Stockbrokers
Association of Australia
Incorporating SDIA

26 October, 2012

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Consultation Paper: ASX BookBuild

I refer to the ASX Consultation Paper entitled *ASX BookBuild: Bringing efficiency, fairness and transparency to the primary equity markets*.

The Stockbrokers Association of Australia acknowledges the ASX's ongoing commitment to improving the performance of capital markets, and appreciates the opportunity to comment on the Proposals in the Consultation Paper. Are comments are set out below.

The Stockbrokers Association supports in principle initiatives which would foster share ownership, particularly among the broader public; enhance the fairness and integrity of Australia's capital markets; and improve the efficiency of capital raising by listed entities.

Initiatives achieving these outcomes can help build a stronger economy, help business to grow and to pursue business opportunities, and can help foster Australia's growth as a regional financial hub.

The Association looks with interest to see how much take-up there will be of the ASX BookBuild facility.

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Complex range of Factors relevant to every capital raising

From the Association's experience, the issues which listed entities face in raising capital are varied and quite complex. In our view, some of the commentary and analysis of the traditional methods of capital raising, and the likely benefits flowing from using the ASX Bookbuild facility, that have been made following the announcement of ASX BookBuild, have been somewhat simplistic

Companies have the task of balancing a number of competing factors in determining the best way in which to raise capital, and the optimum price for the issue, in the particular circumstances of each particular raising. These factors can vary significantly from case to case.

If it were simply a matter that an auction type mechanism, such as ASX BookBuild, will deliver superior results to the extent that is suggested, then we think this mechanism would undoubtedly have featured more heavily up until now.

We note however from various reports that auction facilities of the type represented by ASX BookBuild have been trialled in many jurisdictions in the past, in 25 jurisdictions according to one report, but have been dropped in all of those cases. In our view, this is a reflection of the complexities inherent in capital raising to which we have referred, and that facilities such as ASX BookBuild do not ultimately prove to be as attractive as they may initially appear on a superficial level.

One of the key issues is the need to avoid the risk to pricing that arises from having a longer timeline for the raising. The need for certainty is particularly paramount in times of high volatility, such as have been experienced in the last few years following the GFC.

Another issue of great importance to listed entities is the quality of the share register. Boards are quite justified in placing strong emphasis on this consideration.

Companies have a legitimate interest in allocating stock in a capital raising to investors who have a commitment to owning the stock and supporting the company in preference to investors who are interested purely in a trading opportunity and are likely to "dump" the stock at the first opportunity. The latter is not in the interests of the company and its shareholders, or of the equities market in general. It can destabilize the share price, which could potentially harm the company and its shareholders, and jeopardize the prospects of success of future raisings.

A potential outcome of ASX BookBuild may be an increase in the number of investors having a small shareholding as a result of the allocation process. It would be legitimate for many issuers to endeavour to avoid having an excessively fragmented register with lots of investors holding very small parcels. The latter can have the potential in some cases to significantly impact on the cost of managing the company's affairs. Another outcome of smaller fragmented allocations is likely to be an increase in the number of investors choosing to sell the stock at the first opportunity as a result of having received a smaller allocation than they had hoped for, and being of a small size that they consider not worth holding on to.

Companies in the small to mid-cap sector very commonly rely very heavily on raising capital from individual wholesale investors. With some exceptions, institutional investors are generally not as active in that sector, and the costs of offerings to retail investors are often too prohibitive.

Small to mid-cap companies will generally look to raise capital from existing shareholders who are already familiar with the company. This will enable the company to raise capital more quickly, and also minimize regulatory risk, with the company having already established the wholesale status of the investors under section 708 of the Corporations Act. It will also enable the company to reward shareholders who are committed to the company.

In many instances, companies require certainty regarding the actual amount of capital to be raised. Locking in the price and having as short a timetable as possible provides greater certainty for the company. These considerations can be paramount where the company is entering into the capital raising to meet a critical commercial undertaking. To give an example, an oil and gas company requiring $50m to acquire a parcel of land adjacent to their existing acreage will need to undertake this in a timely manner to be able to commit the proceeds as part of the land acquisition contract. The expanded timetable for the corporate to run an auction, and uncertainty around the price and therefore the amount of capital that is ultimately raised, do not benefit the execution of these arrangements.

For these reasons, we question whether the ASX BookBuild facility will be of much appeal to many capital raisings in the small to mid cap sector. The significant weight which those companies will quite justifiably attach to the above mentioned factors is likely to outweigh the possibility of any additional price tension that might be achievable under a wider auction process available to other investors.

On this latter point, we also note that it is not a foregone conclusion that an auction mechanism will invariably generate positive price tension. An auction mechanism also has the potential to generate the unwanted result of negative price tension, leading to delays or even an aborted book build. This may be a factor in companies preferring a more traditional method of raising capital to ASX BookBuild.

We note that ASX BookBuild does attempt to address the regulatory risk issues arising in relation to section 708. The requirement that bids only be entered by an ASX Market Participant with whom the bidder has entered an ASX BookBuild Agreement, which includes a warranty that the bidder complies with any of the BookBuild restrictions, such as wholesale status requirements if that is the case, is a good one.

However, how much comfort issuers will derive from the client warranty arrangements remains to be seen. If clients falsely warrant that they are wholesale, then issuers will still be faced with the issue of exercising powers to sell out those clients, but companies are likely to prefer not having to go through that process, partly due to the administrative burden of having to do so, and partly because what the companies require is certainty that the capital has been raised.

There is also some question as to how much comfort the stockbrokers will derive from the ASX BookBuild client agreements either. Clients may claim that they did not fully understand what they were signing, or that the broker should have done additional due diligence on them before accepting their warranty, such that the client agreements, whilst sounding like a good idea, may be more problematic that they may at first appear.

Potential for Manipulation

Notwithstanding the measures that have been incorporated in the ASX BookBuild process, such as the random timing of closure of the book, members of the Association have expressed concerns as to the potential for the on-line bidding process to be capable of manipulation. This is regarded as a real possibility.

Settlement risk

It is not clear from the Consultation Paper whether a broker placing bids on behalf of a client into ASX BookBuild will be liable under the relevant BookBuild Rules to honour payment for the bid should the client receive an allocation but fail to make payment. This would be a material consideration for brokers in determining whether they will agree to participate and/or whether brokers will require clients to deliver funds prior to making a bid.

Conclusion

In view of the range of considerations that need to be weighed up by boards in deciding the best means for raising capital in the particular circumstances existing at the time of each raising, it is important that Boards retain an appropriately wide discretion as to how to proceed and the choice of method.

Whilst the ASX BookBuild facility provides an additional option for companies, and one which will no doubt be attractive in appropriate cases, it is correct that it should not be be made mandatory.

We do not believe that there should be any stigma on a Board in terms of corporate governance should a Board decide for appropriate reasons to take a different avenue to manage a capital raising, nor should Boards be required to justify why they have not chosen to use ASX BookBuild.

We appreciate the opportunity to provide comments in respect of this Consultation Paper. Should you require any additional information or wish to discuss further any of the matters raised in this Submission, please contact me or Peter Stepek, Policy Executive on **pstepek@stockbrokers.org.au**.

Yours sincerely,

David W Horsfield
Managing Director/CEO