

ISSUE 22 – October 2016

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> Proposed Changes to the Takeovers Code - Consultation

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Welcome to our October Newsletter

In this newsletter Bevan discusses the important effect that capital structure has on a company's success. We also note the recently released Proposed Changes to the Takeovers Code, which may impact Unlisted Issuers. As usual, we provide a trade summary, a review of issuer and broker activity, and market metrics over August and September 2016. We invite you to share and comment on our social media pages (Facebook, LinkedIn and Twitter), especially to offer any feedback or suggestions as we develop the new Unlisted platform.



Capital Structure

by Bevan Wallace - Chairman

Without the capital necessary to support their business plan companies not only compromise their ability to pursue valuable strategies but also risk failure.

Expectations for future cash flows and ultimately profit tend to dominate the discussion when it comes to evaluation of business strategies with all too often the presumption being made that capital will be available when required. The reality is that access to capital is not assured let alone the terms upon which it might be accessed. Further, when it comes to raising incremental capital it is not the business strategy that was first tabled and part-funded that is evaluated. The additional capital raising has to stand on its own merits and is assessed against the business financial position and prospects as they are at the time the funds are sought as well as execution against the original strategy.

Capital structure and financial capacity are therefore essential components in the design and implementation of a business plan. An appropriate capital structure is determined not only by the prospective operating cash flows and investment requirements inherent in the business plan but also by the risk profile as represented by cash flow volatility. Such volatility can be determined by sales cycles or prospective working capital requirements and business development expenditures to support projected growth.

Capital structure has to be robust with the underlying financial capacity providing sufficient resources to ensure that the business plan can continue to be funded under reasonably foreseeable scenarios with some additional scope to buffer for unanticipated adverse events.

For most business start-ups it is promoter equity and possibly secured bank finance in conjunction with accommodation from creditors and landlords that forms the foundation capital. Access to bank finance is generally determined by the nature of the underlying business assets to be funded, with monies typically advanced only on assets that have a value in alternative use such as property or equipment.

A capital constraint is generally binding for not only start-ups but also rapidly growing businesses due to the inability of the promoter to fully fund the business strategy. Compromises are made and consequently value creation is deferred or put at risk in anticipation of being able to execute with fewer resources.

Introduction of additional equity partners helps to alleviate the capital constraint. The promoter cedes aspects of control, incurs establishment and additional governance costs but gets to fully fund the business strategy thereby bringing forward the release of value. The capital raising process also serves to stress test the business plan as it is subjected to independent scrutiny.

Recent legislative changes provide promoters with a wider range of options to secure capital. Crowd funding has proved popular due to the ability to access a network of potential investors at reasonable cost and minimal ongoing compliance obligations. For larger projects preparation of a Product Disclosure Statement and marketing through broker intermediaries emulates the well-trodden prospectus path and can be undertaken in conjunction with seeking quotation on an exchange.

Offering quotation on an exchange does introduce additional compliance obligations for Issuers but it also offers investors the prospect of liquidity, thereby improving the likely attributed value and reducing the cost of capital. It is the trade-off of the cost to the Issuer against the value attributed by the investor that ultimately determines the merit of the case for listing.

Once quotation on an exchange is achieved any subsequent capital raising is more easily facilitated due to establishment of a reference price and price history. These arms-length prices can afford comfort to existing and potential equity investors, other providers of capital to the business such as banks and creditors, and also customers and other stakeholders.

Unlisted as a prescribed exempt market provides such benefits to investors without undue compliance costs for Issuers. In addition to listing fees the Issuer incurs the cost of an annual audit and has to be mindful in the execution of its communication strategy. Failure to follow Unlisted's Market Rules can result in sanctions.

A step up from Unlisted is a licensed exchange which provides additional comfort to investors in the form of additional statutory protections and a more prescribed rule set and arguably better liquidity. This additional investor comfort comes at a cost to the Issuer in the form of increased compliance obligations and a more prescribed operating environment requiring additional engagement with

financial sector service professionals and regulators. Failure to comply with rules and regulations will result in sanctions many of which are severe. This environment is therefore favoured by a limited number of Issuers whose business scale or ambitions are sufficient to carry the additional governance obligations and absorb the associated cost.

Quotation on an exchange is however no assurance that the business plan will succeed, although follow on capital raisings are easier, particularly on a licensed exchange due to specific legislative exemptions. Quotation on a licensed exchange does not however guarantee equity capital will be forthcoming when sought as evidenced in the immediate past by the failed attempts of Wynyard Group and G3, the latter even resorting to a crowd funding platform in an attempt to obtain funds.

Unlisted, through its regulatory positioning and Market Rules, has attempted to balance the costs and benefits to Issuers and investors of participation on an exchange and in doing so gives Issuers the opportunity to more actively manage their capital structure in support of their underlying business plan and strategies. To this end, our most recent Issuer to capital raise was ProTen obtaining AU\$34 million in June 2015 while Rural Equities has conducted a number of share buy-backs the most recently completed this month being the repurchase of \$4m of shares.

Unlisted looks forward to facilitating not only existing Issuers' ongoing management of capital structure and investor liquidity but also those of new Issuers as they bring appropriately framed offerings to market.

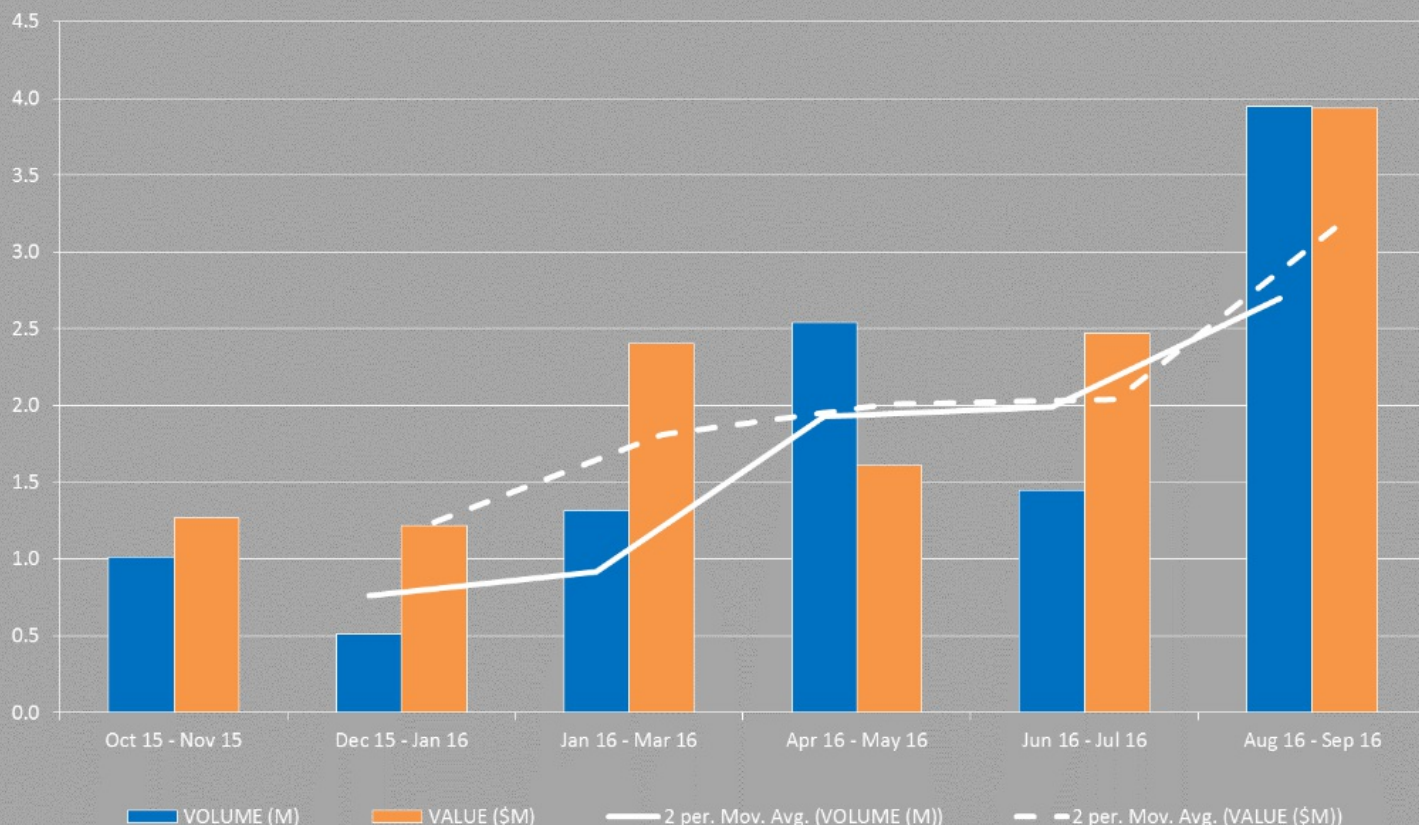
Trading Review

October 2015 – March 2016

TRADE SUMMARY

In the two months of trading from 1 August 2016 to 30 September 2016, Unlisted has facilitated 167 trades of 4.0 million shares worth \$3.9 million, at a monthly average of 84 trades of collectively 2.0 million shares worth \$1.97 million. This compares with 104 trades and 1.4 million shares worth \$1.24m over the previous two-month period to 31 July 2016. In total 608 trades of 10.9 million shares worth \$13.13 million were completed in the 12 months to 30 September 2016.

BI-MONTHLY VOLUME AND VALUE COMPARISONS



During the two-month period the most trades were in Silver Fern Farms at 61 (37% of all trades) followed by Skyline at 34 (20% of all trades) then Zespri at 25 trades (15% of all trades). The majority of the value was traded was in Skyline and Zespri. Skyline traded \$1.32m (34% of total value traded) followed by Zespri Group at \$1.4m (36% of total value traded).

Price movements were largely positive, with Proten, Skyline, Pharmazen and Silver Fern Farms all appreciating by at least 10%. In the two months leading to 30 September 2016, Proten appreciated by 20 cents (15%) and Pharmazen appreciated by 1 cent (17%), closing at \$1.50 and 7 cents respectively. The next largest gains in this period were by Silver Fern Farms and Skyline, which both increased by 12.4% to close at \$1.09 and \$25.00 respectively. Rural Equities also experienced a small price gain of 6 cents (1.5%), closing at \$4.13.

Zespri experienced the sole price decrease this month, declining by 30 cents (9%) to close at \$3.20. However, the stock has appreciated by \$1.45 (83%) from its first traded price of \$1.75 in February 2016.

All other stock prices remained unchanged over the period.

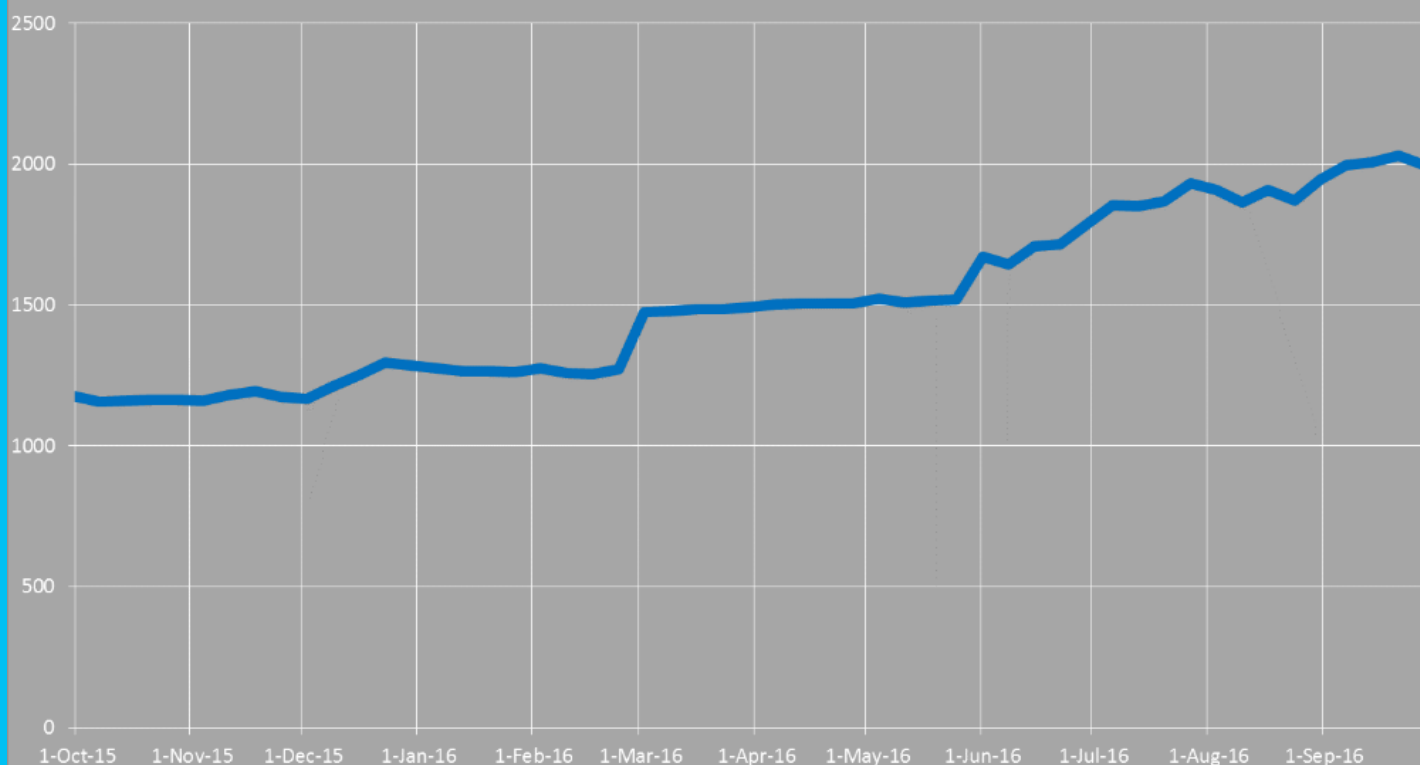
ISSUER ACTIVITY

There have been no listings or delistings during the review period.

MARKET METRICS

As at 30 September 2016 the aggregate market capitalisation of all stocks was \$2 billion, compared with \$1.9 billion on 1 August 2016. The bulk of this increase can be attributed to Skyline, for which the market capitalization appreciated from \$758m to \$851m (71% of the total Unlisted market capitalization increase). ProTen also contributed significantly, increasing by \$23m (17% of total increase). Other stocks that experienced an increase in market capitalisation include Silver Fern Farms (\$12m), Rural Equities (\$2.1m), and Pharmazen (\$1.6m). This total increase in market capitalisation of \$132m was offset a decrease of \$36m (9%) for Zespri Group. The overall net increase in market capitalisation was \$96m.

UNLISTED MARKET CAP - 1 OCTOBER 2015 TO 30 SEPTEMBER 2016 (\$millions)



ISSUER PROFILES

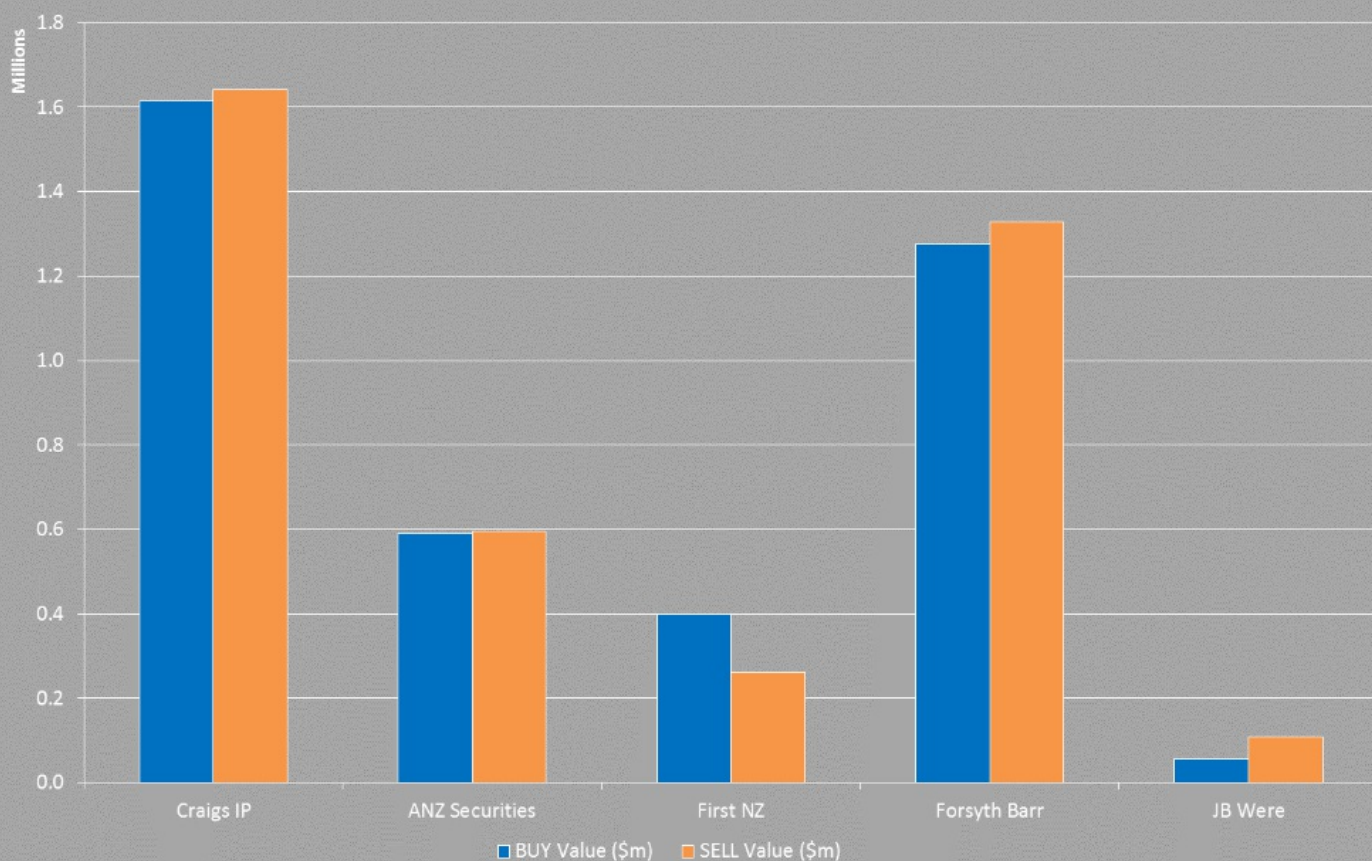
Unlisted has recently posted updated issuer profiles for Fronde and Speirs Group.

BROKER ACTIVITY

Craigs Investment Partners was the most active broker in the two months to 30 September 2016, with top buying and selling activity. It completed 64 buy trades worth \$1.6m (38% of total activity) and 63 sell trades worth \$1.6m (38% of total activity).

The second most active broker overall was Forsyth Barr, with 93 trades in total (39 buy trades worth \$1.3m and 54 sell trades worth \$1.3m). However, based on number of trades ANZ Securities was more active than Forsyth Barr on the buy-side, undertaking 43 trades worth \$592k.

BROKER ACTIVITY BY VALUE (\$m) - 1 AUGUST 2016 TO 30 SEPTEMBER 2016



PROPOSED CHANGES TO THE TAKEOVERS CODE - CONSULTATION

The Takeovers Panel has released a [consultation paper](#) containing three proposed substantive amendments to the Takeovers Code which may impact Unlisted Issuers. These changes aim to address the concerns of:

1. The disproportionate cost of code compliance for small companies;
2. Difficulties caused when takeovers occur over holiday periods due to timing requirements being defined in calendar days; and
3. The limited electronic access for shareholders.

The proposed changes are as follows:

1. Add a total asset threshold of more than \$20 million to the criteria of a "Code company" for companies that are not listed on a licensed financial product market;
2. Amend the code to state the timing provisions as working days rather than calendar days;
3. A target company must provide an email address of every e-shareholder to an offeror and every Code-regulated communication made by a Code company or an offeror to an e-shareholder must be made electronically.

[Submissions](#) are due by 5:00 p.m. on Friday 2 December 2016.

LOOKING AHEAD

Development of the new trading platform and website is well underway and we are starting to undertake testing and expect to be fully live early in the new year. This platform will give us some unique functionality and provide a better interface with users. We are also looking at how to facilitate electronic clearing and settlement and are reviewing several options which we will soon be discussing with the broker community.

We continuing to talk with prospective new issuers, and look forward to bringing them to the market when they are ready.



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