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Shopping for Financing "At-the-Market"

Alternate Option May Offer Huge Savings, as Conventional Methods Can Cost 10x More

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Publicly traded life science companies are constantly searching for new sources of capital to fund their activities. Companies generally follow a traditional approach employing conventional financing vehicles such as secondary offerings, registered directs, and private investments in public equities (PIPEs).

When possible, issuers attempt to time offerings to coincide with the reaching of important company milestones such as a positive clinical data release, FDA action, or partnering activity. Another goal is to raise sufficient capital to provide a cash runway that will enable the company to fund operations through to the next milestone event.

Conventional financing vehicles have a long and successful history of raising capital for emerging companies. However, they can present existential risks, especially for companies with very long product-development timelines such as life science companies if the issuer depends on conventional financings alone.

A conventional financing is a single discrete event. The ability to complete the transaction is thus dependent on the general financing environment at the time the deal is announced. Financing windows open and close unpredictably, so a planned transaction may not occur.

Extrinsic events, such as market volatility, or intrinsic events, such as a data announcement or anticipated partnering deal may not turn out as planned. Any delays in financing could put the company in a perilous financial position.

Traditional financings can be expensive to execute particularly for life science companies. Offerings today are typically announced at an average discount to the prior closing price of about 7.5%. Underwriters' fees run about 5%.

Warrants are also a significant cost for life science companies, averaging 24% of a transaction or higher. Companies that are running out of capital will confront costs above these numbers. All together, transaction costs could total about 35% of the raised capital.

Finally, management time and attention can be significant. For some transactions, time spent with prospective investors can be significant. The company may need to proceed through a quiet period when management is precluded from discussing the company and its prospects with investors.

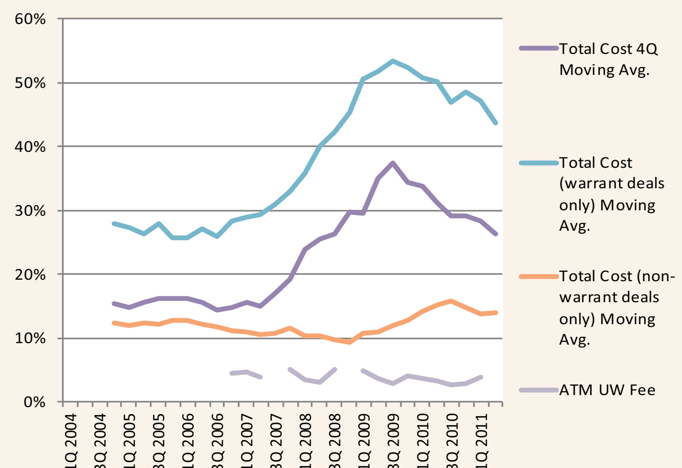
Considering these issues with conventional financings, management might want to consider additional tools to broaden the financing options.

At-the-Market Option

Forward-looking CFOs employ multiple tools to support their companies' financing activities. Their goal is to increase financing flexibility so that the company can successfully access capital to fund activities when needed and at a reasonable price.

An at-the-market (ATM) financing vehicle is one tool that has received increased attention in the life science community

Figure 1. Cost of capital for conventional financings in the life sciences is higher than ATM fees even in financings without warrants (four-quarter moving average analysis). The gaps in ATM underwriter fee are due to periods without ATM activity.



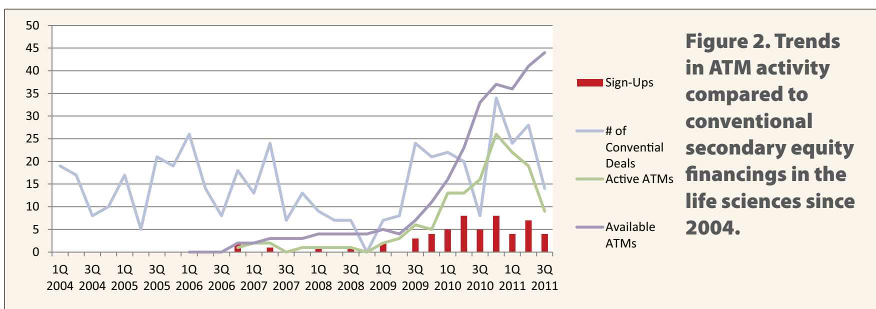


Figure 2. Trends in ATM activity compared to conventional secondary equity financings in the life sciences since 2004.

over the past few years. An ATM is an offering of newly issued shares into the existing trading market. Selling shares under an ATM agreement requires a Form S-3 registration statement to be filed, pursuant to Rule 415(a)(4) with the U.S. Securities and Exchange Commission.

An ATM enables the issuer company, via the services of a broker-dealer acting as an agent, to sell stock into the market over a period of time determined by the issuer at a minimum price also determined by the issuer. There is no offering discount. Underwriter fees are generally a straight percentage of the capital raised. There are no warrants or commitment fees that are part of the transaction.

ATMs offer issuers several advantages. They enable companies to exert more control on the timing of capital raising activities. ATMs also have a lower cost of capital than conventional financings (*Figure 1*).

An ATM costs the issuer only the underwriters' fee, which on average is 3.8% for life science companies compared to the combination of costs previously described that can total about 35% for life science companies.

Unlike an equity line of credit (an alternative financing tool that is sometimes confused with ATMs), the shares are not sold to previously identified parties at a discount to the volume-weighted average price (VWAP); they are sold at the market price.

ATMs are flexible. They are not an alternative to conventional financing vehicles, but are complementary, so an issuer could supplement a more traditional financing with an ATM.

ATMs are a tool for companies that have a solid long-term financing strategy incorporating several financing vehicles to provide flexibility and generate capital but at a lower cost than conventional financings. However, ATMs are not the best tool to employ in all situations; when a significant amount of capital is needed in a short period of time, conventional financing approaches may be the more appropriate choice even if they are more expensive.

ATM Activity Continues to Grow

Life science companies raised $154 million via ATMs through the third quarter of 2011. This compares to $123 million through the third quarter of 2010, a 25% increase. This was driven by an increase in available ATMs from 26 in the second quarter of 2010 to 44 in the third quarter of 2011, and the signing up of 15 new ATMs through the third quarter of 2011.

Figure 2 illustrates these trends and compares them to the volatile but generally flat trend for conventional secondary equity financings on a quarterly basis since 2004.

The key metrics to gauge future ATM activity are the number of new, available, and active ATMs (*Figure 2*). These have been trending up since life science companies began to sign up for ATMs on a regular basis in 2009.

While the amount of capital raised in any particular quarter can vary as a function of the market environment and predetermined trading parameters that each issuer's ATM operates within, expectations are that life science companies will continue to increase their use of ATMs.

These would not necessarily displace more conventional financing vehicles, but would complement them as companies become more familiar with ATMs and the enhanced financing flexibility that they provide.

Life science CFOs are constantly looking for funding, but uncertainty in the capital markets makes this a difficult and expensive exercise. Companies face both internal variables, such as clinical trial results and the timing of collaborations, and external variables, such as regulatory changes, that can impact fundraising activities. In addition, the cost of capital can be quite expensive with many conventional financing vehicles.

One solution is for CFOs to include additional options, such as ATMs, in their financing toolbox. ATMs are an ideal tool for companies that have a solid long-term financing strategy incorporating several financing vehicles that provide flexibility and reduce the overall cost of capital. GEN

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