowest Sale Price of the Common Stock on the Purchase Date or (ii) the arithmetic average of the three (3) lowest Closing Sale Prices for the Common Stock during the twelve (12) consecutive Business Days ending on the Business Day immediately preceding such Purchase Date

One of the perceived benefits of this type of formula is that the sale price is known to the issuer at the time the drawn down notice is delivered because the formula is backwards-looking. There is also no stated discount in the formula. Using the purchase price formula above, let's look at the effective cost of capital in one of the scenarios where an issuer might want to raise capital.

The following price and volume graph might represent that of an issuer that announced good news such as clinical trial results or feedback from the FDA. The lowest sales price



on the purchase date is $3.25 and the average of the three lowest closing prices over the past 12 days is $1.79. Using the purchase price formula above, the sales price under the equity line would be $1.79 although the issuer's stock price is trading at $3.53. This represents an effective discount of 49%, which is highly dilutive.

On the other hand, if this issuer started using an ATM on the purchase date, their net sales price on that day would be approximately $3.42 (current market price minus ATM underwriter commission of 3%). The issuer and its shareholders would enjoy the benefits of the increased stock price and avoid the unnecessary dilution cause by the complicated equity line pricing formula.

Upfront warrants or commitment shares

Many times equity line facilities include warrants or commitment shares that the issuer pays to the capital provider upon setting up the facility. The value of the commitment shares can be 1% to 5% of the total value of the facility. The shares are paid to the capital provider regardless of whether the equity line facility is ever used. In addition to adding to the overall cost of capital, these commitment shares might present an additional concern for issuers. While most equity line agreements include an anti-shorting or hedging provision, a close read of that language reveals that the equity line provider is only precluded from establishing a NET short position. With the commitment shares obtained upfront, the capital provider is free to sell those shares, before, during and after, drawdown periods without violating the anti-shorting provision of the equity line agreement.

In an at-the-market offering, issuers do not pay warrants or commitment shares. This is another factor that makes ATMs one of the lowest cost ways to access the equity capital markets.

While there are many other differences between ATMs and equity lines, three differences discussed in this article are restrictions on use, method for determining sales price and upfront warrants or commitment shares. Companies seeking to raise growth capital would be well served to have a deep understand of the various capital raising alternatives and the implications for using them. X

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