Anatomy of a Reverse Stock Split for Nasdaq-Listed Companies

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With the number of listed companies subject to potential delisting due to failure to meet the minimum bid price requirements on the rise, companies with stock prices near $1.00 need to be prepared for the possibility of receiving a notice of non-compliance from Nasdaq. Company boards and in-house counsel and finance teams must plan ahead with respect to possible actions to be taken to return to compliance with the minimum bid price requirements. With the new Nasdaq requirements for reverse stock splits now in place, it is imperative to prepare in advance and meet timelines in order to avoid having to delay a reverse stock split due to lack of required approvals and documentation.

The authors acknowledge the assistance of Katherine Petty of Donohoe Advisory Associates LLC (www.donohoeadvisory.com), which specializes in advising public and private companies and law firms on stock exchange listing matters and related corporate governance issues

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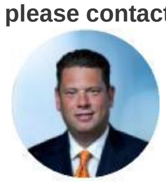

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Why a Reverse Stock Split?

An article in the Wall Street Journal in December 2023[1], found that as of the date of publication, 557 companies listed on U.S. stock exchanges were trading below $1.00 per share, up from fewer than 12 in early 2021. Interestingly, the article highlighted that of the companies trading below $1.00 per share, 464 are listed on The Nasdaq Stock Market.

Most of the companies trading under $1.00 are not in compliance with Nasdaq's continuing listing standards that require a minimum bid price of $1.00. If a company is unable to maintain compliance with Nasdaq's listing standards, the company will face the prospect of delisting.

Under Nasdaq Rule 5810(c)(3), if a company's bid price is lower than the applicable minimum bid price for 30 consecutive trading days, Nasdaq will issue a notification of non-compliance to the company. The company is then required to disclose its receipt of the notice of non-compliance on a Form 8-K. Companies that are notified of non-compliance with the minimum bid price requirements will automatically receive a compliance period of 180 days and, in the case of companies listed on The Nasdaq Capital Market, may receive an additional 180 day compliance period, assuming the company meets the continued listing standard for market value of publicly held shares, and all other standards for initial listing on The Nasdaq Capital Market upon the expiration of the initial grace period. During the compliance period, a company can return to compliance if the bid price closes at or above $1.00 for a minimum of ten consecutive business days. Note, however, Nasdaq may require 20 business days in its discretion, which typically happens if a company's margin of compliance (the amount by which the price is above the $1.00 minimum standard) is low, there is a lack of trading volume indicating a lack of bona fide market interest in the stock at the posted bid price, there is a low number of market makers quoting at or above $1.00 or if the stock price is generally trending down.

You can check Nasdaq's "watchlist" any time to see the companies that are subject to a 180-day compliance period. These companies are looking for ways to bring their stock price back over the minimum bid price requirement of $1.00.

There are a number of approaches companies may take to regain compliance and avoid delisting. For example, a wait-and-see approach may naturally resolve the share price issue or the company may anticipate business improvements or a release of positive news, which the company expects to lead to an improved share price over the $1.00 minimum bid price requirement.

For other companies, though, proactive action in the form of a reverse stock split of its common stock is necessary. In a reverse stock split, a specified number of shares of the company is exchanged for one share, resulting in a higher per share price and the new price is often significantly higher than $1.00 minimum requirement. For example, in a five-for-one reverse stock split, five shares are exchanged for one share, with the resulting stock price at five times the original price. To effect a reverse stock split, a company must file a certificate of amendment to the company's charter. Once the company's shares have traded over the $1.00 threshold for 10 consecutive business days (or 20 consecutive business days, if Nasdaq so requires), the company will regain compliance with Nasdaq listing requirements.

Board Considerations for Reverse Stock Split

Once a company finds itself with its stock price consistently under $1.00 per share, the company's board of directors needs to consider its options with respect to a reverse stock split, including (i) any required stockholder approval, (ii) the timing of the reverse stock split, and (iii) the ratio of the reverse split. Among the factors the Board should evaluate when considering implementing a reverse stock split are:

- How the split will affect the stock price, particularly from a timing perspective and any interplay with other potential positive news releases.
- How the split will affect the company's compliance with other Nasdaq requirements. For example, companies listed on the Nasdaq Capital Market must have at least 500,000 publicly held shares outstanding and, therefore, the reverse split cannot result in having fewer than 500,000 publicly held shares outstanding.

[1] Alexander Osipovich, *Why are so Many Stocks Trading Below $1 on Nasdaq?*, Wall Street Journal (Dec. 4, 2023), https://www.wsj.com/livecoverage/stock-market-today-dow-jones-12-04-2023/card/why-are-so-many-stocks-trading-below-1-on-nasdaq--duCFBJuL1VPOxAJS2154.

- Any prior reverse stock splits implemented by the company. Under Nasdaq rule 5810 (b)(3)(a)(iv), if a company implements reverse stock splits that exceed 250-for-1 in the aggregate over a period of two years, it is not entitled to a compliance period as described above.

Stockholder Approval

The majority of listed companies are incorporated in jurisdictions that require stockholder approval to effect a reverse stock split, or include such a requirement within their charter or bylaws. Generally, the process for obtaining stockholder approval involves the following:

- The company's board is required to present a proposal with respect to the reverse stock split at the company's annual meeting of stockholders or call a special meeting of stockholders. The company should consider providing a range of split ratios for approval by the stockholders, such as a range of 5-for1- to a 100-for-1 split ratio, with the company's board having ultimate decision making power to determine the ration to implement.
- The company will be required to provide disclosures regarding the reverse split in its proxy statement, including:
  - Reasons for the reverse split;
  - Effects on the company's securities; and
  - Risks associated with the reverse stock split.
- Obtaining the requisite vote to adopt the proposal. For companies incorporated in Delaware, as a of the 2023 amendments to Section 242 of the DGCL, Delaware corporations are now permitted to secure stockholder approval by the majority of votes cast (or such higher threshold that may be included in a company's organizational documents) rather than approval of majority of shares outstanding to pass a reverse stock split proposal. Prior to the new standard, many Delaware companies had difficulty achieving approval from a majority of outstanding shares to pass a reverse stock split proposal due to lackluster voting participation by many stockholders of public companies.

Implementation

Once a company receives stockholder approval for the reverse stock split, the company must then implement the reverse stock split within the Nasdaq compliance period.

If the stockholders approved a range of split ratios, the company's board needs to decide on the final split ratio. This decision may depend on the stock price at the time of board approval and the ratio needed to comfortably keep the share price over $1.00 for some length of time. It is recommended the board consult with its investor relations team, legal counsel, and other advisors in determining the reverse split ratio.

In addition, the company should review all outstanding terms of incentive plans and derivative securities, such as equity plan awards, warrants and rights, to determine whether any approvals or advance notice is required prior to the reverse split, as some derivative securities will also be affected by the reverse stock split. Additionally, some agreements, such as those related to credit facilities or stockholder agreements, may include restrictive covenants that require approval prior to effecting a reverse split.

Effective November 2023, Nasdaq proposed and the SEC approved new requirements for notice of reverse stock splits due to the number of reverse stock splits increasing and, with that, the burden on the staff at Nasdaq.

Under the new notice rules, Nasdaq must receive the following information before noon on the fifth business day before market effectiveness of a reverse stock split:

The definitive split ratio;

The draft press release announcing the reverse split, including the date and time of the company's intended release of its public disclosure regarding the reverse stock split;

- Confirmation of completion of technical requirements, such as the new CUSIP being DTC eligible;
- The draft amendment to the company's certificate of incorporation;
- Confirmation that the stockholders have approved the transaction;

- The Total Shares Outstanding (TSO)/Par Value before and after the split;
- A copy of the company's board of director's resolution(s) authorizing the reverse stock split; and
- The expected marketplace effective date (as of the open of business).

With the new requirements that Nasdaq is unlikely to waive, taking action on a timely basis is paramount. Accordingly, we have attached to this memorandum a timeline for actions leading up to the first trading day post-split.

Companies must also obtain a new CUSIP number (which can be completed within a few hours by filing an application with CUSIP Global Services) for the post-split shares and have that CUSIP number published as an early part of the process. In order to provide sufficient time to effect a reverse stock split, the new CUSIP should be obtained at least 10 business days prior to the reverse stock split becoming effective.

Following the CUSIP number being published, the company's transfer agent will notify The Depository Trust Company ("DTC"). DTC must then declare the CUSIP as "eligible" on its system. DTC approval can take up to five business days, so it is imperative when contemplating a reverse stock split to allow sufficient time for DTC to make the new CUSIP eligible, in order to avoid delays. Of particular note, the CUSIP must be deemed "eligible" by DTC five business days before the first day of trading of the company's stock on a post-split basis.

Under the new Nasdaq notice rules, the company's press release announcing the reverse stock split must be made before noon on the second business day before the first day of trading of the post-split shares (the day before effectiveness). This creates challenges for companies, as the details of the reverse split are now made public one day earlier than they had been prior to the effectiveness of the new Nasdaq requirements, allowing more time for trading on the news prior to the market effectiveness of the reverse split. Prior to public disclosure of the reverse stock split, the company will need to file the amendment to its certificate of incorporation with the appropriate State regulatory agency reflecting the reverse stock split and provide confirmation of filing to Nasdaq prior to noon on that day.

On the next day, after market close, the reverse stock split goes effective. Any fractional shares are typically determined based on the closing share price on that day and are calculated based on the post-split price per share. It is worth noting that only certificated or book entry shares (including the individual entry for DTC), as opposed to street holders, are subject to fractional share payment or rounding. As most companies have a relatively small number of registered holders, or holders that hold a company's stock directly with the company, opposed to street holders who hold a company's stock through the broker-dealer they purchased the shares though, this amount tends to be relatively low.

Finally, on the next day at market open, trading begins of the new post-reverse split shares and the price is automatically updated by Nasdaq as a multiple of the prior day's closing stock price.

Thereafter, if applicable, the company must provide notice of adjustment to holders of options and warrants and other securities—typically via e-mail or registered mail, depending on the requirements stipulated in the agreement with the holder. Under the terms of holders of options and warrants and other derivative securities, notice may be required in advance.

SAMPLE

Reverse Stock Split Timeline For Nasdaq Listed Company

Date	Action Item	Responsible Party
T- 1 month	Submit CUSIP application to obtain number for new common stock [*turnaround for the application is typically within one to two business days, but can be expedited – many transfer agents request a few weeks before effectiveness. Discuss with the Transfer Agent the required timing to publish the CUSIP to provide DTC with enough notice.]*	**Counsel**
T-1 month	Send CUSIP to transfer agent	**Counsel**
T-12-14 Business Days	Transfer Agent to begin CUSIP eligibility process with DTC	**Counsel; Transfer Agent**
T-6-10 Business Days	If the timing and ratio of the reverse split have not been determined — Company Board of Directors' meeting/written consent to approve actual reverse split ratio and filing of amendment to Certificate of Incorporation[2]	**Company; Counsel**
T-6 Business Days	Provide any notices required under the terms of any options, warrants or other securities, to be provided prior to a reverse split.	**Company; Counsel**
T-5 Business Days	Confirm with DTC the CUSIP is eligible	**Counsel**
T-5 Business Days	Submit Company Event Notification to Nasdaq including the draft press release *[Due no later than 5 business days prior to the Market Effectiveness Date]*	**Counsel; Company**
T-2 Business Days	File amendment to Certificate of Incorporation for effectiveness on T-1 Business Days at 5 pm	**Company; Counsel**
T-2 Business Days	Send filed copy of Certificate of Amendment to Transfer Agent and Nasdaq	**Counsel;**
T-2 Business Days	File Form 8-K announcing amendment to Certificate of Incorporation [*must be filed before Nasdaq's 12 noon announcement two days before market effectiveness*]	**Company; Counsel**
T-2 Business Days	Transfer Agent or Company to prepare list of other equity holders with individual reverse stock split calculations (e.g. warrant holders)	**Transfer Agent; Company**
T-2 Business Days	Nasdaq to announce reverse stock split at 12 noon [*2 days prior to market effectiveness*]	**Nasdaq;**
T-1 Business Day	Provide final signed treasury order (direction letter from Company to Transfer Agent) and trading bulletins from Nasdaq to Transfer Agent; Company sends amounts to fund fractional payments	**Counsel; Transfer Agent**

[2] These resolutions should include a resolution that the shares subject to any equity incentive plan and any outstanding awards are also subject to the reverse split.

T-1 Business Day	After 5:00 pm EST, Transfer Agent will issue post-reverse stock split shares into an exchange account and issue shares to holders who do not require a letter of transmittal	**Transfer Agent**
T	Company common stock to trade on a split-adjusted basis on Nasdaq at the opening of trading	**N/A**
T	Transfer Agent to provide list of stockholders with individual reverse stock split calculations	**Transfer Agent**
T+2 Business Days	Submit Shares Outstanding Change Form to NASDAQ [*must be filed no later than 10 calendar days after the effective date of the split if outstanding shares decrease by 5% or more*]	**Donohoe**
Week of Effectiveness of Reverse Stock Split	Send notices of adjustment to holders of other equity securities affected by the reverse split (unless notification prior to the reverse split was required)	**Company; Counsel**