KEY ISSUES FOR ASX LISTED ENTITIES RAISING CAPITAL TO FUND ACQUISITIONS

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Legal Briefings – By **Nicole Pedler, Ting Fan**

It can be efficient and effective for ASX listed entities to fund major acquisitions out of the proceeds of a capital raising. However, there are also interrelated risk, timing, process and approval factors to balance. In this article we survey some of the more recent major capital raisings to fund acquisitions and outline the key factors for ASX listed entities to consider when funding an acquisition through a capital raising.

IN BRIEF

- Sale agreements that are "subject to finance" are unlikely to be acceptable to vendors and yet a capital raising cannot ordinarily for practical purposes be conducted during a sale process and before entry into a sale agreement.
- Our survey of 20 major capital raisings to fund acquisitions of listed and unlisted targets showed remarkable consistency in the approach taken to ensuring certainty of funds whilst managing related disclosure, risk and timing issues.

CERTAINTY OF FUNDS

A prospective acquirer requires certainty of funds on entry into a sale agreement as vendors do not typically accept 'subject to finance' conditions.

The same stance in relation to funding conditions can be expected from listed entities the subject of control proposals when negotiating scheme or bid implementation agreements. Additionally, in the implementation agreement context, material breach of warranties to the effect that a bidder has a reasonable basis for expecting it will be able to fund the bid consideration usually entitles the target to terminate the implementation agreement. In the takeovers context, it is an offence to propose a takeover bid if the person proposing it is reckless as to whether they will be able to perform their obligations under it if a substantial proportion of the offers under it are accepted.

The requirement for certainty of funds on entry into the sale or implementation agreement raises various related challenges for a ASX listed acquirer looking to fund an acquisition out of the proceeds of a raise.

TIMING, DISCLOSURE AND SEQUENCING

The main challenge in this context is that in order to raise new capital, the prospective acquirer needs to be able to explain to potential investors what the funds will be used for and certain information in relation to the transaction. Inevitably, however, the relevant sale process involves ongoing confidential and incomplete negotiations with various settings and terms changing up until the sale agreement is signed. This means that the capital raising needs to occur after the sale agreement has been signed.

Where the sale agreement is to be signed ahead of the capital raise and the agreement is not subject to a financing condition, a prospective acquirer needs certainty it can raise the amount needed (whether that be for the full or a partial amount of the purchase price) but has no certainty as to whether it will be able to raise that amount until it completes the raise.

To address this catch-22, the usual approach is that the acquirer would, either immediately before or at the same time as entering into the sale agreement, enter into an underwriting agreement for any shortfall in funds it wishes to raise. Indeed, in a survey of 20 major capital raisings conducted to fund an acquisition in the years spanning 2011 to 2020 (which are set in the table below), all such raisings were either fully underwritten or underwritten to an amount that was (together with other committed funding sources) adequate to cover the consideration for the acquisition.

After entry into the underwriting agreement, the capital raising is then typically launched on the same day that the sale agreement is signed and announced. In the 20 deals surveyed, the relevant capital raise was announced either together with, or within minutes of, the announcement of the proposed acquisition or deal.

Entry into the sale agreement will trigger an obligation to disclose the proposed acquisition. Further, as part of the capital raising the acquirer will need to disclose information (including information otherwise not required to be disclosed due to the carve-outs to the disclosure requirements) that investors and their professional advisers would reasonably require for the purpose of making an informed assessment of:

- the assets and liabilities, financial position, performance and profits and losses of a the listed entity; or
- the rights and liabilities attaching to the relevant securities,

or confirm that there is no such information in its cleansing notice. The format for such disclosures vary depending on the type of capital raising.

The important point to keep in mind is that this disclosure requirement applies to the listed entity as a whole, so if the acquirer has other information about itself that was being withheld under a carve-out to the disclosure requirement, that information would need to be disclosed.

TYPE OF CAPITAL RAISING

Listed entities raising capital to fund acquisitions prioritise minimising the time taken to raise capital and increasing certainty of raising the requisite funds. This being the case, the most common structures used for capital raises in this context are:

- **Placement** – offer to institutional investors in Australia and overseas, who may be existing or new shareholders.
- **Accelerated rights / entitlement issue** – offer to all existing shareholders (except excluded foreign registered shareholders) to subscribe for additional shares in proportion to their holding (pro rata), where it is structured as a two-stage process with an initial (accelerated) institutional component, and a secondary (non-accelerated) retail component.

The preferred structure will depend on investor interest, available pricing and approvals required (see below) among other factors.

As a placement is not a pro rata offer and does not require any offer to be made to the acquirer's shareholders, it will have a dilutive effect to existing shareholders. This is mitigated for institutional and sophisticated shareholders of the target who would often be offered an opportunity to invest under the placement. To give retail shareholders an opportunity to avoid the dilutive effect of the placement, a share purchase plan (which has an elongated timetable as compared with a placement) is often added to the placement, offering retail shareholders an opportunity to each subscribe for up to $30,000 of new shares.

APPROVALS UNDER THE ASX LISTING RULES

Whether any shareholder approvals under the ASX Listing Rules (**LRs**) are required by the acquirer for the capital raising or the acquisition itself will depend largely on the relative scale of the acquisition to target to the acquirer and the amount of capital to be raised.

15% rule and exceptions

LR 7.1 provides that an entity cannot issue new equity securities which would exceed 15% of the entity's ordinary securities without shareholder approval, subject to exceptions.

There are exceptions (which are technical and have their own limitations which need to be worked through for each deal) for rights issues and placements to fund cash consideration of Australian schemes and takeovers where the terms of the issue are disclosed in the takeover or scheme documents, provided the issue does not constitute a reverse takeover under the LRs.

Significant changes to the nature of scale of the acquirer's activities or changes to its main undertaking

LRs 11.1 and 11.1.2 provide that if an entity proposes to make a significant change to the nature or scale of its activities, it must provide full details to ASX and, if required by ASX, obtain shareholder approval.

As set out in Guidance Note (**GN**) 12, ASX has adopted a movement of 25% as the appropriate benchmark for determining whether or not a transaction involves a significant change to the scale of an entity's activities requiring notification to ASX (but not necessarily shareholder approval), the relevant measures being: consolidated total assets, consolidated total equity interests, consolidated annual revenue, consolidated EBITDA or consolidated annual profit before tax.

GN 12 provides that a change in the nature of an entity's main undertaking is an important consideration as to whether ASX will exercise its discretion to require shareholder approval under LR 11.1.2. In terms of which undertaking is an entity's 'main undertaking':

- ASX considers it reasonably compelling evidence that a business is the company's main undertaking if that undertaking accounts for more than 50% on each of the following measures: consolidated total assets, consolidated annual revenue, EBITDA and consolidated annual profit before tax; and
- if the 50% threshold is exceeded on one or more, but not all, of those measures, ASX will examine more closely whether that undertaking is the entity's main undertaking.

WHAT HAPPENS IF THE ACQUISITION DOES NOT COMPLETE?

If the capital raising completes, but subsequently the proposed acquisition does not complete, then the entity which undertook the raise will need to consider what to do with the excess funds. To return the funds to investors who participated in the capital raising will likely require a selective buy-back, which is cumbersome because it requires a special resolution of shareholders with no votes cast in favour by investors in the capital raising, and the proceeds returned is less than the amount invested due to tax and other costs.

An alternative approach was taken in the capital raising for Seven West's acquisition of Seven Media Group in 2011. In that instance, Seven West conducted an entitlement offer (together with a placement and a public offer) of convertible unsecured loan securities (**CULS**) which would convert into ordinary shares only in the event that the transaction proceeded, or otherwise be redeemed and repaid together with a redemption premium to the issue price. Subsequently, the transaction was completed and Seven West announced a conversion date for the CULS.

The more common approach is to disclose in the prospectus to investors that there is a risk of the acquisition not completing and include the prospective acquirer's intentions for the funds raised in the event the acquisition does not complete.

In all 20 of the deals surveyed, the proposed transaction proceeded to completion.

OTHER FUNDING ALTERNATIVES

Aside from the proceeds of a capital raise, Funding can also come from existing cash reserves or debt, finance obtained for the specific acquisition, the issue of scrip consideration or a combination of more than one source. Notably, in the 20 cases surveyed, only three cases involved acquisitions that were proposed to be fully funded by a capital raise.

SURVEY OF 20 ACQUISITIONS FUNDED BY CAPITAL RAISES

#	Bidder	Target	Listed or unlisted target?	Deal announced	Deal value	Size of raise	Type of capital raise
1	HUB24	Xplore Wealth / PARs / Easton	Listed and Unlisted	Oct 2020	A$93m	A$60m	Placement and share purchase plan
2	Uniti Group	OptiComm	Listed	Jun 2020	A$532m	$270m	Accelerated non-renounceable entitlement offer
3	Iress	OneVue Holdings	Listed	Jun 2020	A$107m	A$170m	Placement and share purchase plan
4	WorleyParsons	Jacobs Engineering Group	Unlisted	Oct 2018	A$4.6b	A$2.9b	Accelerated non-renounceable entitlement offer
5	Bingo Industries	Dial A Dump	Unlisted	Aug 2018	A$577.5m	A$425m	Accelerated non-renounceable entitlement offer
6	Rural Funds Group	JBS Australia's five Australian feedlots and associated cropping land	Unlisted	Jul 2018	A$127.7m	A$149.5m	Accelerated non-renounceable entitlement offer
7	oOh!media	Adshel	Unlisted	Jun 2018	A$570m	A$329.9m	Accelerated non-renounceable entitlement offer
8	Reliance Worldwide Corporation	John Guest Holdings	Unlisted	May 2018	A$1.22m	A$1.1b	Accelerated non-renounceable entitlement offer
9	Cleanaway	Toxfree Solutions	Listed	Dec 2017	A$671m	A$590m	Accelerated non-renounceable entitlement offer
10	Nufarm	Portfolio of crop protection assets	Unlisted	Oct 2017	A$627m	A$446m	Accelerated renounceable entitlement offer
11	Beach Energy	Lattice Energy	Unlisted	Sep 2017	A$1.585m	A$301m	Accelerated non-renounceable entitlement offer
12	Link Administration Holdings	Capita Asset Services	Unlisted	Jun 2017	A$1.493b	A$883m	Accelerated renounceable entitlement offer
13	Yancoal Australia	Coal & Allied Industries	Unlisted	Aug 2017	US$2.45b	US$2.5b	Placement and renounceable entitlement offer
14	Aventus Retail Property Fund	Two large format retail centres in Sydney	Unlisted	May 2017	A$436m	A$215m	Accelerated non-renounceable entitlement offer
15	Downer EDI	Spotless Group Holdings	Listed	Mar 2017	A$1.089b	A$1.011b	Accelerated renounceable entitlement offer
16	Boral	Headwaters Incorporated	Listed	Nov 2016	A$3.5b	A$2.05b	Placement and accelerated renounceable entitlement offer
17	Metcash	Home Timber & Hardware Group	Unlisted	Aug 2016	A$165m	A$100m	Placement and share purchase plan
18	DUET Group	Energy Developments	Listed	Jul 2016	A$1.407b	A$1.67b	Placement and accelerated non-renounceable entitlement offer
19	AGL Energy	Macquarie Generation	Unlisted	Aug 2014	A$1.505b	A$1.232b	Accelerated renounceable entitlement offer
20	Seven West	Seven Media Group	Unlisted	Feb 2011	A$4.085b	A$1.154b	Placement, accelerated non-renounceable entitlement offer and public offer

KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.

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