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Open season for IBs and takeovers by stealth: Emergency capital raising relief

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Summary

ASX and ASIC have announced "Temporary emergency capital raising relief".

The relief, which expires at the end of July 2020, provides for placement capacity of 25% where a raising is conducted alongside an entitlement offer or SPP.

The relief, if used, will result in significant dilution for some – particularly retail shareholders and institutional shareholders not invited to participate - or where the entitlement offer is small.

Control implications of capital raisings are also exacerbated – a 19.99% placement combined with sub-underwriting could result in a single holder having a position beyond 30%.

A "supersized waiver" can also be used which would increase the placement capacity to 50% where a one-for-one entitlement offer is undertaken.

The liberal nature of the relief places the onus on boards to ensure raisings are conducted fairly – and not merely in a way suiting investment banks and their favoured clients.

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On 31 March 2020 ASIC and ASX announced temporary emergency capital raising relief to help facilitate capital raisings in the short term. The relief is provided by way of class order waivers under ASX Listing Rule 18.1 and provides a temporary uplift in the 15% placement capacity under Listing Rule 7.1 to 25% conditional on an issuer making an entitlement offer or SPP as a follow-on to the placement at the same price, or a lower price, to the placement price. The regime will expire on 31 July 2020 unless the ASX determines to remove or extend the relief.

Significant dilution may result

The ASX states that the effect of the relief is to ensure all securityholders, including in particular retail securityholders, are offered the opportunity to participate in the capital raising at the same or lower price as placement participants. While the relief does provide those securityholders the ability to participate in the capital raising, the relief undoubtedly results in dilution to those securityholders. In a worst case scenario dilution suffered will be just below 25% where an issuer conducts a 25% placement and then follows on with a minimal SPP for retail shareholders. In such

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a scenario institutional shareholders may also suffer dilution of more than 25% where they are not invited to participate in the placement (and SPP). The ASX relief appears to assume that the upsized placements will be made available to existing institutional securityholders whereas in reality investment bank advisors/underwriters have significant influence on placement allocations.

Control implications exacerbated

Control implications are exacerbated under the relief because the upsized placements can be made to one or a small number of institutional investors. Australia's takeover regime would prevent a placement of more than 19.9% to a single investor, however, where that investor acts as a sub-underwriter to the subsequent entitlement offer the investor could end up with in excess of a 20% stake in a company without needing to make a bid for the company.

For example, if a company made a 20% placement to one investor and conducted a one-for-one entitlement offer which that investor sub-underwrote and subscriptions for the entitlement offer were only 50% - then assuming that the investor received the 50% that was not subscribed for, they would hold just over 30% of the company following completion of the raising.

The "supersized waiver"

A "supersized waiver" is also available where an entity undertakes a placement followed by an entitlement offer. The supersized waiver allows an issuer to calculate the placement size on the basis of the expanded capital base post the capital raising. So, if an issuer decides to undertake a one-for-one entitlement offer, the placement capacity is calculated on the basis of the doubling of the shares on issue which results in a placement capacity under the temporary relief equal to 50% of shares on issue at the time the raising is announced. The "supersized waiver" is included in the class waiver and issuers do not need to apply separately to ASX to get the benefit of the waiver, which they previously had to do.

Scrutiny on boards overseeing capital raisings

The freedom to raise equity capital under the temporary relief measures places a lot of scrutiny on boards to ensure that the raisings are conducted in an equitable manner. Boards will need to

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ensure that existing shareholders on the register at the time the capital raising is announced are afforded the ability to participate and that the investment banks assisting with the raising are not placing discounted stock to their preferred clients. There was some evidence during the GFC capital raisings of investment banks placing away from index funds to their preferred clients knowing that index funds would need to buy on market following the raising to maintain their index weights, and so providing price support in the post capital raising trading period.

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.

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