Capital Raising in Australia: Experiences and Lessons from the Global Financial Crisis

ASX Information Paper

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Executive Summary

This paper looks at the experience of capital raising over the period of the global financial crisis (GFC), both in Australia and some other major global markets. It provides a description of the framework for capital raising in Australia, the methods used by companies, and how they employed these tools through the crisis. It examines some of the criticisms that have been levelled at particular equity capital raising mechanisms. The paper draws the following conclusions:

- The board of directors (given their legal obligations to act in the best interest of the company as a whole) is the appropriate body to decide which capital raising mechanism to adopt in particular circumstances.
- The range of considerations to ensure that the decision is in the interests of the company as a whole include: the size and urgency of the funding required, the market conditions at the time of the raising, the overall cost of capital associated with the option chosen, the costs and availability of alternate sources of funding, the availability of underwriting support, and the interests of all existing and potential shareholders.
- The flexibility of Australia's capital raising arrangements served Australia's real economy well during the GFC. It enabled companies, particularly in the finance sector, to replace debt financing and shore up balance sheets at a time of volatility and financing uncertainty, when many global banks required government capital injections.
- During the worst of the GFC, companies placed a heavier weighting on speed and certainty in their choice of capital raising, making greater use of placements to access capital in a short time period to minimise the market risks associated with a capital raising at a time when retail investor risk appetite was sharply reduced.
- As market conditions stabilised, the weighting they applied to 'fairness' to all shareholders increased and the relative attractiveness of pro-rata issues rose, particularly accelerated rights offers. These enabled companies to access the majority of capital from institutional investors in a short time horizon, while also providing retail investors with the opportunity to participate in the offering on similar terms, but with a longer time period to consider their position.
- Companies should, where possible, seek to minimise the dilution of existing retail shareholders. Some companies have sought to address such issues in recent times by offering a share purchase plan alternative to retail investors.
- A traditional renounceable rights issue, made on equal terms to all shareholders, is considered the 'fairest' option. However, that avenue of capital raising often needs to be balanced against the length of time it can take to complete such an offer, with the consequence that shareholders are exposed to greater costs and execution risks. In contrast, a placement (particularly where there was no offer to retail investors) clearly raises issues of shareholder dilution but can usually be completed more quickly and at a lower cost.
- The GFC saw noticeable shifts by companies between reliance on non-renounceable rights structures during the worst of the crisis and a shift back towards renounceable offers as markets stabilised. It also saw new variants of accelerated rights offers emerge to respond to the extreme market volatility.
- In the market circumstances at the time, a failed capital raising could have had serious consequences for the viability of any company, or even more serious systemic consequences if a capital raising by a bank had failed.
- The fact that the market in general and individual companies were able to adjust their capital raising preferences quickly to suit the prevailing market conditions suggests that the regulatory framework worked well overall.
- While some stakeholder groups have called for narrowing the range of options available to boards, often suggesting ASX or ASIC prescribe a single capital raising mechanism (usually a renounceable rights issue) to ensure the fairness of the offer, the experience of the GFC shows that a more flexible approach is better adapted to volatile or extreme economic circumstances, or to specific circumstances facing an individual company.
- It is not possible to make a considered assessment of the final option chosen by each individual company, without knowledge of the full information that was before the board, including the range of risks that had to be balanced when the decision was taken.
- Company boards should clearly communicate with shareholders about the factors that influenced their choice of capital raising mechanism.

Introduction

The events of recent years commonly referred to as the global financial crisis were more severely felt by banking organisations in the US and Europe, rather than those in Australia. The GFC started with the troubles in the US sub-prime mortgage market and quickly translated into specific financial problems at US investment bank Bear Stearns (June 2007). The GFC peaked during extreme volatility in the six months following the collapse of Lehman Brothers (September 2008) which saw unprecedented stress in global capital markets.

These impacts were most severe in credit markets and a range of over–the-counter (OTC) markets. While global stock markets saw sharp declines in equity valuations, particularly securities of financial companies and other companies with highly leveraged balance sheets, the public securities markets continued to function effectively, providing transparent price discovery and liquidity to enable investors to trade. This happened at a time when some OTC markets effectively ceased operating.

The ability of companies to raise equity capital in the virtual absence of alternative debt issuance or bank funding was an important safety valve that enabled many companies to reduce debt exposure and shore up balance sheets. In some markets, most notably the US and UK, governments felt they had no option but to step in to inject capital into major financial institutions deemed 'too large to fail'.

The stress testing of the Australian financial system during the worst of the GFC provided a unique opportunity to assess the system's existing arrangements and the outcomes they deliver. It shows the system can respond quickly to external shocks and then move back into a more 'business as usual' mode when conditions recover.

Australia weathered the global financial storms relatively well, despite the reduction in financial wealth felt by many investors, particularly those exposed to a small number of high profile corporate collapses. A number of factors contributed to this outcome – strong macroeconomic fundamentals going into the crisis, very prompt fiscal/monetary policy responses during the crisis, the benefits of micro-reforms implemented prior to the crisis, and a robust financial sector. The quality of Australia's financial sector regulatory framework also contributed to the avoidance of some problems that emerged in other economies.

The ability of companies to rapidly and flexibly tap public equity capital markets (largely from institutional funding sources) during the worst of the GFC, when equity values were sharply reducing, also played an important role, particularly for large companies in some of the most vulnerable sectors. A failure of an equity capital raising by a large Australian bank, for example, could have had serious systemic consequences.

In contrast, the corporate bond market in Australia remains relatively underdeveloped and does not provide as robust an avenue for raising long-term capital. However, the refinancing risks exposed by the GFC may act as a catalyst for key stakeholders to actively broaden and deepen this market. ASX believes that developing an active retail market for Commonwealth Government bonds is an important first step in growing a similar retail interest in corporate debt issues.

Questions were asked about the methods employed by some companies to raise equity capital, and particularly, whether retail investors were treated fairly. While it is difficult to make conclusive judgements on the merits of individual decisions taken by boards (and therefore even less valid to make generalised judgements), it is important to recognise that the flexible arrangements that exist in Australia attempt to balance the interests of a range of stakeholders while providing the flexibility for companies to adjust quickly to changing circumstances. It is for boards to use that flexibility in a manner that fulfils their legal obligation to act in the best interests of the company as a whole.

Critics did not always place sufficient weight on the extreme funding pressure companies faced at the time and their need to raise capital rapidly to restore investor confidence in the company's health when market confidence was low and uncertainty levels high. The suggestion that retail investors were not treated fairly is predicated on an assumption that a sufficient number of retail investors were in a position (or willing) to commit additional capital to a company at a time of considerable uncertainty. Yet financial flows suggest risk appetite, especially amongst retail investors, was low for a protracted period during the GFC.

The Global Financial Crisis

To provide some context to the assessment of recent equity capital raising experience over the past few years it is worth briefly revisiting the extreme impacts that the GFC had on capital markets and hence the environment in which companies sought to raise debt or equity finance.

Credit and Debt Markets

The most dramatic indicator of the impact the GFC had on the functioning of financial markets was in the interbank credit market. Interbank markets are integral to the functioning of many associated financial markets via benchmark spreads between risk free rates, bank borrowing rates and credit spreads to a diverse range of bank customers, which span the width and breadth of a nation's economy.

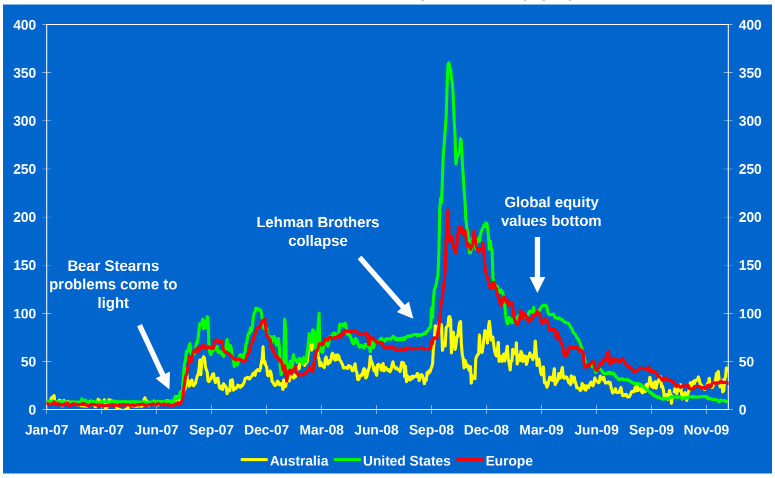
Interbank spreads for Australia, the US and Europe over the course of mid-2007 to mid-2009 experienced extreme swings and heightened volatility. In all markets, pre the GFC, credit market spreads tended to average around 10 basis points. In August 2007 spreads spiked to around 50 basis points and remained high and volatile for the following 12 months, before seriously widening in the US and Europe (and moving higher in Australia) at the time of the collapse of Lehman Brothers. The blow-out in spreads reflected both very tight liquidity conditions and sharply higher credit risks, as market participants anticipated possible defaults by other large financial institutions.

The spreads only began to shrink as aggressive easing of monetary policy calmed nerves and lowered the risk of systemic default. This included unprecedented injections of liquidity into the system and government action in the form of guarantees to financial institutions (or in the case of the US and UK, large injections of equity by government).

The fact that Australian spreads generally remained significantly below those prevailing in overseas markets is likely to have reflected the relatively lesser concerns around the financial position of Australia's major banks, which maintained their strong ratings throughout the GFC.

The dislocation in credits markets, and the problems experienced in the global credit default swap (CDS) market, hampered companies' ability to tap short or long-term debt markets. This was at a time when banks were also seeking to aggressively wind back their business lending in order to focus on their own liability management imperatives.

Interbank Market Spreads* (bps)



* Credit markets spreads are measured as the spread between the relevant benchmark 3 month interbank rate and the Overnight Index Swap (OIS) rate.

Short-term private sector borrowing rates declined significantly in the US from mid-2007, and despite spiking during late 2008 at the height of the financial crisis, they continued to fall to historically low levels. In contrast, reflecting the relative strength of the Australian economy, similar short-term rates in Australia did not begin to move sharply lower until the Reserve Bank of Australia (RBA) began aggressively easing monetary policy following the collapse of Lehman Brothers in the US. Despite the sharp reduction in market interest rates, the very tight credit conditions severely constrained the availability of short-term debt finance and bank lending.

A similar restrictive environment for the issuance of long-term corporate debt both in Australia (where the market has never been particularly deep) and overseas meant that non-financial companies had limited opportunities to roll-over existing debt funding or tap new sources.

Equity Markets

The extreme stress in credit and debt markets also flowed through into large falls in equity valuations.

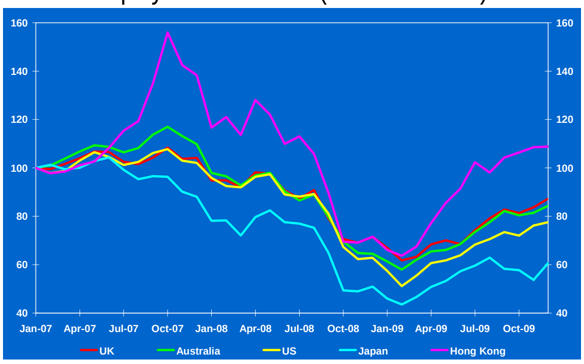
In Australia, the All Ordinaries Index (after peaking at an all-time high of 6854 points in November 2007) fell by 55% to a low of 3112 in March 2009.

Benchmark equity indices in other major global markets followed a broadly similar path.

- In the US, the S&P 500 Index fell 57% from its all-time high in October 2007 to a low in March 2009.
- In the UK, the FT100 Index fell 48% from its recent high in June 2007 to a low in March 2009.
- In Japan, the Nikkei 225 Index fell 61% from its recent high in July 2007 to a low in March 2009.
- In Hong Kong, the Hang Seng Index fell 65% from its all-time high in October 2007 to a low in October 2008.

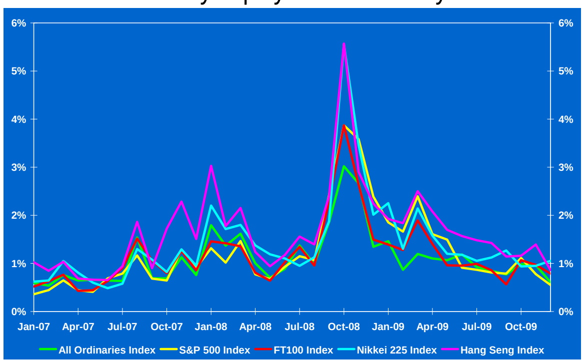
Since mid-March 2009, most major equity markets have experienced a strong rebound, with the All Ordinaries ending calendar year 2009 up 57% on its lows of the year. This compared to broadly similar rises in many major markets, for example the US up 65%, UK up 54%, Japan up 50%, and the characteristically more volatile Hong Kong, up 93%.

Equity Index Prices* (Jan 2007=100)



* End of month figures.

Monthly Equity Index Volatility*



* Monthly average of daily movements in the underlying index.

The sharp declines in equity valuations were accompanied by markedly elevated levels of volatility in equity markets (as measured by daily movements in the benchmark indices). For Australia and the US this volatility, which traditionally averaged around a 0.5% price movement in a day, peaked in October 2008 at a monthly average movement of 3% (in Australia) and nearly 4% (in the US). Similar patterns were seen in other major markets, although the magnitude of the volatility was even more extreme in Hong Kong and Japan.

After the spike in late 2008 volatility declined steadily and by the end of 2009, in many markets, it had moved back towards its pre-GFC levels.

The GFC and Equity Capital Raising

The severe movements in asset valuations and unprecedented volatility associated with the GFC created considerable financing uncertainty for companies given the heightened risk aversion of investors to commit more capital in extreme global economic and financial market circumstances.

If access to new equity capital had also been limited, combined with the curtailing of bank business loans, companies would have been vulnerable to negative market sentiment (particularly given the trend that had emerged over several years for market value of equity covenant triggers in corporate borrowing documentation).

Overall business confidence, as measured by the National Australia Bank, declined steadily over the course of 2008, before dropping at an accelerating pace in the last quarter of 2008 and bottoming in early 2009.

The heightened volatility was particularly problematic for companies seeking to raise equity capital, as the uncertainty affected the willingness of investors to commit new capital. This resulted in a significant increase in the price discounts required to get raisings completed, as well as increasing other costs associated with making secondary issues (eg obtaining underwriting support). In fact, the very tight credit market conditions and very uncertain financial situations facing major global investment banks (including concerns about the solvency of some) during the period September 2008 to March 2009, made obtaining underwriting support very difficult for periods beyond a few days.

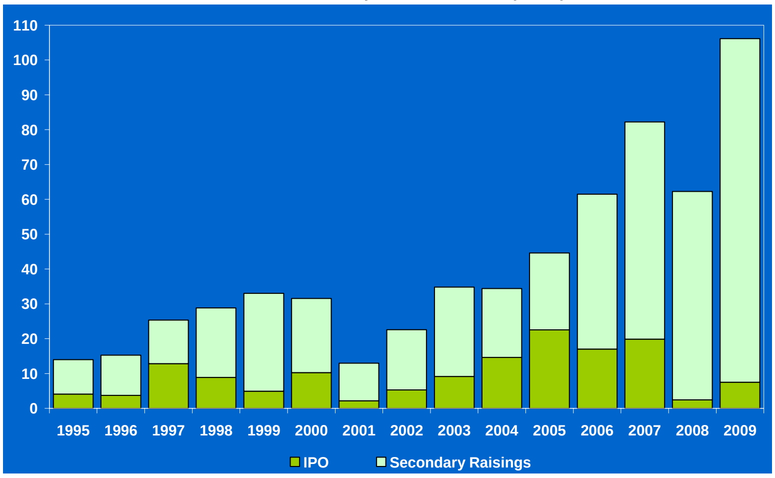
However, the actual experience of equity capital raising in Australia, and many other major markets over the course of the GFC, remained robust despite the extreme market turmoil.

In most jurisdictions initial public offerings (IPOs) virtually ground to a halt through the second half of 2008 and the first half of 2009, before picking up towards the end of 2009 as some confidence returned to markets and risk appetite started to recover. Secondary capital raisings continued to help existing listed companies to reduce their debt exposures and repair their balance sheets.

In Australia, the RBA noted[1] that companies took advantage of relatively robust profit performance to increase their reliance on internal sources of funds to act as a buffer in financing their operations. The RBA also noted that prior to the GFC around two-thirds of overall company funding came from retained earnings, with the remainder funded externally (equity, debt, and loans). This reliance varies between industries, with larger resource companies funding only 10% externally while the property/infrastructure sectors generally fund 60% externally (largely debt). There is also a large group of listed companies, for example small mining exploration companies, for whom equity finance is the only source of funding for their operations as they are yet to generate revenue and are unable to access debt or bank lending.

During the past two years companies have tended to rely even more on internal funding, where possible, combined with equity raisings to reduce their gearing and to react to tighter debt market/borrowing conditions.

Australian Capital Raised ($bn)

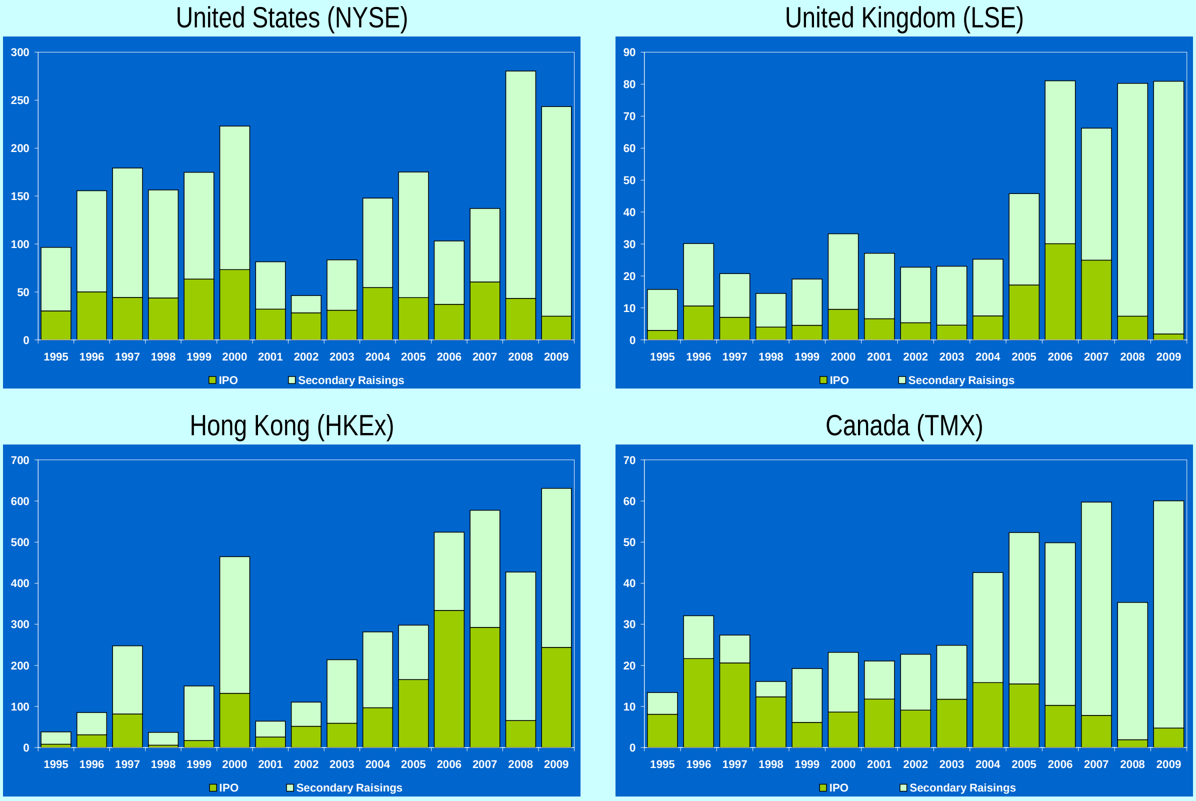


Over the longer term the amount of new equity capital raised through public markets in Australia has risen strongly, with a record $106 billion raised in calendar 2009. The past three years have seen particularly strong secondary raisings (the three largest years on record), with the flow of new IPOs being more sensitive to swings in asset valuations and general levels of business confidence.

This rising trend in aggregate capital raising has also been seen in a number of other major markets such as the UK, Hong Kong and Canada. The longer term trend in the largest US market, NYSE, has been relatively flat over the period as a whole, although with wide cyclical fluctuations.

[1] "Australian Corporates' Sources and Uses of Funds", Reserve Bank of Australia Bulletin, October 2009.

Capital Raised in Other Major Markets (local currency bn)

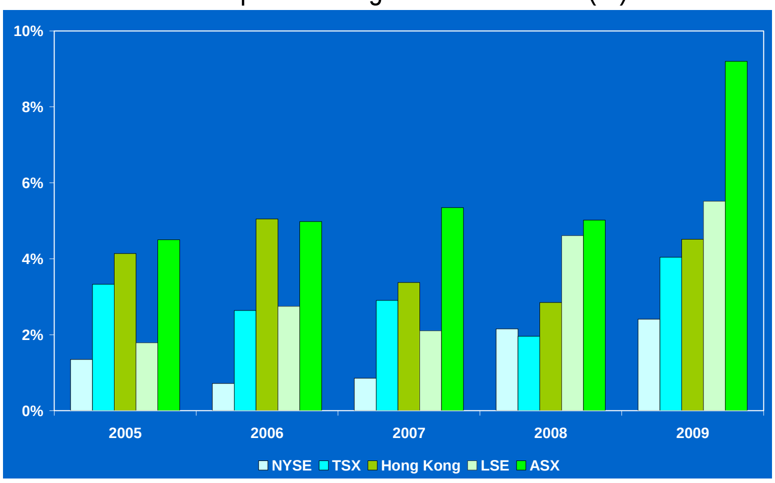


Source: World Federation of Exchanges, Exchange websites.

One indicator that is often used to compare the ability of a market to grow through companies raising new capital, as opposed to growth achieved through changes in the value of existing securities, is the value of capital raising as a proportion of total market capitalisation. This is a rough proxy for growth in the overall market coming from the flow of new capital into companies, both new listings and existing companies.

Using this measure, Australia generally performs better than most major markets, both pre-GFC and during the period of market turmoil. In fact, in calendar year 2009, ASX-listed companies raised new capital representing over 9% of total market size, well up on the average of around 5% in the previous four years.

New Capital Raising and Market Size (%)

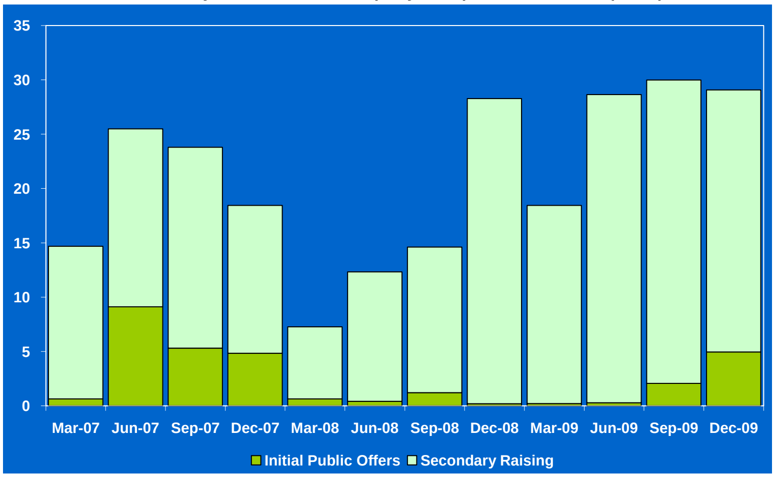


* Value of capital raised expressed as a proportion of average monthly market capitalisation.

The strength of the Australian capital raising experience can be seen, at an aggregate level, by looking at the amount raised quarterly over the past three years. This tracks how capital raising activity responded to the specific market events during the period of the GFC.

Listing of new companies, and the pipeline of prospective IPOs, essentially dried up between early 2008 and mid 2009 in Australia and across the globe. In fact, it was not until the last quarter of calendar 2009 that life returned to the primary issuance market. While new companies were not able to come to market, many listed entities were able to raise secondary capital, which held up well throughout the period, dipping in early 2008 but returning to healthy levels for the remainder of the period.

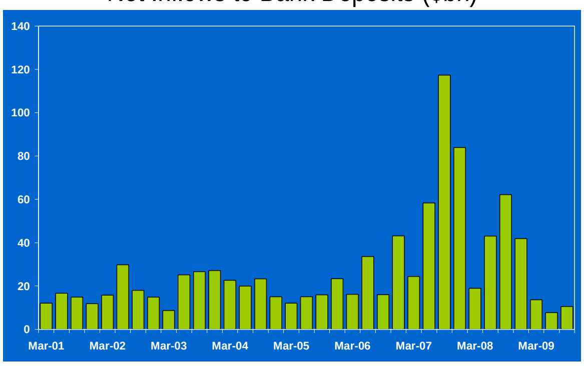
Quarterly Australian Equity Capital Raised ($bn)



It is worth remembering the impact of the crisis on the risk aversion of investors. Through the course of 2007 and 2008 flows into Australian bank deposits increased markedly above historical levels. A traditional safe haven investment, cash management trusts, while showing large inflows during 2007, experienced a net outflow in 2008 as redemption freezes in a number of hedge funds and other managed investments created a contagion effect. There were also significant net withdrawals from managed equity funds through 2007 and 2008 as retail investors sought to reduce their exposure to equity investments.

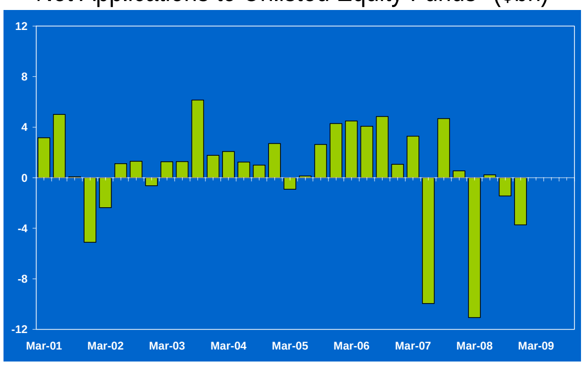
These trends indicate a strong rise in risk aversion amongst retail investors which also affected their appetite for participation in new capital raisings. This factor would have affected the choices made by companies in their method of capital raisings.

Net Inflows to Bank Deposits ($bn)



Source: Reserve Bank of Australia.

Net Applications to Unlisted Equity Funds* ($bn)



Source: ABS, Managed Funds (No 5655.0).
* Data for first three quarters of 2009 not available.

The remainder of this paper looks beneath the aggregate figures to better understand the choices made by companies. The results of those choices go a long way to explaining the relatively strong performance of Australia's financial and real economy during the period of the GFC.

The Nature of the Australian Equity Market

When considering questions around capital raisings it is important to understand the structure of ASX's listed market.

The Australian equity market accommodates a wide diversity of companies (by size, type, and stage of life-cycle development) within a single regulatory framework. This makes the Australian market different to many of its global peers. The ASX market encompasses a relatively small number of very large companies, a larger number of mid-sized companies and a very long tail of small companies.

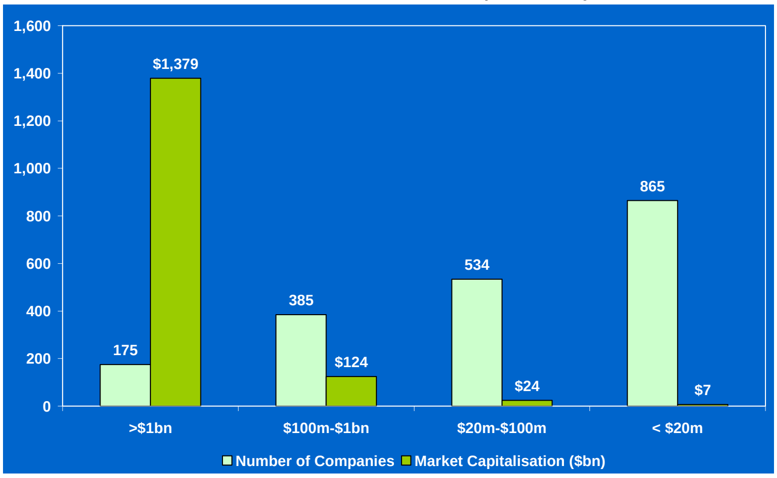
In some other global markets, smaller companies have been moved onto a separate board which operates under less onerous regulatory arrangements to the larger companies that make up the main board (examples include the Alternative Investment Market (AIM) in the UK and the TSX Venture Market in Canada).

Australia has previously experimented with segmenting its market with 'second boards' established in the mid-late 1980s. These were closed after a few years as the market never gained traction with smaller listed companies (which it was designed to assist) or with investors. Instead, ASX has maintained the model of a single market catering to a wide mix of companies, large and small, all needing to adhere to common listing rule standards. Such an approach provides small companies with access to the public market to meet their funding needs while requiring them to comply with appropriately high regulatory standards for the protection of retail investors.

As at 31 December 2009 there were 1,959 listed domestic companies with a total market capitalisation of around $1.5 trillion.

The dispersion of market capitalisation across the official list is very wide. As at the end of 2009, a total of 175 companies had a market capitalisation greater than $1 billion, with 385 companies between $100m-$1bn, 534 companies between $20m-$100m and 855 companies below $20m.

Distribution of ASX Listed Companies by Size



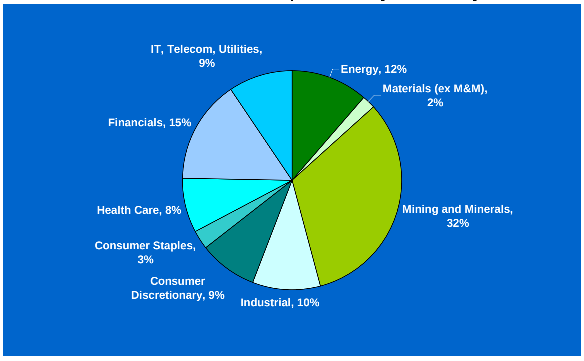
While the number of companies is dominated by smaller companies, their actual share of total market capitalisation is disproportionately small, with 2% accounted for by companies with market capitalisation less than $100m, 8% by companies between $100m-$1bn, and 90% by companies greater than $1bn.

The wide dispersion of companies means that rules and regulations governing capital raising need to be flexible to address the needs of this broad demographic of companies. ASX recently considered changes to the listing rules governing placements by small and medium sized enterprises (SMEs) to increase flexibility for companies wishing to utilise this capital raising mechanism, but decided against proceeding with the proposals at this time.

The structure of the Australian market is explained, in part, by the industry sector breakdown of listed companies. Mining and metals sector companies comprise the largest block of companies by number (32%) but account for a smaller proportion of total market capitalisation (23%). In contrast, the financial sector accounts for a relatively small number of listed companies (15%) but a much larger share of total market capitalisation (35%).

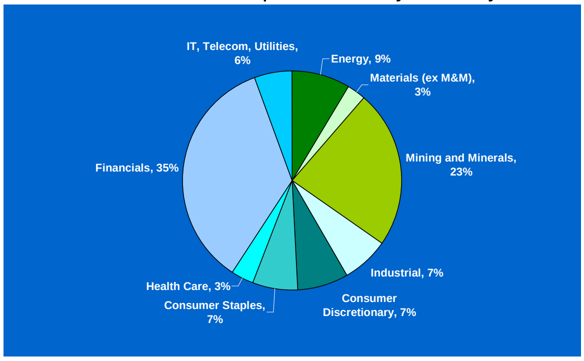
This skewed distribution reflects the large number of very small resource exploration companies combined with a handful of very large resource companies, while the financial sector is dominated by the large four domestic banks and some insurance/wealth management groups.

Share of ASX Listed Companies by Industry Sector*



* As at 31 December 2009 (Source: ASX).

Share of ASX Market Capitalisation by Industry Sector*



* As at 31 December (Source: ASX).

The spread of ownership of Australian equities is also a factor that drives the capital raising options chosen by companies. At the aggregate level, retail investors directly own slightly less than 20% of all listed equities, with domestic institutions owning slightly less than 40% and foreign investors slightly more than 40%.

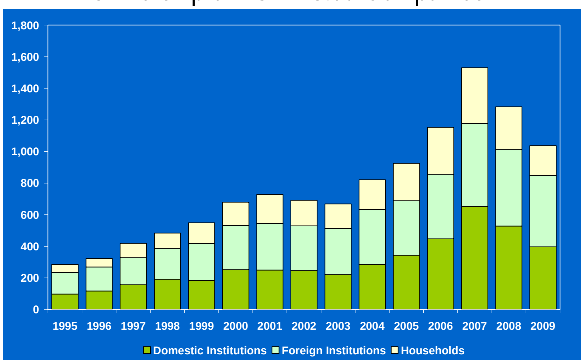
The flow of funds into compulsory superannuation provides a steady stream of capital-seeking investment opportunities and has provided a source of demand for equity securities issued by companies. The bulk of this institutional investment is directed towards larger listed companies, particularly in the top 300.

The share registers of small companies are generally dominated by retail investors. The ASX model of listing both large and small companies under a single framework means that the listing rule standards applied to large and sophisticated companies are also available to retail investors who invest in the smaller, sometimes more speculative, companies.

The spread of ownership is an important factor in capital raising decisions taken at the individual company level, with boards having to consider the ability and willingness of existing shareholders to contribute additional capital when deciding the type of capital raising to pursue.

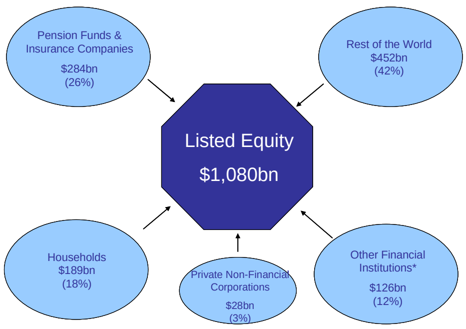
Capital raisings are also an opportunity for the boards of small companies to improve the quality of their share registers by adding new institutional shareholders as they grow, an outcome that requires the use of placements.

Ownership of ASX Listed Companies*



* As at 30 June (Source: ABS Cat. No 5232.0).

Ownership of ASX Listed Companies*



* As at 30 June 2009 (Source: ABS Cat. No 5232.0).

The Structure of Capital Raising in Australia

Initial Equity Capital Raising

The initial listing of a company on ASX is governed by the requirements of both the Corporations Act (2001) and the ASX listing rules.

The Corporations Act requires companies and other issuers to issue a prospectus or Product Disclosure Statement (PDS) when raising capital from retail investors. ASX listing rules also impose a similar obligation on entities prior to listing. Such disclosure aims to provide prospective shareholders with sufficient information to make an informed investment choice. The issuer is responsible for compliance with the disclosure requirements and neither ASIC nor ASX 'approve' offer documents.

The ASX listing rules are a binding agreement, with the statutory backing of the Corporations Act, between the company and ASX attesting that the company meets the initial listing requirements, which include a minimum number of shareholders at the time of listing, and company size[2]. The company must also agree to comply with the ongoing listing requirements, which include obligations relating to continuous disclosure and periodic reporting. Admission to the official list, and the category of an entity's admission, is at ASX's discretion.

ASX's role in the capital raising process	
ASX does	*ASX does <u>not</u> ....*
• Process applications for new listings to determine that the entity satisfies the admission criteria in the listing rules and imposes conditions on the entity if necessary. • Consider applications for waivers of specific listing rules in appropriate circumstances. • Arrange for quotation of new securities to allow secondary market trading to commence, once necessary conditions have been met. • Enforce continuing disclosure requirements to keep investors appropriately informed, subsequent to the release of formal disclosure documents (where required), allowing them to make decisions about participation in equity capital raising. • Manage trading halts to facilitate secondary issues and ensure trading is conducted on the basis of full information. • Set timetables for some different types of secondary issues to provide investors with time to consider their participation. • Monitor secondary trading immediately prior to capital raising announcements to detect any instances of possible insider trading – with referral to ASIC for further investigation. • Set circumstances where shareholder approval is required for a company to follow a particular course (eg the 15% limit on placements) over a 12 month period. • Provide a facility for the secondary trading of renounceable rights (if required).	• Assess the business model of listed entities or their financial prospects in determining their appropriateness as an investment. • Set formal requirements for companies with regard to specific disclosure documents (eg PDS), Corporations Act requirements or in relation to ASIC administered exemptions. • Approve the contents of disclosure documents – ASIC checks for compliance with disclosure requirements (rather than approving the content of the document itself). • Approve the decision of the company's board about which secondary capital raising method to employ (other than to ensure it is consistent with the listing rules) or assess the impact on specific groups of shareholders of the avenue chosen.

ASX is re-examining proposals it first floated for public consultation in late 2007 to raise the minimum admission requirements for listing on ASX markets (combined with changes to the minimum spread requirements). At that time, one aspect of the proposal was to raise the minimum assets test measure from $2 million to $4 million. In the wake of the GFC, ASX is currently assessing the appropriateness of its existing admission requirements.

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[2] The listing rules currently prescribe that the company must have:
- a minimum 500 investors each holding $2,000 of shares or a minimum of 400 investors holding $2,000 and 25% held by unrelated parties; and
- the company must satisfy either a profit test ($1m net profit over the past 3 years plus $400,000 net profit over the past 12 months) or an assets test ($2m net tangible assets or $10m in market capitalisation).

ASX does not assess the underlying business model of companies seeking a listing or make judgements on their future prospects when assessing their listing application. This is appropriately a matter for investors to assess whether they wish to invest in a particular company, seeking financial advice where necessary.

Companies choose to list for a variety of reasons, including the need to raise new capital (immediately and/or in the future) to fund growth strategies, to expand their public profile with a range of stakeholders, and/or to facilitate an orderly exit for early stage investors (eg family-owned companies or private equity investors).

The benefits of listing for a company are balanced with the added responsibilities that come with being a listed company, particularly with regard to greater transparency of their activities, enhanced corporate governance standards, the need to comply with the ASX listing rules, and the greater price volatility that comes with a being on a public market.

The vibrant nature of new listings in the ASX market is a by-product of the history of the market which has been welcoming of small companies, over many years, several of whom have grown into major listed companies. The strong growth in new listings over recent years has been driven by the particularly strong commodity price cycle. It has also been influenced by the fact that Australia has never had a deep venture capital industry (compared to countries such as the US) which caters to the capital needs of start-up and early-stage companies. Consequently, companies in Australia often seek a main board listing at a much earlier stage in their lifecycle than in other markets.

In recent years the role of private equity funds in acquiring listed companies, removing them from the official list and restructuring their operations before eventually returning them to public ownership through a subsequent listing, has been prominent.

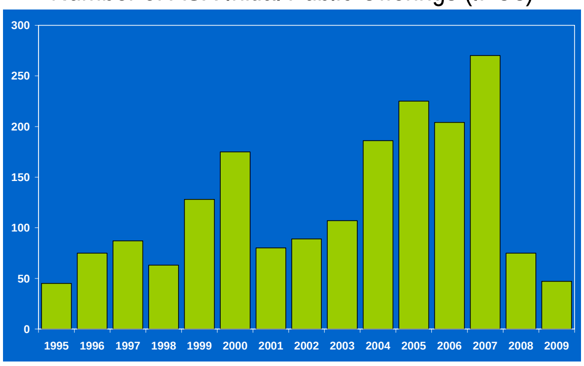
At the peak of equity market valuation back in 2007 there was a concern that the activities of private equity funds would produce a sharp decline in the size of the Australian public equity market following a number of high profile takeover bids. However, the onset of the GFC and the tight credit conditions that resulted eliminated many of those concerns. More recently, the cycle has turned and a number of assets that were taken private have been re-listed (eg Myer Ltd) or are expected to return to public ownership as the economy returns to a healthy growth path.

Trends in Initial Capital Raisings

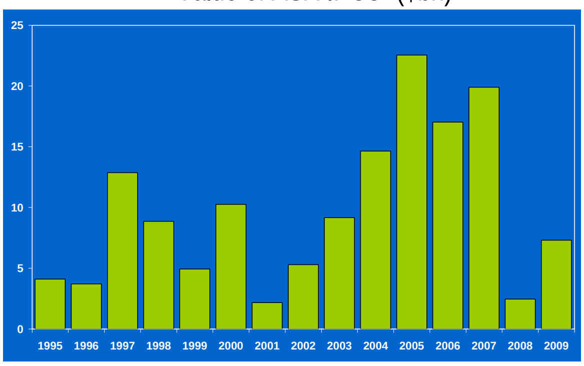
The IPO cycle generally is very closely related to swings in market valuations, as the owners of private companies seek to make the most of favourable market conditions to maximise the value they receive for their ownership interests.

As noted earlier, the GFC severely restricted the flow of new companies seeking to list. In 2008, the value of new IPOs listed on ASX was $2.5bn, the lowest since 2001 when $2.2bn was listed in the wake of the collapse of the global technology bubble and a recession in the US. Calendar year 2007 saw a record number of new listings, although the total value of these listings fell a little short of the peak experienced in 2005, while the 47 new companies listing in 2009 was the lowest number since 1995. On average, over the period since 1995, the market has seen around 124 new listings per year worth $9.7bn a year.

Number of ASX Initial Public Offerings (IPOs)



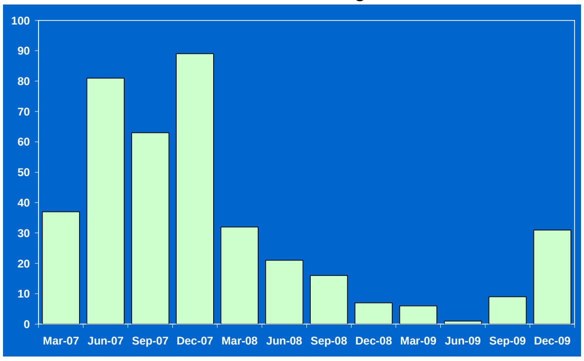
Value of ASX IPOs* ($bn)



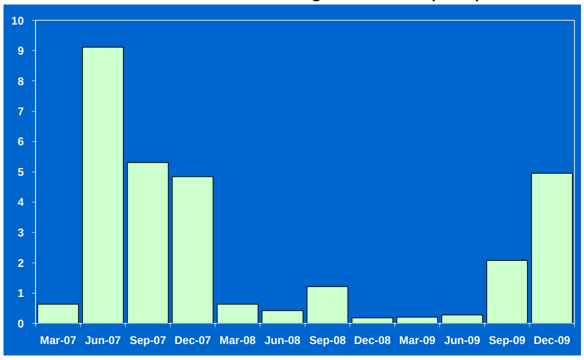
* Measures the value of the new listing, not new capital raised.

The quarterly pattern of new listings during the past three years shows a steep decline from the peak in the number of new listings in the December quarter 2007 (when the market indices reached record highs), as equity valuations slid and volatility rose. Between December 2008 and September 2009, the number of IPOs slowed to a trickle before beginning to pick up towards the end of 2009, as the equity market stabilised and share prices recovered.

Number of IPOs during the GFC

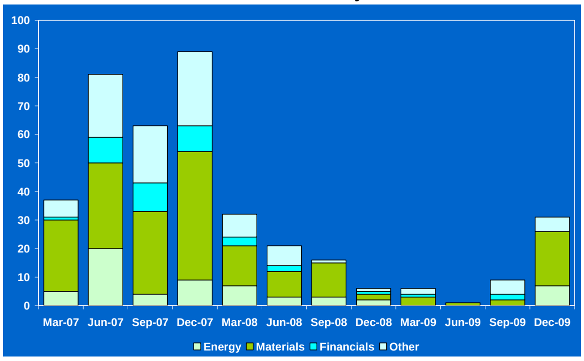


Value of IPOs during the GFC ($bn)

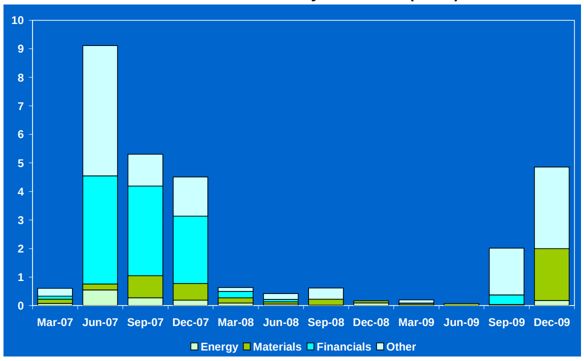


A breakdown by industry sector shows that the vast majority of listings by number were in the materials sector (largely in the metals and mining sub-sector), although these companies make up a much smaller proportion of the value of the newly listed companies. The record number of new listings in 2007 was largely driven by resource companies, although it was the financial sector that accounted for the largest portion of the value of newly listed companies.

Number of IPOs – by Sector



Value of IPOs – by Sector ($bn)



Over the past two years, the impact of the GFC on asset valuations has reminded investors of the risks associated with newly listed companies, which have often fallen in value soon after listing, particularly those with no track records or operating in inherently risky industry sectors.

There have also been concerns expressed about whether more 'complex' products other than 'plain vanilla' equities should be listed on ASX at all. Traditionally Australia has not restricted investor access to a wide range of financial products across the risk-return spectrum, both exchange-traded and OTC. This is in contrast to, say, the US where investor access to some products can be restricted to only 'sophisticated' investors (usually defined by the value of their assets).

Under the Australian system, investor protection is largely achieved by product disclosure; and in cases where investors seek financial advice, the Corporations Act requirements for advisers to consider their clients' financial circumstances when providing advice.

This approach was broadly endorsed by the recent Parliamentary Joint Committee on Corporations and Financial Services inquiry into financial services and products in Australia. The Committee concluded "that it is not for the parliament or the government to determine for whom particular investment products are appropriate. This is a decision for individual investors, in consultation with a financial adviser bound by a fiduciary duty to put their clients' interests ahead of their own."

ASX lists a variety of securities including ordinary shares, preference shares, stapled securities, listed managed investments, interest rate and hybrid securities, derivatives (including futures, options, and warrants), and structured products. ASX requires market participants to obtain signed client agreements prior to allowing retail customers to trade in a number of more complex or leveraged products. These agreements require the client to confirm that they understand the nature of, and risks associated with, the products and have read the appropriate disclosure material.

ASX has considered, from time to time, allowing different corporate structures to list. For example, ASX does not currently permit companies to list non-voting shares. In 2007, in response to interest from a small number of listed and unlisted companies, ASX considered whether to remove this restriction. However, following a mixed response to a public consultation on the proposal, ASX decided not to pursue any change to its listings policy, albeit the issue will be continually reviewed.

Another example that has been prominent in market commentary is partly paid securities. A partly paid security (also known as a contributing share) is an ordinary share where only part of the full par value is paid upfront, with the remainder paid through future calls.

When market conditions were favourable, a number of property/infrastructure developers raised capital through partly paid shares, which suited their funding needs that were spread over a number of years. The risks to issuers and investors posed by sudden changes in economic/capital market conditions were highlighted by the GFC and the circumstances surrounding the listing in September 2008 of BrisConnections.

After a detailed review of the circumstances around BrisConnections, ASX is satisfied that partly paid securities fundamentally are not a flawed product and should continue to qualify for listing and trading on ASX (subject to the entity satisfying the normal listing requirements). In practice though, the recent negative publicity associated with partly paid securities is likely to affect their attractiveness as a structure for some time.[3]

However, partly paid securities have a long history as a capital raising device in Australia (particularly in the mining, property development and infrastructure sectors), as well as being used to facilitate retail investment in large government privatisations (eg the Telstra sale process).

There is no reason to believe that these sectors will be any less reliant on new capital in the future. In fact, the Commonwealth and State Governments have identified a range of priority infrastructure projects that will need to be funded in the future and there is clearly a role for various forms of equity capital in meeting those funding needs. There has been speculation that these investments could be funded, for example, through direct equity investment by superannuation funds. However, it would be unfortunate if retail investors lost the opportunity to invest directly in such products as part of building a balanced portfolio, if an attractive investment can be developed. It would also be unfortunate if the transparency and price discovery benefits a public listing brings are no longer associated with these large and important economic projects.

A healthy stream of initial public offerings by companies is an important building block of a vibrant equity market. A vibrant equity market is one that can regenerate and grow in an environment where companies are constantly emerging and disappearing from the market as a result of takeover by foreign or private investors, or due to business failure. Listing on the public market provides an important source of finance for emerging companies that can contribute to the economic wellbeing of the Australian economy as well as provide valuable employment opportunities.

As noted above, the Australian market has a history of strong growth in attracting new listings, although this growth was curtailed during the course of the GFC. Over the medium to long-term, ensuring that ASX listing admission standards remain relevant to the needs of both companies seeking finance and a wide group of investors seeking attractive investments will help contribute to confidence in the integrity of the Australian equity market.

Secondary Equity Capital Raising

As noted earlier, ASX-listed companies have taken advantage of the flexibility inherent in the capital raising regime to raise significant amounts of capital in a very difficult and volatile environment to stabilise and strengthen their financial position.

3 ASX did impose a requirement on market participants to require retail investors to sign a client agreement prior to trading in partly paid shares.

However, over the past 12 months there also has been considerable comment about a range of issues relating to secondary capital raisings, particularly whether retail investors were treated 'fairly' in the process of raising this capital. Much of this comment has been prompted by the capital raising choices made by company boards during the crisis. It is interesting to see how, at a high-level, the choices changed significantly during the course of the crisis as market conditions worsened but have recently returned to a more normal mix.

The Australian regulatory regime (including ASX listing rules) seeks the balance of providing flexibility to a diverse range of listed companies to raise capital in a timely and cost effective manner, while treating existing and potential shareholders fairly.

The main strength of the system is that it empowers boards to properly exercise their fiduciary duty to make decisions on capital raising that are in the best interests of the company as a whole.

Boards are in the best position to make an assessment about the appropriate capital raising strategy for their company, being ideally placed to appreciate and manage a range of, often conflicting, considerations, which include the:

- Amount of capital needed and the urgency with which it is needed;
- Environment within which the company is seeking to raise capital, particularly prevailing market conditions/risks and the impact this has on the demand for securities;
- Company's size and the industry sector within which it is operating;
- Purpose to which the capital raised is to be used (eg to fund an acquisition, reduce gearing, etc);
- Current structure of its share register (spread and distribution of holdings amongst retail and institutional segments), the likely interest or ability of existing shareholders to contribute more capital, the need to restructure the ownership register by attracting new investors, and the desired post-raising share register structure;
- Impact on existing shareholders of the option chosen (eg dilution of shareholders not taking part in the offer); and
- Expected cost of raising capital under different capital raising mechanisms (eg the discount to current market price), including the desire to secure (at an acceptable cost as well as duration of) underwriting support, which is directly related to the risk of there being a shortfall in demand.

These are not assessments that lend themselves to a one-size-fits-all solution mandated by an external party (be it a regulator or market operator). But is one that a company board has a fiduciary responsibility to undertake and for which it should be accountable to shareholders.

The two general rule frameworks within which such decisions are taken are: merit-based rules and/or disclosure-based rules.

Merit-based rule frameworks prescribe 'acceptable behaviour' and impose the rule maker's judgement as to the appropriate parameters, rather than allowing flexibility for these to evolve over time to reflect changing market practice and the expectations of different shareholders. Merit-based frameworks tend to adopt a one-size-fits all approach and limit the options available to boards. While this provides a transparent and potentially easy to understand set of rules, it may prove problematic for companies who face a specific set of circumstances or at times of significant financial stress when such an approach is not practical.

In contrast, disclosure-based frameworks are generally more flexible and are particularly appropriate for well-developed markets where innovation and improving standards are driven by market disciplines. While there may be some limits placed on a company's activities to achieve objectives of fairness and efficiency, these are delivered predominately through a system of disclosure-based rules which enable investors to form judgements about how a company is being managed. This in turn affects investment decisions and the value of the company, and allows investors to exercise their voting rights to influence management.

This is the approach that is well established in the Australian market. There is no statutory requirement for pro-rata issues. Companies can issue shares of up to 15% of issued capital on a non-pro-rata basis in a 12-month period without seeking shareholder approval. There are exceptions to this rule that mean that issues via security purchase plans do not fall within the 15%. There are no restrictions on the number of shares that can be issued on a pro-rata basis through a renounceable rights issue, or on the discount that can be offered on the share issue price under such issues. There is, however, a limit on how much can be raised through a non-renounceable offer (ie no greater than a 1:1 offer ratio).

ASX believes that the regulatory framework should not create an unnecessary bias towards a particular form of fundraising – or limit options that may be in the best interest of the company and its shareholders. Rather, it should facilitate the widest variety of forms of capital raising in the context of an informed market. The responsibility for making the right choice, in the circumstances, is left to company directors. They must assess and determine what form of capital raising is most appropriate for a particular transaction, having regard to the company's capital needs and its shareholder base.

The main equity raising options provide a spectrum in terms of the balance between 'time to market', cost and certainty of outcome, versus maximum participation of all shareholders.

At one end of the spectrum institutional placements can be finalised in a very short timeframe (1-2 days); while at the other end of the spectrum are 'traditional' renounceable pro-rata rights issues that include all shareholders, but are more costly and take much longer to execute (at least 23 business days). Recently, a range of 'non-traditional' (ie accelerated) rights issues, have emerged to offer a different trade-off between time to market and maximum shareholder participation than the two traditional methods. Share purchase plans, which favour smaller investors but do not provide the same equality of opportunity as pro-rata issues, have also become more prominent. This follows ASIC policy changes to facilitate such offerings in response to concerns from companies that the level allowed to be raised (which had been in place for many years) had not kept pace with market movements and a desire to make such offers a more attractive mechanism to address the needs of retail investors.

These alternative options can be pursued individually or as a package (eg an institutional placement combined with a SPP for retail shareholders). The decision involves complex choices between a range of often conflicting considerations that are unique to a particular company and the market circumstances at the time. This is why boards use professional advisors to assist them in determining the appropriate course.

Another aspect of recent capital raising experience that has drawn public attention has been concerns about significant movements in share prices just prior to capital raising announcements.

A key element of ASX's market surveillance activities is to examine trading in advance of major corporate announcements, including capital raisings, to ensure continuous disclosure requirements have been maintained. This also involves seeking to identify any suspicious pre-announcement trading, which would be referred to ASIC for further investigation and possible enforcement action.

In December 2009, ASIC released a consultation paper around best-practice arrangements for protecting market sensitive information, including the practice of conducting informal 'soundings' of institutional investors in advance of finalising an issue structure to finetune arrangements and provide information to underwriters about the level of demand.

A further issue for the Government to consider later in 2010 will be whether the potential introduction of new market operators offering secondary trading in ASX-listed securities may have practical impacts on the operation of the capital raising process. In particular, whether arrangements/rules need to be put in place to manage any risks associated with multi-market trading (for example, a common approach to trading halts) to ensure that the capital formation process is not adversely affected. To date, there is no visibility of policy thought having been given to this issue.

This situation is not unique to Australia. In the US, the SEC is currently conducting a major review of the impact of recent market structure changes in equity markets. One part of that broad assessment is examining whether the fragmenting of markets and the growth of new trading strategies have been supportive of the capital raising activities of companies of all sizes. In announcing its review the SEC noted that the role of capital markets is to provide a "means for investors to save for the future, and to allocate those savings efficiently among companies that put that capital to work in our economy", and any market structure must be assessed against its ability to achieve these important objectives. The SEC went on to stress that the markets are not ends unto themselves.

Trends in Secondary Capital Raisings

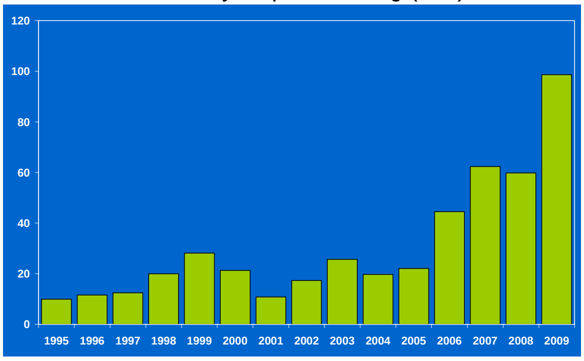
The amount raised through secondary issues has trended significantly higher over the past five years, after being relatively flat for the previous decade. This experience spanned the final years of an extended bull run and the most serious bear market for many years.

As referenced earlier, secondary capital raising in total generally remained strong throughout the GFC, with 2009 being a record year, with $98.6bn raised, 58% above the previous record year of 2007.

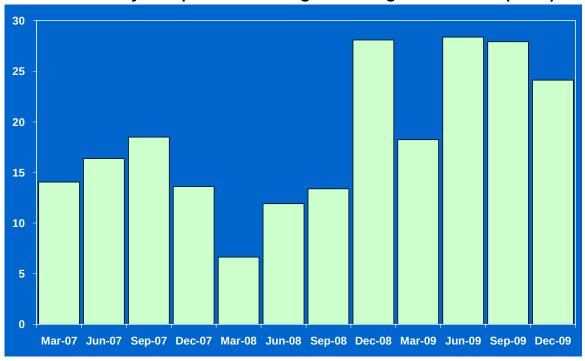
During 2009, over half of all ASX listed companies raised some additional equity capital. Of the top companies, around 80% of S&P/ASX 200 Index companies raised capital, and they accounted for around 90% of the total amount raised.

While there was a brief dip in secondary raisings in early 2008 (the March quarter tends to be a seasonal low), the remainder of the year was healthy with a sharp increase in the December quarter 2008 when conditions were at their most volatile. The strong performance continued throughout 2009. Issue discounts required to attract investor interest did widen in 2008 and 2009 to counteract reduced investor risk tolerance and reduced market liquidity.

Secondary Capital Raising ($bn)



Secondary Capital Raisings during the GFC ($bn)



While the aggregate capital raising performance was strong it doesn't tell the full story of a significant shift in the mix of capital raising methods employed during the three-year period 2007-2009.

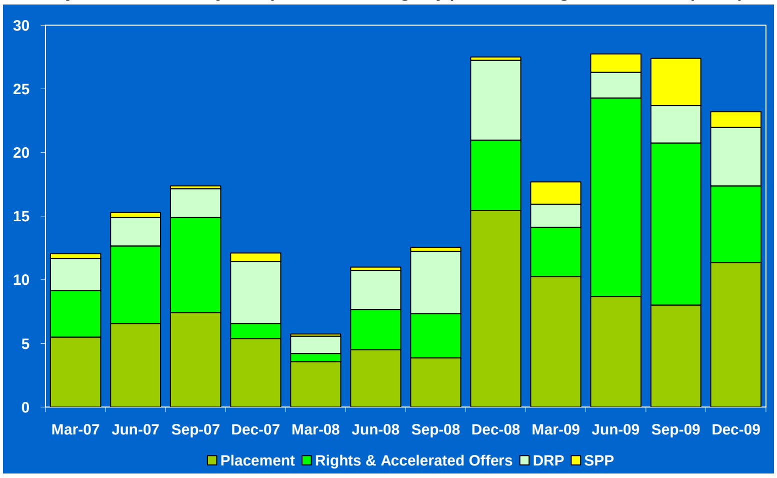
It is clear that during the depth of the financial crisis (December quarter 2008 and March quarter 2009), companies made increasing use of placements to raise capital. This was driven by the greater speed and certainty of funding this method entails, particularly at a time when retail investors may have been unlikely to commit additional funds given the heightened uncertainty. As noted earlier, financial flows into traditional safe havens, such as bank deposits, signalled that the retail sector's appetite for risk assets was greatly reduced during much of 2007 and 2008.

The market volatility and severely constrained credit conditions during the period September 2008 to March 2009 significantly affected the ability of companies to obtain underwriting support for their issues and was a principal driver of their capital raising choice. Such support was particularly important at the time, given the need for a company's board to protect against the high risk of a shortfall in raising. Underwriters were only willing and/or able to take on underwriting risk for a short time period. However, as market volatility began to subside, asset values recovered, and risk appetite returned, companies moved back towards a greater reliance on pro-rata issues (largely accelerated rights offerings).

On average over the three years (2007-2009) the most common secondary equity raising methods (by value) were: placements (41%); rights and accelerated issues (31%); dividend reinvestment plans (18%); share purchase plans (5%); and other (5%).

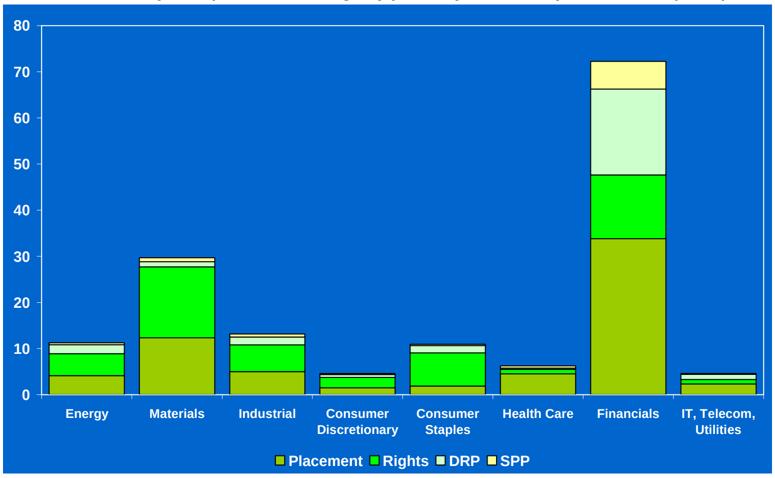
During the worst of the crisis (six months to March 2009), placements made up 55% of the value of secondary raisings and rights issues 20%. As markets recovered (six months to September 2009) the proportions reversed with placements accounting for 30% and rights issues 50%. The proportion of capital raised through SPPs also rose from 4% of total secondary raisings to 9% between the two periods.

Major Secondary Capital Raising Types during the GFC ($bn)



By far the largest industry sector raising capital between 2008 and 2009 was the financial sector, dominated by raisings by the large four trading banks during the peak of the crisis and in the early stages of recovery. It was also a sector that was particularly reliant (in both dollar and percentage terms) on the use of placements to raise capital.

Secondary Capital Raising Types by Industry Sector* ($bn)

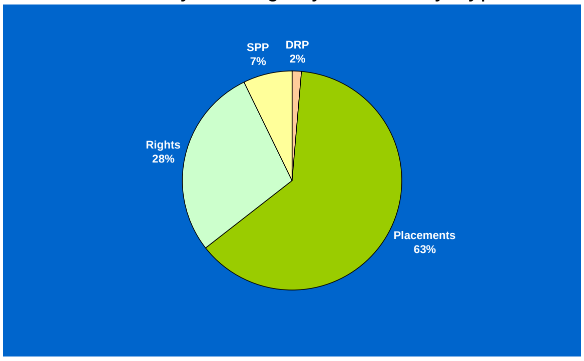


* Data covers the 2008 and 2009 calendar years.

A company's size is an important factor in determining the most appropriate type of capital raising. Generally, smaller companies have a limited range of options available, leading them to be more reliant on placements. Among the reasons for this are the different shareholder register structures of smaller companies (ie a large retail shareholder base), limited or no access to internal funding sources or lending/debt finance, the inability to raise significant capital via a rights issue, the need to move quickly as favourable market conditions emerge, and, sometimes, the desire of a particular company to attract a large cornerstone investor.

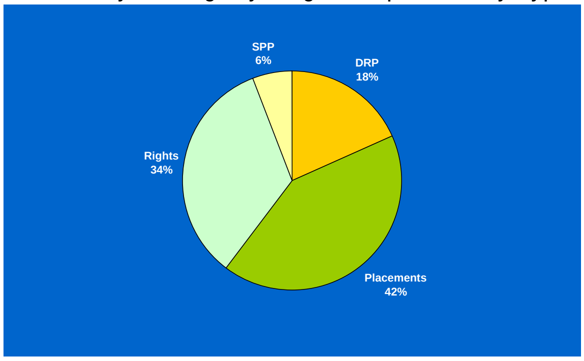
Around 95% of all secondary capital raised in 2008 and 2009 was by companies with a market capitalisation above $100m (81% by companies above $1bn). For those larger companies, the main capital raising choice was placements, with rights issues and DRPs also being significant options. In contrast, smaller companies (market capitalisation <$100m) only accounted for 5% of total secondary raisings. For these SMEs, placements accounted for almost two-thirds of all raisings, with rights issues also being a significant contributor.

Secondary Raisings by SMEs – by Type



* Proportions based on capital raising during 2008 and 2009.

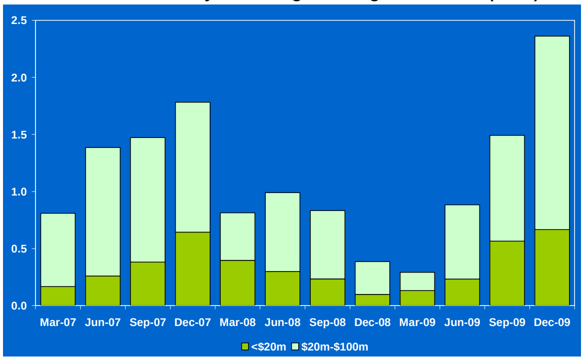
Secondary Raisings by Large Companies – by Type



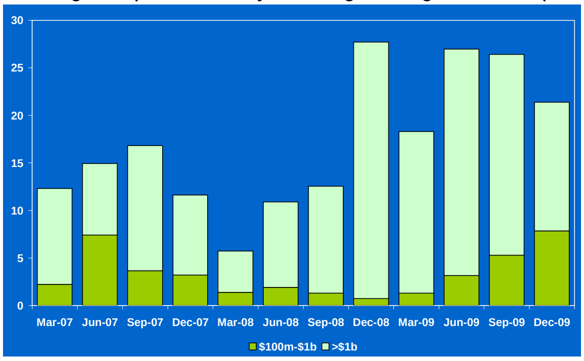
* Proportions based on capital raising during 2008 and 2009.

From the March quarter 2008 until around the September quarter 2009, smaller companies[4] (see left panel) experienced restricted access to new capital, and during the period between December quarter 2008 and March quarter 2009 the data suggests it virtually dried up. In contrast, larger companies (see right panel) were still able to raise capital for most of this period. In fact, the December quarter 2008 was a record quarter for secondary raisings.

SME Secondary Raising During the GFC ($bn)



Large Cap Secondary Raising During the GFC ($bn)



The largest capital raisings during the past two years were by the big four banks, with two property groups, two resource companies and two diversified financial companies also featuring. The banks relied largely on placements and DRPs (and to a lesser extent SPPs) for much of their funding. The property groups used a mixture of placements and rights issues, while the resource companies mainly utilised rights issues.

Companies Raising the Most Secondary Capital over 2008 and 2009 ($bn)

Company	Industry	Placement	Rights	SPP	DRP	Other*	Total**
ANZ	Banks	4.6	-	2.2	3.5	0.2	10.5
NAB	Banks	5.0	-	0.8	3.8	0.7	10.2
CBA	Banks	6.0	-	0.9	2.2	0.0	9.1
Wesfarmers	Finance/Retail	0.9	6.3	-	0.9	0.1	8.1
Westpac	Banks	4.4	-	0.4	3.0	0.1	8.0
Rio Tinto Ltd	Resources	-	4.2	-	-	-	4.2
Westfield	Property	3.1	-	0.1	0.8	0.0	4.0
General Property Trust	Property	0.1	2.9	-	0.3	-	3.4
Santos	Resources	-	3.0	-	0.4	0.0	3.4
Suncorp-Metway Ltd	Financial	1.1	0.7	-	1.0	0.0	2.8

* Other raisings include calls, options and employee share schemes.
** Components may not sum to total due to rounding.

[4] The breakdown by company size is an estimate based on average market capitalisation, rather than the specific size at the time of the capital raising. Market capitalisation of companies fluctuated significantly over the course of the GFC.

As noted earlier, the primary strength of the existing framework is that it does not arbitrarily narrow the options available to boards to raise capital in a manner that they believe is in the company's and shareholders' best interests. Whether they achieve this in practice can only be assessed by their shareholders and the market more generally. A successful capital raising can add significant long-term value to a company, while a poorly executed one can involve significant loss of shareholder value (not only the value of the additional equity issued but the stock of equity already in the hands of shareholders).

It is also important to acknowledge that assessing a particular decision on the choice of capital raising option with the benefit of hindsight is problematic. This does not allow for appropriate weight to be given to the uncertainty facing directors about future market conditions at the time in question (a particularly strong factor during the crisis) nor the range of possible outcomes flowing from the options they consider. Boards need to weigh up all the costs, benefits and risks of options they consider before making a final decision. There have been reports that the funding pressures of the GFC have prompted boards to become increasingly sophisticated in their consideration of these issues.

However, the listing rules do provide significant checks and balances (including requiring shareholder votes in some circumstances particularly when related parties are involved) to moderate the activities of companies in order to protect the interests of retail investors.

There are various listing rules that apply to the different types of capital raisings. These listing rules prescribe limits, timetables, etc, that must be adhered to (unless waived) once the entity decides which capital raising option it will employ. The rules also seek to provide protections by, for example, limiting the size of placements, preventing related parties from participating without consulting shareholders first, constraining dilution, etc.

The rules have a particular focus on the need for appropriate information to be provided to investors to make a decision on an offer and sufficient time for them to make that decision. ASX also believes it is important that boards communicate the thinking behind their choice of capital raising structure to allow investors to make ex-post assessments of their decisions. Such an approach represents good investor relations practice and, as such, should be considered by all companies. ASX will give consideration to whether there may be merits in requiring such communications through the listing rules.

The following sections look in more detail at recent trends within the four major types of secondary capital raising:

- Placements;
- Rights Issues;
- Share Purchase Plans; and
- Dividend Reinvestment Plans.

Placements

A placement involves the issue of securities to a limited number of significant and/or predominately institutional investors. They can be made to a select group of existing shareholders or may be used to introduce a new cornerstone investor to the share register.

Placements provide the fastest mechanism to raise capital (1-2 days) and are generally the least risky option to raise funds due to the truncated issue timetable, which reduces exposure to market risks. They are also generally less costly to underwrite and require a smaller price discount relative to current market price.

However, placements have the greatest potential to result in dilution of existing (particularly retail) shareholders' economic and voting interests and, as such, are subject to a 15% (of issued capital) limit in a 12-month period on capital that can be raised without shareholder approval.

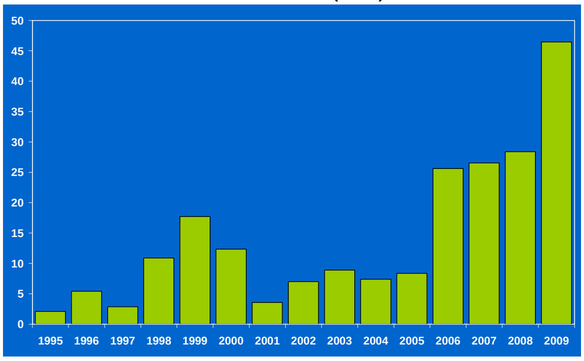
A total of 790 companies made placements during 2009, raising a record $38.3bn. This compared to 546 companies raising $27.4bn in 2008 and 797 companies raising $24.9bn in 2007.

The largest amounts raised by companies in 2008 and 2009 through placements were:

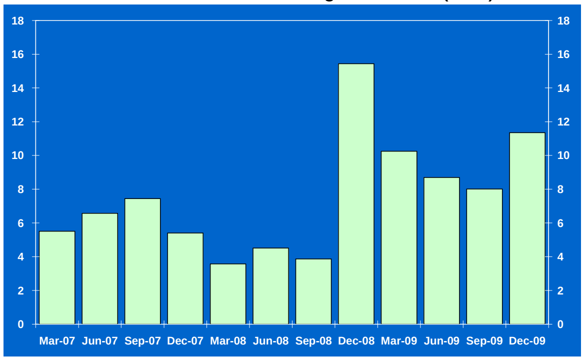
- Commonwealth Bank of Australia, a total of $6.0bn in October ($4.0bn[5]) and December 2008 ($2.0bn);
- National Australia Bank Ltd, a total of $5.0bn in November 2008 ($3.0bn) and July 2009 ($2.0bn);
- Australia and New Zealand Banking Group, a total of $4.6bn in October 2008 ($0.1bn), June 2009 ($2.5bn), and December 2009 ($2.0bn);
- Westpac Banking Corporation, a total of $4.4bn in August 2008 ($1.0bn), December 2008 ($2.5bn) and April 2009 ($0.9bn); and
- Westfield Group, a total of $3.1bn in December 2008 ($0.2bn) and February 2009 ($2.9bn).

There was a drop in the value of placements made in the first three quarters of 2008, but a sharp rise in the December quarter (as the banks raised a large amount of capital to strengthen their balance sheets in the face of more difficult access to capital in offshore markets). The value of placements has trended down since that highpoint but has stabilised at relatively high levels.

Placements ($bn)



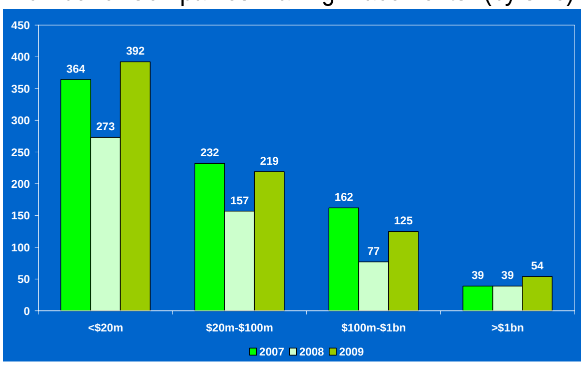
Placements During the GFC ($bn)



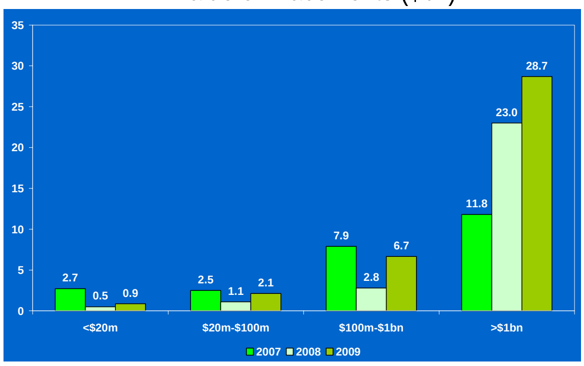
Smaller companies issue the vast majority of placements, accounting for around 75% of the total number of companies making placements. Despite dropping in 2008, use of placements rebounded in 2009, with the number of companies with a market capitalisation below $100m making placements rising by 42% and those above $100m rising by 54%.

However, the actual value of those placements, in aggregate, rose by 85% for companies below $100m and a still very robust 37% for those companies above.

Number of Companies Making Placements* (by size)



Value of Placements ($bn)



* Companies may make more than one placement a year.

The main advantages of placements for companies are their speed and certainty. Placements enable an issuer to raise capital relatively quickly and cost effectively from targeted investors, and are often preferred over rights issues for that reason. Placements can be closed in a matter of a few days.

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[5] Included a placement of $2.0bn of Perpetual Exchangeable Resaleable Listed Securities (PERLS).

Placements can be undertaken without a prospectus by utilising one of the exceptions[6] to the Corporations Act prospectus requirements, which reduce the time and costs associated with preparing comprehensive disclosure documentation. A company is required to issue a cleansing statement affirming that there is no material information that it is aware of that has not been disclosed to the market under the continuous disclosure rules.

Placements are generally the lowest cost mechanism for raising capital, primarily because the truncated timetable reduces the risks of a shortfall in the issue and lowers underwriting costs. There are also reduced compliance costs associated with simpler disclosure requirements for placements to institutional investors.

There may also be less risk associated with inappropriate pricing if a placement is undertaken through a price-range book-build because the price is determined by the market.

Placements exclude certain existing shareholders (particularly retail investors) and are generally considered less fair because they dilute the economic and voting rights of non-participating shareholders.

The '15% of issued capital in 12 months rule' in ASX Listing Rule 7.1 applies to placements and, as such, the issuer must either seek prior shareholder approval for a placement if it will exceed the limit or ensure the issue falls within the 15% limit[7].

This can be a significant potential constraint, especially for smaller companies, as the dollar amount they can raise is limited, particularly at times of depressed share prices, such as experienced during the GFC. The median percentage of issued capital raised through placements by smaller companies in 2009 was only marginally below the 15% limit, while for larger companies the median raising fell in the range of 12-13%.

It is clear that the use of placements, while providing access to significant amounts of capital in a short time period, does discriminate against, and involve dilution of, retail or other large individual investors who are not offered shares through the placement.

However, it also needs to be acknowledged that the injection of capital (particularly between September 2008 and March 2009) rapidly provided these companies with a more stable financial footing, which was to the long-term benefit of all shareholders.

The value proposition of investing in smaller (often more speculative) companies can also be very different to investing in larger companies. For example, an investor in a small mining explorer is more likely to be looking for return predominately through capital gain (ie higher share price), while an investor in a large, well-established company may be seeking a balanced mix of income (via dividends) and more modest capital gain. If a (dilutive) placement helps the small company achieve that capital gain, its investors that didn't participate in the placement may be less concerned with the dilution of their interests.

The surge in placements in late 2008 generated some public commentary that the issues were unfair to retail investors. It is worth noting that most of the commentary related to placements by large companies.

It was certainly the case that not only were placements used more regularly at that time but that many required significant price discounts to get them completed, making them dilutionary to non-participating investors. Generally speaking, in 'normal' market circumstances such treatment would appear, at face value, to not be fair to smaller investors, although the circumstances in late 2008-early 2009 were by no means 'normal'.

Those that argued against the use of placements during the heightened volatility implicitly assumed that a pro-rata rights issue could have been successfully completed, with retail investors committing additional capital at a time of significant uncertainty, and that companies could have survived an extended period of uncertainty about the prospects of securing the capital they needed. It seems unlikely, in retrospect, that this could have been achieved. Moreover, this was almost invariably the assessment of many boards at the time the capital raising choices were made.

[6] The most commonly used exceptions in relation to placements are the 'sophisticated investor' and 'professional investor' exceptions which allow access to such investors but not to retail investors. There are also exceptions to the 12 month restriction to the on-sale of securities issued via a placement without a disclosure document that provides for the securities to be freely traded following their issue.

[7] If the issue falls within the 15% limit, the issuer can 'refresh' its limit after having made the placement by subsequently seeking security holder approval for the issue under the placement in accordance with Listing Rule 7.4.

Institutional investors were always likely to have a greater risk appetite given the steady flow of funds into superannuation which needed to be invested. While cash holdings of funds may have been elevated during the period, they would also have been able to inject risk capital to companies on the basis of long-term expectations of valuations eventually recovering.

As noted earlier, the massive flow of funds into less risky assets, such as bank deposits, suggested that the risk appetite of retail investors was sharply lower during this time. It was also the fact that some SPPs offered to retail investors (usually in conjunction with placements) early in the crisis tended to be under-subscribed.

In response to public concern about the fairness of institutional placements companies began to increasingly offer SPPs alongside placements to address the interests of retail investors. This trend was assisted by ASIC policy changes that made SPPs a more attractive option for companies.

In 2007 around 100 companies conducted both a placement and a SPP (within close proximity). This number fell to around 70 in 2008 before rising again to around 200 companies in 2009.

Companies need to be aware of the trade-offs involved in conducting placements. They should place appropriate weight on managing the interests of their retail investors, and ensuring that other options are not more appropriate. Companies may also wish to consider an accompanying offer (say an SPP) to address the interests of retail investors.

Rights Issues

A rights issue is an offer to all existing shareholders to subscribe for additional securities in the company in proportion to their holding, usually at a discount to the current market price of the shares. Shareholders have the choice of accepting the offer in whole or part.

So called 'traditional rights issues' take longer than other forms of capital raising. This means they have tended to fall out of favour, particularly during the volatility associated with the GFC. In recent times, 'accelerated rights' issues have become a more attractive option for companies as they maintain much of the essential 'fairness' of a traditional rights issue, while also partly addressing the desire for speed and certainty in the capital raising by 'locking-in' a large part of the institutional funding up-front. They also provide for retail participation on equivalent terms.

Placements are usually conducted either overnight or while the security is in a trading halt, minimising market risk and the likely discount to market price. A trading halt can also be used in a similar manner to facilitate the institutional portion of an accelerated rights offer. However, a traditional rights offer (given its extended timetable) does not allow for a similar approach to be taken.

Rights issues had previously been considered less attractive to listed companies because of the Corporations Act requirement that a detailed prospectus accompany any rights offer. However, the Corporations Act now provides exemptions, in particular circumstances, from the prospectus requirements for traditional rights offers. ASIC has extended this relief to accelerated pro-rata offers to make them a more appealing option for companies to consider (vis-à-vis placements) while maintaining appropriate disclosure standards[8] .

Traditional Rights Issue

In a traditional rights issue, an entity raises capital by offering existing security holders the opportunity to subscribe for new securities or interests in proportion to their holdings of securities or interests in that class. The terms of the offer are the same for each holder, including the timing of the offer. In certain cases (renounceable rights issues) the shareholder may be able to receive some value for their rights even if they do not participate in the capital raising. But in other cases (non-renounceable rights issues), any rights not taken up are extinguished with no value accruing to the investor.

Traditional rights issues are conducted according to a detailed timetable prescribed in the ASX listing rules. While the timetable for rights issues has been shortened in recent years, any further significant reduction in the timetable to make

[8] Subject to certain conditions being met, a rights issue can be undertaken without a prospectus. In these cases a short form offer document, a 'cleansing notice', is used. However, there has been a reasonably slow take-up of prospectus-free rights issues. This is primarily because of the different liability regimes applicable to a prospectus-based rights issue versus a prospectus-free rights issue. The company and the directors have a due diligence defence where a prospectus is used that is not available where the exemption is used.

traditional issues more attractive relative to accelerated issues would need to be balanced against any reduction in time for retail investors to receive and consider any offers. The increasing use of electronic modes of distribution for communications between companies and their shareholders may provide some scope to consider whether these methods could also be employed to facilitate a shorter timetable for rights issues.

Traditional Renounceable RightsIissue

A rights issue is ‘renounceable’ if the right of each security holder to subscribe for their entitlement may be sold to a third party (who need not be an existing security holder). This enables security holders to realise some value for their rights when they are unable or unwilling to exercise those rights and contribute additional capital to the company.

There are no limits imposed (other than by the market’s appetite) on the amount of funds that can be raised under a renounceable rights issue. Subject to the rights having an intrinsic value and there being demand for them, ‘renounceability’ may increase the pool of potential investors and lead to a higher likelihood of the rights being exercised and there being a smaller shortfall.

The ability to trade renounceable rights makes it easier for shareholders to access the benefits of a rights issue and assists in ensuring fairness and equality for all security holders. If market conditions are such that a deep discount to current market price is required to attract capital, it is not particularly unfair for existing holders in terms of dilution as the rights may well have greater value and could be sold. A renounceable rights issue may involve a larger discount on the current market price to assist in facilitating an active market for the rights.

If underwritten, making the rights renounceable may reduce some of the underwriting costs because the expectation of a more fully subscribed issue would reduce the size of the potential shortfall for the underwriter to take-up.

However, during times of extreme market disturbances the longer timetable for completing a renounceable issue carries the potential to make it a costly option, compared to a placement, given the market risks over that extended period[9].

Traditional Non-Renounceable Rights Issue

The entitlements of security holders under non-renounceable rights issues cannot be transferred. As such, there is no compensation for the dilution of interests experienced by existing security holders who choose not to exercise their rights to contribute extra capital by purchasing additional securities.

One of the main reasons for undertaking a non-renounceable rights issue, as opposed to a renounceable issue, is that the board believes that there is unlikely to be a market for the rights; for example, if the market for the securities of the company is illiquid. The lack of market for the rights is likely to be more of a significant issue for smaller companies and, as such, a non-renounceable rights issue may be a more viable option for smaller companies.

While considered not as equitable in relation to potential dilution of non-participating shareholders as renounceable rights issues, a non-renounceable rights issue is considered fairer than a placement as shareholders are offered the opportunity to participate. Existing shareholders still have the choice of subscribing to the offer if they want to avoid dilution.

There are relatively loose limits imposed (other than by the market appetite) on the amount of funds that can be raised under a non-renounceable rights issue. Such issues can only occur if the issue ratio is no more than 1:1 (ie a doubling of the number of shares on issue).

As with renounceable rights issues, a non-renounceable issue is also subject to a significantly longer timetable and hence greater market risks vis-à-vis a placement.

[9] Appendix 7A of the listing rules prescribes that the minimum time within which a pro-rata rights issue may be completed is 23 business days from the date of the announcement of the offer to ASX.

Non-Traditional or 'Accelerated' Rights Issue

The industry has adapted the traditional rights issue structure to allow (mostly larger) companies to raise funds more quickly and give boards more certainty about the funds that will be in place at a certain point in time. Non-traditional rights issues, which are often referred to as 'accelerated rights issues', are structured as a two-stage process with an initial (accelerated) institutional component and a secondary (non-accelerated) retail component.

The advantage of this structure from the company's perspective is that it receives the bulk of its funding from institutional investors very rapidly and the risk of an overall shortfall in subscriptions is reduced. Institutional holders are required to deal with their rights before other holders and are generally allotted their securities first. An accelerated offer typically involves book-building offers to institutions, which are conducted similar to the process for a placement over a one to two business day period.

This then allows the company to offer retail investors a longer period (generally around three weeks) to consider whether they wish to take up their rights. Retail holders have the opportunity to participate in the capital raising, and it assists in balancing fairness and equality for all security holders with the need to secure funding quickly.

The accelerated structure also generally makes it easier and cheaper to obtain underwriting for the issue, when compared with a traditional rights issue, given the risk of a large shortfall is reduced.

However, the accelerated offer structure is only really suitable for companies that have both a significant institutional and retail shareholder presence on their share register. An accelerated offer does not work for companies with a predominately retail investor-dominated share register.

The main types of accelerated rights issue structures are:

- Jumbo structure – a 'first round' non-renounceable pro-rata offer is made to institutional shareholders over a two-day period while the security is in a trading halt. Entitlements not taken up are then offered to other institutional investors by the company. This stage is followed by a 'second round' non-renounceable offer to retail investors on the same terms as the institutional offer. Jumbos were traditionally priced during the 'first round' book-build but the market volatility during the GFC saw the emergence of an alternative fixed price Jumbo structure;

- RAPIDS (Renounceable Accelerated Pro-rata Issue with Dual book-build Structure) or AREO (Accelerated Renounceable Entitlement Offer) structure that provides for a renounceable accelerated pro-rata rights issue (initially to institutions and then to retail investors), with a dual book-build structure. That is, an institutional book-build and a separate, subsequent retail book-build to sell the rights not exercised by institutional investors and retail investors respectively. Any 'premium' received above the offer price is remitted to those investors who don't take up their rights; and

- SAREO – Simultaneous Accelerated Renounceable Entitlement Offer which has emerged more recently as a variation of the AREO structure, in that the rights which have been renounced are sold through a single book-build (open only to institutional investors) after both the institutional and the retail offers have been completed.

The fixed price Jumbo and SAREO structures were two new innovations that emerged during the GFC in response to market demands. They were facilitated by the flexibility inherent in the existing capital raising framework in Australia.

The SAREO structure developed from a concern that the timing of the book-builds for the renounced rights in a RAPIDS or AREO offer could result in significantly different prices for the institutional and retail investors, given they were conducted weeks apart. In a falling market (such as occurred during the GFC), institutional investors were more likely to get greater value for any renunciation of rights than retail investors, while the effect is reversed in a rising market with retail investors getting greater value for their rights.

By conducting a single book-build, the SAREO structure would provide identical treatment to each group of investors. Although questions have been raised about the willingness of institutional investors to wait approximately four weeks to find out what price they will get for their rights.

While past practice used to be that rights would be traded for a short period on-market through the ASX trading platform, such an arrangement is less common now. Companies often make use of shortfall facilities or back-end book-builds in both traditional rights issues and accelerated rights issues to deal with any shortfall that arises by allowing holders (or other investors) to subscribe for the shortfall.

Listed companies require, and ASX commonly grants, waivers from certain listing rules to allow them to undertake accelerated rights issues.[10] Given that these offers have now become common market practice, ASX intends to consider whether there would be benefits in amending the listing rules to more formally acknowledge them, perhaps by including timetables for particular offer structures.

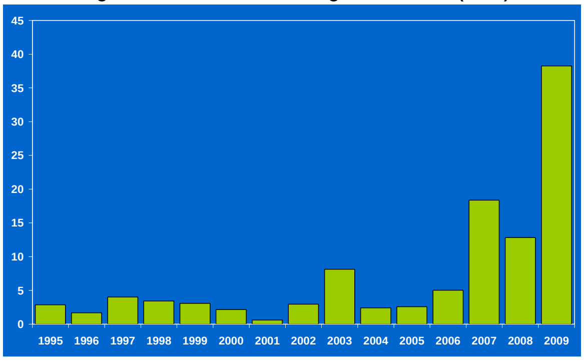
ASIC has provided Class Order relief to facilitate accelerated rights issues being undertaken without a prospectus, similar to the relief for traditional rights issues. However, companies often continue to provide more comprehensive disclosure through a prospectus because of the differing liability regimes and the availability of a due diligence defence.

Trends in Pro-Rata Rights and Accelerated Rights Issues

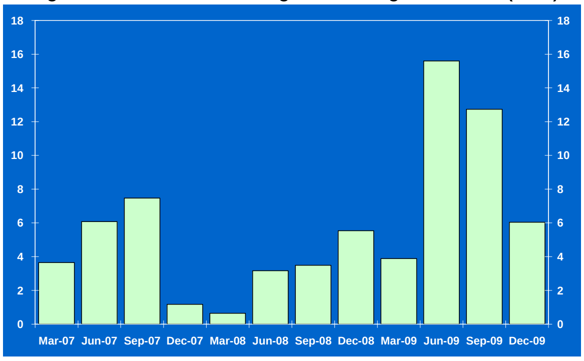
The period between 2007 and 2009 saw a much higher use of rights and accelerated rights issues as a capital raising mechanism. The amount of capital raised through rights issues in 2009 was more than double the previous record in 2007.

While there was a decline in late 2007 and early 2008 in rights issues, they remained a reliable capital raising tool for most of the period, accelerating as the market rebounded in the second quarter of 2009.

Rights & Accelerated Rights Issues ($bn)



Rights & Accelerated Rights During the GFC ($bn)



A total of 412 companies made rights issues during 2009, raising around $38.3bn. This compared to 260 companies raising $12.8bn in 2008 and 315 companies raising $18.4bn in 2007.

The largest amounts raised by companies in 2008 and 2009 through rights issues were:

- Wesfarmers $6.3bn through an accelerated renounceable offer ($2.6bn) in May/June 2008 and an accelerated non-renounceable offer ($3.7bn) in February/March 2009;
- Rio Tinto Ltd $4.2bn through a renounceable rights issue in July 2009[11];
- Santos Ltd $3.0bn through an accelerated non-renounceable offer in May/June 2009;
- GPT Group $2.9bn through two accelerated non-renounceable offers in November 2008 ($1.3bn) and May/June 2009 ($1.6bn); and
- Alumina Ltd $1.9bn through an accelerated renounceable offer ($0.9bn) in September/October 2008 and an accelerated non-renounceable offer ($1.0bn) in May/June 2009.

[10] The main waivers required granted for accelerated rights issue are: Listing Rule 3.20 (timetable waiver – because the record date is not at least 7 business days after the announcement of the offer); Listing Rule 7.1 (because the offer is made to the institutional and retail shareholders at different times, albeit at the same price and at the same ratio, the offer does not qualify as a pro-rata issue in terms of Listing Rule 7.2 exception 1); Listing Rule 7.40 (timetable waiver – because the offer does not follow the timetables laid out in Appendix 7A of the Listing Rules); and 10.11(to permit related parties to participate in the issue - because the offer does not come within the definition of a pro-rata issue the exception in Listing Rule 10.12 for related parties to participate without shareholder approval is not available).
[11] Rio Tinto is a Dual Listed Company, with a separate listing (Rio Tinto PLC) in London. The London listed entity made an identically structured issue, as required under UK law, to raise around £7.3bn.

As noted earlier, renounceable rights issues are considered to provide the fairest mechanism to raise funds by providing equality of opportunity for all shareholders to participate in the capital raising and providing them with some compensation for dilution should they decide against participation.

Non-renounceable rights issues are normally thought of as being 'fairer' than placements in that they provide all shareholders with the opportunity to participate. But are not as fair as renounceable rights issues because they do not provide compensation for dilution if the rights are not exercised.

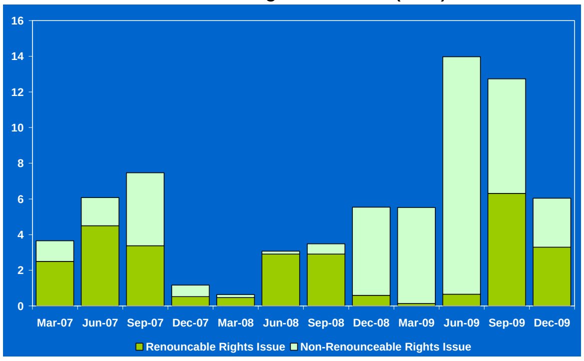
While the boards of companies need to consider fairness for retail investors when deciding which capital raising option to pursue, they also need to consider the best interests of the company as a whole and the risks associated with each option. The GFC provided a good example of a volatile market environment that prompted a reweighting by boards for a period of several months of the considerations going into the choice of issue type.

As the equity market weakened and investor sentiment deteriorated there was a clear shift from AREOs and RAPIDS toward Jumbo (non-renounceable) entitlement offers, as underwriters had no appetite for risk (and very tight credit conditions also affected their ability to take on any risk) during the worst of the crisis. As noted above, Jumbo entitlement offers were adapted, in response to market conditions, to incorporate a fixed price structure, frequently following confidential soundings of a small number of key securities holders/potential investors. The shorter execution risk (two days rather than four days to conduct the institutional offer) also made the Jumbo structure more attractive during the period. This phenomenon was restricted to companies with large institutional registers.

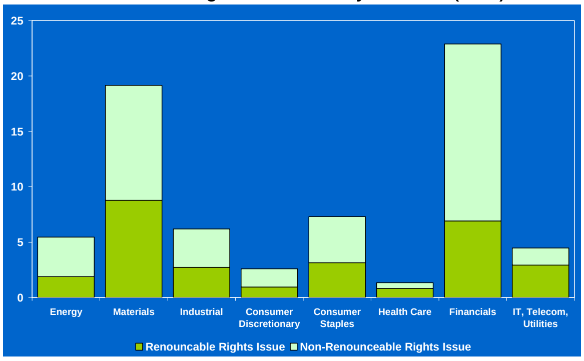
From the December quarter 2008 through to the middle of 2009, the use on non-renounceable issues dominated when compared to the preceding period where renounceable structures were more popular. Starting from the third quarter of 2009 the trend started to shift back towards a more even mix of renounceable and non-renounceable issues.

That is probably a reasonable response to the changing conditions, with the extreme volatility followed by more stable market conditions.

Nature of Rights Issues ($bn)



Nature of Rights Issues* by Sector ($bn)



* Based on total rights issues from CY 2007 through CY2009.

The breakdown between sectors shows that the financial sector was particularly reliant on non-renounceable issues, as were the energy and to a lesser extent the materials sectors (the latter being somewhat distorted by a single very large renounceable issue).

Some commentators have suggested that, in the context of increased use of non-renounceable offers, ASX or ASIC should mandate, through the listing rules or Corporations Act, that all rights issues should be renounceable.

As noted previously, ASX believes this choice is best left to individual boards to make, rather than establishing prescriptive rules that limit flexibility for companies to tailor their capital raising strategy in the best interests of the company as a whole.

It is not clear whether outcomes for investors who do not wish to participate in the raising would be significantly different, particularly in the environment existing during the GFC. For example, in a falling market the value attached to renounced rights is likely to be significantly lower (or non-existent). So it could be argued that requiring renounceability would have offered little practical benefit for shareholders in that circumstance.

Nevertheless, ASX Listing Rule 7.11.4, requiring the maximum offer ratio of 1:1 for non-renounceable offers, does force any company seeking to raise capital above that threshold to adopt a renounceable rights structure, given the significant dilution that could result for non-participating shareholders.

ASX has also received some complaints from non-resident shareholders that they have not been compensated for being unable to participate in a non-renounceable rights issue.

The Corporations Act and ASX Listing Rule 7.7 both impose a requirement, in certain circumstances, that pro-rata rights issues be made "to every person with a registered address in Australia or New Zealand." Offers to non-resident shareholders need not be made if the board deems it unreasonable given the number of shareholders, the number of shares that they would be eligible for, or the costs of complying in the foreign jurisdiction. However, the company needs to inform the non-resident shareholders of the offer and that they are not eligible to participate.

If the rights issue is renounceable, the company must appoint a nominee to sell the rights and forward any net proceeds to the non-resident investor. However, in the case of a non-renounceable issue the relevant requirements do not prescribe how an entity should deal with non-resident shareholders who are not offered the opportunity to participate in the offer. That is, whether there should be compensation in these cases. ASX is aware that some companies provide compensation to their foreign shareholders, despite the fact they are not obliged to do so.

Individual boards need to consider carefully the interests of their non-resident shareholders when making their capital raising decisions and to communicate their approach and the reasons for their decision.

Share Purchase Plans

A share purchase plan (SPP) is an offer of securities up to a set dollar value to existing shareholders of a listed company.

While such an offer can be made to all shareholders, recent practice has often seen a SPP linked to an institutional placement. In which case, the offer is only made to those shareholders who were not offered shares through the placement.

Unlike a rights issue, a SPP is not a pro-rata offer, meaning that all shareholders are not offered shares based on the size of their holdings. It is essentially a rudimentary means to provide an opportunity for retail shareholders to participate in a non pro-rata capital raising in a way that seeks to broadly approximate pro-rata treatment, without actually providing equality of treatment.

Shareholders are able to subscribe up to the maximum amount offered in the SPP. The company also may indicate that it is seeking a maximum amount of capital through the SPP mechanism and if aggregate subscriptions exceed that amount then final investor allocations may be subject to scaling back. Shareholders who decide against participating receive no form of 'compensation'.

Companies often use SPPs because retail shareholders are unable to participate in share placements offered to institutional investors, at a discount to the market price. One way for a company to address fairness concerns is to offer all other shareholders the opportunity to take part in an SPP.

From the perspective of small shareholders, SPPs are advantageous because they may receive more than a pro-rata share of securities than they might receive under, for example, a rights issue. However, larger individual shareholders (ie those with a current shareholding above the amount being offered through the SPP) can still suffer dilution through a SPP, although some companies have attempted to overcome this dilution by offering a top-up to this group of shareholders. Also, any shareholders who decide against subscribing to shares through the SPP, will suffer dilution to the extent that other shareholders take-up the offer. Although in practice, this potential dilution is unlikely to be as significant as that associated with placements, and the relative dilution for individual shareholders compared to a rights issue will be dependent on the shape of the company's share register and the specific structure of the offer.

Share purchase plans offer an expedient and cost effective method of raising up to $15,000 from each existing shareholder in a 12-month period without the need to issue detailed disclosure documentation (under the terms of an ASIC Class Order). Companies are required to issue a cleansing notice at the time of a SPP offer.

Prior to June 2009, the maximum amount that could be issued under a SPP to an individual investor, without a prospectus or PDS was $5,000 in a 12-month period, although ASIC had, from late 2008 granted a limited number of waivers to the $5,000 limit to allow issues of up to $10,000. However, ASIC subsequently issued a Class Order in June 2009 to increase the amount to $15,000[12].

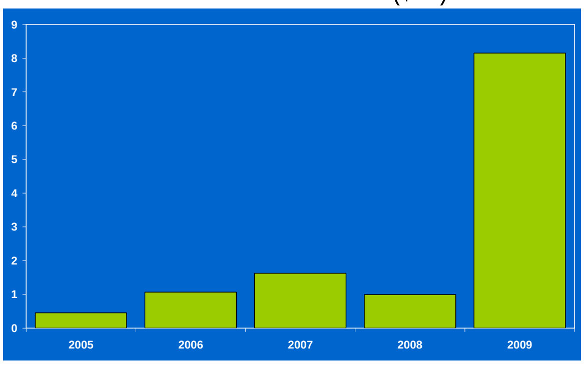
ASIC also removed another impediment to the effectiveness of SPPs. Previously, where custodians held securities on behalf of a number of individual beneficial investors in a single account on the company's share register, the SPP could be offered to the custodian as the registered holder of securities and not to each of the beneficial owners individually so they could each receive their full entitlement. It is now possible (but not required) for such offers to be made to all beneficial holders.

SPPs have become an increasingly useful capital raising option for companies (although still relatively small compared to other options) as a result of the ASIC policy changes.

The upper limit of $15,000 per shareholder still remains a factor that limits the usefulness for companies seeking to use a SPP structure in isolation to raise capital. However, it is not a prohibitive limitation for larger companies as a SPP usually is part of a broader capital raising strategy, such as in combination with an institutional placement.

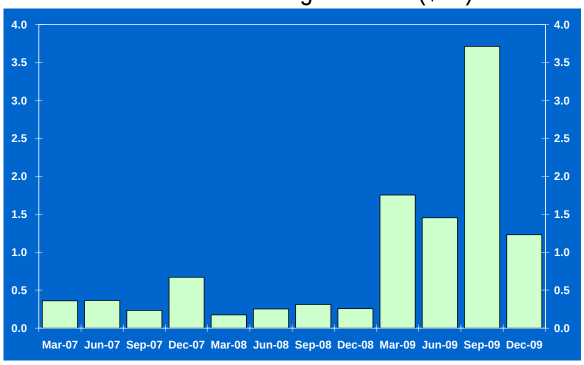
The amount of capital raised via SPPs rose over 800% between 2008 and 2009, to be around 500% above the previous annual high in 2007. It rose particularly strongly in early 2009 and spiked again when ASIC formally increased the maximum issue amount in mid-2009.

Share Purchase Plans* ($bn)



* Prior to 2005 capital raised through SPPs was not separately identified.

SPP Issues During the GFC ($bn)



A total of 267 companies made SPP issues during 2009, raising around $8.1bn. This compared to 110 companies raising $1.0bn in 2008 and 165 companies raising $1.6bn in 2007.

The largest amounts raised by companies in 2008 and 2009 through SPP issues were:

- Australia and New Zealand Banking Group, $2.2bn in July 2009;
- Commonwealth Bank of Australia, $866m in March 2009;
- National Australia Bank Ltd, $751m in September 2009;
- Macquarie Group Ltd, $669m in June 2009; and
- Westpac Banking Corporation, $441m in February 2009.

[12] The ASX listing rules currently prescribe a $5,000 threshold for SPPs. ASX has indicated that it will amend the rule to make it consistent with the higher monetary limit. Until this inconsistency in the listing rules is amended, ASX will grant waivers to allow $15,000 to be raised per shareholder.

It was not uncommon that SPP offers during the worst of the crisis were undersubscribed. Although as markets recovered, investors began to appreciate the attractiveness of purchasing discounted shares, and offers started to be fully or over-subscribed.

Although not strictly a pro-rata issue, SPPs are exempt from the ‘15% in 12 months capital raising threshold’ without shareholder agreement in Listing Rule 7.1.

The funding that can be accessed using SPPs is also restricted by Listing Rule 7.2 exception 15, which prescribes that: SPPs can only be used once in any 12-month period, the funding raised must not exceed 30% of the company’s securities already on issue, and the issue price must be at least 80% of the market price for the securities.

While there is no specific timetable for SPPs, companies usually take around one month to conduct an offer. So there may also be some funding uncertainty in relation to the take-up of the SPP, although the risk is not a critical impediment if a significant placement has already been completed.

A number of other practical concerns have arisen in the operation of SPPs.

As markets recovered, SPPs also gained in popularity as the discount to the current market price at which they are offered made them a very attractive investment in a rising market. While SPPs were often targeted at ‘compensating’ existing retail investors, the ASX listing rules could be used to allow for a record date for eligibility to participate in a SPP to be set after the public announcement of the offer.

This timing enables new shareholders to purchase a very small parcel of shares to be eligible to participate in the SPP on the same terms as existing shareholders. This would effectively allow these new opportunistic shareholders to dilute existing shareholders.

In December 2007, ASX released draft listing rules changes following a review of the regulatory framework for conducting SPPs. The analysis identified that most of the problem was with companies announcing forward record dates. Some existing shareholders who had committed to sell their shareholdings failed to deliver on the scheduled T+3 settlement basis, thereby remaining as the registered holder at the record date and able to participate in the SPP to the detriment of purchasers.

ASX has announced its intention to introduce a requirement that companies which offer a SPP must ensure that it is open to all shareholders on the register the business day before the SPP is announced. The proposal is designed to remove the incentive and ability for sellers to manipulate the delivery of entitled securities to the detriment of purchasers. It is also designed not to add to the length of time it will take a company to conduct a SPP or detract from the underlying principle of the SPP of providing long-term shareholders the opportunity to purchase shares at no brokerage, and possibly at a discount to the market price, as a reward for their loyalty.

The ASX listing rules currently do not prescribe any timetable requirements for SPPs, but this could be considered if it offered benefits to both listed companies and shareholders. There are also no protections available in the settlements system for a person who believed they had purchased the securities which failed to settle as scheduled (and therefore be eligible to participate in the SPP). Such protections are available for pro-rata entitlements issues such as rights issues.

The proposed listing rule changes would also prevent opportunistic entry to the register just prior to the record date by removing the opportunity to join the share register after the announcement in order to acquire a benefit intended for existing shareholders.

These proposed changes to the listing rules are still awaiting regulatory approval.

It is, of course, also the case that investors can purchase a portfolio of very small holdings in a range of companies, well in advance of any announcement by the company, and so have the opportunity to participate in a SPP (on equal terms with shareholders with larger holdings) that any of the companies subsequently decide to undertake. This is a consequence of the fact that a SPP only provides a crude version of pro-rata treatment. While it may be possible, for example, for the authorities to address this through setting minimum holding requirements to qualify for an offer though a SPP, it would be difficult to determine what an appropriate minimum would be – particularly given Australia does not currently set minimum trade lots. In any event, the aggregate dilution attributable to this type of opportunistic participation in SPPs is likely to be insignificant.

Another complaint some shareholders have had with the practical operation of SPPs has been the different approaches companies take to scaling back oversubscriptions. This problem is exacerbated by the opportunistic purchases described above, which can make it harder for companies to forecast how much might be subscribed through a SPP as the share register can expand significantly following the announcement of the offer.

It is hoped that the proposals to address the timetable issues might have the added benefit of reducing the extent of scale-backs needed.

ASX does not believe it is appropriate for it to prescribe how companies should deal with oversubscriptions. The decision a board would face would depend on the extent of the oversubscription and whether the excess funds could be put to a productive use. This is again an area where the board is best placed rather than having a third-party determine a prescriptive (and uniform) approach. It is good corporate governance for companies to clearly articulate (in advance if possible) their approach to scale-back and the factors that guided their final decision.

Dividend Reinvestment Plans

Under a dividend reinvestment plan (DRP), shareholders are permitted to reinvest all or part of their dividend payments in new shares. The opportunity to participate is available to all shareholders.

While DRPs account for a significant proportion of secondary capital raisings they are of use only to companies who actually pay dividends. Their usefulness is also limited as an emergency/flexible capital raising tool by the amount of funding that can be raised (in essence, capped by the amount of dividend distributed) and the fact that the timing is inflexible (ie being tied to the timing of the payment of dividends).

A DRP can be undertaken without the need to issue a prospectus if the offer is for fully-paid securities. DRPs are also exempt from the '15% in 12 months capital raising threshold' in Listing Rule 7.1[13]. Whether or not DRPs are underwritten may have an effect on the price of securities during the DRP period.

The flow of capital to companies via DRPs held up well over the course of the GFC. In fact, a record amount was subscribed in 2008, with the normal seasonal peak in the December quarter 2008 surpassing the similar peak in 2007 despite the greater volatility in markets.

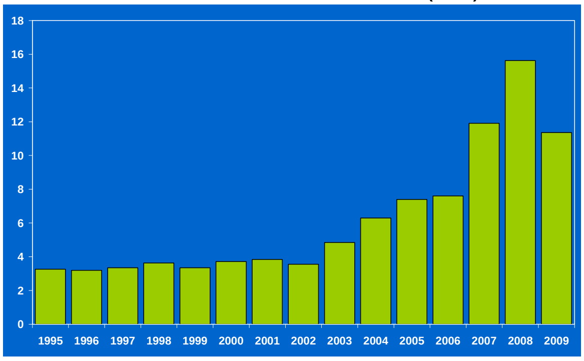
A total of 230 companies made use of DRPs during 2009, raising around $11.4bn. This compared to 269 companies raising $15.6bn in 2008 and 271 companies raising $11.9bn in 2007.

The largest amounts raised by companies in 2008 and 2009 through DRP issues were:

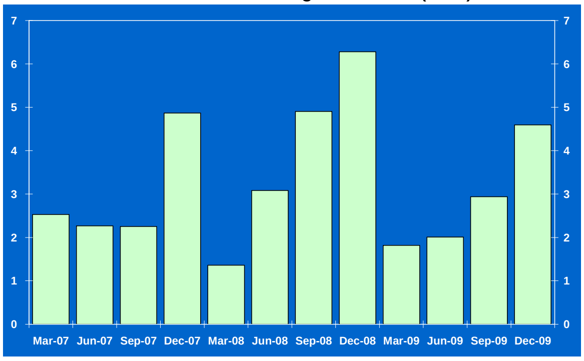
- National Australia Bank Ltd $3.8bn;
- Australia and New Zealand Banking Group $3.5bn;
- Westpac Banking Corporation $3.0bn;
- Commonwealth Bank of Australia $2.2bn; and
- Woodside Petroleum Ltd $1.3bn.

[13] An issue of a shortfall under a dividend reinvestment plan to an underwriter is not exempt from Listing Rule 7.1, but it is not uncommon for ASX to provide waivers in cases where this occurs.

Dividend Reinvestment Plans ($bn)



DRP Issues During the GFC ($bn)



Comparing the Australian, UK and US Secondary Equity Capital Raising Systems

It is often suggested that Australia should look at approaches to capital raisings in other major markets as a benchmark to assess our own arrangements. However, during the GFC the Australian market was often held up globally as a model for other jurisdictions to follow (this was supported by the ability of the Australian market to allow entities to raise equity capital quickly). As noted earlier, secondary equity capital raising in a number of other major markets also held up reasonably well during the GFC.

The secondary market capital raising regime in Australia provides greater flexibility, in terms of the size of capital raising and how it is structured and priced, than in the UK but is somewhat less flexible than in the US.

For the purpose of high-level comparison we have focused on capital raising in the primary equity market, and not the possibly more relaxed rules that may apply on alternative overseas markets which cater only to smaller listed entities. This reflects the fact that much of the recent commentary in Australia has been in relation to capital raising by larger companies. However, many ASX listed companies are of a size that would only qualify them for a listing on a 'second board' in other countries (and not the main board with its higher minimum standards), so a more reasonable comparison might be to the rules applying in these alternative markets.

Capital raising rules, in all countries, are subject to complex sets of regulations, exchange rules and exemptions/waivers to these requirements. The following description is designed to provide a general overview of each country.

Capital Raising in the UK

The UK Companies Act 1985 and the UKLA listing rules provide for shareholder pre-emption rights[14], which require that a listed entity proposing to make a secondary share issue for cash must first offer the shares to existing shareholders on a pro-rata basis, on equal or more favourable terms, before the shares can be offered to anyone else. These types of rights issues are commonly referred to as statutory or pre-emptive rights issues.

The Companies Act and the listing rules require shareholder approval of a special resolution to waive pre-emption rights in public companies.

In practice, the waiving of the pre-emption right is largely dictated by the Pre-Emption Group[15] Guidelines, which have effectively applied significant restrictions on the size and pricing of issues without pre-emptive rights.

The Pre-Emption Group Guidelines provide that for any non-pre-emptive secondary issue of shares: the amount that can be issued should not exceed 5% of issued capital in a 12-month period, or 7.5% in a rolling three-year period; and the price discount for the issue should not exceed 5%.

While the Guidelines do not have statutory backing and are not referred to in the listing rules, they are a very powerful tool by virtue of the fact that the members of the Pre-Emption Group and investor protection committees own a

[14] Section 89 of the UK Companies Act 1985 and Listing Rule 9.3.11.
[15] The Pre-Emption Group comprises institutional investors, listed companies, banks, the London Stock Exchange and corporate finance practitioners. The Guidelines were published in 1987 to provide a basis of understanding between listed companies and investors on the circumstances in which pre-emption rights may be waived pursuant to section 95 of the Companies Act 1985 and the listing rules.

significant proportion of the issued share capital in UK main board companies. As such, companies and advisors seek to structure issues so that they comply with the Guidelines.

While the UKLA listing rules do not prescribe restrictions on the size of pre-emptive or non-pre-emptive secondary issues (as a percentage of issued capital), they do provide a 10% limit to the discount that can be offered on the share issue price for all issues other than renounceable rights issues.

Given the restrictive approach taken by the guidelines and investors generally to non-pre-emptive issues, rights issues are the most common method of raising equity capital in the UK.

The UK regulatory framework for secondary capital raisings generally is not supportive of accelerated rights issues (ie the Jumbo model), which is an increasingly common method for raising capital in Australia because of the advantages of raising large sums quickly. The UK Financial Services Authority has in recent years examined Australian accelerated entitlement offers (in particular, AREO structures) and we understand it is proposing to issue discussion papers on the possibility of introducing these structures in the UK.

In relation to rights issues, the Australian regime has, until recently[16], provided for shorter secondary capital raising timetables and, as such, facilitated significantly faster capital raisings than that in the UK. Timetables for non-pre-emptive issues in the UK appear comparable to that in Australia.

The UK has more extensive disclosure requirements for secondary securities offerings than that required in Australia. The UK implemented additional disclosure requirements in 2005 in order to comply with the 2005 EU Prospectus Directive.

The UK Financial Services and Markets Act 2000 and the UKLA Prospectus Rules require that an approved prospectus be published before an offer of securities is made to the public and before securities are admitted to trading on a regulated market.

Unlike the situation in Australia, there is not significant scope to utilise exemptions for prospectus-free or reduced content/short form disclosure documents for rights issues or open offers in the UK. As such, a prospectus, which is not different substantially in content to that required for an IPO, generally is required for all rights issues and open offers in the UK.

The main exemption categories in relation to prospectus requirements are: shares issued in substitution for shares on the same class; takeovers; mergers; free-of-charge scrip dividends; employee offers; and institutional/ 'qualified investor' placements where the shares represent less than 10% of the number of shares of the same class already admitted to trading on the same regulated market over a period of 12 months.

Capital Raising in the US

The secondary capital raising regime in the US provides greater flexibility for secondary share issues than that in Australia. The US regime does not provide any restrictions on the size of issuance, as a proportion of issued capital, for public offerings for cash. Shareholder approval is required for private placements representing 20% or more of issued capital.

This greater flexibility appears to be offset by the more burdensome disclosure and SEC registration requirements applying to secondary share issues by larger listed entities in the US than those in Australia.

The US regulatory framework provides for a significant degree of flexibility in the structuring, price and issue size of secondary share issues.

In general, US state corporations laws do not provide default pre-emption requirements. However, some may include provisions on pre-emptive rights, which either permit corporations to pay stockholders to waive their pre-emptive rights or indicate that pre-emptive rights are only valid if they are provided for in the corporation's constitution.

[16] On 10 February 2009 the FSA shortened the minimum subscription periods for non-statutory rights issues from 21 days to 10 days, which is equivalent to the subscription period under the Australian regime. However, the subscription period for statutory or pre-emptive rights issues (ie rights issues that comply with the Companies Act and do not require shareholder approval) is still 21 days.

In practice, the only direct restrictions that apply to secondary issues in the US are those that are established by the rules of market operators. NYSE and NASDAQ rules both require shareholder approval for issues of ordinary shares that will result in a change of control and that are equal to, or greater than, 20% of the issued capital, subject to a number of exceptions. The exceptions that allow issuances of 20% or more without shareholder approval require that it be a public offering for cash or that there be no discount to the current market share price.

Under the NYSE and NASDAQ rules, it would appear that for public offerings for cash, where there is no change in control, there are no restrictions in terms of issue size as a proportion of issued capital and or in relation to the discount that can be offered on the share issue price.

However, in relation to private placements, exchange rules require shareholder approval for the issuance of common stock (or securities convertible into or exercisable for common stock) equal to 20% or more of the existing common stock, or 20% or more of the voting power outstanding before the issuance for less than the greater of book or market value of the stock.

The key drivers for how secondary share issues are structured in the US are related to commercial imperatives and the type of SEC registration or filing required.

The disclosure and SEC registration requirements appear to be, in general, more onerous and require longer timetables for public offerings than those required in Australia for rights issues. There is also less scope to make prospectus-free or reduced content disclosures in conjunction with public secondary share offerings in the US than in Australia.

The Securities Act of 1933 provides for the requirement that issuers file a registration statement with the SEC for approval prior to making a public offering, although certain ‘well-known seasoned issuers’ may be able to search for indications of interest prior to registration. The registration statement requires the inclusion of a prospectus, unless certain exemptions apply.[17]

Debt Capital Raising

While a deep and liquid equity market was able to support significant secondary equity capital issuance during the GFC, the same cannot be said for corporate debt issuance. The lack of a deep and liquid corporate debt market left companies exposed as the short-term nature of their debt/loan liabilities meant that they were quickly affected by the tight credit conditions.

Development of a vibrant corporate bond market should be an important priority for companies who seek greater funding stability, investors who seek a broader range of investment products with a different risk/return mix, and government which has an interest in the economic benefits that a new medium to long-term funding mechanism for Australian companies can deliver.

Australian companies draw on a broad range of external funding sources to support their business activities. In addition to equity capital raisings, businesses are able to externally fund their operations through debt issues and/or business loans. In Australia, the liabilities of non-financial corporations are split around 50:50 between equity (listed and unlisted) and debt/loans.

Of the non-equity liabilities, the primary obligations are shorter-term loans, placements and bills of exchange (35% of total liabilities). The relatively short duration of such funding left companies exposed to significant refinancing risk when the GFC prompted a severe credit tightening. In Australia, for example business credit growth declined in the year to November 2009 to its slowest pace since 1992.

Long-term bonds only account for around 7% of total liabilities and around three-quarters of these were issued in offshore markets, with only one-quarter issued domestically. Domestic corporate bonds issuance was depressed from

[17] The majority of exemptions relate to small issues or issues by small businesses who may be allowed to file a registration statement using a simplified form. The other main exemption relates to private offerings where the purchaser of the securities must meet conditions designed to restrict the offer to sophisticated investors who agree not to sell or distribute the securities to the public.

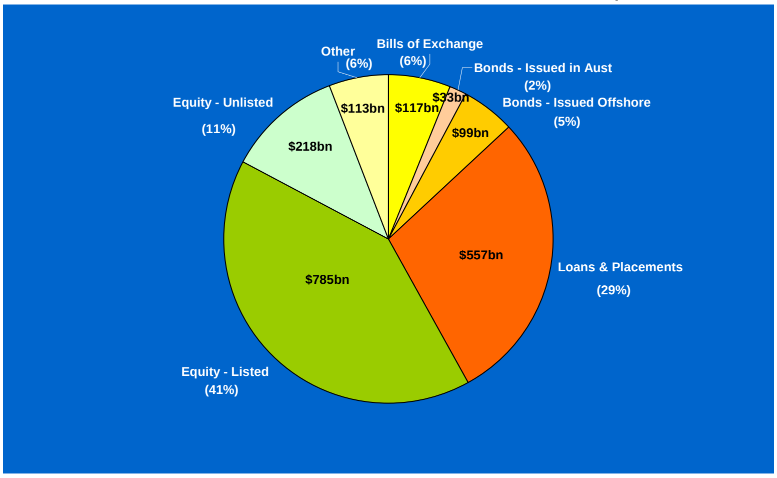
the second quarter of 2007 through to the third quarter of 2009, although offshore issuance began to pick-up from the first quarter of 2009.

Some commentators have suggested that the recent experience of very tight funding conditions for an extended period may provide a significant impetus to the development of a corporate bond market in Australia. This would allow companies to seek longer-term funding stability by issuing bonds with a medium-term maturity of 5-10 years.

However, to date, while some companies have sought the longer-term stability of issuing corporate bonds they have tended to issue them in offshore markets, particularly in the US which has a well developed corporate bond market for both public and private debt securities of short, medium and long-term maturities.

Deepening and broadening the local corporate bond market will have the added benefit of reducing reliance of Australian companies on offshore funding sources and reducing the contagion risks (such as those experienced during the GFC) when foreign markets experience difficulties unrelated to Australian circumstances.

Liabilities of Australian Private Non-Financial Corporations*



* Amount outstanding, as at September 2009. (Source: ABS Australian Financial Accounts).

The corporate bond market in Australia remains relatively undeveloped. Even some recent local issuance, including high profile retail debt issues, has not reduced the interest of local companies in foreign debt issuance, given the significantly lower interest rate environment in countries such as the US, and despite the cost of swapping the funding back into Australian dollars.

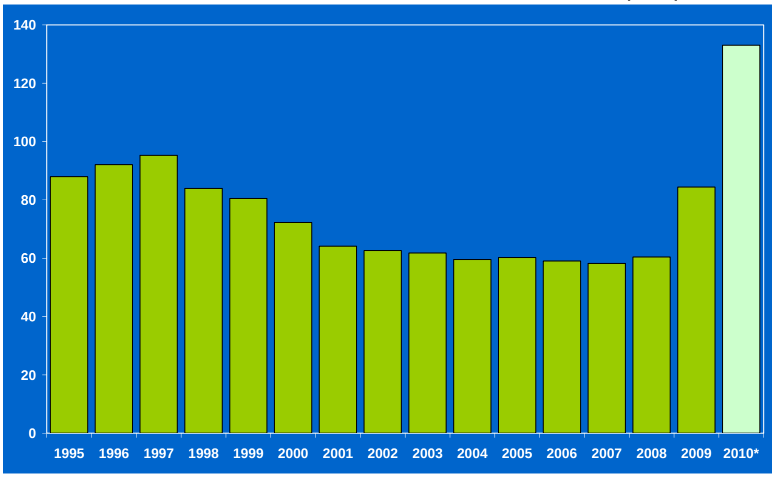
ASX is committed over the medium-term to developing an exchange-traded bond market that will enable retail investors to access a range of bonds (issued by both the Government and private companies) to provide the opportunity for greater portfolio diversification and a corresponding reduction in the volatility in portfolio returns.

Both institutional and retail investor portfolios in Australia are considered to be overweight in equity and property investments and underweight in fixed interest securities.

This, in large part, reflects the steady decline in Government bond supply from the mid-1990 to the early years of the following decade as a relatively strong fiscal position saw the Government's financing needs decline. In 2002-03 the Government conducted a review of the Commonwealth Government Securities (CGS) market to determine whether, in light of expectations of ongoing budget surpluses, the Government should continue to issue bonds to maintain a minimum stock on issue. The review determined that the many economic and capital market benefits that flow from having a viable Government bond market argued for the maintenance of a stock of securities on issue of at least $50bn. Given the reduced funding needs, the Government decided to establish a series of funds (most notably the Future Fund) to accumulate financial assets to assist in meeting future funding needs in a range of specific areas.

The decline in bonds on issue only began to reverse in 2009, as the prompt and aggressive fiscal policy response to the GFC saw issuance begin to expand sharply.

Commonwealth Government Bonds on Issue ($bn)



As at 30 June. * Estimate for 2010 based on the 2009-10 Mid-Year Economic & Fiscal Outlook.

ASX believes that the development of a retail CGS market is a vital pre-requisite for establishing a vibrant corporate bond market in Australia. Such a market will provide a transparent risk-free benchmark for retail investors to assist them in assessing the attractiveness of corporate issues, and provide them with access to fixed interest securities across the risk/return spectrum.

The anticipated funding needs of Government over the next few years, including the need to finance major infrastructure projects, means it is timely to consider ways for the Government to supplement institutional demand for securities with a new distribution mechanism for retail investor demand. For example, the opportunity to achieve greater diversification, through a risk-free security, will be increasingly important for an ageing population with a need for greater certainty in income streams and a more diverse range of annuity-type products.

Once retail investors have developed their understanding of, and had experience trading in, the set of fixed interest securities with the lowest credit risk, the environment would be conducive to greater opportunities for broadening the range of securities that could be listed, traded in retail sizes on the ASX platform, and cleared and settled through its settlement system to meet the needs of investors.

At present the corporate bond market is generally only accessible to wholesale investors through primary issuance and OTC trading. This has been the result of both demand from institutional investors for limited securities, and the significant practical barriers and compliance costs associated with offers to retail investors.

As at end December 2009, there were only 10 corporate bond issues listed on ASX.[18] In addition, ASX had listed a range of other interest rate products including: 16 floating rate notes; 18 convertible notes; and 34 hybrid securities.

However, strong retail investor interest in debt issues by AMP and Tabcorp Holdings in 2009 indicated there is strong underlying demand for such securities.

In offering corporate bonds for issue, listed entities need to comply with the relevant provisions of the Corporations Act and, for listed bonds, the ASX listing rules.

Offers of corporate bonds to retail investors generally require full prospectus disclosure for each initial and subsequent offer of bonds, except in relatively limited circumstances (generally where the securities have an identical maturity and coupon rate to previous issues). In contrast, an issuer of listed equity generally only requires a transaction-specific prospectus for offers of shares or share options and securities that are convertible into shares.

The existing regulatory requirements applying to offers of corporate bonds are designed to provide appropriate levels of disclosure to maintain investor protection. However, the time and expense involved in complying with the requirements have been identified as a significant impediment to the growth of a retail corporate bond market.

[18] There were two other bond issues which were suspended from trading.

In December 2009, ASIC released Consultation Paper 126, *Facilitating Debt Raising*, which indicated that it is considering providing relief from the fundraising provisions of the Corporations Act “to facilitate efficient corporate bond raisings by listed entities, provided that investor protection is not unduly compromised”. Under the proposals, ASIC would allow an exchange-listed entity to offer corporate bonds to retail investors using a simplified prospectus, similar to that required for many equity issues. Such a document would comprise a ‘base’ prospectus (which could be used for several different offers) and a supplement that would relate to the specific offer. Any relief would apply only if various conditions related to the nature of the ‘vanilla’ bond issue, the issuing company, and disclosure requirements are satisfied.

The recent report by the Australian Financial Centre Forum[19] on measures that may enhance Australia’s financial services sector, also proposed measures to reduce the regulatory burdens associated with corporate debt issues by listed companies to retail investors.

In addition, for an entity to be admitted to the official list as an ASX debt listing it must satisfy a range of conditions set out in Chapter 1 of the listing rules. These relate to matters such as the nature of the issuer (generally a listed company or government entity) and the fact that they have an ‘investment grade’ rating from a recognised credit rating agency[20].

There is considerable scope to grow the corporate bond market in Australia, to provide another important and stable source of finance for companies and an important new asset class for, particularly retail, investor portfolios.

It is hoped that one long-term impact of the recent GFC will be an increased demand from companies for bond finance. Increased issuance will be matched by increased demand from a range of investors as larger issues increase the prospects of more liquid secondary trading. In addition, the prospect of regulatory change to reduce the compliance costs associated with retail offers may open up new avenues of demand for corporate bonds.

Conclusion

The experience of the past few years demonstrates that the relatively flexible capital raising arrangements that apply in Australia, governed by the Corporations Act and ASX listing rules, have allowed Australian companies to raise significant amounts of equity capital at a time of severe market dislocation.

The strong capital raising performance helped companies strengthen their balance sheets and helped provide an important buffer against the adverse effects of the GFC. A prescriptive capital raising regime may have generated a very different and, possibly a worst case, outcome for some listed companies.

The heightened volatility and sharp declines in asset values at the peak of the crisis saw a shift of approach by companies away from renounceable rights issues and towards a reliance on placements, and to a lesser extent accelerated non-renounceable rights issues.

As conditions stabilised and then recovered, companies re-weighted their strategies away from placements and back towards rights issues, with renounceable issues becoming a more attractive option. New variants of the accelerated offers emerged to address concerns of equality of treatment between institutional and retail investors. In addition, policy changes saw SPPs become a more viable option for companies to consider when wishing to use placements, but also provided opportunities for retail investors to participate in the capital raising.

It is important that companies, when assessing their capital raising choices, consider the interests of all their shareholders and communicate the reasons for their decisions to their shareholders. Ultimately, it is a matter for the board. It is best placed to understand and balance all the relevant factors. The board is also the group that will ultimately be held accountable for the decisions made.

[19] “Australia as a Financial Centre: Building on Our Strengths”, a report by the Australian Financial Centre Forum (November 2009).

[20] Recent policy changes announced by ASIC require that credit rating agencies obtain a financial services licence in order to provide ratings. This has resulted in the major rating agencies deciding, for the time being, to only seek a licence that would enable them to provide a rating to wholesale investors, not for the use of retail investors. This may make it more difficult for prospective issuers to meet the listing rule requirements.