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PIPEs: Citadel's Playbook

This is another entry in the list of 2001 articles I have found on the internet about Citadel and PIPEs

This one is from May 2001.

https://instruct.uwo.ca/law/307a/Articles/public_ventures_do_private_deals.htm

The big thing I learned from this one comes from a seemingly off-hand comment about the SEC it appears that these PIPE deals can occur without the notifying of the SEC. While I do not believe it absolves them from their gross negligence, it appears that these secretive back room deals can happen in a way that hamper the proper tracking and enforcement of investment capital. Also the PIPE deals appear to be able to pump and dump stock if the artificial dillution they introduce to a company is handled in a specific way I am still trying to understand. I am beginning to believe that Boston Consulting introduces these PIPE deals as trojan horses in contractual agreements between Hedgefunds and businesses that allow them to raise capital or choose to crush the business and absorb them into the Amazon fold. I also suspect the record high FTD data from many businesses during the Pandemic may be overflow from these deals that needed to be repurposed or claimed as collateral. I also suspect that the assets not yet purchased on Citadel's last filing may have something to do with these as well. If what I am reading is true then Citadel can literally use debt from PIPE deals as collateral and repeat as many times as they like while being a market maker and manipulating prices however they wish with the use of dark pools to make a financially profitable self fulfilling prophecy. I do not have the data to back these claims up, but more pieces are falling into place and I would appreciate some help on this.

"Locked in a costly lawsuit with a big pharmaceutical company, Igen International was within a few months of running out of cash earlier this year. And with biotechnology stocks falling, there seemed little chance of raising money by selling more shares to the public.

But Igen was helped in February by a little-known New York investment fund called Acqua Wellington, which agreed to purchase up to $60 million of new Igen shares over 28 months. Igen, a medical diagnostics company based in Gaithersburg, Md., has already taken advantage of the offer to raise $25 million.

Acqua Wellington has offered similar deals to about a dozen biotech companies in the 16 months it has been in existence, creating a stir among executives akin to that of suddenly discovering a rich uncle. And no wonder. With technology and biotech companies finding it nearly impossible now to sell new stock to the public, money offered by funds like Acqua Wellington is providing lifelines for many companies.

Such financings are known as private investments in public equities, or PIPE's. An investor or group of investors negotiates directly with a company to buy shares, often at a discount to the prevailing market price. While companies do not like selling their shares at a discount, getting some money is usually better than getting none.

"There's a recognition that PIPE's are going to be the only means of financing companies this year and maybe into next year," said Brian M. Overstreet, president of DirectPlacement.com Inc., an investment bank that tracks such deals.

But there is a risk as well. Some desperate companies agree to such onerous terms that the financing can hurt more than help. These are called toxic or death- spiral financings and can result in severe dilution of the value of existing shares, hurting other shareholders. The mere announcement that a company has done such a deal can send its stock into a tailspin from which it may never recover.

Intraware Inc. , a software company in Orinda, Calif., raised $25 million last June from Marshall Capital Management, the Citadel Investment Group and Promethean Asset Management. Intraware's stock, which traded above $21 the day before the deal was announced, plunged to near $5 in the next two months, though business issues beyond the financing contributed to the decline.

"We got valued down to the point where many people thought this ship might not make it," Peter Jackson, the chief executive, said. "Every day you're tortured by your investors and questioned by your employees."

This year, Intraware raised money from its original venture capital backer and several wealthy individuals to buy out the providers of the financing.

Only about 10 percent of PIPE's are toxic, Mr. Overstreet said. And some private placements of shares are structured to produce less dilution of existing shareholders than if shares were just sold on the open market. Private deals can also often be arranged more quickly than public stock offerings, without waiting for the Securities and Exchange Commission to approve a prospectus and without the road show needed to entice investors.

"How can you minimize management time spent running around the world to promote the stock?" asked Steven B. Engle, chairman and chief executive of La Jolla Pharmaceutical Company , which has raised nearly $80 million from three private placements in the last year and a half.

Net2000 Communications , a telecommunications service provider in Herndon, Va., raised $65 million last month in a private placement from existing institutional shareholders and some new ones. "By obtaining this funding we position ourselves to be one of the survivors," said Charlie Thomas, founder and chief executive, noting that several rivals have gone bankrupt.

To be sure, private financings are down substantially this year for the same reasons that public financings are down. Companies do not want to sell stock, publicly or privately, at today's low prices if they can avoid it, because it dilutes the holdings of the existing shareholders. And investors who bought stock in technology companies last year, even at discounted prices typical of private deals, lost money as the stocks plunged, so they are wary now.

"Anyone who has a choice doesn't want to finance in this environment and anyone who doesn't have a choice isn't that interesting to invest in," said Roger McNamee, a managing director of Silver Lake Partners in Menlo Park, Calif., which made private investments last year in companies like the Gartner Group , a consulting firm, and Cabletron Systems , a networking company.

In the first quarter of this year, $2.5 billion was committed to public companies in 184 PIPE's, down sharply from $8.4 billion in 385 PIPE's in the period a year earlier, according to PlacementTracker.com, a Web site run by DirectPlacement.com. Still, the number of PIPE's in the first quarter exceeded the number of stock offerings by already public companies. And the decline in tech and biotech PIPE's was less pronounced than the decline in stock offerings by public tech and biotech companies.

PIPE's come in many varieties. In the simplest deals, an investor or group of investors purchases common stock. In other cases they buy debt or preferred stock that can be converted into common stock.

A danger for companies comes when the price at which the debt or preferred shares can be converted into common stock can be adjusted downward if the company's stock falls. Critics of such deals say such a structure can give the providers of the financing an incentive to try to lower the stock price so they can obtain more shares when they convert.

Existing investors fear the dilution caused by these deals. And short- sellers, who bet a stock will go down, flock to stocks of companies that do such deals. "It's like putting a bull's- eye on yourself to get your securities shorted in a big way," said John Nelson, portfolio manager for small- company stocks for the

State of Wisconsin Investment Board, a pension fund for public employees that has warned companies it invests in to shun such deals.

Log On America Inc. , a Rhode Island provider of telecommunications services, sued Promethean, Citadel and Marshall, which provided it with financing last year, accusing them of shorting the stock to drive it down. In a court filing, the companies denied the accusation and said that Log On was just trying to escape from its obligations.

"The notion that we benefit from a stock going down is absurd," James F. O'Brien Jr., managing member of the New York-based Promethean, said in an interview. He said allowing the conversion price to be reset is a concession to the companies because it allows them to pay back the investor in common stock rather than cash. He also said Promethean's deals usually capped the amount of a company's stock it can own at about 10 percent or less. Citadel, based in Chicago, and Marshall, a subsidiary of Credit Suisse Group would not comment on the record.

But defenders of these convertible deals say that other financings not normally labeled as toxic allow the conversion price to be reset and that last year, many technology stocks declined for reasons other than financings. Even some companies that enter into such deals say the agreements were negotiated fairly and that their other financing options were limited.

"You have to go with what's available, and those folks were available and willing to move relatively rapidly," said Robert Jackson, vice president for investor relations at Applied Digital Solutions . Applied Digital, based in Palm Beach, Fla., is developing various Internet technologies. It raised $20 million in October from investors led by Ramius Capital. Applied Digital's stock, which had been trading at $3 to $4 for months, plunged to below $1 by the end of the year. Short interest in the company's stock has risen from 300,000 shares to more than 6.5 million, Mr. Jackson said. And according to the company's regulatory filings, if the investors converted all their shares, they would own more than 20 percent of the company and the company could be forced to delist from Nasdaq.

Some controversy has also surrounded deals like those offered by Acqua Wellington, which are called equity lines of credit. Acqua Wellington agrees to buy up to a certain amount of stock from a company over a period of time, paying about 5 percent less than the prevailing market price.

The crucial feature of such a deal is that the company can choose when and if to sell its stock, so it can wait until the stock price rises. "You can load your gun but you're not required to shoot it," said Fredric D. Price, chairman and chief executive of BioMarin Pharmaceutical , which can sell up to $50 million to Acqua Wellington over 20 months. "You should use it only under advantageous circumstances."

Aviron , a company developing a flu shot, arranged an equity line from Acqua Wellington in January, 2000. If it had taken all the money at once, it would have received about $20 a share. But by spacing out its sales to Acqua Wellington over a year as its stock rose, Aviron raised $84 million at an average price of about $30 a share, said Fred Kurland, chief financial officer of the company, based in Mountain View, Calif.

But Mr. Nelson of the Wisconsin investment board, while not referring to any specific investor, said equity lines of credit might be merely the latest incarnation of toxic financing. Why, he asked in the letter to companies his funds invests in, would an investor who believes a company's stock will rise not try to buy as much of the stock as possible upfront?

Mr. Nelson said the providers of equity lines of credit had an incentive to short the stock in the time between a company's saying it wants to sell some stock and the time the purchase is actually made. Such investors often quickly the sell the stock they obtain onto the open market, potentially depressing prices.

Isser Elishis, chief investment officer for Acqua Wellington, said it was hard for an investor to pick the moment when a stock was at its lowest point. "By being able to average into something, history has shown us you do a lot better than trying to pick spots," he said.

Mr. Elishis said his company did not short the stocks it invested in. And while Acqua Wellington does not hold shares forever, it does not usually sell them immediately.

Executives at several biotech companies said they have had no problems with Acqua Wellington and, indeed, are grateful for such flexible financing. Louis G. Lange, chief executive of CV Therapeutics , which arranged last year to sell up to $120 million of stock to Acqua Wellington over 28 months, said: "It's almost too good to be true."