

CAPITAL MARKETS: **CONVERTIBLE** **NOTES**

February 25, 2026

GIBSON DUNN

Presenters



Stewart McDowell

Partner
New York



Eric Scarazzo

Partner
New York



Adam Lapidus

Of Counsel
New York



Kate Long

Of Counsel
New York

AGENDA

01 Convertible Notes Overview

02 Advantages of Convertible Notes

03 Disadvantages of Convertible Notes

04 Issuing Convertible Notes

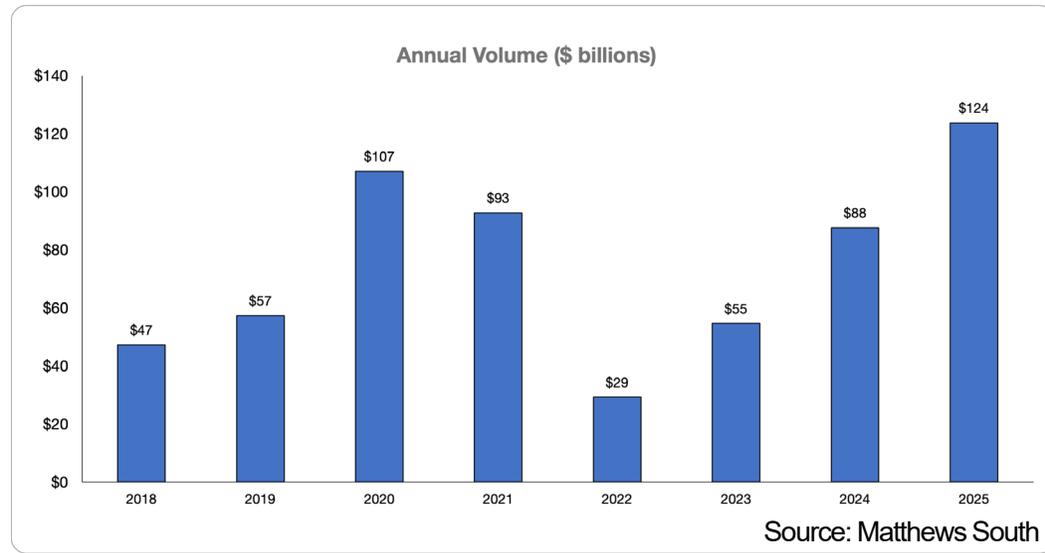
05 Key Points for Derivative Transactions

06 Key Tax Points for Convertible Notes

CONVERTIBLE NOTES OVERVIEW

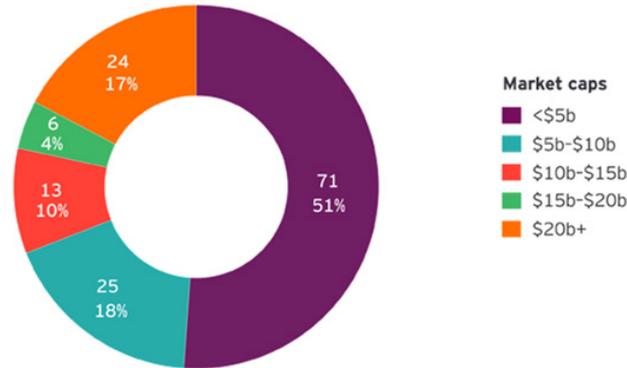
01

Convertible Bond Issuance in 2025



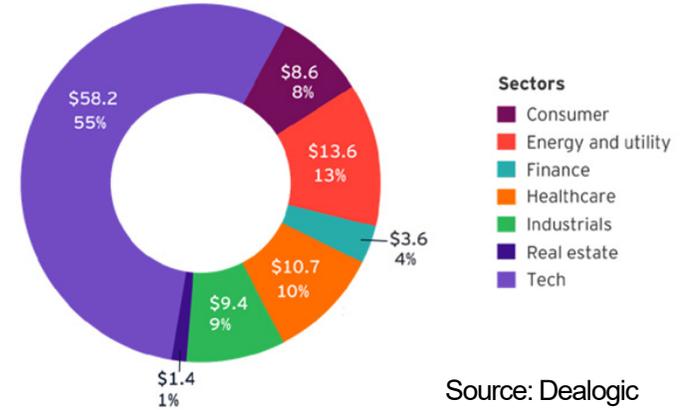
2025 was a record setting year in the convertible bond market

Number of issuers by market cap



Issuers ranged in size, but included a significant number or larger cap companies

Sector breakdown \$ in billions



Technology issuance leads, but broad range of industries represented

What is a Convertible Note?

A fixed rate debt instrument that provides the holder the right to convert the principal into shares of common stock of the issuer

Right to convert may be contingent on certain triggers

Downside protection

The issuer is obligated to repay at least money invested (“par”) plus accrued interest

Upside potential

If stock price rises, conversion option becomes valuable or “in-the-money.” This embedded option has value to investors

Contemporaneous transactions

A convertible note offering may be done in conjunction with derivative transactions (such as a call spread or capped call) and/or a stock repurchase

Customary Terms for “Plain Vanilla” Convertible Bond?

Maturity: Often 5 or 7 years

Seniority: Generally senior unsecured

Interest: Generally payable semi-annually

Redemption: Issuer may have right to redeem bonds

Generally after a non-call period

Generally has a price test – share price must be 130-150% of conversion price in order to redeem (so bonds significantly “in-the-money” when called)

Generally with a “Make-Whole”

In practice, call for redemption “forces conversion”

Customary Terms for “Plain Vanilla” Convertible Bond?

Fundamental Change

Typically events that result in the shares issuable upon conversion of the note no longer being publicly traded (e.g. change of control (unless substantially all consideration consists of shares of a listed company)) or delisting event

Generally triggers two events:

Additional value (Make-Whole) upon conversion

Investor put right (generally cash equal to par value)

Make-Whole

Increase in conversion rate upon specified events, based on stock price at time of event and timing of event (additional conversion value decreases over time and as value of shares increases)

Compensates investors for lost option value

ADVANTAGES OF CONVERTIBLE NOTES

02

Advantages of Convertible Notes

Lower Interest Rate

Given embedded option, investors generally accept a lower interest rate. Pricing has been attractive in recent transactions

Potential Equitization of Obligation

If the issuer's common stock price rises, holders will convert rather than allow bonds to reach maturity, and notes will be converted instead of repaid as a debt obligation (often giving the issuer choice of settling in cash, shares or a combination).

Minimal Covenants/Generally Unsecured

Most converts have minimal operating or financial covenants, other than those relating to treatment in a fundamental change. For issuers without an investment grade debt rating, this can be a significant benefit compared to high-yield bonds, which typically have significant financial and operational covenants

Most converts are unsecured and many do not have subsidiary guarantees

Debt Ratings

Generally not required or obtained

DISADVANTAGES OF CONVERTIBLE NOTES

AKA: LIVING WITH CONVERTS

03

Disadvantages of Convertible Notes

Dilution/Pressure on Stock Price

Conversion of convertible notes can be significantly dilutive

Hedging strategies of investors may put downward pressure on stock price, especially in near term

Operational Complications

Fundamental change provisions may complicate M&A transactions

Merger covenant and conversion price adjustment provisions may complicate spinoff transactions

Long notice/observation/settlement period

Accounting may be complicated, and may result in changes between long-term to current liability status from period to period

While unusual, inclusion for some issuers of debt limitation/limitation on lien covenants limit future financing flexibility

Difficult to obtain consent to amend (many key provisions require 100% approval)

Early Redemption/Refinancing Difficult

Convertible notes are generally redeemable only if they are in the money, so may be difficult to unwind prior to maturity

In the absence of an effective redemption right, any restructuring must be on the basis of a negotiated transaction or open market purchase

Because converts are an “equity security” restructuring through tender or exchange offer more complicated than straight debt

Call Spread/Capped Call can make early repurchase/exchange transaction more complicated

Coordination with other credit instruments may be complicated

ISSUING CONVERTIBLE NOTES

04

Issuing Convertible Notes Process Points

Rule 144A/Registered Offering

Convertible notes are generally Rule 144A eligible, and many are done as a Rule 144A offering. They may also be done as an offering registered under the Securities Act

Resale registration is generally not required for 144A offerings – instead there is a legend removal process once Rule 144 resale becomes available (one year after issuance) –

CALENDAR THIS DATE

Offering can generally be effected within 2-4 weeks of process kickoff, subject to MNPI considerations

Documentation/Process Items

Business/Legal/Accounting due diligence

Accounting/tax review

Offering Memorandum/Prospectus

Investor presentation

Purchase/Underwriting Agreement

Comfort Letter/Opinions

Other closing documentation

Documentation for derivative/share repurchase transaction

Potential Third Party Approvals

NYSE/Nasdaq Shareholder Approval Requirements (20%/Related Party/CoC tests)

Authorized Shares

Other Debt Agreements

Issuing Convertible Notes

Key Economic Points / Points of Negotiation

Key Economic Terms

Conversion Price – % premium over common share price at pricing

Conversion terms – convertible at any time versus contingent conversion

Settlement method – physical, cash, or combination

Observation period

Redemption/conversion at issuer's option

Covenants/Other Terms

Specific exceptions/ adaptations to conversion price adjustment provisions (eg dividend threshold)

Terms of any individualized covenants

Cross default terms

Investor “blocker” provisions

PIPE Terms More Variable

Convertible notes issued in a non-144A private placement to one or two investors may have many more variable terms

KEY POINTS FOR DERIVATIVE TRANSACTIONS

05

Three Derivative Structures

Consideration	Bond Hedge + Warrant (BH +W)	Tax-Integrated Capped Call	Non-Integrated Capped Call
Structure	Issuer purchases a call option mirroring the embedded conversion option; concurrently sells a higher-strike warrant with maturity 3-6 months longer than the convertible	Single purchased capped call with both a lower strike (matching conversion price) and an upper strike (cap price), structured to qualify for tax integration	Same mechanics, but without the structuring required for tax integration
Documentation	Two separate confirmations	One confirmation	One confirmation
Tax Treatment	Greatest tax benefit	Net premium paid can be tax-integrated with the notes	Net premium treated as a separate capital expenditure
EPS / GAAP Impact	Less favorable	More favorable	More favorable (same as tax-integrated capped call)
Upfront Cost	Lower	Higher	Higher (similar to tax-integrated capped call)

Key Terms

Number of Options/Warrants: Covers the same number of shares underlying the convertible note issuance to provide dollar-for-dollar offset within the protection range

Settlement Method: May be physical, net share, or cash settlement; default method specified in confirmation with issuer election rights under certain conditions; must coordinate with how the issuer intends to settle conversions under the notes

No Credit Support / Collateral: Derivatives must be structured without collateral or credit support to preserve equity classification under ASC 815-40; any credit support would disqualify equity accounting treatment

Adjustments: Strike price, cap price, and number of shares adjust for stock splits, extraordinary dividends, and other corporate events; adjustments are generally calculated by the bank counterparty

Extraordinary Event Termination: Mergers, tender offers, delisting, nationalization, or insolvency events may give the bank counterparty the right to terminate; termination payment calculated based on instrument value at time of termination

Warrant Expiration (BH+W Only): Warrants are European-style options exercisable only at expiration, with exercise dates beginning 90 days after the final maturity of the notes to avoid settlement timing conflicts

Call Spread Dealer Selection: Many banks are invited to bid on call spread pricing at launch; ultimately split 3-5+ ways based on pricing and relationship considerations

Unwind Mechanics and Relative Friction

Early Redemption / Refinancing Complexity: Call spread and capped call structures can complicate early repurchase or exchange transactions because the derivative positions must be addressed alongside the notes

Change of Control / M&A Scenarios: Historical experience shows that many issuers with BH+W structures that unwound early experienced unfavorable economic outcomes; capped calls generally produce better outcomes for issuers in early call, refinancing, or M&A scenarios

BH+W Has the Most Friction: Two separate contracts create timing mismatches. The warrant expiration is 3-6 months after note maturity, meaning the warrant obligation may survive a transaction or early unwind; termination payments on warrants are payable by the issuer and based on warrant value at termination

Capped Call Has Less Friction: Single contract with the same maturity as the convertible eliminates timing mismatch; bank counterparty has termination rights on extraordinary events, but no ongoing warrant overhang post-transaction

KEY TAX POINTS FOR CONVERTIBLE NOTES

06

Tax Considerations

- “Vanilla” convertible notes generally are expected to be treated as debt for U.S. federal income tax purposes, although more bespoke convertible notes may instead be more appropriately treated as equity.
- Conversion generally is not a taxable event.
- Certain adjustments to the conversion ratio that have the effect of increasing a convertible note holder’s proportionate interest in the issuer can result in a deemed distribution to the convertible note holder even though no cash is distributed.
- A deemed distribution to a non-U.S. holder can be subject to 30% withholding.
- Any issuer of convertible notes that adjusts the conversion ratio should discuss with its tax advisors whether IRS Form 8937 should be posted.
- If the issuer is a U.S. corporation, investors will want to know if the U.S. corporation is a “United States real property holding corporation” (“USRPHC”) – holding stock of a USRPHC can result in adverse tax consequences to non-U.S. holders.
- If the issuer is a non-U.S. corporation, then a “passive foreign investment company” (PFIC) analysis will need to be done – holding stock of a PFIC can result in adverse tax consequences to U.S. holders.

GIBSON DUNN