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Equity raises for listed companies in financial distress

For companies in financial distress, strengthening the equity base is typically one of the key pillars of a successful turnaround, as lowering the leverage ratio and improving the rating can help to reduce debt financing costs substantially. On top of this, certain (potential) business partners may refuse to engage in or discontinue business dealings with the distressed company if they have doubts about its creditworthiness which can further deteriorate the company's situation. This article sets out a non-exhaustive list of possible routes for a Swiss company (Issuer) listed on the SIX Swiss Exchange (SIX) to conduct an equity raise in such a situation which requires, in particular, that the following two requirements can be achieved:

- A convincing equity story – The Issuer needs to determine (likely with the help of an investment bank syndicate) a specific amount of money (Amount) which is necessary to fund the turnaround and convince the market that the Amount is sufficient; and,
- Transaction certainty – Once the Issuer has communicated its intention to raise capital, there should be as little uncertainty as possible as to whether the Amount can be raised.

Depending on the number of targeted investors, the equity raise can, in principle, be conducted via a private placement (PIPE) with a single cornerstone investor, private placements with a limited number of investors in an accelerated bookbuilding, or a (public) rights offering. See further details of all these options in the following paragraphs. A combination of these transactions, for example, a dual tranche transaction combining a rights offering and a private placement, or other measures such as standby arrangements with individual investors, may enable the Issuer to address a broader group of investors while increasing the likelihood of a successful transaction. In addition, it is typically necessary to align the equity increase with other financial restructuring measures (see the final paragraph of this article). An additional layer of complexity may arise under takeover laws, since a large capital increase may require underwriting banks or investors to obtain an exemption from the Swiss Takeover Board, or the Issuer may propose at an extraordinary shareholders' meeting (EGM) the approval of a selective opting-out from the mandatory bid obligation.

Single cornerstone investor

A cornerstone investor's commitment for the full Amount sends a strong signal to the market and can be the preferred route. A strategic investor is likely to bring sufficient patience to the table to await the outcome of the restructuring and there is less risk of various investors' interests clashing. From a documentation and timing perspective several situations can be distinguished:

If the Issuer has sufficient authorised capital available and the Amount is less than 10% of the outstanding share capital of the Issuer, the capital increase can be effected basically overnight without the need for a prospectus. Often, though, a capital increase of less than 10% may be insufficient to strengthen the equity base as required.

Alternatively, if sufficient conditional capital is available, a larger investment can be structured by issuing mandatory convertible securities, which, if structured correctly, should qualify as equity under international financial reporting standards (IFRS) to achieve the desired positive impact on the leverage ratio and rating. This structure can also be beneficial from an antitrust perspective since mandatory convertible securities do not confer voting rights which grants time to obtain necessary antitrust approvals if applicable reporting thresholds would be exceeded. Assuming that the conditional capital is already formally listed at SIX, no listing prospectus is required.

If neither of these options is available, the Issuer needs to source the investment from an ordinary capital increase which requires an EGM. While this is normally not perceived negatively in the market it does require more lead time.

Accelerated bookbuilding

If the Issuer is convinced that it can raise the Amount from a handful of targeted investors, the preferred route would typically be an accelerated bookbuilding which allows to quickly tap the equity markets with short execution time and little market risk. It offers the advantage that the Issuer can announce the transaction once it has reasonable certainty that the Amount can be raised.

Similar to a cornerstone investment, this requires that the company has sufficient authorised capital available (so as not to require an EGM). If the size of the equity increase is less than 10% of the outstanding share capital, no listing prospectus has to be prepared, which reduces the time to market.

The main downside of an accelerated bookbuilding is, however, that the subscription rights of the existing shareholders have to be excluded which dilutes their shareholding and limits the discount the board of directors can offer. A discount of up to five percent against the prevailing market price is typically viewed as acceptable. Higher discounts may be justifiable under certain circumstances. However, this might not be sufficient to attract enough market interest for large equity raises.

Rights offering

A public offering of new shares via a rights offering takes more time to prepare and implement than the routes described above, particularly during the execution phase as a result of the rights exercise (and trading) period. On the one hand, this increases market risk and can adversely affect transaction certainty; on the other, rights offerings offer the possibility to raise large amounts even in excess of the existing market capitalisation.

A rights offering can be structured as a discounted offering where the shares are offered at a fixed discount to the market price or an 'at market' offering where the offer price is determined in a bookbuilding. Both ways offer advantages and disadvantages in situations where the Issuer is in financial distress.

A discounted rights offering typically ensures a high certainty of achieving the targeted proceeds. As a result of the discount (and, thus, the inherent value of the rights) and the tradability of the rights, almost 100% of the rights are exercised in most cases. However, in a distressed situation, adverse pressure on the share price may cause the share price to fall below the offer price and the transaction to fall through. Also, the outcome may be less 'binary' if there is limited interest from investors despite the discount, particularly due to doubts regarding the equity story. To mitigate this risk a syndicate of banks may agree to guarantees (subject to certain conditions) to raise the Amount by initially committing to buy a high number of shares at a very low price (so-called volume underwriting). This allows the Issuer to send a strong message to the market to reassure investors while preparing the transaction. If neither a volume underwriting nor an 'at market' offering (see below) are feasible and the Issuer fears that the rights trading might collapse, the Issuer should consider excluding the tradability of the rights to avoid the purchasers of the rights suffering an immediate loss if the transaction falls through.

In an 'at market' rights offering, the necessary discount is determined by way of a bookbuilding procedure. Consequently, the dilution will only be known upon conclusion of the bookbuilding at pricing.

Other financial restructuring measures

In a situation of financial distress it is often not sufficient for a company to raise equity. Where the Issuer has debt instruments or financing outstanding, investors in the equity raise will want to have certainty that the funds invested will be used to further the Issuer's business and achieve the operational turnaround, and will not (solely) be spent on debt repayment. Hence, the Issuer may concurrently with the equity raise need to restructure its outstanding debt. The various measures typically need to be interdependent as the different stakeholders will only be prepared to uphold their end of the bargain under the condition that the other measures are also successfully implemented.

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