Cash Box Structure: back in fashion in the wake of COVID-19?

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The outbreak of COVID-19 and the resultant Government-imposed "lockdown" have created numerous procedural difficulties for publicly listed companies in the UK, in addition to the obvious economic impacts.

As outlined in our recent client updates relating to the annual reporting season and dealing with the holding of AGMs, public companies have been grappling with the logistics of holding their AGMs in the midst of the current crisis and the restrictions on social contact.

Many public companies have taken the decision to delay holding their AGMs until much-promised Government relaxations on Companies Act procedures have been enacted. However, one consequence of any such delay is that companies may be running low on shareholder authority to enable them to tap into the Market to raise funds when the opportunity arises.

At each AGM, a UK public company will typically seek a general authority to allot shares and separate authority to disapply pre-emption rights in respect of a portion of that general authority, so as to enable the company to issue shares to investors for cash. For Main Market companies the general allotment authority sought is normally one-third of current issued share capital and the disapplication sought is over 5% of current issued share capital. For AIM companies, the authorities sought tend to be larger, depending on the size of the company and its stage of development.

A company which may have raised funds on the Market via a placing(s) since the last AGM may now be running low on disapplication authority. In normal circumstances, the Company would simply publish a circular and seek specific shareholder authority for a raise to deal with any shortfall. However, in the current environment, companies are faced with the logistical difficulties of hosting a meeting, plus nervousness among brokers at delaying closing a fundraising in such volatile markets.

One possible solution, which Main Market and AIM issuers looking to quickly raise financing have been considering, is the "good" old fashioned cash box placing structure.

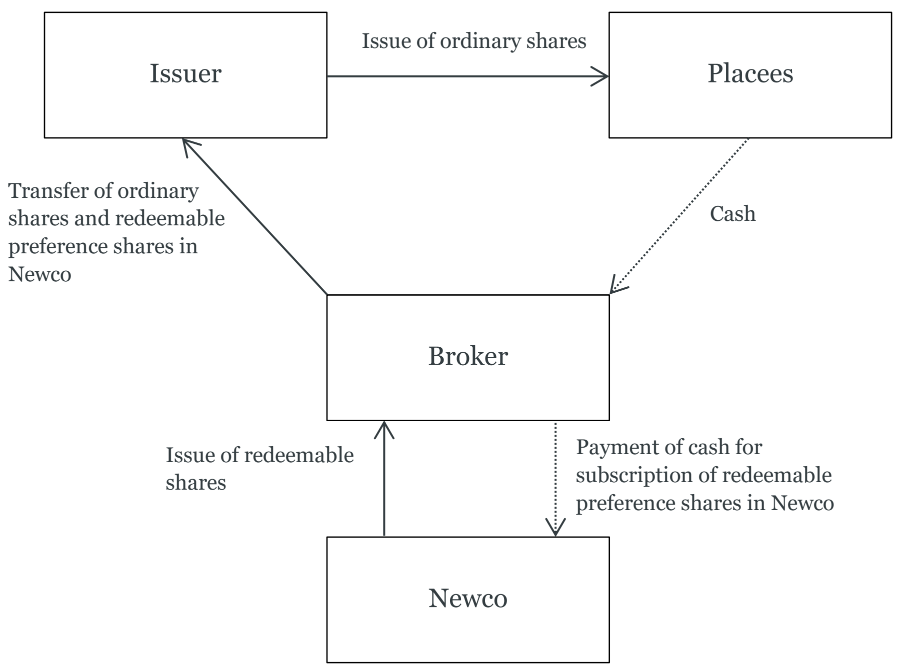
Cash Box Structure

The UK Companies Act permits the allotment of equity securities for non-cash consideration. The cash box structure provides Main Market and AIM issuers with a way to conduct a placing whilst qualifying for this exception, provided always that the company has enough headroom in its general authority to allot shares. So, whilst the disapplication authority may be depleted, a company may still retain sufficient general authority to allot shares for non-cash consideration.

The cash box structure (*see Fig 1 below*) involves the following steps:

- The issuer incorporates an offshore company, usually in Jersey (the "**Newco**"), with two classes of shares – ordinary and redeemable preference shares.
- The issuer's broker subscribes for a number of the ordinary shares of the Newco (usually 10% or more), and the issuer will hold the remainder of the ordinary shares.
- The issuer's broker agrees to subscribe for redeemable preference shares issued by Newco at a price equal to the net placing proceeds. The subscription price for the redeemable preference shares is paid by the issuer's broker to Newco conditional upon, *inter alia*, (i) the admission of the placing shares to the Official List of the Financial Conduct Authority and to trading on the Main Market (in the case of a Main Market listed company or (ii) the admission to trading on AIM (as applicable).
- The issuer allots the placing shares to the placees, or alternatively, to the broker where the placing is being underwritten and is not fully subscribed, in consideration for the transfer by the broker of the redeemable preference shares and ordinary shares in Newco to the issuer.
- The placees pay the placing price for the new ordinary shares in the issuer to the broker, and the broker then uses such proceeds to subscribe for the redeemable preference shares of Newco at a price equal to the placing proceeds less commissions and other expenses in respect of the placing.
- The issuer then completes the purchase of the ordinary shares and redeemable preference shares in Newco from the broker. Once the purchase is complete, the issuer can access the net placing proceeds from Newco either by redeeming the preference shares or by Newco lending the proceeds to the issuer.

Fig.1 Typical Cash-box structure



Historically, the cash box structure has not been popular with institutional shareholders. Indeed, the Pre-Emption Group did not approved of the use of the cash box structure, and had until the recent crisis, treated a cash box structured transaction as an issue of equity securities for cash in the Statement of Principles.

In light of the COVID-19 pandemic, the Pre-Emption Group recently issued a statement recommending that "investors, on a case-by-case basis, consider supporting issuances by companies of up to 20% of their issued share capital on a temporary basis" (ie until 30 September 2020). Any request to make use of this increased threshold must set out the particular circumstances of the company, should follow consultation with a representative sample of the company's major shareholders and should be made on a soft pre-emptive basis.

Conclusion

Given the understandable desire of many public companies to take any opportunity to shore-up their balance sheets in these tumultuous times, and in light of the updated guidance from the Pre-Emption Group, directors of Main Market or AIM issuers who have sufficient general allotment authority but insufficient remaining disapplication authority, may consider the option of using the cash box structure to raise urgent funding without the need to incur the time, cost and logistical difficulties associated with publishing a circular and seeking shareholder approval.

If you have any questions, please get in touch.

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