

Rights issues for small cap companies



A number of companies used rights issues to raise further funds in 2009 - but small cap companies steered clear. Nick Graves and Dominic Davis of the Burges Salmon LLP corporate department look at some of the key points that companies should consider when assessing potential fundraising structures

2009 was the year of the rights issue. A constant stream of companies used that fundraising structure to raise further funds. All rights issues in the UK last year were undertaken by Official List companies, the majority of which were seeking to raise more than £100 million - for example the National Express £360 million rights issue and Lloyds Banking Group plc's £13 billion rights issue, both announced in November 2009.

Small cap companies, however, have steered clear. Why?

To help answer that question, this article focuses on some key points regarding rights issues that companies should consider when assessing potential fundraising structures:

1. What is the main advantage of a rights issue?

Rights issues and open offers are both offers of new shares made to existing shareholders on a pre-emptive basis, in proportion to their existing shareholdings.

Unlike an open offer, however, under a rights issue a shareholder is able to realise the value of his rights to subscribe for the new shares by selling them in the market nil paid. Even a lazy shareholder who does nothing has the right to receive any value above the subscription price if the shares which he could have taken up are sold in the market at a premium to the subscription price plus associated costs.

The shareholder's ability to participate in a rights issue in this way and the creation of a tradable instrument during the subscription period are key benefits of a rights issue.

2. What are the disadvantages of a rights issue?

A prospectus complying with the detailed requirements of the Prospectus Rules must be published.

The requirement to publish a full prospectus is one of the main barriers to the wider use of rights issues. The QCA continues to lobby the European Commission, in response to the EC's Prospectus Directive Review, to remove the need for a full prospectus for rights issues.

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Transaction	Main Market - is a prospectus required?	AIM & PLUS - is a prospectus required?
Secondary placing with institutions	No, unless the issue represents 10% or more of the class of shares already admitted to trading (taking into account other share issues in the previous 12 months).	No, as a placing will usually be made to qualified investors only so should not constitute an offer to the public.
Placing and open offer	Yes.	Yes, unless an appropriate exemption applies (including where, for example, shareholders are qualified investors; any non-qualified investors number less than 100 per EEA State; the consideration for the offer is less than €2.5m). Some placings and open offers have recently been undertaken without a prospectus in reliance on a combination of exemptions (namely, the qualified investor and €2.5m consideration exemptions).
Rights issue	Yes.	Yes. A rights issue involves an offer to the public as the provisional allotment letters are transferable so there is no certainty that the offer is made to or directed at fewer than 100 persons per EEA State.

A rights issue also requires substantial management time and documentation, the key documents, in addition to a prospectus, being (i) a notice of general meeting, (ii) an underwriting agreement and (iii) a provisional allotment letter.

3. Do I need a general meeting of shareholders?

Yes, if there are restrictions on the issuer’s ability to allot the new shares and the directors do not have authority to allot the new shares. A general meeting may also be required to take advantage of the benefits of disapplying statutory pre-emption rights.

4. What role can major shareholders play?

Consider asking supportive major shareholders to underwrite the rights issue. Depending on their shareholding, a waiver of Rule 9 of the City Code on Takeovers and Mergers from the

Takeover Panel may be required. Such a ‘Rule 9 Whitewash’ requires an ordinary resolution passed by independent shareholders on a poll vote in general meeting.

5. When is a supplementary prospectus required?

A supplementary prospectus will be required if a significant new factor, material mistake or inaccuracy relating to the information contained in the prospectus arises between the FSA’s approval of the prospectus and the final closing of the rights issue.

This is significant as shareholders can withdraw their acceptances of the offer within two business days of the publication of the supplementary prospectus.

Although there are a number of challenges involved in a rights issue (not least grappling with the

terminology! (nil paid rights, rump, stick and PALs etc)), small companies should nevertheless consider whether a rights issue is an appropriate fundraising structure, especially given the reduction of the rights issue subscription period to 10 business days.

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