**Introduction to secondary share issues**

This element explains the nature of secondary share issues.  It also provides an introduction to pre-emption rights in this context.

A company which has had its shares listed for a period of time may decide to raise further equity finance by issuing more shares. Subsequent issues of shares into the market are known as **secondary share issues**.

There are many reasons for a secondary issue of new shares by a listed company. These include:

* + **business expansion;**
  + **acquisition of another company or business**; and
  + **debt reduction/strengthening balance sheet.**

These reasons will each be explained on the following page.

Note that, if a company is considering carrying out a secondary issue, it may choose to undertake an initial confidential process of consulting with its largest shareholders to solicit their views on the possible transaction, before it goes ahead with the issue.  This may be undertaken as a ‘**market sounding**’, as provided for in **Art. 11 UK MAR**.

**Secondary share issues: Potential reasons**

1. **Business expansion**

A listed company may wish to expand its business organically by raising further finance to (for example) fund the acquisition of new equipment or premises or employ further staff.

1. **Acquisition of another company or business**

A listed company may also seek to expand by acquiring another company (or a division of another company) operating in the same, or in different, markets. It may wish to raise equity finance to offer as cash consideration.  Alternatively, a listed company may wish to offer its own shares as consideration for the acquisition.

1. **Debt reduction/strengthening balance sheet**

A listed company may be too highly geared i.e. the ratio between its borrowing and its share capital and other capital resources may leave its balance sheet weakened. It may require additional finance to meet its interest obligations or capital repayments under existing loan arrangements or bonds.  It may not have access to further debt finance.  Raising further equity finance by issues new shares has the effect of reducing the company’s gearing and strengthens its balance sheet.

**Key methods of making a secondary share issue**

1. **Placing**: this is the traditional method and involves a placing of shares with institutional shareholders to raise cash (placings are also common in the context of flotations);
2. **Rights Issue**: an offer of rights to apply for new shares, made to existing shareholders;
3. **Open Offer**: an offer of shares, made to existing shareholders (often combined with a placing);
4. **Vendor Placing**: a placing of shares with institutional shareholders to fund the cash consideration for an acquisition (does not involve the allotment of equity securities for cash);
5. **Cash Box Placing**: a variation on a placing which does not involve the allotment of equity securities for cash.

**This workstream concentrates on the three following methods:**

1. **Placing**: this is the traditional method and involves a placing of shares with institutional shareholders to raise cash (placings are also common in the context of flotations);
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**Effect of pre-emption rights**

When issuing new equity securities for cash, a listed company must comply with **pre-emption rights** contained in **s.561 CA 2006** and UK**LR 9.2.1**. Pre-emption rights give **existing shareholders** the opportunity to participate in share issues and to ensure that their existing shareholdings are not diluted.

Pre-emption rights are disapplied by convening a GM and passing a special resolution under **s.570 CA 2006**.

**Pre-emption rights – pre-emptive offer**

If a company allots new shares on a pre-emptive basis, provided its shareholders take up the new shares offered to them, their percentage holding in the company will remain the same. As such, they avoid dilution of their shareholdings: their voting power and share of dividends will remain unchanged.

Example:

In a very simple example using a company with three equal shareholders, with each of the three shareholders holding 100 shares and the company issues 300 new shares, provided each existing shareholder takes up their new shares, they will avoid dilution and continue to own one third of the company’s shares. [*This is also shown as a diagram*]

**Pre-emption rights – non pre-emptive offer**

If a company allots new shares on a non pre-emptive basis and its existing shareholders are not offered new shares, their percentage holding will be reduced. Their voting power and share of dividends will be reduced by this dilution.

Example, if each of the three existing shareholders holds 100 shares and the company issues 300 new shares to a new investor, each existing shareholder’s holding has been diluted by a half and they now each hold one sixth of the company’s shares.

[*This is also shown as a diagram*]

**Pre-emptive versus non pre-emptive issues**

Secondary share issues can be:

**Non pre-emptive e.g. Placings**

or

**Pre-emptive** e.g. rights issues or open offers using the Gazette route (in compliance with s.562 CA 2006) (rare) or the **Disapplication route** (most used in practice).

A **placing** is the classic **non pre-emptive** secondary share issue. Pre-emption rights must be disapplied for a placing.

**Rights issues and open offers** are, strictly speaking, **pre-emptive** in nature. Section 562 CA 2006 sets out the procedure for a pre-emptive issue (known as the Gazette route). However, most companies choose to disapply statutory pre-emption rights in order to gain procedural flexibility for their rights issues and open offers (the **disapplication route**).

Note that the disapplication of pre-emption rights by listed companies is the subject of detailed guidance contained in the Pre-Emption Group Statement of Principles. See element entitled Listed Company AGMs for more detail.

**Summary**

* A secondary share issue is where a listed company decides to raise equity finance by issuing shares.
* There are a number of methods that can be used to make a secondary share issue, but in this knowledge stream you will focus on traditional placings, rights issues and open offers. We will examine these methods in the next few elements.
* Secondary issues are often categorised as ‘pre-emptive’ or ‘non pre-emptive’. The route pursued will determine whether the company will need to seek shareholder approval to disapply pre-emption rights. You will learn more about this when you consider the different methods of secondary share issue.