PIPING UP: With three PIPE deals, Kevan Casey accomplished his company’s goals to get listed on the Amex and expand with a new facility.

Relief Valve?

**DOLLAR SIGNS:** DONE RIGHT, A PRIVATE INVESTMENT IN PUBLIC EQUITY, OR PIPE, COULD BRING YOUR BUSINESS MUCH-NEEDED CASH.

LAST FALL, KEVAN CASEY, CEO OF eLINEAR, had two specific near-term goals for his Houston-based technology solutions company: 1) to get listed on the American Stock Exchange, and 2) to expand, beginning with a new facility in Dallas. “We wanted to get off the [OTC] Bulletin Board as soon as possible so we could get in front of large institutional investors and start moving up the chain,” says Casey, 32. One requirement for listing on the Amex is a minimum of $4 million in shareholder equity, of which eLinear had just $2.6 million.

With only $13.6 million in revenue for 2003, the company was too small for a secondary offering. So eLinear’s management team opted instead to do a Private Investment in Public Equity (PIPE). PIPEs allow public companies to do a limited distribution of securities—in common stock or convertible debt—to accredited or institutional investors, quickly and quietly. “It’s like a hybrid of private and public capital,” says Steven Dresner, co-author of PIPEs: A Guide to Private Investments in Public Equity and publisher of The PIPEs Report. It is public equity, but “it’s much like the traditional private equity market in that you have a select group of seasoned investors who can look at deals and make very quick decisions,” says Dresner.
BUZZ

FOOD FOR THOUGHT: Hungry for more tax deductions?

If so, you’ll be heartened by new information supporting a return to the pre-1986 meals and entertainment deduction rate of 80 percent. A new study suggests that deduction “benefits small businesses more than large firms by a sizable margin,” according to the SBA’s Office of Advocacy, which sponsored the study.

Critics of Congress’ 1986 move to reduce the deduction amount to 50 percent have long held that business lunches and dinners are the small-business equivalent of the marketing programs large companies use. “Big companies can deduct all their marketing expenses,” explains John McDowell of the SBA’s Office of Advocacy. “But small firms rely on meeting with potential clients to win deals. It doesn’t seem fair that large businesses can get a full deduction, and small businesses can’t.”

Will the study help turn the tide? Already, bills to increase the meal and entertainment deduction back to 80 percent are pending in both the House and the Senate. The White House Conference on Small Business has also made restoring the deduction to its 100 percent threshold a top priority. “This is good news for both business owners and the restaurant industry,” says McDowell. “As they say, ‘Restaurants meals make business deals.’”

效率 is one of the PIPE’s draws. PIPEs can be executed in weeks, but a secondary offering can take months. But the tight time frame allows for only limited due-diligence investigation of potential shareholders. And business owners often have to make a tough choice: either discount the stock—sometimes by as much as 70 percent—or offer registration rights that allow investors to sell sooner.

By closing three PIPE deals that raised more than $60 million, eLinear did both. The first, completed last December, raised $1 million from about 80 individual investors who received common stock at a deep discount but must hold the shares for at least a year. The second and third rounds, in January and February, brought in $5 million from mostly institutional investors—including hedge funds, which have been notorious shorters of stock in PIPE deals and which have recently come under the SEC microscope for illegal activity.

And eLinear’s stock initially suffered from short selling, which came as a bit of a shock to Casey. “I was under the impression that their intentions were to grow with the company,” he says of the round two and three investors.

Still, Casey says he wouldn’t trade the compressed schedule. The capital infusion allowed the company to list on the Amex, open a new facility in Dallas and put away enough cash for several years. At the moment, the company is planning some large acquisitions, which will further enlarge its footprint, and is looking at a secondary offering 12 months out.

Going forward, however, Casey says he will turn a more skeptical eye on the motivations of potential investors. “I would try to get to know them better, have more one-on-one communication about where the company’s going,” he says.

That kind of investigation is absolutely critical to a successful PIPE, notes Harlan Kleiman, senior managing director with New York City-based investment bank C.E. Unterberg, Towbin and author of PIPEs: The CEO’s Guide to Successful Private Investments in Public Equities.

“Money always has a face behind it,” he says. “You must know the profile of the person who is buying that significant amount of your stock—or your company can get hurt.”

But the PIPE itself is a neutral mechanism, Kleiman adds. It’s only as good as those doing the deal. It helps that more big investment banks have been getting in on PIPE action, collectively raising $4.47 billion in banking fees through PIPEs in 2003, an 80 percent increase over the prior year, according to Sagient Research Systems, a San Diego firm that tracks PIPE deals. And with $7 billion raised for companies in the first half of 2004—compared with $12 billion annually for 2002 and 2003—the PIPE market isn’t slowing down.

Once seen as the scourge of capital raising, PIPEs are not just for troubled companies anymore, says Colin Blaydon, director of the Center for Private Equity and Entrepreneurship at Dartmouth College’s Tuck School of Business. “It’s been done enough times by strong, viable enterprises that it can be justified as a sensible alternative approach to financing.”

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TAX TALK

BY JOAN SZABO

GETTING THEIR SLICE

SAVE MONEY, AND KEEP EMPLOYEES HAPPY WITH STOCK OWNERSHIP PLANS.

S corporations offer a plethora of tax benefits, but one you may not have considered involves Employee Stock Ownership Plans (ESOPs). Nova Engineering, a Cincinnati-based S corporation, has discovered the tax benefits of ESOPs. CFO Jeff Wyatt says the ESOP’s tax-deferral benefits have been a boon to the company’s cash flow. Wyatt says Nova established an ESOP in 1998 because the company leaders strongly believed in employee ownership. Owning a piece of the pie has also made employees more committed and dedicated to the success of Nova, Wyatt believes. “The best thing about the ESOP is what it has done for the employees,” he says. “As owners, they are motivated to do the best work for us.”