Capital increase

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1. Motivations

- Financing of a project beyond indebtness capacity
- Restructuring of the balance sheet to abide by banks' constraints
- Value transfer from shareholders to lenders
  - Increase in debt value as the capital increase enables to raise the firm's capacity to repay its debt
  - Assumed low discrepancy between debt amount and enterprise value
- Benefit from a cheap financing when the share price is high
  - Implied existing shareholders' low dilution of control
  - Implied low EPS dilution
- Reduction of information asymmetry between shareholders and managers
  - Information disclosure
  - Management's commitment to maximise shareholders' value

2. Rights issue

- Focus on existing shareholders
  - Priority to subscribe to avoid a dilution of their control on the firm
  - Balancing of the share price decrease implied by an issue price that is lower than the share price before capital increase
  - Solution provided by rights issue
- Notations and principles
  - C = share price before capital increase
  - E = issue price
  - N = number of existing shares before capital increase
  - n = number of new shares
  - 1 right given for 1 share held
  - Conditions to buy 1 new share: payment of E and presentation of $\frac{N}{n}$ rights
  - Possibility for existing shareholders to use their rights to subscribe or to sell them to potential new shareholders
- New share price after capital increase = TERP (theoretical ex rights price) $= \frac{NC+nE}{N+n}$
- Right's value = $d = C - TERP = C - \frac{NC+nE}{N+n} = \frac{C(N+n)-NC+nE}{N+n} \Leftrightarrow d = (C-E)\frac{n}{N+n}$
- Alternative proof: same net worth of the old and new shareholders just after capital increase
  - Sale of the right by the old shareholder
  - Purchase of $\frac{N}{n}$ rights by the new shareholder to buy one share
  - $C - d = E + \frac{N}{n}.d \Leftrightarrow d\left(1+\frac{N}{n}\right) = \mathrm{C} - \mathrm{E} \Leftrightarrow d = (C-E)\frac{n}{N+n}$

3. Without preferential subscription rights

- Assumed no interest from existing shareholders for the capital increase
- Importance of the deal's marketing by the investment bank
  - New shareholders to be convinced whereas the issue price is more or less equal to the market price
- Minimum price in France
  - Average of listed price weighted by volumes during the 3 days before price fixing
  - Possible discount
    - Max 5% should the capital increase correspond at least to 10% of the firm's capital
    - Otherwise possible higher discount
- Existing shareholders' waver of their rights to be voted in the background of an Extraordinary General Meeting
- Priority given for 3 days to existing shareholders should they want to subscribe
- Private placement
  - Capital increase representing max 10% of the firm's capital: no required prospectus
  - 10% < capital increase < 20% : possibility not to prepare a prospectus but required prospectus when the shares are eventually listed

4. Equity lines

- Capital increases based on options exercises
- Issue of warrants that are given to a bank
- Exercise of warrants by the bank when asked by the issuer
  - Implicit put granted by the bank to the issuer
  - Issue of new shares when warrants are exercised
- As soon as possible, sale of the new shares by the bank to investors
- Attractive modality for start ups
  - Investment program spread over several years
  - Remote equity needs
  - Opportunity to base future capital increases on improved share prices

5. ESOP

- Employee Stock Ownership Plan
- Discount: c. 20%
- No preferential subscription right
- Distribution of securities when employee profit sharing is paid which enables to finance the deal
- Possible structured products
  - Downside protection
  - Upward multiplier