Rights Issues

What are Rights Issues?

- Pre-emption rights enshrined in European company law
- Mechanism for raising equity without diluting existing shareholders
- A rights issue is offered at a discount to existing share price on a pro-rata basis

Existing shareholders are offered new shares before being offered to new shareholders

Cum rights price

E.g. 2 for 1 rights issue, with issue price of €1.0 (existing share price of €2.0)

Conversion ratio

Discount = €1.0 (or 50.0%)

Understanding the Economics

2 for 1 rights issue, with issue price of €1.0 (existing share price of €2.0)

Rights issue

Full priced issue
(1 share at €2.0)

Determines how much new capital is raised

Bonus issue
(1 free share)

Function of discount and conversion ratio

FINANCIALEDGE

Understanding the Mechanics

$$\textbf{Theoretical Ex-Rights Price (TERP)} = \frac{\text{Existing Shares x Cum Rights Price + New Shares x Issue Price}}{\text{Existing Shares + New Shares}}$$

Weighted average share price after the rights issue

Value of each right = TERP – Issue Price

Intrinsic value of each right

2 for 1 rights issue, with issue price of €1.0 (existing share price of €2.0)

	Value	Calculation
TERP	€1.3	= (1 x €2.0 + 2 x €1.0) / (1 + 2)
Value of right	€0.3	= €1.3 - €1.0

FINANCIALEDGE

Shareholder Alternatives: Take Up Rights vs Sell Rights

2 for 1 rights issue, with issue price of €1.0 (existing share price of €2.0)
The TERP is €1.33, and the value of right is €0.33

Tail-swallowing

Shareholder has 100 shares	Take up rights	Sell all rights	Sell 150 rights
Pre-rights issue			
Value of 100 shares shareholding	€200.0	€200.0	€200.0
Post-rights issue			
Subscription payment	200 x €1 = (€200.0)	-	50 x €1 = (€50.0)
Proceeds from selling rights	-	200 x €0.33 = €66.7	150 x €0.33 = €50.0
Value of shareholding	300 x €1.33 = €400.0	100 x €1.33 = €133.3	150 x €1.33 = €200.0
Total wealth	**€200**	**€200**	**€200**

Adjustment Factors

2 for 1 rights issue, with issue price of €1.0 (existing share price of €2.0)
The TERP is €1.33, and the value of right is €0.33

Problem: Rights issues disrupt EPS and DPS trends

	20X1	20X2	20X3
EPS	0.15	0.18	0.14
DPS	0.09	0.11	0.08

Solution: Adjust historical per share metrics

$$\text{Adjustment factor for EPS and DPS} = \frac{\text{Cum Rights Price}}{\text{TERP}} = \frac{€2}{€1.33} = 1.54$$

Divided by adjustment factor

	20X1 (Restated)	20X2 (Restated)	20X3
EPS	0.10	0.12	0.14
DPS	0.06	0.07	0.08

Rights Issues: First Response

Economics

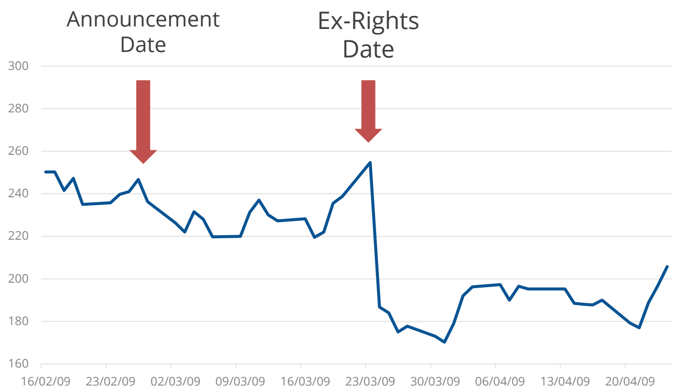
- How much capital is being raised and is this enough?
- How will the capital be deployed?
- Is the rights issue likely to succeed?
- What are the underwriting fees?

Mechanics

- Not required until ex-rights date, though clients may ask about it
- Adjustment factor is a ‘moving target’ until ex-rights date
- Valuation multiples are unaffected

Share Price Reaction

William Hill Rights Issue




FINANCIAL EDGE
www.FE.training
Please do not redistribute these materials without the express
permission of Financial Edge Training.
FINANCIAL EDGE

