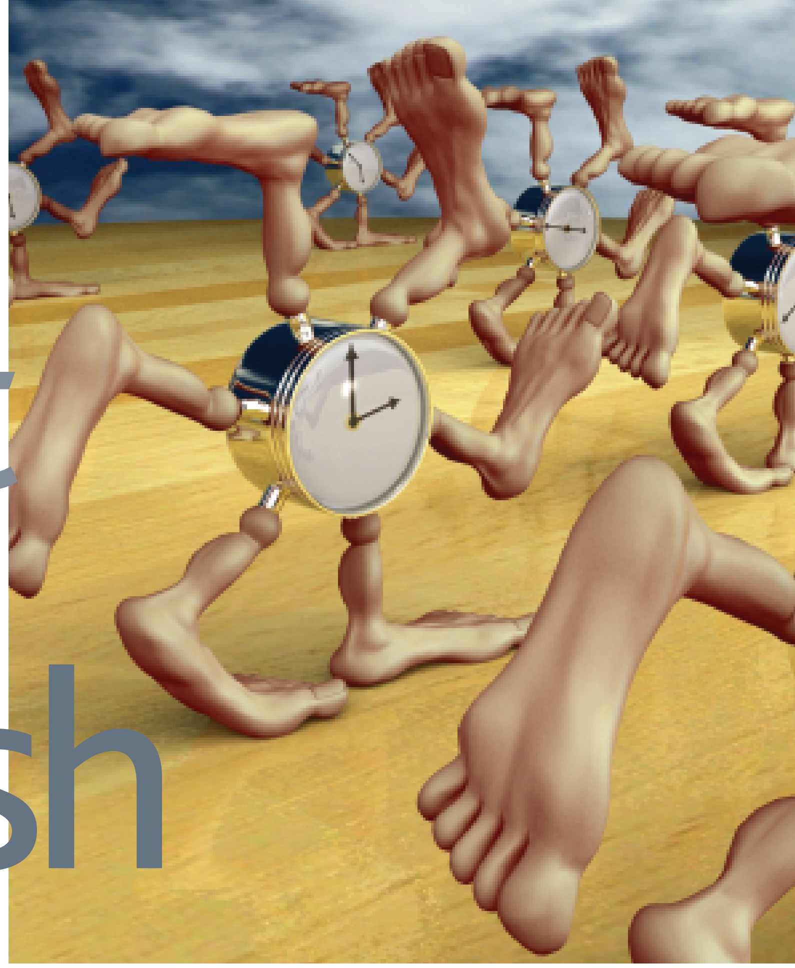
The great rights rush



Executive summary

- There has been little let-up in the corporate rush to the equity market to raise funds to pay off debt piles or even to finance acquisitions. But this year's rights issue successes have been accompanied by just as many flops.

The May issue of The Treasurer reported on a rush of rights issues that marked the opening weeks of 2009 and pointed out the danger of investor fatigue setting in. But even though the first four months of this year saw rights issues with a combined value of £30bn announced, there has been no sign of any slowdown so far. In recent weeks, retailers, property groups and miners are among a "second wave" of companies seeking the favour of investors.

The first week of June saw mining group Rio Tinto announce it was aiming to cut its $38bn debt load through a 21-for-40 rights issue. Aimed at raising $15.2bn, the world's fifth-largest ever rights issue was announced by Rio after it pulled out of a proposed deal with China's Chinalco, which had planned to double its stake in the group to 18%.

Typical of the deep discounts that have marked rights issues since the credit crunch began, the new shares were priced at £14.00 – a 49% discount to the closing price before the offer announcement. Rio will raise $11.8bn (78% of the total) from the UK offering and a further $3.4bn in Australia.

Although the Rio issue is massive, HSBC's record £12.5bn rights issue, completed early in April, has set the bar for Europe so far this year. But as Table 1 shows, despite the HSBC and Rio Tinto blockbusters, issues in the UK have generally been on a smaller scale than those in continental Europe. HSBC's success in managing to get its issue fully subscribed also allowed investment banks to go ahead with underwriting a series of capital raisings for other European firms. They have been encouraged by the recovery in stock markets across the continent from the low points touched in mid-March.

In a number of cases, such as the €8bn cash call by Italy's energy utility Enel and a €3bn call from French food and beverage group Danone, the proceeds are needed to trim a heavy debt load accumulated as a result of major acquisitions during the boom times.

Enel, which took over Spanish utility Endesa, has reportedly racked up total debt of €62bn as a result of its expansion programme. By the end of 2008 Enel's net debt to earnings before interest, tax, depreciation and amortisation stood at 4.3 times. To preserve its A credit rating, Enel's net debt to EBITDA ratio must be reduced to below 3.

Danone's motives may not be restricted to only reducing debt. There are reports that the group is lining up further takeovers, ranging from a set of smaller further acquisitions in the developing markets of Eastern Europe and Asia to its Italian peer, Parmalat.

But if the flow of planned new rights issues has not dried up, there are signs that Europe's investors are becoming more discerning. Their response to Danone and Enel's announcements was unenthusiastic, due partly to the heavily discounted prices set to attract retail investors.

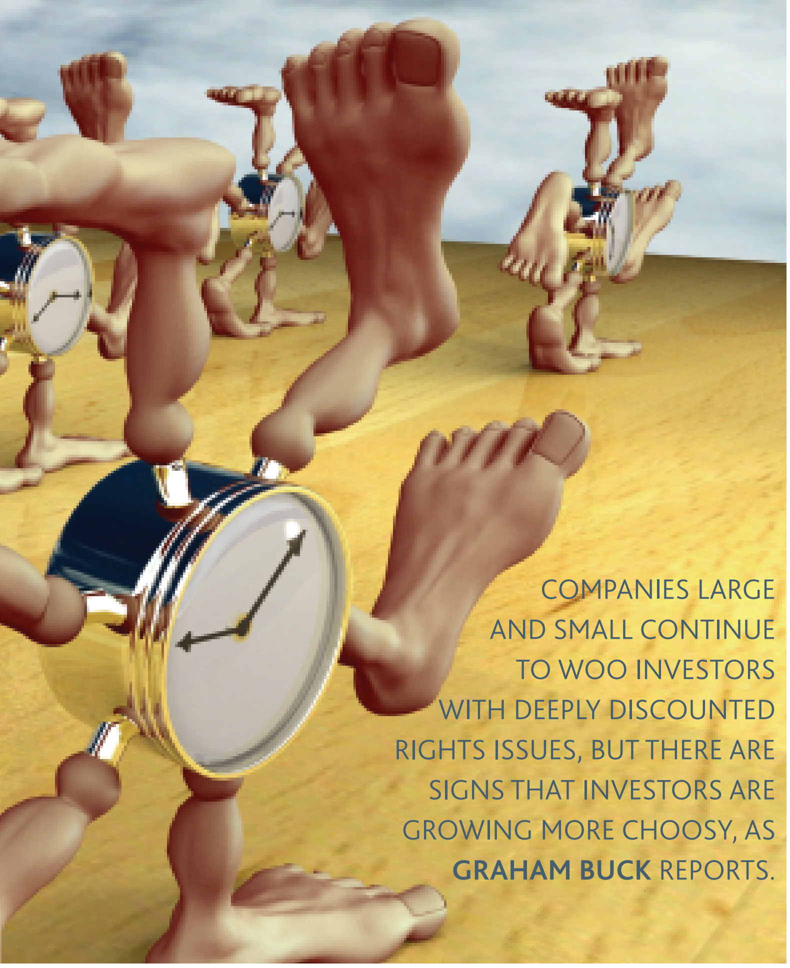
Anglo-Swiss mining group Xstrata, which has been hard hit by the plunging price of platinum, faced opposition to its £4.1bn rights issue earlier this year from investors unhappy with its acquisition strategy.

Closer to home, companies such as publisher Pearson, property company Quintain and private equity group 3i have also found investors responding without enthusiasm to proposed rights issues. More recently, media group Yell was reportedly among those testing the water for a rights issue and finding it distinctly chilly.

Quintain abandoned its plans to raise £100m in April after it became clear that investors would not back the issue. Pearson, recently reported to be interested in legal and financial training group BPP, floated the idea of a £270m rights issue earlier this year but found investors questioned whether it needed an injection of capital.

3i, which aims both to cut debt and to take advantage of buying opportunities among firms hard hit by the credit crunch, had several major investors argue that it was capable of trimming debt from existing cash generation and investment disposals. The group pressed ahead regardless and launched a deeply discounted £732m right issue in May.

In the retail sector, Debenhams announced a £323m issue of new shares to cut debt of £927m in early in June. Again, the group plans to divide the proceeds between reducing its debt pile and providing funds for "opportunistic acquisitions" if the squeeze on consumer spending results in more rivals going under. Currys and PC World owner DSG International, whose proposed £310.6m investor cash call won shareholder approval a few weeks before, initially met opposition to



COMPANIES LARGE AND SMALL CONTINUE TO WOO INVESTORS WITH DEEPLY DISCOUNTED RIGHTS ISSUES, BUT THERE ARE SIGNS THAT INVESTORS ARE GROWING MORE CHOOSY, AS **GRAHAM BUCK** REPORTS.

Table 1: Top 10 European rights issues to date in 2009

Pricing date	Value $(m)	Issuer	Deal nationality
April 6	19,571	HSBC Holdings plc	UK
June 5	11,800*	Rio Tinto*	UK*
May 29	8,000	Enel SpA	Italy
March 18	5,801	Xstrata plc	Switzerland
May 19	4,678	Snam Rete Gas Spa	Italy
March 31	4,624	Gas Natural SDG SA	Spain
April 8	3,724	Nordea AB	Sweden
May 29	3,000	Groupe Danone	France
March 18	2,000	Compagnie de Saint-Gobain SA	France
April 24	1,944	Lafarge SA	France
March 31	1,826	Skandinaviska Enskilda Banken AB-SEB	Sweden
March 19	1,743	CRH plc	Ireland
April 9	1,599	Banco Espirito Santo SA	Portugal

*another $3.4bn will be raised via the group's Australia issue
Source: Dealogic. www.dealogic.com

its structuring. This involves attracting new investors as well as raising money from existing ones who feared their influence would be diluted. Other rights issues proved less contentious, even though the announced pricing significantly discounted the previous closing price.

Platinum miner Lonmin's two-for-nine rights issue to raise £302m was priced at a 44% discount and came only weeks after the group arranged a $575m refinancing package to push debt maturities back to 2012. What possibly swayed investors was the hostile bid for Lonmin last year from rival Xstrata, which has a 25% stake in the company. There is much speculation the bid will be renewed and if so Lonmin is keen to ensure it is made at the highest price possible.

Brewer and pub operator Greene King also successfully got a £207.5m rights issue under way in April, enabling it to buy back £22.1m of debt bonds at a cost of £11.3m and to cherrypick pub properties at favourable prices from rivals. Analysts have suggested that some of Greene King's more resilient rivals will follow its lead.

The ability to make selective purchases cheaply has also worked for property groups. Great Portland Estates, whose portfolio is focused on London's West End, launched a fully underwritten £166m rights issue in May despite the price of 133p representing a 53.4% discount to the closing share price a day earlier. The group promoted the issue to investors on the basis that it would be able to unlock up to £536m in investment funds and take advantage of buying opportunities in a still depressed property market. At the same time, Shaftesbury announced a £149.1m issue at a similar discount to fund development of a new shopping and leisure complex in central London.

The aim of both issues was a marked contrast to those of British Land, Hammerson and Land Securities back in February. The trio raised more than £2bn in emergency cash to shore up their balance sheets and have been reviewing disposals rather than considering new assets.

Other recently announced fundraising includes the £314m rights issue announced by builders merchant group Travis Perkins, which was encouraged by Wolseley's success in completing its £1bn cash call earlier this year. The group has stressed that while proceeds will be used to strengthen the balance sheet and reduce debt, the issue is not an emergency fund raising and has been chosen because other sources of capital are over-expensive. This persuaded it to hold off until Taylor Woodrow and Wolseley completed their more urgently needed rights issues earlier this year, so it could avoid being bracketed with them.

Even waste management group Shanks has seen its earnings come under pressure and has launched a £71.4m two shares for three issue at a 50.8% discount to reduce its net debt of £290m. Support for the issue comes partly from the fact that a healthier balance sheet should assist the group in securing further contracts under the PFI initiative.

But more distressed companies are joining the queue. They include newspaper group Mecom, which in late May announced a £142m rights issue, priced at a hefty discount of 70% discount. The group, which is seeking to reduce net debt of £669m, has recently been in danger of breaching its banking covenants unless it can renegotiate terms with lenders. Home shopping supplies group Findel, whose debt load of nearly £400m is three times its market value, may also follow its lead after principal investor Schroders indicated its support.

The question is whether other distressed companies can attract support over coming months. A quote from one investor, reported in The Financial Times, indicated some of those struggling to stay afloat may find it difficult to attract support unless they can convince investors that a rights issue will ensure their long-term survival.

"Companies must understand they don't have a God-given right to tap shareholders for money," he said. "In the normal course of events companies with poor management, weak strategy and no competitive edge go bust and we shouldn't sell quality investments to fund them."

And UK rights issues are typically characterised by sub-underwriting, with banks charging a fee to guarantee that companies will get their money by mopping up any new shares that are not taken up and passing them on to sub-underwriters, which are often investment groups. The practice is less common elsewhere in Europe and many US investors are either unwilling or not permitted to sub-underwrite.

Sub-underwriters already complain that banks are passing on to them increasing levels of risk while retaining a larger slice of the often substantial fee. The months ahead could see the sub-underwriting of less attractive issues become too tough a prospect, stifling some issues.

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