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ISSUE 06

ON CORPORATE FINANCE

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ASX LAUNCHES 'BOOKBUILD'

NEW ASX BIDDING TOOL HELPS RAISE EQUITY

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- FRAMING A DUE DILIGENCE PROCESS
- SUMMARY OF KEY FEATURES AND DIFFERENCES BETWEEN A SCHEME OF ARRANGEMENT VERSUS AN OFF-MARKET TAKEOVER

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ASX Launches BookBuild

On 8 October 2013, the Australian Securities Exchange (ASX) launched a new bookbuild facility which aims to broaden the number and range of investors who can actively participate in a qualifying capital raising process. The facility (ASX BookBuild) essentially enables investors to participate in a capital raising in much the same way as trading existing shares.

For investors, the facility will provide a level playing field in accessing a capital raising and for companies raising capital, the facility provides a transparent, efficient and cost-effective way to access the maximum number of investors.

The facility has been devised to make the capital-raising process more transparent and fair to investors, using real-time technology which enables investors and company management to observe the progress of bookbuilds rather than wait for a price and share allocation to be determined by underwriters and investment bankers behind closed doors.

ASX chief executive Elmer Funke Kupper described the system as "a tool that might be interesting for small and mid-cap companies to raise capital".

What are the Current Traditional Bookbuilding Practices?

In a traditional bookbuild process, the issuer or investment bank (Bookrunnner) will determine the price of shares to be offered after accepting from a select group of investors (usually institutional investors) confidential off-market bids. The final price will be based on the demand by institutional investors and the price they are willing to pay for those shares.

The most distinguishing feature of a traditional bookbuild is that the issuer or investment bank has the discretion to price and allocate shares across investors, as participation is by invitation and is limited to selected investors who are often clients of the investment bank, including brokers, fund managers and sophisticated investors.

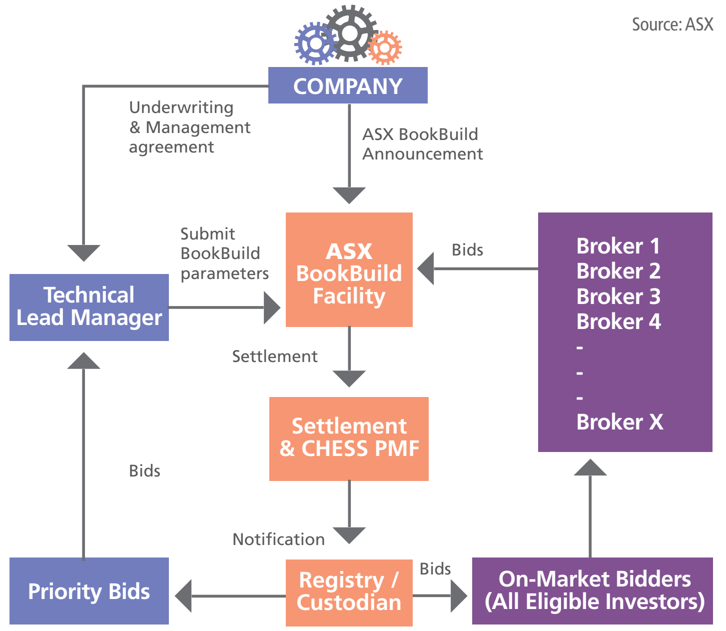
The process is often undertaken in secrecy and to outsiders, the autonomy of the issuer/investment bank and lack of transparency has raised questions regarding fairness of the process and its effect on good corporate governance.

How the New ASX Bookbuilding Facility Works

The ASX bookbuilding facility is an additional tool for companies, brokers and investment banks to consider when looking to price and allocate securities in a capital raising process using ASX infrastructure. The facility can be used for placements, IPOs and rights offers of financial products.

Diagram 1 sets out how the ASX bookbuilding facility works:

Diagram 1



The key steps of the ASX bookbuilding facility are explained in further detail below:

1 Appointment

The Company seeking to raise capital using ASX Bookbuild appoints a Technical Lead Manager (TLM) to act as its agent in the conduct of the bookbuild. The TLM must be an ASX Participant Broker.

2 Preliminary Deal Parameters

Preliminary capital raising parameters are agreed between the Company and the TLM and are set in the ASX Bookbuild web interface. Some of these parameters are disclosed to investors and include:

Variable Parameter	Description
Proposed raising amount/ total securities to be issued	The total value to be raised or the number of securities to be issued/sold via the bookbuild.
Coverage %	The percentage used to determine the bookbuild price. The bookbuild price is the highest price where demand exceeds Coverage % x Total Value (or Total Number).
1st Priority Offer %	1st Priority bidders that bid at or above the bookbuild price receive 100% of their bid. This set percentage is reserved for such bidders and the offer can be used to guarantee existing shareholders their pro-rata allocation.
2nd Priority Bid %	2nd Priority bidders that bid at or above the bookbuild price receive the 2nd Priority Bid % of their bid prior to on-market allocations. The offer is used to guarantee the minimum allocations to identified investors.
Minimum Market %	The minimum % of the issue that will be offered in the on-market allocation stages (i.e. post the Priority allocation stages).

Price Leaders' %	The % of the remaining securities not allocated to 1st Priority bidders and 2nd Priority bidders that are allocated to Price Leaders (all bidders above the final bookbuild price).
Price Leaders Cap	A cap that limits the % of a Price Leader's bid (number of shares) that can be allocated under the Price Leaders' allocation.
Opening Price	The price displayed to the market until coverage threshold is met with bids at or above this price.
Minimum Close Price	A floor price set to protect against the bookbuild closing below a specified level. The ASX BookBuild has a random close function, where the Company and TLM may close the bookbuild at any time without prior notice.
Minimum Allocation Amount	Shares are returned to the pool for allocation on a time priority basis, if an allocation (after scale-back, if any) falls below the Minimum Allocation Amount. The default level is set at $500.
Investment Cap	The maximum allocation to a bidder.

Once parameters are set, the Company waits for investors to place orders, much like an auction.

3 Risk Dispersal

Prior to opening the bookbuild on-market, the TLM secures the total Priority bids for up to 100% of the deal size.

4 Notification and Trading Halt & Pricing

The ASX BookBuild process is initiated when the deal parameters are submitted by the TLM via the ASX BookBuild web interface. The company then requests a trading halt and gives notice on the ASX Market Announcement Platform to announce the opening of the bookbuild to on-market bidders. The ASX issues a new ticker code for the capital raising that is visible to the entire market.

Bidders are able to see a continuous live price on the ASX, and to observe the evolution of the likely auction clearing prices in real time. It allows investors to assess whether their bids are at, or above the final bookbuild price, and will receive an allocation.

5 Collecting and Responding to Demand

Once the bookbuild opens to the live secondary market, brokers may place bids on behalf of eligible investors.

During this bookbuild, the Company and TLM are able to adjust pricing and allocation parameters in response to market demand, which is determined by market bidders lodging their bids (via ASX brokers) and priority bidders adjusting their bids in response to changes in the bookbuild price.

6 Closing

Once the level of demand is satisfactory and the bookbuild price is acceptable, the TLM initiates the close of the bookbuild by informing ASX. ASX will then trigger a random timer closing function of the ASX BookBuild, which provides the market the confidence that the close will not be manipulated.

7 Allocation

Only bids that are at, or above, the bookbuild price will be allocated shares, and these shares are allocated according to a defined set of capital raising rules.

Shares are allocated based on the following priority:

- 1st Priority bids that bid at, or above, the final bookbuild price will receive an allocation of 100% of their bids;
- 2nd Priority bids receive a specified disclosed percentage of the amount of their bids that initially were or were increased to, or above, the final bookbuild price;
- Price Leaders whose bids are above, but not equal to the bookbuild price, receive a specified disclosed percentage of shares that remain unallocated; and
- the remaining shares are allocated on a pro-rata basis to unfilled bids.

Advantages & Disadvantages of the ASX Bookbuilding Facility

Advantages	Disadvantages
Improves fairness, transparency and efficiency • Facilitating wider distribution and bidding participation, and providing a more orderly allocation process, that will support an efficient and fair price discovery, limiting the discounts given. • The automated and on-market facility for bookbuilds offers a more transparent pricing and allocation process for the securities under issuance, thereby enhancing the integrity of bookbuild processes. • With the book build price displayed openly to brokers, it reduces the asymmetry of information and enhances price discovery, allowing for more informed decision making by investors. • The bookbuild price will be disseminated live via external trading systems (but not openly over the internet).	**Investment banking fee structure** • The new system will not be universally popular with investment banks, which have long made a healthy living from managing equity raisings. There are fears that the introduction of the ASX BookBuild Facility will lead to a downward fee pressure for investment banks in Australia as demand of their service may dwindle. • Bids must be made via ASX brokers.

Opportunity to participate	Access
• All eligible investors have the opportunity to participate in the bookbuild via their broker and all brokers will be able to participate and enter bids via ASX Trade according to normal equity market conditions.	• US investors, usually a large part of the Australian market, may find it difficult to participate in real-time, given the time difference. • Issuers thus, may not be able to best tap into foreign markets, especially the US, where there is possibility of sourcing cheaper capital.
Access to all Australian demand	**Mix of investors**
• The Company will have access to a larger pool of untapped capital, thereby being able to contestably price its shares. • Having access to all demand may lower the cost of capital for companies and with greater price tension, a higher issue price may result, than under a traditional bookbuild process.	• Despite seeking to obtain the best price, ASX BookBuild may not run parallel with the Company's strategic purpose – that of achieving a more balanced mix of investors on the register or avoiding allocations to investors who may be perceived to be not compatible with the company's goals in the long term.

It should be noted that normal capital-raising rules under the Corporations Act continue to apply to capital raisings under ASX BookBuild. Therefore for example, if a prospectus would be required normally, then it will also be required using ASX BookBuild.

ASX Bookbuild is only available to ASX listed entities or entities seeking to list. For the latter entities, admission to the official list remains subject to satisfying ASX Listing Rules.

The issuer must pay fees to participate. These are on a sliding scale with a minimum amount of $25,000.

There are no fees imposed directly by ASX on investors that participate in ASX BookBuild. However, brokers may impose fees to lodge bids.

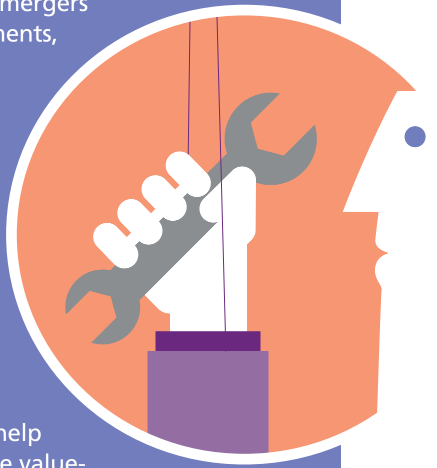
Conclusion

On 14 October 2013, WAM Capital Limited became the first company in Australia to raise capital using the new ASX Bookbuilding Facility. WAM raised over $24 million from sophisticated investors under a placement using the facility and its Chairman, Mr Geoff Wilson, has praised the system for its efficiency and transparency.

The new ASX BookBuild Facility will allow ordinary investors to participate in the majority of new floats or capital raisings through their brokers. It may appeal to issuers whose capital raisings are not underwritten or who are reluctant to give discretion to Bookrunnners on pricing and allocation that applies in a traditional bookbuild.

Boards considering a placement would however need to balance out the benefits of the ASX BookBuild system against the traditional placement structure to assess which method is in the best interests of the issuer in the prevailing circumstances of its capital raising. ■

Framing a due diligence process



Strategic decisions such as mergers and acquisitions or divestments, may be some of the most important decisions that a company makes in its lifetime. Processes for such transactions are complicated and McKinsey & Company reported that roughly 70 per cent fail across the spectrum. Over time, a process has been created focussing on avoiding failure - **due diligence**. To help ensure that investments are value-accretive, it is prudent if not essential that companies undertake a robust due diligence process.

Due diligence is a fundamental decision-assisting process tool used when considering any corporate transaction. The due diligence process assists in the identification of fundamental flaws or issues that require resolution, which may give rise to failure. It also assists in the overall evaluation of the merits of the acquisition. If executed correctly, due diligence will help improve the decision-making and negotiation processes, which may optimise the transaction terms.

The due diligence process should be individually tailored to each transaction. Certain components of due diligence are within control of the acquirer, such as the composition of the due diligence team and the scope. The components that are beyond control may include time constraints (e.g. in a competitive process), surrounding potential transactions, the objectives of other parties, and the available resources which may dictate the depth of the due diligence performed.

The aim of the due diligence process is to draw out meaningful and correct conclusions from a large amount of disparate information in a short time frame.

The following describes the overall framework and areas that should be covered off in a typical due diligence process:

1 Assembling the due diligence team

The collective skills of each set of professional participants (i.e. management, financial advisors, and legal advisers) are critical to the due diligence process and assembling a diverse team is a priority.

Although different teams often specialise, undertaking their specific workstreams and treating such specialties in a "silo", frequently results in an incomplete consideration of complex issues, and loss of critical knowledge sharing opportunities. Conversely, aligning the objectives of each team prevents such issues and strengthens the due diligence. ▸

Framing a due diligence process

continued

We would recommend that a chairman who not only understands the nature of the target business, but has the skills to manage the team, is appointed to head the team and this should lead to an approach which ensures that the team works together for the purpose of achieving the acquirer's goals.

2 Determining the scope of the work to be performed

The scope of the due diligence will be influenced by a variety of factors. The extent and scope of the review are dependent on:

- the type of transaction (e.g. acquiring an entire operating company instead of just its assets is typically riskier. In such a situation it would be essential to identify any liabilities and corporate issues);
- the time frame within which the transaction must occur;
- the complexity of the entity and its credit-worthiness; and
- the surrounding risks.

Planning is essential in ensuring the appropriate scope and that attention is given to the key issues surrounding the proposed acquisition.

3 Creating the due diligence

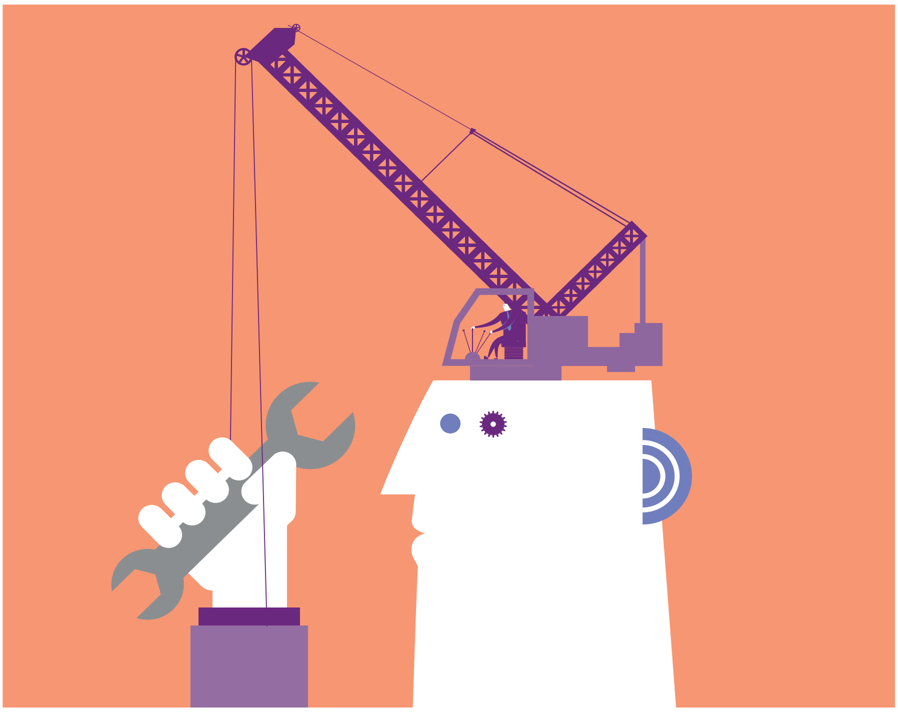
Such checklists should be tailored to the particular risks associated with the target company so as to mitigate any risk of incompleteness.

The checklist should be framed around the buyer's specific requirements addressing the condition of the target company both operationally and financially. Sufficient allowance for the "soft" aspects of the target, such as its corporate culture, to assess its fit with the buyer, also needs to be considered.

4 Executing the due diligence

Data collection is typically done through either a physical data repository or an electronic data room that can be accessed by the due diligence team.

In addition to data collection, due diligence may also require conducting interviews with the target company's management and others who may possess knowledge about the company or proposed transaction, acquiring information from sources external to the target company, and drawing conclusions from the synthesis and analysis of compiled data.



5 Conducting interviews

An interview process involving the buyer's due diligence team and target company's management is critical. Senior executives can provide insight into the strategic direction of the company, whilst lower-middle management can provide information in relation to the day-to-day running of the company. Usually, it is by management interviews that the real issues begin to surface.

In addition to management, undertaking interviews with key stakeholders such as customers and suppliers will provide valuable insights into their relationship with the company which may not be obtained from any recorded data, and is an important part of an extensive due diligence. These interviews may not always be possible. However, dependent upon the competitive level of the sales process it may be possible to satisfy this request, not necessarily directly, but indirectly, for example, by way of customer surveys.

6 Gathering information from sources external to the company

External information provides further in-depth understanding of the target company's situation and helps in corroborating information that has been provided. These come in the form of third-party appraisals, public records, and court filings.

7 Drawing conclusions from data synthesis and analysis

Whilst reviewing individual functions of the checklist is critical, it is important to keep sight of the bigger picture and ultimate aim of the due diligence. Therefore, it is imperative that each professional participant does not become over-focused on a specific area. Reports documenting the conclusions with a key issues section are critical to ensure that decision makers are given the information which they require.

Due diligence is an interactive process requiring careful planning and consideration of issues surrounding the target company. Bringing together a team who have aligned objectives and who work closely together is critical to ensuring that a successful conclusion is reached in this stage of the process. An appropriate chairman of the due diligence team can often be a key to success in this process. ■

Summary of key features and differences between a scheme of arrangement versus an off-market takeover:

	Schemes of Arrangement	Off-market Takeover
Legal regulation	**Corporations Act Chapter 5** Section 411 of the Corporations Act 2001 ("Act") governs schemes of arrangements.	**Corporations Act Chapter 6** Chapter 6 of the Act governs the acquisition of equity interests in a listed or unlisted company with more than 50 members.
Broad mechanism of the acquisition	A scheme must be "friendly" i.e. Directors of the acquiring and target companies must collectively obtain shareholders' approval of the proposed Schemes of Arrangement. Court approval is required.	The acquiring company serves an offer to acquire the equity interests in a target. Takeovers can be hostile or friendly. Generally, the Offeror controls the process.
Court approvals	Two court hearings are required. ASIC is required to decide whether to object to any proposal and lodge a notice with the court.	Not required.
Securityholder approval threshold	A scheme must be passed by: • a majority (more than 50%) in number of members present and voting; and • 75% of the votes cast on the resolution. This is a lower threshold than that of a takeover for 100% of the equity interests in a Target, where the Offeror has to obtain total shareholders acceptance of 90% of shares in order to proceed to compulsory acquisition.	Except for on-market bids (where the offer must be for all outstanding securities) the approval threshold depends on the minimum acceptance condition included in the takeover offer. This can be 90%, 50% or other number. However, compulsory acquisition of any securities in the bid class is available only if the Offeror acquires a relevant interest in at least (by number): • 90% of the issued securities; and • 75% of the securities that the Offeror offered to acquire.
Certainty	All or nothing. If the scheme is approved, the Offeror will obtain 100% of the target securities or nothing if it is not approved.	Success depends on the minimum acceptance condition adopted and the level of acceptances.
Separate treatment for each class of security holder	Separate scheme meetings are held for each separate class of security holder. The possibility exists that one class will not approve the scheme while other class (es) approve(s).	A takeover offer is made for a class of securities.
Structural Flexibility	Under a scheme, many outcomes can be achieved including reduction / return of capital, franking credits distribution, debt restructuring and asset disposals / acquisitions. Once terms are set, they cannot be changed without going back to the court.	A takeover offer is concerned only with acquisition of securities. Any flexibility in a takeover offer is at the Offeror's discretion to increase offer price and waive / modify conditions.
Collateral benefits	Acceptable if disclosed. Such benefits may run the risk of creating a separate voting class of securityholders, requiring separate class meetings.	Terms must be identical for all securities in a bid class. Collateral benefits are not permitted.
Timing	Often takes longer initially to agree transaction terms, approach court and hold scheme meeting(s). However, once agreed the process is relatively fixed and takes approximately 4 months.	Possibly can be done more quickly, once announced. Minimum offer period is one month. However, the Offeror may extend the offer period multiple times, up to a maximum of 1 year.
Conditions	May be conditional.	May be conditional; with certain restrictions.
Consideration	May be cash and/or securities.	May be cash and/or securities.
Disclosure requirements	One explanatory statement booklet that is a statement issued by the Target.	Separate bidder's and target's statement. Can be included in one booklet in an agreed takeover offer.
Independent expert report	As a practical matter, always provided.	Not necessarily provided. Only required in certain circumstances.

Our Corporate Finance Team

Allan Farrar, Director

Contact Allan for advice on SME capital raisings, initial public offerings, ASX listings, valuations and mergers & acquisitions transactions. His speciality sectors also include the property development, manufacturing, retail and distribution industries.

E: afarrar@lawlercf.com.au
P: 9237 6507 M: 0407 219 223

Vince Fayad, Director

Contact Vince for sale advice for private and public companies, fundraising, purchase and financing of businesses, due diligence for the acquisition of businesses, shareholder agreements, corporate strategy and shareholder disputes. He also specialises in commercial valuation and expert reports covering intellectual property.

E: vfayad@lawlercf.com.au
P: 8346 6055 M: 0414 752 804

Peter Cornell, Director

Contact Peter for advice with business valuations, expert reports, financial modelling and mergers & acquisitions. Peter also has experience in acquisition due diligence, infrastructure valuations and preparing purchase price allocation reports, including valuing intangible assets.

E: pcornell@lawlercf.com.au
P: 8346 6086 M: 0419 276 329

Simon Rutherford, Director

Contact Simon for advice on corporate governance, business development and strategy, structure and succession. His experience also includes project managing mergers & acquisitions and preparing groups for sale, debt and equity funding, due diligence and investigative accountants reports.

E: srutherford@lawlercf.com.au
P: 4935 6109 M: 0425 266 123

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