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GAZING ABROAD

U.S. Regulations and Overseas Opportunities Creating Global PIPE Investors

by Joe Gose

The London Stock Exchange's Alternative Investment Market seized upon frustration with The Sarbanes-Oxley Act of 2002 to attract global issuers who otherwise likely would have listed on a U.S. exchange. Now U.S. PIPE investors are hunting for friendly shores, and among the exchanges they're exploring, perhaps none look more attractive than the Australian Stock Exchange (ASX).

Some 1,200 of the 2,000 companies listed on the 20-year-old exchange have market caps of less than A$100 million ($79.2 million)—a private placement sweet spot—and companies completed A$26 billion ($21 billion) of private deals last year. Plus, companies in the red-hot natural resources industry compose 35% of the ASX, while financial services firms make up about 20%. The A$1.4 trillion ($1 billion) market averages nearly 150,000 trades and A$4.3 billion ($3.4 billion) in dollar volume a day. The English-speaking nation helps to smooth due diligence, and a robust retail investor market provides healthy liquidity.

But compared with the U.S., the easy-to-follow rules that govern private placements on the ASX and other foreign exchanges appeal to U.S. PIPE funds most. For years hedge funds, and particularly PIPE investors, have endured what many private issuance experts consider a growing regulatory burden. The Securities and Exchange Commission's newfound focus on Rule 415 of the Securities Act of 1933, which regulates resale registration statements, is but the latest example. Essentially, the commission is more closely scrutinizing the amount of shares Form SB-2 filers can

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U.S. PIPE ACTIVITY BY FOREIGN ISSUERS

Source: PrivateRaise. Includes Equity Lines

TREND *Watch*

EVOLVING AGREEMENTS

EITF 00-19 and Rule 415 Alter Liquidated Damage Provisions

The Financial Accounting Standard Board cleared up the most troubling issues concerning the Securities and Exchange Commission's misguided interpretation of EITF 00-19 last year. But several months later, caps on liquidated damages continue to show up in stock purchase agreements to the dismay of some PIPE professionals.

But the continued use of liquidated damages caps marks just one example of an ongoing evolution of how PIPE agreements are being structured. In addition to caps, investors and issuers are including language to address the SEC's potential delay or flat-out denial of resale registration statements in PIPE transactions, which is a product of the commission's shift in interpretation of Rule 415 of the Securities Act of 1933.

PIPE players have broadly acknowledged the need for structural changes

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register in a PIPE relative to the issuer's size and to the type of security.

The interpretation in some cases prevents the smallest of companies from raising the amount of capital they need, and it has introduced more uncertainty to the buy side of the equation. In particular, small companies who try to issue more than 33% of their market float may face several rounds of questions from the SEC as to why the resale registration isn't in fact a primary offering. Additionally, such issuers may be forced to parcel out the shares into separate registration statements several months apart, which could ultimately put investors in the lurch.

But in Australia and other countries, private placement shares are frequently freely tradable immediately upon the transaction's closing or soon after, says Troy Rillo, a managing director with **Cornell Capital**, which has completed PIPEs in 10 countries over the past couple of years, including some 20 deals in Australia. On the ASX, for example, private placement issuers typically make a Section 708A filing upon the transaction's close or within five business days thereafter. Referred to as a "cleansing statement," the Section 708A notice essentially states that a company has met its continuous disclosure obligations, which allows investors to make informed decisions in relation to acquiring the securities.

Shares whose issue is accompanied by a cleansing notice are free-trading beginning the first business day after the filing. The vast majority of ASX private placement issuers file cleansing statements—frequently the transaction agreement compels them to do so. In the far fewer private placements which do not involve cleansing statements the shares are restricted for 12 months.

Although the ASX lacks definitive market data on the number of U.S. funds invested in private deals issued by its firms—ASX issuers generally don't disclose investors—some two dozen traditional PIPE funds are exploring the market, suggests David Batista, a managing director for **HPC Capital**, a U.S. placement agent that is bullish on the ASX. Plus, he adds, roughly more than a dozen have completed or are actively seeking deals in Australia.

> *The growing interest in offshore exchanges coincides with much hand-wringing in the U.S. business and political arenas over a perceived burdensome regulatory environment that is steering companies away from the U.S.*

"A lot of traditional PIPE funds are starting to broaden their horizons because of the over-regulation of the PIPE market in the U.S.," says Batista, whose firm has facilitated 46 PIPEs in the U.S to secure $267 million since 2002, according to PrivateRaise. "At this point, a lot of funds are at the stage of, 'We've heard a lot of great things about Australia, so we're taking a really hard look, asking the questions and getting everything in place so that when the next opportunity comes along, we'll be ready to make an investment if we so choose.'"

The growing interest in offshore exchanges coincides with much hand-wringing in the U.S. business and political arenas over a perceived burdensome regulatory environment that is steering companies away from the U.S. The U.S. Chamber of Commerce most recently weighed in by launching the Center for Capital Markets Competitiveness, a vehicle to push for reforms to the country's regulations as other countries ratchet up competition for business. In a speech at the First Annual Capital Markets Summit on March 14, Chamber President and CEO Thomas Donahue said that capital markets outside the U.S. were becoming "deeper, quicker and more competitive."

"At the same time, the United States is stuck with legal and regulatory regimes developed in the 1930s, a time closer to the Civil War than to today," he added. "The predictable result? U.S. capital markets are experiencing a steady decline in their share of global activity. They are increasingly being viewed by both domestic and foreign firms as a more dangerous and complicated place to do business."

Pricing Similarities

Generally, the regulatory flexibility found overseas doesn't necessarily translate into pricier PIPEs, experts say. Investors in ASX common stock private placements, for example, usually receive discounts of up to 20%, while convertible debt investors often pay exercise premiums of 10% to 100%, says Eugene Tablis, of counsel with the **Moses & Singer** law firm in New York. He acts for a number of ASX issuers in the U.S. capital markets and is working with the ASX to generate more PIPE deals between U.S. capital sources and companies on the exchange.

Beyond pricing, the ASX's rules governing private placements mirror U.S. exchange rules in some ways but not in others. Similar to the Nasdaq "20% Rule," for example, the ASX prevents companies from issuing more than 15% of their market cap in a rolling 12-month period without shareholder approval. On the other hand, share-

holder approval also is required for market price discounts that exceed 20%. Pre-emptive rights issues are infrequent, though it's not uncommon for ASX private placement issuers to offer securities to existing shareholders with the same terms that institutional investors are receiving. Because investors can trade shares almost immediately after a deal closes, short-selling tends not to be an issue, Batista adds.

Even as U.S. PIPE funds begin to get a handle on the ASX, some longtime PIPE players are hoping to build interest among ASX issuers. In late February and early March, representatives from HPC Capital, **Palisades Equity Fund** and **Cantara** (formerly GreenLight SA) joined Tablis to hold three seminars in Perth, Melbourne and Sydney. The goal: To educate ASX companies about the opportunities to tap into U.S. institutional capital in private placements. According to Tablis, about 100 issuers attended each of the events, which were also facilitated by the ASX.

"Australian companies are very hungry for U.S. institutional capital," says Tablis, who represented ASX issuers while with New Zealand law firm **Chapman Tripp Sheffield Young** before heading to the U.S. several years ago. "Australia is capital-rich. But the capital tends to be much more risk-averse and heavily skewed toward the top end of the market, which is why micro cap companies are going offshore for funding to either Asia or the U.S."

Recent Deals

In November, **Firebird Management**, a New York hedge fund that has invested $18.7 million in 12 deals since 2004 in the U.S., and Canadian placement agent **PowerOne Capital Markets Ltd.** invested A$2.07 million ($1.6 million) in **Antisense Therapeutics**, an Australian biotech drug discovery and development company that has a market cap of roughly A$39.3 million ($31.1 million). The company issued 69 million shares to the investors for A$0.03 each, which was at market at the time the deal was announced; Firebird Global Master Fund and Firebird Global Master Fund II acquired 60 million shares and PowerOne acquired the balance, according to Antisense Therapeutics filings. Antisense's shares were recently trading around A$0.045.

Most recently, **pSivida**, a biotech firm listed on the ASX as well as the Nasdaq Global Market, issued more than 50 million ASX shares for A$0.24 each to raise A$11.5 million ($9.1 million), which represented a roughly 4% discount at the time the deal closed in mid-February. HPC Capital acted as placement agent in the PIPE, and pSivida announced that it sold the securities to U.S., European and Australian institutional investors, although it did not disclose them. The company also issued four-year warrants to purchase more than 100 million shares for A$0.23 each. pSivida's stock was recently trading around 22 Australian cents on the ASX.

The pSivida placement marks the only placement HPC Capital has brokered thus far, but the firm's principals expect to facilitate more deals in the near future. "We were taken aback at how quickly there was follow-through with respect to interest from issuers in raising capital," says Batista, referring to the Australian seminars, which he attended. "At this point, we have a very healthy backlog."

On March 14, HPC Capital also facilitated a private placement for **ICP Biotechnology** (ICPbio), a New Zealand biotech firm listed on the New Zealand Exchange (NZX). ICPbio raised some NZ$930,000 ($650,000) by selling roughly 4.1 million shares for 18 NZ cents—which was about market—and some 1.2 million shares for 16.2 NZ cents. Investors included Cantara on behalf of **Crescent International** and **RECT Funds** of New Zealand. Moses & Singer and New Zealand law firm **Bell Gully** represented ICPbio, which has a market cap of NZ$31.2 million ($21.6 million). The shares were recently trading around 18 cents.

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Global Capital

In some cases, U.S. PIPE investors haven't needed foreign exchanges to court them to pursue overseas deals. Cornell Capital's Rillo says the firm started investing in ASX companies in 2003 and since then has broadened its reach. The fund has some $700 million under management, and about 15% of its assets are invested in companies trading on roughly 10 foreign exchanges, including markets in Singapore, Italy, Brazil and Hong Kong. Cornell Capital is aiming to increase that to 25% over the next several months, Rillo says.

The firm generally provides equity lines and buys convertible notes. In some cases, Cornell Capital enters into both transactions with a single issuer simultaneously, a strategy it employed in the U.S. until 2005, when a new SEC interpretation of such deals ended the practice.

Still, each market poses varying challenges, such as pre-emptive rights issues, which makes it important to enlist local partners who are familiar with the laws and customs, among other influences, Rillo acknowledges. Funds may need to educate regulators in other countries, too, about what they're able to disclose or not disclose to exchanges under U.S. law.

Yet the vagaries have hardly soured Cornell Capital on doing deals on foreign exchanges. Among other transactions, Cornell Capital is providing a 70 million euro ($93 million) equity line to **Viaggi del Ventaglio**, an Italian tour operator, as part of a recapitalization and restructuring. The company and Cornell Capital reached an agreement in October and Ventaglio's board approved the deal in December. The shares climbed 50% between October and December to 1.07 euros from .715 euros but have since dropped to around .8 euros.

"There are a variety of things that attracted us overseas," Rillo says. "There tends to be a little less competition, so you get higher quality deals and better pricing. And I hate to say it, but you have a much more favorable regulatory environment."

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