

Our Bespoke Analysis is a précis of interesting governance and disclosure issues that have potentially material impacts on shareholder returns.

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Lessons from GFC capital raisings: implications in the current environment

Simon Connal
23 March 2020

Summary

Capital raisings that took place during the GFC contain many lessons in the current environment.

- **GFC capital raisings revealed a preference for placements rather than entitlement offers**
- **Some placements were made on expanded (post raising) capital bases where undertaken alongside entitlement offers and led to dilution of up to 30%**
- **Issue price discounts were largest when raising capital to pay down debt**
- **Fees paid to underwriters didn't always appear to reflect genuine underwriting risk**

Preferred structure for capital raisings is accelerated renounceable entitlement offers, timetable was significantly shortened by ASX in 2014 and should be the starting point for non-distressed raisings.

Further reading on the GFC capital raisings is available [here](#) and post GFC capital raisings is available [here](#).

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During 2008 and 2009 Australian listed entities raised large amounts of equity capital as the global financial crisis led to a significant tightening in credit markets. The right of existing investors to maintain their ownership position in a company was abandoned in many cases as listed entities sought to raise funds expeditiously.

During 2008 and 2009 entities within the ASX200 raised \$98.94 billion in new equity capital through placements, renounceable and non-renounceable entitlements offers and SPPs. Just under 2% of capital raised (\$1.89 billion) was paid to investment banks for underwriting and advisory work but the investment banks were required to subscribe for only 2.7% of all securities that they underwrote.

Just under half of the funds raised (45%) through the GFC capital raising period was by way of placement and 31% of the funds raised were by non-renounceable entitlement offers where existing shareholders received no compensation for dilution suffered.

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The average discount to the prevailing security price for capital raisings to reduce debt was 24.6% and in most cases there was minimal information on how the discount was derived.

In the current environment it may be useful to reflect on some of the problematic features of the GFC capital raisings so that investors are best placed to protect their ownership interests in their investments.

1. Use of placements rather than entitlement offers

Given the ease and speed with which companies can issue securities through a placement in Australia it is unsurprising that placements were the most common form of capital raising during the GFC. Placements are, however, the most dilutive form of capital raising for investors who are not invited to participate. On average the GFC placements diluted non-participating securityholders by just over 19%. Placements were priced at a weighted average discount (using the 10 day average closing price prior to the placement being announced) of just over 12%. Many of the GFC placements were made alongside entitlement offers to ease the dilution burden however 20% of all funds raised through placements were not.

Of particular concern were placements made to one (or a handful of) investor(s) who took strategic allocations. Apart from dilution investors should be wary of placements made to strategic investors who may be able to exert significant influence following the placement, either through subsequent board representation or by way of a stake that is large enough to have an influence on control transactions.

2. Placements made on an expanded capital base can lead to dilution of up to 30%

Under ASX Listing Rules a 15% cap is imposed on the placement of securities during a rolling 12 month period and offers in excess of the 15% cap require prior securityholder approval (outside of specified exceptions). The ASX does, however, waive this requirement if certain specific features exist and waivers are routinely granted allowing issuers to make placements of greater than 15% ahead of underwritten entitlement offers which allows issuers to calculate the 15% dilution cap on the basis of the entities' expanded capital base following the entitlement offer. So, if a company elects to undertake a one-for-one entitlement offer, this effectively results in a 30% placement capacity.

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3. Issue price discounts

The GFC capital raisings revealed variation in discounts that applied depending on the purpose of the capital raising. The weighted average discounts (again using the 10 day closing average) were as follows:

- Pay down debt: 26.4%
- Working capital/strengthen balance sheet: 21.6%
- Fund acquisition: 17.1%
- Enhance capital position – banks: 12%
- Fund projects/exploration/expansion: 10.8%

Underwriters often prefer large discounts in capital raisings and investors should be particularly conscious of discounts that apply when capital is raised by way of placement. Discounted entitlement offers are less problematic given that all securityholders will have the opportunity to get access, on a pro rata basis, to the discounted securities.

The GFC capital raisings indicate that underwriters were good at pricing their own risk given that there were a small minority of cases where underwriters were forced to take up material shortfalls. There is an inherent conflict of interest of the role of investment banks acting as underwriter and price advisor on capital raisings.

4. Fees paid to underwriters/advisors

Fees paid to underwriters/advisors in the GFC capital raisings varied depending on the form that the capital raising took (fees paid for placements averaged 1.74%, for non-renounceable entitlement offers they averaged 2.32% and for renounceable offers they averaged 2.4%) which partly reflected the time that underwriters were “on risk” for the raising. However, since the GFC raisings the ASX has introduced an accelerated timeframe for entitlement offers which enables the institutional component of entitlement offers to be completed in a timeframe which is similar to that of placements.

In some cases in the GFC capital raisings underwriting fees were paid on committed allocations (where large shareholders had already committed to take up their entitlements in full) at the same

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rate as the portion of the raising that the underwriter was genuinely “on risk”. In some cases underwriters received additional underwriting fees where allocations were upsized due to demand exceeding supply for placements.

5. Sub-underwriting by strategic shareholders

Investors should also be conscious of the extent to which entitlement offers are underwritten and sub-underwritten as well as the identity of any sub-underwriters. While the Australian takeovers regime places a cap on anyone acquiring (increasing the extent of) a 20% or greater interest in an ASX listed company without launching a bid for the company, an exception to this rule includes circumstances where the interest is acquired through the underwriting or sub-underwriting of an entitlement offer.

Preferred structure for capital raisings – accelerated entitlement offers

The preferred structure for capital raisings to preserve equity amongst shareholders (the protection of pre-emptive rights), and to raise equity capital expeditiously, is for issuers to make use of the accelerated timetable for entitlement offers that the ASX introduced after the GFC capital raising period (the revised timetable was introduced in 2014). More specifically, the use of renounceable entitlement offers is preferred to non-renounceable offers. Under the accelerated timetable the institutional component of the raising (which is often the largest portion of an issuer’s share register) can be conducted on the day of announcement of the raising and the retail component completed on 14 business days. Under the regime that applied in the GFC period the same raising took 26 days to complete.

Further reading:

In 2013 OM released a report on capital raisings undertaken in the post GFC period which examined the \$33 billion raised by the ASX300 entities in 2010 through to 2012. That report is available [here](#).

The original study of the GFC capital raising is available [here](#).

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