

FUND RAISING FOR HIGH GROWTH COMPANIES – SOME GOOD NEWS

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Some recent Corporations Law changes allowing rights issues by listed entities without a prospectus as well as proposed ASX Listing Rule changes that reduce the shareholder spread requirement (from 400 to 200) and allow for advance annual shareholder approval to make private placements of up to 25% of issued capital (rather than the normal allowable 15%) should make fund raising for high growth companies easier in a number of respects.

1. RIGHTS ISSUE

- 1.1 Since 28 June 2007, ASX listed public companies are able to undertake a rights issue without a prospectus provided that the securities being offered (normally ordinary shares) are quoted and trading in that class of securities has not been suspended for more than 5 days during the last 12 months (or since quotation if the class of securities where they have been quoted for less than 12 months) and provided certain other technical requirements, which are generally relatively easy to comply with are met (see Section 708AA of the Corporations Act).
- 1.2 In addition to complying with Section 708AA of the Corporations Act it is also necessary to comply with Chapter 7 of the ASX Listing Rules and with the timetable requirements in Appendix 7A of the ASX Listing Rules. There is no requirement to obtain shareholder approval for a rights issue (ASX Listing Rule 7.2 Exception 1).
- 1.3 This change has considerably lessened the costs associated with rights issues as before these changes it was necessary to issue a prospectus in order to make a rights issue and as a result companies tended to prefer to raise capital from professional and sophisticated investors under the disclosure exemptions in Section 708(8) and (11) of the Corporations Act and the “15% in a year” exemption to shareholder approval requirements permitted under the ASX listing rules (ASX Listing Rule 7.1). In fact we understand that the changes were made following pressure from shareholder groups as there was a perception that the regime favoured new professional shareholders over existing shareholders.
- 1.4 These changes have now made rights issues much more attractive as a means of raising capital from existing shareholders.

2. SHAREHOLDER SPREAD

- 2.1 Before a company can list its shares on the ASX it must comply with a list of requirements set out in the ASX Listing Rules.
- 2.2 These include (ASX Listing Rule 1.1):
 - (a) the structure and operations of the company must be appropriate for a listed entity;
 - (b) a prospectus (in some cases a Product Disclosure Statement or Information Memorandum) must be issued and lodged with ASIC;

- (c) it must satisfy the “profits test” or “assets test”; and
 - (d) it must achieve a sufficient spread of shareholders.
- 2.3 Achieving a sufficient spread of shareholders is often very difficult. The company must have at least 500 shareholders (this is reduced to 400 shareholders if at least 25% of shares are held by non related parties) holding shares worth at least \$2,000 (excluding restricted or escrowed securities). In most small floats (and even some larger ones) a considerable amount of time is spent trying to find sufficient shareholders to take up the offer in order to meet this requirement.
- 2.4 The shareholder spread requirement is not met if spread is obtained by artificial means (ASX listing rule 1.1 Condition 7). It is not clear exactly what this means. In practice the ASX applies this requirement by excluding more than 2 shareholders at the one address. In addition the ASX counts nominee holders as one holder only.
- 2.5 At times companies attempt to reduce the shareholder spread hurdle by structuring their new listing as a “backdoor listing”. This in essence involves selling the company into a listed shell. The difficulty with such a transaction is that the costs and risks are normally higher due to the need to prepare a share sale agreement, appoint separate lawyers to act for the listed entity, conduct due diligence on both entities and obtain listed entity shareholder approval. Due to ASX Listing Rule 11.1 and ASX Guidance Note 12 the company will still in effect have to comply with all the normal listing requirements in Chapters 1 and 2 of the ASX Listing Rules. The only benefit then is that it may be easier to achieve shareholder spread, but this will obviously very much depend on the share register of the listed entity.
- 2.6 On 14 December 2007 ASX released two public consultation papers suggesting certain changes to the ASX Listing Rules. Included in these suggested changes is a proposal to change the spread requirement such that companies seeking to list must have at least 200 shareholders (currently 400), each with a holding of at least \$2,000 worth of shares; and net tangible assets of at least \$4 million (currently \$2 million). In doing so the ASX have recognised the reality that the spread requirement as it stands today is regarded by many as the most difficult hurdle for listing and shareholder spread, particularly in smaller listed entities, is not necessarily a good proxy for liquidity.

3. 15% RESTRICTION

- 3.1 In the one of the two public consultation papers released by ASX on 14 December 2007, ASX also propose that listed companies with a market capitalisation under \$100 million be able to obtain at their AGM a shareholder mandate to make placements up to 25% (rather than 15% as is allowed without shareholder approval) of the amount of issued capital for a period of 12 months from the AGM. The mandate will have to be renewed each 12 months and there will be a restriction on the price at which capital is raised so as not to be at greater than 20% discount to market.
- 3.2 At present it is possible to obtain prior shareholder approval to exceed the 15% placements threshold but there is a requirement that the securities be issued within 3 months of the shareholder meeting date (ASX Listing Rule 7.3.2).
- 3.3 This ability to obtain a mandate in advance to raise up 25% of issued capital that lasts for a full 12 months (and therefore can be renewed at each AGM) will provide

smaller listed entities with a more appropriate level of flexibility given their greater proportionate need for capital.

4. TIMING

- 4.1 The Rights Issue change has been in effect since 28 June 2007 and quite a number of listed companies have taken advantage of the change by undertaking rights issues without a prospectus.
- 4.2 The proposed ASX changes reducing the shareholder spread requirement and allowing for shareholder mandates to make private placements of up to 25% of issued capital are at this stage only ASX proposals. The period allowed for by ASX for public comments expired on 15 February 2008. ASX still needs to draft the specific rule changes, seek public comments on them and seek input from ASIC before the changes can take effect. At this stage these changes are not expected to take effect until towards the end of this year.

5. CONCLUSION

- 5.1 The recent Corporations Act change allowing rights issues by listed entities without a prospectus has made rights issues much more attractive as a means of raising capital from existing shareholders.
- 5.2 Our firm has made a submission to ASX in support of the proposed changes to the ASX rules outlined in this article. Reducing the spread requirement from 400 to 200 will reduce listing costs without materially effecting liquidity. Enabling an annual mandate vote at the AGM to enable placements of up to 25% will increase flexibility for small listed entities that need to raise relatively significant amounts of capital on a fairly regular basis to support their growth.

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