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Raising capital as if taken from an ATM machine: At-the-market Equity Programs - A model used by Tesla

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The visit of Elon Musk to Germany last week was a reminder of what the USA is known for: Creative entrepreneurship. In Germany, we can feel Musk's entrepreneurial initiatives above all through the construction of the Tesla Giga factory in Grünheide (Brandenburg). Under Musk's leadership, Tesla Grohmann Automation from Rhineland-Palatinate, one of the most innovative German federal states, has transformed from an automotive supplier to a microfactory for complex vaccines, including those developed by CureVac, is also part of Musk's investments in Germany. Then he is also successful in space travel via SpaceX.

I. Tesla – Recent Equity story

On paper Tesla still clings to its image that its most sustainable product is creating losses. Nevertheless, the share price has reached astronomical levels because of the opportunities for the future (or, as one likes to say in such cases, considering the higher valuation of future cash flows). In 2020 alone, it has risen by 500%, this combined with a recent 1:5 stock split. Tesla's stock is now one of the most popular securities traded by retail investors on the Robinhood platform. At the same time, Tesla has an enormous need to invest and reduce debt. Both aspects argue for raising capital in addition to the already existing cash pile of US$ 8.6 billion. Somebody is up to something.

No sooner said than done: After a secondary placement of shares in February 2020 for US$ 2 billion via a rights offering, last week Tesla made use of a flexible instrument available under U.S. securities laws: It allows to place new shares by selling them in tranches on the market at market price rather than placing them to a pre-determined price in a securities' offering. Figuratively speaking, Tesla uses existing or new shareholders like an ATM machine. Such programs are also being referred to as Dribble-Out Programs: When capital market conditions are favorable, *i.e.* when the share price is high and demand is continuously solid, shares from the program are sold on the market on short notice, like a dribbling, e.g. in soccer.

Until now such programs have mostly been used for smaller emissions. In order not to push down the share price, there is a tendency to make smaller takedowns. Not so with Tesla: US$ 5 billion, more than double the regular issue of shares in February 2020, shall be collected via ATM sales. In view of the so far robust share price, Tesla expects the sale of larger quantities of shares to have little impact on the share price. In case of a rights offering, however, at least a temporary price discount must be considered. Not even the announcement of the ATM program had any impact on the share price. Under ordinary circumstances the volume of the offer should in fact have resulted in a lower price. The share price did, however, not fall until the end of week 36, when tech stocks retreated from their previously high level. In the following days Tesla was denied inclusion in the S&P 500 Index which would have triggered large institutional share purchases. On that news the share price fell a further 20%.

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II. Dribble-out or ATM Equity Programs under US securities laws

Dribble-out programs allow the issuer to avoid using the comparably inflexible form of a subscription offer. In the traditional placement, the shares resulting from a capital increase are subscribed by an investment bank in one single tranche and then placed on the market after a usually expensive and time consuming roadshow at the close of which the subscription price has been fixed (mostly by bookbuilding). In the case of a subscription offer, the subscription triggers a fee of 1.5 to 3.0% of the proceeds. In the case of Dribble-out equity program*,* the new shares are sold on the market without incurring considerable costs by means of selling portions of the volume by broker dealers. The fees then only amount to only approx. 0.5% of the sales proceeds. The subscription rights of existing shareholders need to be excluded.

ATM programs naturally are made under a shelf registration statement and a prospectus. An equity distribution agreement is concluded with the investment banks that carry out the sales transactions. In many ways this resembles the underwriting agreement for traditional placements. The due diligence process is also similar. The price of the share placements via ATM sales is fully determined by the respective market conditions. There are therefore less critical points for negotiations between the parties to the contract. ATM programs can even be implemented in up to 30 days. Certain documents of the transaction, such as legal opinions and comfort letters, may need to be updated as of the closing date of each takedown. No material information relating to the issuer must remain unpublished as of the individual takedown dates.

From the issuer's perspective, an opportunity is missed if the share price rises sharply immediately following the share issue and the subscribers or subsequent buyers of the share earn from the rise in price. This was the case just recently in the CureVac case, when the closing price on the day of the initial listing (IPO) on NASDAQ in New York was 250% above the issue price. However, ATM sales cannot be used in the context of primary offerings. They are only suitable for secondary ones.

III. Equivalent equity offerings under European laws; Summary and forecast

Under German law, the ATM program most closely resembles the so-called authorized capital to place new shares. Authorized capital is a kind of reserve capital created in advance for future use, also in individual tranches. However, German law always requires the placement of the shares as part of a traditional subscription offer. Up to now at-the-market sales are permitted. Therefore, this flexible instrument cannot (yet) be used for placement governed by German law.

To summarize, ATM programs can be regarded as an attractive alternative to the traditional share offerings. The high flexibility, control of the issuing company over the individual tranches and the sales price and the ability to inject capital just in time are major advantages over the inefficiencies of traditional offerings which can be observed. The disadvantages of the customary one-tranche subscription offerings include the negative impact on the share price resulting from the volume of the offer, the discount on the subscription price and the costs and time required for marketing.

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