Guide to Rights Issues

What is a Rights Issue?

A rights issue occurs when a company offers existing investors the opportunity to buy new shares in the company, typically at a discount to the prevailing share price.

Under the scheme, the company will grant existing investors the right to subscribe to newly issued shares in proportion to their existing shareholdings. The terms are often described as a proportion of your existing holding i.e. 1 for 5 means you are able to buy one new share for every five shares already held.

Shareholders are granted this right in order to preserve their 'pre-emption rights' which are rules put in place to protect shareholders by preventing their stake in the company being diluted by new issues.

Why do Companies have a Rights Issue?

Companies may want to raise additional capital for any number of reasons. Often, if the firm involved has a high or unsustainable level of borrowing they will have a rights issue in order to raise funds to repay all or part of that debt. Alternatively, a firm may want to raise additional cash to expand or to acquire a rival.

The management of the company involved are obliged to set out the reasons why they are holding the issue in the offer document, which will also contain other useful information such as the risk factors to consider.

Who Qualifies to Participate in a Rights Issue?

To be eligible to participate in the offer you will need to hold ordinary shares in the company on what is known as the "ex-rights date". After this date it is likely that the share price of the company involved may fall (all other things being equal) to take into account the dilutive effect of the new shares being issued.

If you are entitled to participate in the rights issue, either the company will write to you with the relevant forms if you hold your shares directly, or your custodian will contact you to let you know.

What are Nil Paid Rights?

The rights to buy new shares under the Rights Issue are called 'Nil Paid Shares' and these are separately traded on the stockmarket for the duration of the offer. The price of these Nil paid shares will theoretically be the price of the ordinary shares (ex-rights) less the subscription price of the rights issue, though in practice it may be slightly different.

What are your options?

If you hold shares in a company which is having a rights issue, you have the following options:

- ### Do nothing

There is no obligation to buy new shares in the company and if you do not want to do so, you do not need to. This is known as allowing the offer to lapse. Upon the conclusion of the rights issue the company will sell your rights on your behalf and send you the proceeds of this sale (if applicable) less expenses.

- **Take up your rights**

Alternatively, you may like to take-up your rights and buy the additional shares to which you are entitled under the offer. Such an acquisition would normally be free of both stamp duty and brokerage expenses and would also maintain your proportional ownership of the company.

- **Sell all of your rights**

If you do not want to take-up your rights to buy new shares you could also consider selling the Nil Paid Rights in the market. The benefit of this is that you will often get the proceeds sooner than when allowing them to lapse (see above) and you will be certain of the amount you will receive, which would otherwise only be determined at the end of the offer period. The disadvantage is that the brokerage commissions involved in doing so may exceed the expenses you would have incurred if you had simply allowed the offer to lapse.

- **'Swallow the Tail' (sell enough rights to take-up the remainder)**

If you would like to buy additional shares under the offer but do not have the capital to spare within your portfolio there is an alternative. You could sell enough of the Nil Paid Rights in the stockmarket in order to raise sufficient proceeds to buy new shares using the remainder of your entitlement.

What should you do?

Each situation is different and we would advise all shareholders to take professional advice where possible. If you do not have an advisor or do not wish to take advice there are a number of key considerations you should make:

Is it worthwhile?

The first and most obvious consideration is whether or not it is worth participating in the rights issue and taking-up your rights i.e. whether the rights issue subscription price is below the prevailing market price. Although the subscription price is often set at a discount to the market price, on occasions share price falls can mean that it is cheaper to buy shares on the stockmarket than it is to buy them through the rights issue.

Is it a good investment?

Secondly, you may also like to consider whether new shares in the company are a good investment, irrespective of the fact you already hold some. If the company is heavily indebted, is struggling to perform and has an uncertain future you may like to stay clear unless you have confidence in the management team's ability to make things better. If the company is using the proceeds to make an earnings enhancing and strategic acquisition on the other hand, and is performing strongly, your response may be more favourable.

Is the investment suitable for you?

Finally, we would also suggest that you consider whether such an investment is suitable for you. Is it consistent with your investment objectives and your attitude to risk? Will the additional investment unbalance your portfolio and leave you with overweight exposure to any one particular investment, sector or asset class?

What happens at the end of the Rights Issue?

At the conclusion of the rights issue the company will announce how many shareholders have taken-up their rights and will organise for the new shares to be credited to those shareholders who participated.

For any shareholders who lapsed their rights the company will attempt to sell those new shares not taken up in the stockmarket and will return the proceeds, less the subscription price and expenses. If the company is unable to sell these new shares in the stockmarket they will be bought by the underwriter, a third-party who has guaranteed that the company will raise the amount of money it is seeking from shareholders.