

## Theoretical Impacts of Widespread Portfolio Limited's Proposed Rights Issue

### Introduction

This assessment of the theoretical impact of Widespread Portfolio Limited's (WID) proposed rights issue has been prepared at the request of its board by Capital Economics Limited. The focus of the assessment is on the potential of the issue to shift wealth between categories of equity securities and between large and small shareholdings. The following sections of this report consider, in turn:

- the scale of the issue in terms of its potential to cause significant effects on the unit prices of WID's equity securities;
- the scale of the potential adjustments to the exercise prices for WID's warrants under section 9 of the terms for the warrants;
- the theoretical implications of the issue for the relative unit values of WID's equity securities; and
- the potential distributional effects of these potential changes in unit values.

A final section draws some conclusions from this investigation.

### Scale of the issue

The proposed rights issue would potentially see around 66.32 million new shares in WID issued. (This assumes 80,000 shares per shareholder which are fully taken up by 829 shareholders.) New equity raised would be \$829,000 at the subscription price of 1.25 cents per share. Table 1 calculates that the issue would potentially increase the number of shares on issue by 6.4 percent and the value of the firm's equity securities by 4.6 percent. The difference arises because the subscription price for the rights is lower than the current share price. This 4.6 percent calculation is based on the average traded share values for WID and for the listed warrants (WIDWA) of 1.476 cents and 32.9 cents respectively for the five days ended 14 May 2008, and an illustrative value for WID's unlisted warrants of 23.9 cents.

	Pre-Rights Issue			Rights Issue Potential Effect	Post-Rights Issue	
	No on Issue	Unit Price	Value		No on Issue	% Increase
Shares	1,029,516,919	\$0.01476	\$15,195,670	66,320,000	1,095,836,919	6.4%
Listed Warrants	8,505,123	\$0.329	\$2,798,185	To be assessed	8,505,123	Tba
Unlisted Warrant	900,000	\$0.239	\$214,673	To be assessed	900,000	Tba
<b>Value Equity Securities</b>			<b>\$18,208,528</b>	<b>\$829,000</b>	<b>\$19,037,528</b>	<b>4.6%</b>

If the value of WID's listed and unlisted warrants did not change, WID's share price would theoretically fall from 1.476 cents to 1.462 cents (ie by 0.9 percent). This calculation is theoretical. It illustrates the scale of the rights issue and is not a share price prediction.

## Section 9 adjustments to exercise prices of Warrants

Section 9 of the terms and conditions of the existing warrants contains a formula for adjusting the exercise prices for the warrants in the event of a rights issue. The formula is:

$$O^1 = O - E.[P - (S+D)]/(N+1)$$

Since WID pays no dividends,  $D = 0$ .  $E$  is 100 since each warrant purchases 100 shares in WID.  $S$  is set at 1.25 cents and  $P$  is currently 1.476 cents, so  $P-S = 0.226$  cents. If this were a pro-rata issue,  $N$  would be 15.52 (rounded) (being 1029,516,919 existing shares divided by the 66.32 million new shares).

On this basis, in cents per warrant,  $O^1 - O = -100 * .226 / (15.52 + 1) = -1.4$  (rounded).

Since the listed warrants currently have exercise prices of \$2 and \$3 per warrant, the new exercise prices (rounded) are \$1.986 and \$2.986 respectively.

The unlisted warrants have exercise prices that are currently 10 percent higher, at \$2.2 and \$3.3 per warrant respectively. Applying the same formula to adjust these exercise prices would change them to \$2.186 and \$3.286 respectively. All this is in table 2.

	Adjustment	Listed Warrants		Unlisted Warrants		New Relativity
		Current	New	Current	New	
$\Delta O$	-\$0.0136	2	\$1.986	2.2	\$2.186	10.07%
		3	\$2.986	3.3	\$3.286	10.05%

Note that the formula in section 9 assumes a pro-rata issue. However, the logic of the adjustment to the exercise price when a rights issue dilutes existing shares does not depend on how the new shares were distributed.

## Theoretical indicative post-issue values of equity securities

Other things being equal, a rights issue that reduces the share price (eg the 0.9 percent calculation above) and the equity value of the firm per ordinary share should tend to reduce the value of the warrants by a *greater* proportion. There are two offsetting considerations. The first arises from the reduced exercise prices for the warrants. The second arises because the greater number of head shares reduces the potential dilutive impact of the warrants when exercised. In some theoretical models this could materially increase the value of the warrants.

In a range of theoretical models that treat these competing considerations in different ways, the net effect on the value of the listed warrants varies from close to zero to a fall of the order of 1.5 percent. Table 3 provides an illustrative calculation in which the value of the warrants

falls by 1.2 percent. This drop accommodates a smaller fall in the share price than the original 0.9 percent calculation.

	Pre-Rights Issue			Post-Rights Issue			Effect of Issue		
	No on Issue	Unit Price	Value	No on Issue	Unit Price	Value	No on Issue	Unit Price	Value
Shares	1,029,516,919	\$0.01476	\$15,195,670	1,095,836,919	\$0.01466	\$16,061,298	6.4%	-0.7%	5.7%
Listed Warrants	8,505,123	\$0.329	\$2,798,185	8,505,123	\$0.325	\$2,764,165	0.0%	-1.2%	-1.2%
Unlisted Warrant	900,000	\$0.239	\$214,673	900,000	\$0.236	\$212,063	0.0%	-1.2%	-1.2%
Value Equity Securities			<b>\$18,208,528</b>			<b>\$19,037,528</b>			<b>4.6%</b>

The indicated fall in the combined value of the listed and unlisted warrants is under \$40,000. In the modelling work done as part of this exercise a fall of the order of \$45,000 is also plausible.

### Distributional effects

All existing shareholders will have the right to purchase 80,000 shares at 1.25 cents per share. This is an outlay of \$1,000. In addition each will be able to apply to apply to subscribe for rights to an additional 320,000 shares in the event of shortfalls. The maximum purchase per shareholder is therefore \$5,000. This is not a pro rata issue.

Table 4 uses the outcomes postulated in table 3 to calculate the gains and losses for different combinations of holdings of shares and listed warrants. As should be expected, small shareholders make a small overall profit out of the rights issue while losses are made by larger shareholders. The largest loss in the table is the loss of \$30,157 that would be incurred by someone who held 100 million shares and 5 million warrants after the rights issue. This loss would represent 1.0 percent of the value of that portfolio.

	No of Warrants Owned	No of Post-Issue Shares Owned by Investor				
		100,000	500,000	1,000,000	10,000,000	100,000,000
	0	\$168	\$127	\$75	-\$855	-\$10,157
	1,000	\$164	\$123	\$71	-\$859	-\$10,161
	5,000	\$148	\$107	\$55	-\$875	-\$10,177
	100,000	-\$232	-\$273	-\$325	-\$1,255	-\$10,557
	1,000,000	-\$3,832	-\$3,873	-\$3,925	-\$4,855	-\$14,157
	5,000,000	-\$19,832	-\$19,873	-\$19,925	-\$20,855	-\$30,157
Memorandum items						
	1. Change in share price	-\$0.000103				
	2. Change in warrant price	-\$0.004000				
	3. Gain on rights issue	\$169.92				

It must be stressed that all the numbers in tables 3 and 4 are illustrative and indicative rather than predictive.

## Conclusions

The essential point is that, other things being equal, a rights issue that increases the number of shares by 6.4 percent while adding only 4.6 percent to shareholders funds will in theory reduce the share price, and plausibly the unit values of a firm's warrants.

While any falls in the unit values of WID's warrants are not significant in one of the models used in this report, the analysis in tables 3 and 4 above explored the potential magnitude of the effects based on a theoretical model in which the expected effects are more significant.

The indicative numbers in these tables point to a redistribution from those with larger holdings in favour of those with smaller holdings. However, the amounts of the redistribution are modest as a percentage of the value of those holdings and are not material in relation to normal market volatility.

Since the largest shareholdings are concentrated at board level, it is not credible on the basis of these calculations that the board could be departing from the normal pro-rata approach in order to do the smaller investors a disservice.

While the board may wish to consider whether the alternative arrangements to adjusting warrant values, that are provided for in section 11 of the terms of the warrants, should be triggered in order to wind back a portion of the projected changes, the small scale of any changes and their uncertain magnitude suggests that any benefits from taking on the complexities of assessing alternative adjustments could be less any benefits that would be derived for the company or for shareholders.

Nothing in this report should be read as a prediction as to how the unit values of securities will actually respond to the rights issue and nothing in this report constitutes a legal opinion on any matter.

Bryce Wilkinson, PhD  
Director  
Capital Economics Limited  
15 May 2008