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Alternative capital markets financing options

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Meet our presenters

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“At-the-Market” (ATM) Offerings

Ora Wexler, Partner
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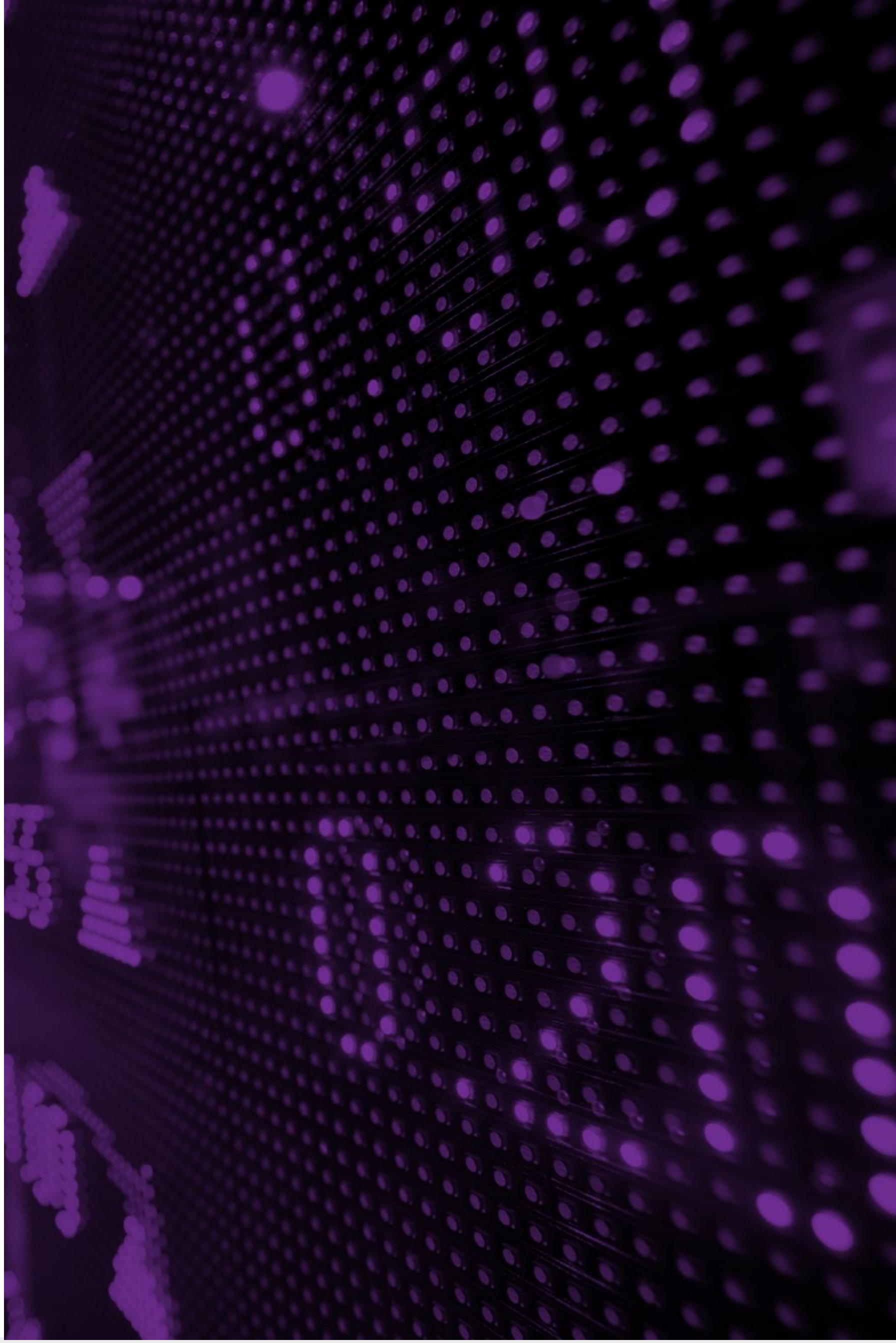
Overview of ATM Offerings

- Form of prospectus offering
- Sales by a registered dealer on behalf of the issuer (typically on an agency basis) into the market, at prevailing market prices
- Like a “line of credit”
- Generally no marketing efforts (i.e.; roadshows) or marketing materials
- Allows quick and cost-effective market access “as needed” or when a traditional public offering may not be available or desirable
- “Quieter” process than traditional offering
- Does not preclude simultaneously pursuing a traditional offering
- Agent cannot over-allot or undertake market stabilization activities during ATM offering



Basic components

- Base shelf prospectus
- Prospectus supplement
  - Brief document that specifically establishes the ATM program and sets out the terms
    - Qualifies maximum value (or number) of shares offered
    - Discloses identity of agent, agent commissions and description of agreement
    - Describes any exemptive relief obtained from securities regulators
  - Filed in all jurisdictions where the base shelf prospectus is filed (and translated into French)
- Equity distribution/sales agreement
  - Similar to agency agreement - appoints agent to sell shares on a “best efforts” basis
  - Provides customary underwriter protections, including representations and warranties from the issuer and comfort letters from the issuer’s auditors
  - The agent and its counsel typically undertake due diligence procedures that are substantially the same as would be undertaken for an underwritten offering, including, for example, conducting legal due diligence and Q&A sessions

Basic components

- Placement notice delivered by issuer to agent to commence distribution
  - Includes maximum number/amount of shares to be sold and sale period, and can include minimum price and other limitations
  - Issuer cannot issue a placement notice or sell securities when it is in possession of material undisclosed information
- Settlement of trades (T+3)
  - Issuer issues shares; agent pays net sales proceeds to issuer
- Periodic deliverables under equity distribution/sales agreement
  - In light of the ongoing nature of an ATM program, the equity distribution/sales agreement will provide for periodic updates to the issuer’s representations and warranties, the auditor’s comfort letters and due diligence

Proposed CSA Amendments

- Effective date: August 31, 2020
- Amendments eliminate:
  - Need for issuers to obtain discretionary exemptive relief
  - Overall size and daily sales limits (i.e.; 10% cap and liquidity requirements), and streamline ongoing reporting requirements
- Cover page disclosure
  - Requirement to disclose on the cover page of the base shelf prospectus that the prospectus may qualify as an ATM offering
- Designated news releases
  - Issuers will be required to identify news releases disclosing information that constitutes a "material fact" as "designated news releases" in order to incorporate material facts by reference into an ATM prospectus
- No automatic exemption from French translation requirements
- Bring Canadian ATM offering rules in line with U.S. rules

Pros

Cost of capital

- 2% - 3% agent fee
- No price discount

Price overhang

- Eliminates expectation of discounted offering which is the primary cause of the overhang
- Combats short-sellers by becoming less predictable from a financing standpoint

Flexibility

- Size, price and timing are controlled by the issuer
- No obligation to execute sales
- Less management time and attention
- Ability to access capital on short notice, is continuous despite market conditions

Dilution

- Complete control over dilution - can be turned on and off at the option of the issuer

Cons

Investment Bank Preference

- Banks prefer traditional equity offerings because they earn higher underwriting commissions

Size

- ATM offerings tend to be substantially smaller in size than traditional offerings

Costs

- Initial setup, ongoing due diligence and periodic reporting costs are costly

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Overview of high yield debt

Dan Shea, Partner
Calgary

Agenda

- Overview of high yield debt
- Benefits of high yield debt
- Current state of the market
- Offering process

Overview of high yield debt

- Classification is not connected to yield, but instead is driven by a company's credit rating
  - Companies that have a credit rating below investment grade (i.e. less than BBB- from S&P, Baa3 from Moody's or BBB(low) from DBRS) are classified as high yield issuers
- Also colloquially referred to as "junk bonds" or "speculative grade debt"
- Market developed in the United States in the 1980s and was often a source of financing for leveraged buyouts in its infancy
- Prior to the 1980s the market was comprised predominately of "fallen angels" – companies that lost their investment grade status after issuing bond

Overview of high yield debt

- Essentially emerged in Canada just over a decade ago
  - Canada now has a more mature high yield market with dedicated high yield institutional investors, high yield debt teams at most major investment banks, and numerous seasoned / repeat high yield issuers
  - But high yield still occupies a relatively small portion of the corporate debt market in Canada
- US high yield market is very active and many Canadian issuers opt for US$ deals given the market depth
- What does a typical high yield debt issuer look like?
- What is the typical offering size and structure?

Benefits of high yield debt

- Longer term / permanent capital compared to bank debt
  - Five to ten year bullet maturities (i.e. no amortizing payments)
- Fixed interest rate, providing potential to achieve low-cost of capital and long-term financing in the current interest rate environment
- Less onerous covenant package compared to bank debt, providing greater operational flexibility
  - Incurrence-based – rather than maintenance-based – covenants, with the result that companies cannot “fall out” of compliance with covenants
  - Designed principally to limit companies’ ability to incur debt (both secured and unsecured), pay dividends and make investments in non-controlled entities, while providing flexibility to operate / grow the business
  - Covenant pattern generally requires 50% of adjusted earnings to be reinvested in the business (and not used for dividends or buybacks)

Benefits of high yield debt

- Often unsecured while permitting a specified amount of senior secured first lien bank debt
- Provides an alternative to bank debt and/or an additional form of capital to help diversify an issuer’s capital structure and maturity profile
- Compared to a US$ high yield bond, avoids currency risks and swap costs

Current state of the market

- Debt capital markets have generally seen record levels of activity and record pricing since the onset of the Covid-19 pandemic
  - Many companies took advantage of historically low interest rates and erred on the side of caution by bolstering liquidity
- Market activity in Canada has been focused on the investment grade space with a limited number of deals in the Canadian high yield market since the pandemic by high quality issuers
- US high yield market has seen significant issuance levels since the pandemic, with continuously improving terms and pricing
- Canadian high yield activity also impacted by the challenges in the energy sector, which historically accounted for a large portion of high yield transactions prior to the recent commodity price declines

Current state of the market

- But the high yield market remains open and receptive to more transactions as market and economic conditions continue to improve and uncertainty around the impact of the pandemic lessons
- Opportunities also exist for quasi-high yield products
  - Debt that is modelled off high yield terms, but is not rated and not sold to traditional high yield institutional investors
  - Recent examples in the cannabis and mining sectors
  - Deals are typically marketed along with warrants, attract retail distribution and are often listed on an exchange

Offering process

- Generally offered via private placement with a detailed offering memorandum
  - Less frequently offered by prospectus – but high yield investors are generally indifferent
  - Private placement will be structured as an offering to accredited investors – as a practical matter, the pool of investors consists of large institutional investors and potentially select high net worth individuals depending on the transaction
- Timing of the offering process
  - For public companies, can be completed quickly (in as few as a couple weeks)
  - Can take several months for private companies that do not have an existing public disclosure record
- **<u>Advanced preparation is critical</u>**
  - Given the potential for short windows in the high yield market, advanced preparation can be critical to a successful offering

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Overview of environmental / ESG finance tools

Bill Gilliland, ICD.D
Partner, Calgary

Environmental / ESG finance tools

- Green Bonds*
- Transition Bonds*
- Sustainability Bonds
- Sustainability-Linked Bonds

Green Bonds

- “Green Bond” standards developed in the market
- Label applied to a financing
- Green Bond Principles (GBP) - voluntary process guidelines prepared by ICMA
- Dentons first Canadian law firm member of GBP (2014)
- Climate Bond Initiative
  - Certification standards
  - Deal commentary
  - Dentons has provided some assistance to CBI on certification standards
- Market practice important - need to work with advisors who understand development of ESG markets and acceptance of the various products

Green Bond Principles - 4 core components (+ one recommendation)

- Use of Proceeds - utilization of the bond proceeds for Green Projects - renewable energy, energy efficiency, pollution prevention, clean transportation, green buildings, sustainable water management, others. (generally not for general corporate purposes)
- Process for Project Evaluation and Selection - Clear communication to investors how project satisfies "Green Project" criteria
- Management of Proceeds - net proceeds of the bond issue need to be tracked somehow to specified use of proceeds
- Reporting - annual reporting of use of proceeds, and qualitative or where feasible quantitative reporting on impact of the Green Project

- Fifth recommended component - external review

Green Bonds - why?

- Project green credentials into capital market
- Attract new investors
- Differentiate capital market product - potentially defensive
- Pricing advantage? - primary and secondary markets - increasing evidence

Green Bond examples

- Multi-fuel (coal, gas, wind, solar) US power generation company has issued green bonds to build new wind generation

- British Columbia utility has issued green bonds to finance renewable energy, biogas, energy efficiency, pollution prevention/control (demand side incentives to commercial and marine transportation customers to switch to compressed natural gas and liquid natural gas), and clean transportation. (not retrofitting of existing natural gas infrastructure)

- Property owner issued green bonds to refinance a LEED platinum office building

- Numerous other Canadian examples

Transition Bonds - a new tool

- Green bonds not for issuers in fossil fuel industries or limited “green” use of proceeds
- Greenwashing concerns for use of green bonds by these issuers
- A new tool required to help those companies finance their transition to lower emissions
- Demand is growing/evolving for bonds in this space
- ESG investors
- Attract new investors
- Differentiate in the market

Early transition bond examples

- UK natural gas distribution network operator issued transition bonds to retrofit natural gas pipelines to reduce methane leaks and to transport hydrogen, develop natural gas plants and build hydrogen fueling infrastructure, plus renewable energy and clean transportation
- Hong Kong power company issued transition bonds to finance the construction of a large natural gas powered generation plant (in a market dominated by coal generation)
- A few other similar examples

Basic principles - but no prescribed framework…yet

- Use of proceeds - transition use of proceeds (doesn’t need to be “green”)
- Project evaluation and selection
- Management of proceeds
- Reporting
- AND… need a demonstrated longer term commitment and pathway for transition

Canada taking a leading role in developing the framework

- 2019 Report of the Expert Panel on Sustainable Finance commissioned by the Government of Canada
- Recommendation # 9 - expand Canada's green fixed income market, and set a global standard for transition-oriented financing.
- Reflects our Canadian economy - resource, extractive and fossil fuels
- CSA Technical Committee is leading the creation of a Transition Finance Taxonomy, with input from the financial sector in Canada
- Dentons is represented on that committee
- Transition Finance Taxonomy expected to be released within the next few months

Questions?

Thank you

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