New Zealand Shareholders Association Inc.
NZSA®
Many Investors, One Voice

NZSA Policy No 23 – Capital Management

Application: This policy applies to all NZX listed companies.

Purpose: NZSA maintains a range of policies to moderate the behaviour of all participants in the NZX listed company sector. These policies should be read in the context of the NZSA Policy Framework Statement.

Statement No 23:

This policy document updates the previous versions of the 'Capital Raise' and 'Dividend' policy documents, as part of a regular review plan. These have now been combined into a single policy covering 'Capital Management'.

The policy document and supporting commentary expands the scope of the policy towards a broader approach of 'capital management', thereby including dividends, buybacks and dividend reinvestment plans as well as capital raise methodologies within a single policy.

In terms of capital raise, NZSA continues to uphold the key principle that existing shareholders should be offered the first opportunity to participate in capital raisings on a pro-rata basis. We also introduce some recognition of factors that could lead an organisation to prefer a different form of capital raise methodology. This is partly a response to NZSA's expanding coverage.

NZSA will continue to advocate for retail shareholders to have equitable treatment when compared with institutional investors.

1.0 Policy: Capital Management

1.1 Regardless of the type of capital management action (for example, dividends, capital raise or buyback), NZSA expects a clear rationale to support the capital management action or any material changes to it.

Capital Raise

1.2 NZSA considers a renounceable, pro-rata rights offer as the 'default' option for any listed company seeking additional equity funding. This method allows the company to offer all shareholders additional equity in proportion to their current holding.

1.3 NZSA expects that any renounceable pro-rata rights offer will be accompanied by a liquidity event.

a) NZSA considers that a **'bookbuild' event** (including brokers, institutions or other wholesale investors) is a required component of a renounceable

rights offer. This allows potential value to be derived for shareholders who take no action, either intentionally or through lack of awareness.

b) NZSA encourages the separate listing of entitlements so that shareholders who cannot participate have the option of taking proactive action to sell their entitlement.

1.4 NZSA understands that different methodologies of capital raising may be in the best interest of shareholders where the factors shown below are present:

a) Issuer Maturity

b) Issuer Risk (or financial position of the issuer)

c) Ability to command a premium relative to the current share price, as compared with an entitlement offer option

d) Investor Demand

e) Timeliness

   a. NZSA does not consider deadline pressure associated with an acquisition, in and of itself, to be a reason to not undertake an entitlement offer. On the contrary, we consider that this may indicate a lack of planning on the part of the Board.

   b. NZSA considers timeliness as a factor where a company is funding an acquisition by way of placement to the vendor.

f) The impact of terms, conditions or costs associated with underwriting - although this should be considered in the context of total transaction costs.

1.5 Notwithstanding our comments in section 1.4, NZSA does not support the introduction of ANREO's (see section 3.5e below) as a capital raise method in New Zealand's listed markets.

1.6 NZSA expects companies raising capital by alternative methods (e.g., SPP, Placement etc) to disclose the core factors (as per section 1.4) that influenced their decision.

1.7 Where alternative (non-entitlement) capital raise methods are utilised, NZSA expects disclosure of:

a) The scaling methodology that will be used, should scaling be necessary. For SPP, NZSA expects applications to be scaled in accordance with shareholdings on the record date, to avoid 'gaming' of entitlement.

b) The known percentage of shareholders (both in number and shares) who will not be given the opportunity to take up a full pro-rata entitlement.

c) The dilutionary impact on shareholders.

d) For Placements, NZSA will consider the relationship of the agreed price for shares as compared with the prevailing share price.

1.8 Regardless of capital raise methodology, NZSA expects both clear disclosures as to the

refund of any oversubscriptions and for the refund to be processed as soon as practicable (within 5 days) after allocation

1.9 For all capital raise methodologies, NZSA expects disclosure of:

a) underwriting fees and advisory fees

b) the names of the investment bank/advisor and underwriter

1.10 When companies use a combination of capital raise methodologies (e.g., for institutional and the retail holders):

a) NZSA expects 'downside protection' for offers to retail shareholders, ensuring they pay no more for their capital than that paid by institutional holders.

b) Allocations for capital raise between "institutional" and "retail" holders are set with regard to the proportion of the share register that each group represents at the record date.

Capital Management and Dividends

1.11 NZSA expects a prudent justification by Directors relating to the payment (or non-payment) of dividends.

a) This may include, but is not limited to, long-term affordability or alternative investment opportunities.

b) Justification may be provided in the form of an approved dividend policy.

1.12 NZSA is broadly supportive of Dividend Reinvestment Plans (DRP's) as a form of capital raise as they are one way of encouraging long-term investment.

a) In general, we do not expect any DRP to be "underwritten" – as this calls into question whether a Dividend should be paid at all.

b) NZSA will look at the cost of equity associated with a DRP. We expect the company will be able to use those funds to generate further incremental return above the cost of equity implied by the price that the DRP shares are issued at.

1.13 NZSA expects the long-term return of imputation credits to shareholders via dividend payments.

a) Where an issuer chooses to not pay a dividend, despite an imputation credit balance and available cashflow, NZSA expects a clear rationale to be to be communicated to shareholders that justifies retaining cash rather than distributing dividends.

b) This policy expectation should be viewed in the context of section 1.11 above - ie, a prudent assessment by Directors in terms of affordability or alternative opportunities that improve returns for shareholders in the long-term.

1.14 Where no imputation credit is available, NZSA expects the issuer to have considered

other forms of shareholder distribution, such as a buyback or court-approved capital return. If these options do not provide optimal returns for shareholders, NZSA expects the company to be clear in its rationale as to why it is still paying an unimputed dividend.

1.15 NZSA is not supportive of dividends exceeding free cashflow (operating cashflows adjusted for the impact of IFRS 16 and maintenance capex) on the basis that does not allow for ongoing replacement of existing assets.

a) In general, NZSA is unlikely to support dividends where they are funded by 'new' borrowing.

b) There may be some exception applied where an issuer has no (or low) existing long-term debt,

1.16 We recognise some validity to an issuer maintaining dividend flows in the context of 'smoothing' one-off impacts over time.

1.17 NZSA prefers off-market buybacks, capital returns or a special distribution as a means of returning capital to existing shareholders or providing shareholder return (see 1.14).

1.18 While on-market 'buybacks' as a form of capital return provide less certainty for investors as to the exact quantum of the return, these may be preferable where imputation credits are not available.

a) NZSA is unlikely to support a buyback where the period of purchase is operating at the same time as a DRP, as this is essentially returning capital and raising capital at the same time.

b) We are more likely to support a share buyback where there is clear evidence that the buyback price represents an effective use of capital relative to other investment alternatives.

c) We will support buybacks where the purpose of the buyback is to be utilised within CEO or Executive incentive schemes as an alternative to diluting shareholders.

2.0 Advocacy

2.1 NZSA has made submissions during 2021-22 on the NZX Corporate Governance Code and NZX settings related to Capital Raise. We will continue to advocate for greater investor protection related to capital raise methodologies (see paragraph 3.7).

2.2 NZSA believes that the level of competition for risk amongst investment banking providers in New Zealand is relatively low. This continues to cause concern as issuers look to Australian providers, who are subject to different jurisdictional interests and norms in relation to retail investors.

NZSA will continue to support greater competition for investment bank services in New Zealand to support the ongoing health of capital markets.

3.0 Commentary

Capital Raise

3.1 NZSA recognises that decisions relating to capital raise are made by the company's Board, who are bound to act in the best interests of company. This has the potential to create some 'conflict' between shareholders and Directors – Directors are duty-bound to raise capital at a time and rate that minimises the cost of equity for the company. This may be at odds with the interests of individual shareholders.

3.2 The timing of a capital raise is likely to reflect either a specific opportunity facing the company or the need for re-capitalisation and/or balance sheet security.

a) In general, companies seek to raise funding (which may include capital) on terms that minimise their cost of capital in the long-term or provide specific incremental gain (such as from an acquisition).

b) NZSA recognises that in the short-term, the timing of a capital raise should reflect a period where sentiment towards the issuer is favourable, resulting in a lower cost of equity for the company (i.e., high share price).

c) NZSA believes it remains critical for shareholders to assess each capital raise on its own merits, regardless of methodology.

d) Investors should bear in mind that, in a capital raise where the cost of equity is "low" for the company (i.e., the share price is "high"), if the company's plans fall short of expectations, the commitment to purchase further shares may come at a high cost to the individual investor.

3.3 Notwithstanding comments in para. 3,1 and 3.2 above, NZSA believes that existing shareholders should be the first port of call for fresh capital.

3.4 NZSA recognises that different companies face different situations in raising capital. This has led us towards a 'factor-based' approach in determining appropriate capital raise methodologies (see policy statement 1.4).

The situation facing an NZX blue-chip may look very different to that of a listed technology start-up.

3.5 The NZX has set out clear definitions surrounding different methodologies, in its consultation paper issued in July 2022. In summary, there are 5 common forms of capital raise:

a) **Placement** (non pro-rata): Shares offered to new or existing shareholders at an agreed price.

b) **Share Purchase Plan** – SPP (non pro-rata): an offer to existing holders to subscribe for shares up to a monetary limit at an agreed price.

c) **Rights issue** (pro-rata): Renounceable or non-renounceable rights to purchase shares issued to existing shareholders in proportion to their

existing holdings. Renounceable rights may be quoted on market and may be subject to a 'bookbuild' for the sale of unused rights, allowing shareholders who did not participate to receive some value.

d) **Accelerated renounceable entitlement offer – AREO** (pro-rata): Similar to a rights issue, however, 'accelerates' the ability for institutional investors to be allocated shares ahead of retail investors.

e) **Accelerated non-renounceable entitlement offer – ANREO** (pro-rata): Similar to an AREO, however, the value associated with any rights entitlements not utilised are foregone by investors

There are various advantages and disadvantages (from the perspective of both issuer and investor) to each capital raise methodology, as summarised in the table below.

	Advantages	**Disadvantages**
Placement	**Investors** • Depending on placement price, may be value accretive **Issuer** • Certainty of capital, greater control over terms • Speed and ease (institutional components able to be completed quickly) • May provide access to people capability or additional opportunity	**Investors** • No access to participate • Depending on placement price, may result in value loss. • Dilution for non-participating shareholders • The "new" investor has access to more detailed information than other investors. **Issuer** • Potential uncertainty for capital amount; may have to offer shares at a discount • Disclosure of confidential information to a third party • The new investor may place certain restrictions or covenants on the issuer • Potential underwriting costs
Share Purchase Plan	**Investor** • Favours existing shareholders • Ability for existing shareholders to participate to avoid dilution • Ability to purchase additional shares with no brokerage **Issuer** • Lack of certainty of capital	**Investor** • Dilution will occur for shareholders who cannot (or will not) participate. • SPP 'caps' may limit the ability of larger shareholders to participate to the level of their shareholding. • Level of discount may affect share price outcome, reducing value for non-

	raise amount (depends on participation). Where an SPP is used in conjunction with a placement, this is likely to reduce this risk for the issuer.	participants. • Dilution may also occur if SPP applications are scaled back without reference to the individual shareholders initial holding.
Rights Issue	**Investor** • Favours existing shareholders • Pro-rata mechanism avoids dilution for all participating shareholders • For a 'renounceable' offer, bookbuild and/or rights trading processes allow non-participating shareholders to receive some value. • Shareholders may have the ability to purchase additional rights on-market • Ability to purchase additional shares with no brokerage	**Investor** • Where rights are 'non-renounceable', the shareholder will suffer loss of value through non-participation. **Issuer** • May take more time than alternative forms, exposing the issuer to price uncertainty and market risk driven by external events. • Some uncertainty as to the level of capital raised. • Exposure to underwriting costs • Lack of certainty of capital raise (depends on overall participation)
AREO	**Investor** • As per 'Rights Issues' above. **Issuer** • Certainty and speed – the institutional component of the offer can be completed within a few days. • Reduces market risk and/or price uncertainty, as the pricing is set by the institutional offer component.	**Investor** • No disadvantage **Issuer** • Some uncertainty as to the level of capital raised from the retail offer (participation). • Exposure to underwriting costs
ANREO	**Investor** • As per 'Rights Issues' above. **Issuer** • As per AREO	**Investor** • The shareholder will suffer significant loss of value if they do not participate. The value of the rights cannot be traded and there is no payment via 'bookbuild' processes to return value to non-participating shareholders **Issuer** • As per AREO

3.6 Companies are able to (and do) use a combination of these structures.

3.7 Over the past 3 years, New Zealand has experienced far greater levels of investor engagement within markets. We believe that warrants a greater focus on investor protection.

a) We believe that any capital raise structure should protect the interests of shareholders who cannot or did not utilise their ability to participate in a capital raise.

b) This is particularly relevant for newer investors who may make an erroneous assumption as to the value of a capital raise and the impacts of not participating.

c) NZSA believes that a 'liquidity event' should be associated with capital raise structures that maintain an ability to return value to the underlying shareholder where a right to participate in a capital raise is not utilised.

d) In this context, we believe the bookbuild processes associated with rights offers and AREO's are more protective for individual investors than the ability for investors to trade rights on the Exchange - as the investor does not need to do anything to gain some residual value.

3.8 In the context of section 3.7, NZSA continues to oppose the introduction of ANREO's within New Zealand. These force investors to participate to retain both proportionality and value, and do not account for investor sophistication levels or individual investors' financial circumstances.

3.9 NZSA recognises that Australian practices and norms will have an impact on the structure and market for capital raise in New Zealand. This is not necessarily in the interests of a healthy NZ capital market, NZ retail shareholders or even issuers themselves.

a) NZSA recognises the significant level of "institutional cash" prevalent in Australian markets.

b) However, we also believe that there is significant *retail* investor cash available for investment in New Zealand, with cost of equity expectations similar to that able to be achieved outside of New Zealand.

c) We will continue to advocate for NZ companies to look towards local investors as a preference to seeking investment offshore.

Capital Management

3.10 NZSA acknowledges that Dividend Reinvestment Plans (DRP's) could be seen as dilutive for shareholders who do not participate. The decision as to whether to participate is up to the individual shareholder.

a) Shareholders who elect to receive a dividend, rather than reinvest in additional shares, will have their proportional shareholding reduced as they have effectively received a dividend as an alternative to buying shares.

b) To this extent, NZSA believes shareholders are receiving fair value for their loss of proportionality.

3.11 However, we do consider that DRP’s should be considered in the context of other corporate actions – particularly share buybacks, as this would see an issuer both raise capital and return capital in the same period.

a) Factors that may influence how NZSA views this conflict include timeframe and purpose associated with the share buyback.

b) For both DRP’s and share buybacks, the assumptions around effective cost of capital become a key analysis factor in identifying their eventual value to shareholders.

Dividends

3.12 Any decision relating to dividends is made by the Board. A Board remains accountable to shareholders for dividend (and other capital management) decisions.

3.13 NZSA recognises the role of differing shareholder expectations in decisions made by issuers in relation to dividend payments. Traditionally, New Zealand shareholders have maintained a high expectation in relation to dividend yields from their investments.

a) We believe that shareholders have some role to play in adjusting their expectations to support issuers in maximising value for the company (and therefore shareholders’ interests) in the longer term.

b) The role of dividends should be a key factor in investor decision-making. NZSA values the clear expression of dividend intentions to support investors – for example, an investor reliant on dividend cashflows is unlikely to invest in a loss-making, technology start-up.

c) NZSA adopts a “total returns” approach in determining how returns are best received by shareholders, including growth opportunities, cost of capital and tax efficiency.

3.14 Given New Zealand’s imputation credit regime, NZSA will look closely at the payment of dividends where **no** imputation credits are available, as this may represent a tax-inefficient return to shareholders.

a) For example, if a company derives value from a non-taxable activity (such as property valuation gain), and then pays a dividend, what was non-taxable is now taxable income for the shareholder.

b) Similarly, a company that derives most of its income overseas (and pays tax in those jurisdictions) is effectively exposing NZ-based shareholders to double-taxation when an unimputed dividend is paid.

c) The geographic distribution of shareholders may be a relevant factor for the issuer in determining whether to pay an unimputed dividend.

3.15 Conversely, where dividends are not paid by issuers, and imputation credits arising from tax paid on New Zealand-sourced profits are retained by issuers, this represents a delay in shareholders receiving a tax entitlement. In its reviews of annual reports, NZSA will monitor imputation accounts to identify situations of hoarding of imputation credits.

NZSA policy does recognise situations where the expected future opportunity available

to investors is greater by non-payment of dividends (thereby retaining imputation credits).

3.16 Within some sectors and issuers, it has become commonplace to pay dividends based on operating cashflow, which may be at a level above Net Profit. This essentially implies that an issuer will fund major asset replacement through either debt or a future capital raise, that the asset itself does not need replacing or is not depreciating at the rate implied in the accounts.

a) NZSA believes that a company should retain enough internal cash to ensure it is able to fully-fund major asset replacement.

b) NZSA recognises this funding requirement may be impacted by optimising debt/equity ratios.

c) NZSA notes there are other factors that may impact dividend decisions and will consider the rationale for these as they arise

4.0 Key Regulatory Requirements

Companies Act 2003

NZX Listing Rules

References

NZX Listing Rules

NZX Corporate Governance Code (Consultation Paper)

NZX Capital Raise Settings (Consultation Paper)

Chapman Tripp discussion document

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Definitions

none

Related Policies

none

Document Control

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