More scrutiny needed for private placements

The placees should be made known when undertaking such exercises to the detriment of minority shareholders

THE arguments, as I have often asserted, of not favouring and limiting private placements are monumental.

Yet there continues to be numerous examples of this type of corporate exercises, which erode the interest of minority shareholders especially in cases when the reasons are not compelling.

There are many reasons for our dissatisfaction. When the company is doing well and having sufficient cash flow, where the capital structure is not highly leveraged nor the public shareholding spread an issue, why the need for private placements before a rights call is made? Minority shareholders in such cases, where the board had a proven track record, are more than willing to participate in such exercises to support their company. Besides, taking up the rights would not dilute their shareholdings.

Private placements are pre-emptive rights to price-discounted shares. They are offered to selected people, not known nor revealed, and could be detrimental to other minority shareholders.

Who are these placees? Are they friends of the major shareholders? On what basis do they deserve discounted stock in the company? And why have they been offered these shares over existing shareholders?

If the prime objective is to raise funds (as it should be - and not to fend off hostile interest), then a rights issue is always preferable, at least in the first instance. This way, shareholders have an opportunity to participate. For shareholders who are not keen on partaking, he or she always has the option of selling those rights in the marketplace.

The detriment to the minority shareholder is clear. If the share price rises once the private placement exercise is announced, the effective discount to the market price is further widened. The placees suffer minimal downside, while enjoying tremendous upside if and when the exercise goes through.

And depending on the size of the placement, the new stock has a dilutive effect on earnings per share and net assets per share, simply because there will be many more shares in circulation than previously. Thus, the dilution to minority interests is equal and proportionate to the size of the placement.

With the dilutive effect, another concern would be how long before any value can be accreted to the company, if any.

Recent examples have surpassed the typical thresholds of 10% of the outstanding share capital with some even hitting 30%. In one case, an additional share option scheme was issued thus the dilutive effect could be as high as 50% of the company's share capital.

This move, in our opinion, could be interpreted by the market as a means of fending off hostile takeovers. However, it is to the detriment of the other minority shareholders' rights since their interests have been ignored in favour of the major owners protecting their interests by way of a private placement. Though this is within the law, minority shareholders will be disadvantaged if all companies start doing such corporate exercises. This is true, especially in a region where bulky shareholding structures are prevalent.

We assert that there should be far greater scrutiny over private placement exercises by regulators, shareholders and directors.

As an overarching principle, the placees should be made known. How the placees can add value to the company, if such placement exercises are desperately needed by the company, should also be disclosed. This will be in line with other exercises like reverse takeovers and white knights in restructuring plans where placees/ acquirers are known.

Regulators should intervene and require companies to not only identify such placees, but to also offer details of their credentials, such as to demonstrate their worth as recipients of price-discounted company shares. In addition, the utilisation of the proceeds must be specific.

We also suggest that limits be introduced on private placements. For example, limiting the issue to no more than 10% of the issued shares at the time of the mandate or the amount required to meet the minimum public spread. This is subject to regulatory approval, with the discounts not exceeding a certain quantum, of say 10%, as currently stipulated in the listing requirements.

Finally, there are no reasons why a board can't proactively implement these measures on its own company in the first instance.