Rights Issues

There is a subtle but confusing cross-country difference in rights-issue procedures. In North America it is usual for companies to give shareholders one right for each share that they hold, but several rights are generally required to buy one of the new shares on offer. In many other countries it is common to give shareholders *less* than one right for each share that they hold, but each right entitles the shareholder to buy one new share.[1]

This distinction only matters when you come to calculate the value of a right. With the North American rights-issue procedure a shareholder receives more rights but each is worth correspondingly less. The following examples illustrate this:

1. We saw in Chapter 15 how the Canadian company, Ivanhoe Mines, needed to raise C$1.2 billion to help finance its Mongolian copper mine. To do so, it gave each shareholder one right for each share that he or she currently held. Twenty rights entitled the shareholder to buy 3 new shares at C$13.93 each. This offer price was 44% below the pre-announcement share price of C$24.73.

   Consider Mr. Brown who held 20 shares at the time of the announcement. His shares were worth 20 x $24.73 = C$494.60. If he took up his rights, he would own 23 shares and the expected value of his holding would increase by the amount of the new cash to $494.60 + (3 x $13.93) = C$536.39. Each share would then be worth $536.39/23 = C$23.32. This is the *ex-rights price.* The bad news is that the ex-rights price is below the price before the issue, but this is offset by the fact that Mr. Brown now owns three more shares.

   As soon as the shares start trading ex-rights, shareholders can also buy or sell the rights to buy new shares. For example, suppose that instead of taking up the offer, Mr. Brown decides to sell his 20 rights. How much could he sell them for? Anybody who bought the rights and paid 3 x $13.93 to exercise them, would obtain 3 shares worth 3 x $23.32 = C$69.96. Thus 20 rights

[1] The North American right is sometimes known as a *New York right.* The European right is (confusingly) termed a *Philadelphia right.* Neither term is in common usage.

would be worth $69.96 – (3 x $13.93) = C$28.17, and one right would be worth $28.17/20 = C$1.41.

[Notice that in Chapter 15 we finessed the distinction between North American and European practice by calculating how much you would need to pay for the rights to buy just one share. Since 20 rights were needed to buy 3 shares, 20/3 rights were needed to buy one share. These rights to buy one share would be worth $1.41 x 20/3 = C$9.39.]

2. In 2009 the British bank HSBC needed to raise £12.5 billion. To do so, it gave shareholders 5 rights for each 12 shares that they owned. One right entitled the shareholder to buy 1 new share for £2.54. This price was 47% below the preannouncement price of £4.84 a share.

   Consider Ms. Green who held 12 shares at the time of the announcement. Her shares were worth 12 x 4.84 = £50.08. If Ms. Green took up her rights, she would own 13 shares and the expected value of her holding would increase by the amount of the new cash to 58.08 + 2.54 = £60.62. Each share would be worth 60.62/13 = £4.66. This is the *ex-rights price.* Again, the ex-rights price is below the price before the issue, but this is offset by the fact that Ms. Green now owns one more share.

   Suppose that instead of taking up the offer, Ms. Green decides to sell her rights. How much could she sell them for? Anybody who bought one right and paid £2.54 to exercise it would obtain one share worth £4.66. Thus 1 right must be worth 4.66 – (2.54) = £2.12.