

Addisons FocusPapers

Raising Capital in Difficult Times

In the current global financial crisis raising capital has become a significant issue for many companies. Banks and financial institutions are now more cautious about their lending practices, regularly imposing relatively stringent financial and security covenants. As an alternative to bank finance, many companies have looked to the equity markets in an attempt to “repair their balance sheets”. Whilst the number of initial public offerings has almost reduced to a trickle over the past eighteen months, recent capital raisings in the secondary market have been relatively numerous, large and successful. This FocusPaper briefly examines some of the alternative forms of raising capital that companies might consider pursuing.

Pro-rata Rights Issues

Both listed and unlisted companies may engage in rights issues pursuant to which existing shareholders are offered an opportunity to subscribe for further shares on a pro-rata basis. Rights issues by unlisted companies require a prospectus to be prepared and lodged with the Australian Securities & Investments Commission (“ASIC”), unless one of the disclosure exemptions apply. Rights issues by listed companies do not require a prospectus provided that certain conditions set out in section 708AA of the Corporations Act 2001 (Cth) (“Act”) are satisfied. These conditions include, among others, that the class of securities being offered are quoted securities at the time the offer is made and that trading in the offer securities has not been suspended for more than 5 trading days in the past 12 months.¹

Rights issues can be divided into “traditional” rights issues and “non-traditional” rights issues. Traditional rights issues are made on a pro rata basis to all securityholders, that is, in proportion to their existing securityholdings and on the same terms for each securityholder. Non-traditional rights issues, often referred to as “accelerated rights issues”, involve an offer to institutional investors, followed by an offer to retail investors – this basic form of accelerated rights issue is sometimes referred to as a “jumbo” structure.

¹However, ASIC has stated in Regulatory Guide 189 dated June 2009 that it will consider granting case-by-case relief to permit an issuer to rely on section 708AA where the shares have been suspended for more than 5 days, where it appears that the securities are adequately priced and the market is fully informed.

Addisons FocusPapers

Another form of accelerated rights issue is the RAPIDS² or AREO³ structure. RAPIDS and AREO rights issues also involve making an offer to institutional investors before retail investors, except that rights not taken up are sold in:

- (a) an institutional bookbuild, in respect of those rights not taken up by institutional investors; and
- (b) a retail bookbuild, in respect of those rights not taken up by retail investors.

ASIC has issued Class Order 08/35 (issued on 12 May 2008) to allow non-traditional rights issues to be conducted without disclosure, subject to certain conditions. Class Order 09/459 has also been issued to allow a shareholder to acquire a voting power in excess of 20% as a result of participating in an accelerated rights issue.⁴ Previously, such an acquisition would have been prohibited by section 606 of the Act.

In respect of listed companies, the timetables set out in the ASX Listing Rules for rights issues must be complied with. Because of their unique structure, accelerated rights issues require waivers from the ASX in respect of the timing of certain events. The Listing Rules also set out general requirements for rights issues which must be adhered to by listed entities. For instance, a listed entity that proposes a rights issue is required to offer the securities to all holders with registered addresses in Australia and New Zealand. An entity must also offer the securities to all other overseas holders, unless the entity considers that it is unreasonable to do so (having regard to specific factors) and a relevant notice is given to those overseas holders.

Share Placements

Many companies raise capital by issuing securities to specific investors. Such offers require disclosure, unless one of the disclosure exemptions in the Act apply. Some of the common exemptions include where:

- (a) securities are issued to no more than 20 investors, as a result of personal offers being made, and not more than \$2 million is raised by the issuer in a 12 month period;
- (b) securities are offered to a sophisticated investor, being an investor with net assets of at least \$2.5 million or gross income for each of the last two financial years of at least \$250,000, in either case certified by a qualified accountant;
- (c) securities are offered to a professional investor, as defined in section 9 of the Act. A professional investor includes, among others, a financial services licensee, a superannuation fund, an approved deposit fund and a person who controls at least \$10 million;
- (d) the minimum amount payable for the securities, on acceptance by the investor, is at least \$500,000;
- (e) an entity offers securities to a senior manager of the entity or their spouse, parent, child, brother or sister or a body corporate controlled by any of those persons. A

² “Renounceable Accelerated Pro-rata Issue with Dual bookbuilds”

³ “Accelerated Renounceable Entitlement Offer”

⁴ ASIC Class Order 09/459 was issued on 12 June 2009.

Addisons FocusPapers

“senior manager”, in relation to a corporation, is a person (other than a director or secretary of the corporation) who participates in making decisions that affect a substantial part of the business or who has the capacity to affect significantly the corporation’s financial standing.

An issuer should consider in advance whether a proposed placement will be made to a related party of the issuer. A related party can include a major shareholder of the issuer, a director of the issuer and the relatives of a director. An entity can also be a related party of an issuer if the entity believes or has reasonable grounds to believe that it is likely to become a related party of the issuer at any time in the future. If a proposed investor is a related party, the provisions of Part 2E of the Act which restrict a public company giving a financial benefit to a related party may apply. Depending upon the circumstances, a prohibited related party transaction could include an issuer issuing shares to a related party at a significant discount to the trading price or market value of the shares.

The Listing Rules also require that, unless a relevant exception applies, an issuer must not issue or agree to issue equity securities to a related party, without the approval of holders of ordinary securities. Approval of shareholders may also be required where an issue is being made to a person whose relationship with the issuer is, in ASX’s opinion, such that approval should be obtained.

Listed entities must ensure that a share placement does not contravene Listing Rule 7.1. Listing Rule 7.1 limits the number of equity securities a listed company may issue in any 12 month period, without shareholder approval, to 15% of its ordinary shares on issue. This rule is subject to various exceptions, such as where an issue is made under a pro-rata rights issue or an employee incentive scheme.

Share Purchase Plans

On 15 June 2009, ASIC released Class Order 09/425 to provide disclosure relief for securities acquired pursuant to a share purchase plan. Subject to certain conditions, this Class Order will allow a listed company to issue up to \$15,000 worth of shares to each of its existing shareholders, without the need for a prospectus or other disclosure document. Class Order 09/425 replaces Class Order 02/831 which only allowed shareholders to acquire a maximum of \$5,000 worth of shares.

Exception 15 of Listing Rule 7.2 provides that Listing Rule 7.1 does not apply to an issue of securities under a share purchase plan for offers not exceeding \$5,000 to existing shareholders. Accordingly, if an entity wishes to issue up to \$15,000 worth of shares under a share purchase plan pursuant to ASIC Class Order 09/425, the issuer will still be required to seek a modification from ASX to increase the monetary limit under Exception 15 from \$5,000 to \$15,000 – at least until ASX amends Exception 15.

Convertible Notes

Convertible notes offer a useful means of raising capital without the immediate dilutionary impact of issuing shares. A convertible note generally entitles the holder to convert its notes to shares during a specified period or upon the occurrence of certain events. Important terms to consider when negotiating agreements to issue convertible notes include:

- the interest rate of the notes and when interest is payable;

Addisons FocusPapers

- whether the notes will be secured against the assets of the issuer;
- when the notes may be exercised (“conversion period”);
- whether the issuer can require that the notes be converted;
- when the notes expire (“maturity date”);
- whether the issuer has the option of repaying (“redeeming”) the notes before the maturity date;
- the formula by which the notes convert into shares (“conversion price”). Often the conversion price will be based on the volume weighted average price of the shares traded in the last several weeks before an exercise notice is given to the issuer. This means that a lower conversion price results in a greater number of shares being issued to the convertible note holder upon conversion.

Convertible notes are “equity securities” for the purposes of Listing Rule 7.1. Accordingly, the 15% restriction in Listing Rule 7.1 may apply to the issue of convertible notes. However, Listing Rule 7.1 will not apply where an issuer has issued convertible notes, and those convertible notes cannot convert into shares unless prior shareholder approval is obtained. In this regard, the terms of a convertible note often provide that shareholder approval must be obtained under Listing Rule 7.1 before the convertible note can be converted into shares.

For more information please contact:

David P. Selig, Partner

Telephone: +61 2 8915 1010

Facsimile: +61 2 8916 2010

Email: david.selig@addisonslawyers.com.au

Nathan Greenfield, Solicitor

Telephone: +61 2 8915 1042

Facsimile: +61 2 8916 2042

Email: nathan.greefield@addisonslawyers.com.au