Fundraising; but at what price?

15th May 2020

Since late March, we have now seen **in excess of £4.2bn of new equity capital raised** as a direct response to the Covid-19 crisis.

The majority of this fresh capital has been "defensive", primarily as a means to bolster balance sheets, improve near term liquidity and bridge the demand gap that has opened up for a large swathe of UK PLC. A minority has been more "offensive" as the turmoil has created opportunities for some companies. However, uniting many of these fundraises has been the use of the relaxation around pre-emption rules.

Pre-emption rules are a key plank of UK shareholder protections and the implications of their relaxation (allowing for up to 20% issuances) have begun to gather increasing coverage. Our own conversations with investors demonstrate the tricky balance between a desire to support portfolio companies at a time of uncertainty, tempered by a natural resistance to unnecessary dilution.

Our latest ***Radnor View*** explores these themes by looking at the spate of recent fundraising transactions in more detail. We focus on two key areas;

1. deal pricing relative to the size of share issuance;

2. deal pricing versus pre Covid-19 share prices (1st Feb 2020) relative to size of share issuance;

Immediate premiums / discounts – the headline picture

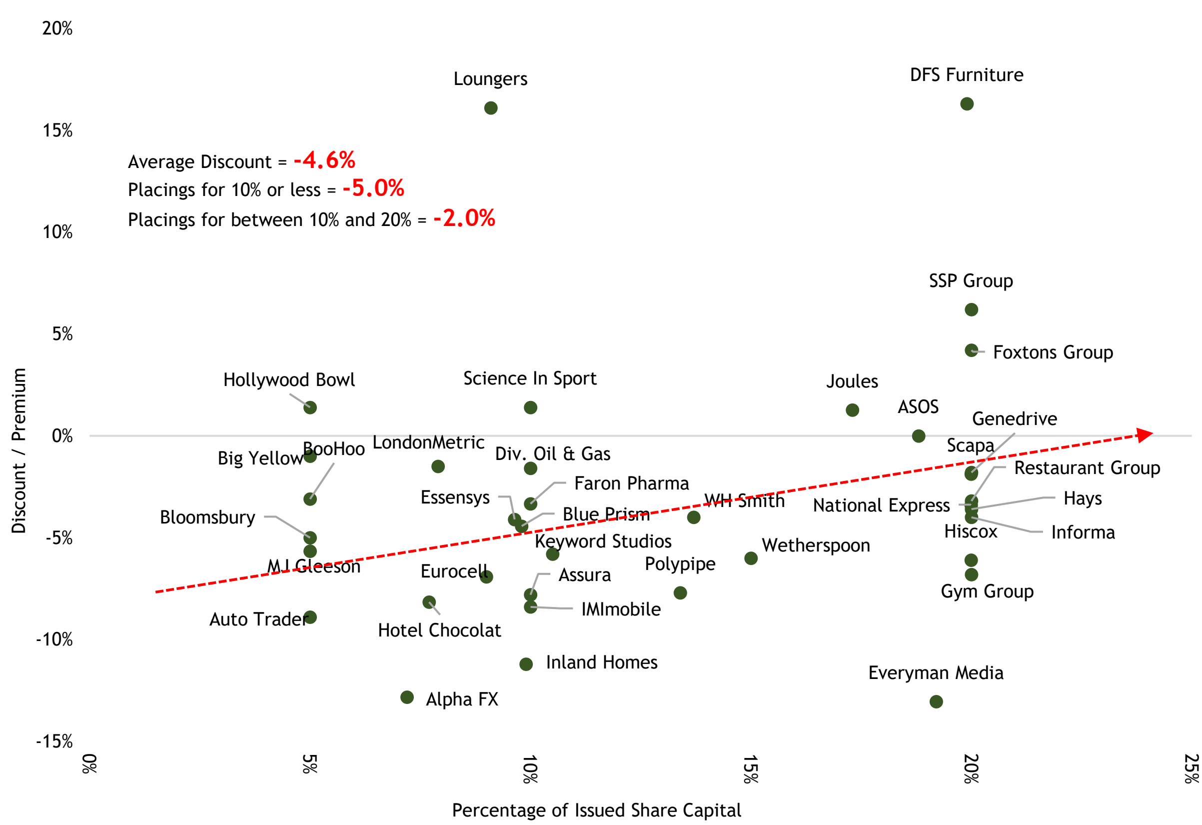
In *Figure 1* below, we show 38 fundraises that have taken place since 20th March 2020, where the percentage of issued share capital placed was less than 20%.

Of these 38 separate placings, just under half took advantage of the relaxation in pre-emption rules and saw between 10% and 20% of the issued share capital being placed; with many other placings either at, or very close to the revised 20% limit.

In total, these 38 placings have raised gross proceeds of **£3.86 billion**, of which **£3.07 billion** involved placings of **greater than 10%** of the issued share capital. The standout raise in this category was the

£1 billion (20%) placing by Informa PLC, but even excluding that, £2.07 billion has been raised under the relaxed pre-emption regime.

Figure 1: Discount / Premiums vs Percentage of Shares Issued



Source: Company announcements, FactSet

Figure 1 shows a **counter-intuitive** relationship between dilution and pricing. Typically, for a materially dilutive pre-emptive equity raise (ie, a rights issue); we expect to see existing holders compensated for having to put their hands in the pockets by a material level of discount (the 9 for 4 Hyve Group rights issue at a 68% discount being a current case in point).

However, these are not normal times and it is clear the 20% pre-emption relaxation has, in effect, created a "rights issue on the cheap" alternative. ***Figure 1* shows the average discount level has actually narrowed as the relative size of the placing has increased.** According to our calculations, the average discount for placings of greater than 10% the issued share capital is **-2%**, compared to **-5%** for placings of less than 10%. Even if we exclude outliers like DFS Furniture (20% placing at a 16% premium), which was priced in very specific fashion (to avoid seeking shareholder approval for a share split), **we still find larger placings being priced at a tighter discount than their smaller brethren.** Why is this?

- **Need.** There is a clear correlation between the companies most negatively impacted by the Covid-19 crisis and the scale of the funds being raised. **Investors are being supportive** of those companies that have come under significant short-term stress. This is both clear from the data but also our own conversations with investors. This is especially so for those companies where the absence of fresh equity funding raises short term existential questions. In many of these situations, the certainty of funds (ie avoiding the risk of not gaining shareholder approval) and short timeframe of the firm placing deal structure is very attractive from a company perspective, even if it does disadvantage those investors unable to participate; speed is everything.

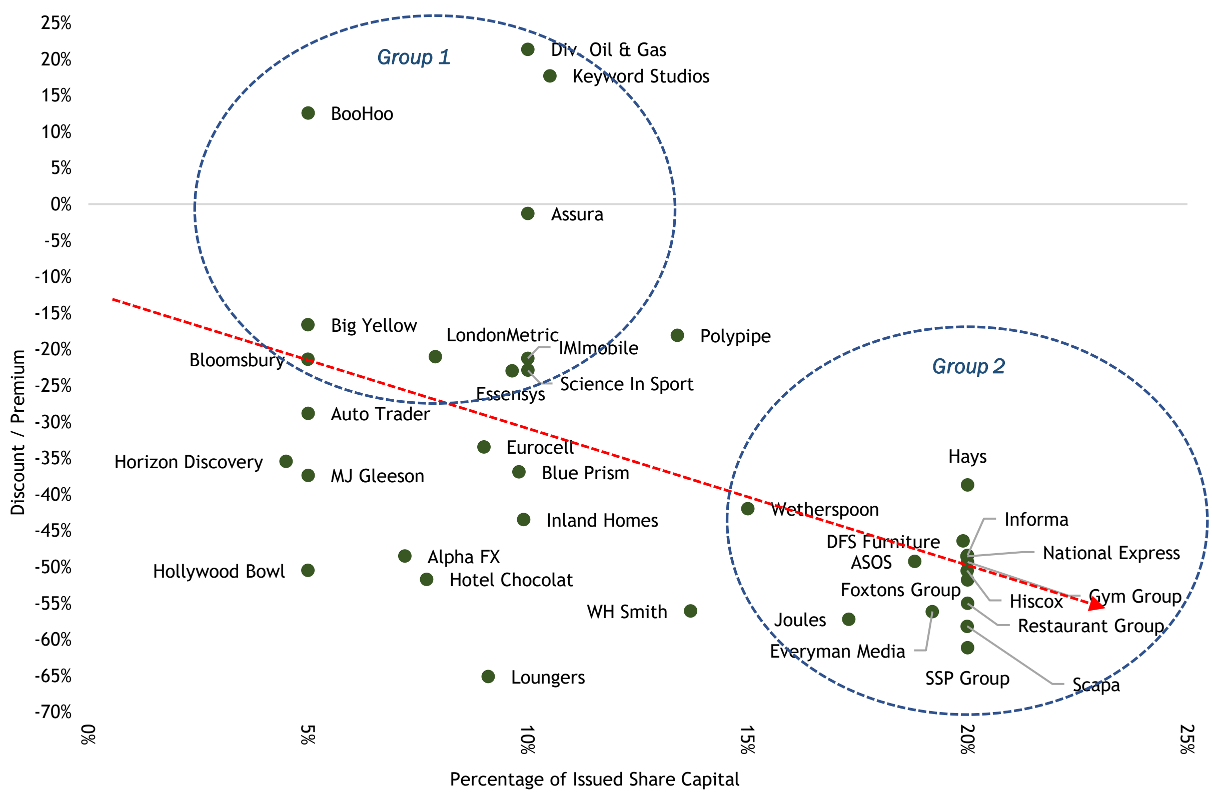
- **Dilution leverage.** Even though many companies raising in excess of 10% have made public statements around respecting pre-emption in the final allocations; these are firm placings nonetheless and allocations will vary. For raises in excess of 10% the dilution effect becomes more material and **existing holders have very little choice but to participate** in order to protect their future value.

- **Depth of pocket.** It is also clear, when looking at the composition of the share registers of many of the companies in question, there is **simply not the depth of pocket from within existing holders** (on a purely pro-rata basis) to be able to fulfil the gross amount required. This situation is exacerbated by the MAR wall-crossing rules which, amongst other things, limits the number of investors that can be wall-crossed prior to the formal launch of the fundraise. For the larger fundraises; either existing holders have had to participate in excess or material, new investors must get involved. Here the dynamic is different as they do not have an existing position to "average down" with an entry point significantly below pre Covid-19 levels.

Deal pricing compared to pre Covid-19 price levels

Looking at the pricing of recent fundraisings on a previous day's closing price basis only paints half the picture. In *Figure 2* below, we show the pricing of the 38 sub 20% placings compared to their respective 1st February share price levels.

Figure 2: Deal pricing vs 1st February 2020



Source: Company announcements, FactSet

In *Figure 2*, the correlation is much more marked, with a clear trend from top left to bottom right. **Those companies raising at the 20% level, have been tended be those whose share prices have fallen the**

most from pre Covid-19 levels and where the market had already begun to price in heightened levels of short-term stress. Broadly speaking, we can see two core groupings in the chart.

- **Group 1.** Those companies at the top left where placings have sat within the traditional pre-emption boundaries; where balance sheets were stronger and the placings were characterised as being, at least partly "offensive" and future opportunity oriented. Interestingly, three of the companies here (Big Yellow, LondonMetric and Assura) sit in structurally advantaged sub-sectors within real estate where fundraises were focused on securing near term development or acquisition opportunities. Alongside **Big Yellow**, we note that another Radnor client, **Bloomsbury Publishing** also sits in this top left quadrant of the chart, reflecting the smaller size of fundraising and relative pre-crisis balance sheet strength.

- **Group 2.** Those companies at the bottom right where the Covid-19 impact has been most severe in share price terms; especially across Leisure, Retail, Transport, Events and Recruitment.

However, it is worth highlighting that a number of these companies (Informa and Hays being the most prominent), although witnessing significant share price declines, have not demonstrated similar levels of financial distress in terms of near-term liquidity. Both chose to raise at the 20% level, and both were able to price at c.4% discounts. In this "new normal" we wonder whether the discounts would have been higher if they had raised a lesser percentage? What is clear is that there are more fundraises to come, and as competition for fund manager cash becomes more competitive, pricing will remain important.

Concluding thoughts

From our conversations with investors, our sense is that we are moving beyond the initial mad rush for equity. Investors have clearly been supportive but are likely to become much more discriminating around deal pricing. We are also more likely to see the number of "offensive" fundraises increase as a proportion of the whole. This is not to say that companies are out of the woods financially; far from it but "defensive" fundraises are likely to become more considered.

Looking forward, we see investors becoming more focused on the use of proceeds (and associated returns) and far more questioning as to the dilutive cost of any raise. In this environment, we believe corporates will need to consider the following key questions:

- Who are my shareholders and how have they been impacted by this broader fundraising activity?
- What is the natural depth of pocket of my share register?
- To what extent will new investors have to be involved?
- In a wall crossing situation, who should be on the list?

Answering these questions is a key part of our advisory role with our clients.

For enquiries please contact:

Iain Daly
Director, Radnor Capital Partners
+44 (0) 203 897 1832