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COVID-19: EFFECTIVE COMMUNICATION WITH INVESTORS

The JSE has over the past few months issued various letters dealing with disclosure obligations in relation to the impact of the covid-19 pandemic on the businesses and operations of issuers. The aim of these letters have been to guide issuers to provide investors with sufficient information to enable them to make informed investment decisions.

The JSE has continued to monitor developments in the market and during recent discussions with several investors, the importance of timeous, detailed and transparent communication and its impact on price formation and decision making was emphasised. Share price volatility caused by uncertainties (for example the impact of covid-19 pandemic or whether an issuer intends to embark on a capital raising) does not facilitate nor encourage capital raisings.

This letter aims to focus on disclosure obligations both from a continuing obligation perspective and when issuers embark on capital raisings. Timeous, detailed and transparent communication will contribute to the demand and success of the capital raising in question.

Firstly, issuers are reminded that the General Principles contained in the preamble of the JSE Listings Requirements (the “**Requirements**”) impose the following obligations on issuers, to:

- provide full information of activities that are price sensitive;
- ensure adequate opportunity to consider this information;
- ensure equal treatment for all shareholders; and
- ensure that the Requirements promote investor confidence in standards of disclosure.

(“**General Disclosure Principles**”)

Taking into account the General Disclosure Principles, the following focus areas should be considered by issuers when raising capital.

Executive Directors: Dr L Fourie (Group CEO), A Takoordeen (CFO)

Non-Executive Directors: N Nyembezi (Chairman), ZBM Bassa, MS Cleary, VN Fakude, Dr SP Kana, FN Khanyile, BJ Kruger, Dr MA Matookane

Group Company Secretary: GA Brookes

1. Business insights

Detailed disclosure of information is a key component of price formation, but is even more important when investors are requested to inject new capital. Investors are particularly interested in information that provides them with insight into any uncertainties. In relation to the current economic climate, one such uncertainty is covid-19. Investors are therefore seeking information that will assist them to assess the potential impact of the covid-19 pandemic on the cashflows of issuers.

Investors are in need of a forward looking assessment of various factors including (i) the impact the covid-19 pandemic may have on demand for the issuers' product/ services, (ii) on supply chains deliverables and (iii) any other covid-19 related business issues that issuers are experiencing. It is also important to provide insight to investors on the future cash flow position of the issuer, taking into account disclosures in respect of (i) debt covenants triggers, (ii) the proximity of the issuer breaching debt covenant triggers and (iii) the board's view of debt levels and how any potential breach of debt covenant triggers can be addressed.

The narrative referred to above should ideally consider both the income statement (for example revenue and expense line items) as well as the balance sheet (specifically debt levels) and actual cashflows. Issuers are reminded that if their narrative becomes a profit forecast/estimate (pursuant to paragraph 8.37 of the Requirements) they must comply with paragraphs 8.38 to 8.44 of the Requirements.

We ask that issuers provide investors with the above mentioned business insights both when they fulfil their continuous reporting obligations (as set out under section 3 of the Requirements) and when embarking on a specific corporate action.

2. Financial reporting obligation under IFRS

In terms of understanding future cash flows careful attention must be given to present a statement of cashflows that is in compliance with IAS 7.

IFRS 7 disclosures provide important information for investors to understand the future liquidity obligations of an issuer. This information should be presented with a great degree of detail and issuers are reminded that excessive aggregation reduces its usefulness.

3. Specific disclosures in circulars

As discussed below, the Requirements place certain specific disclosure obligations on issuers to discuss the latest business developments.

Paragraphs 7.D.2 (description of the business) and 7.D.5 (prospects) of the Requirements provide issuers with the opportunity to give a detailed account of the past impact of the covid-19 pandemic and the future business prospects. The JSE does not believe that a short paragraph addressing each topic is sufficient. The information described in the ‘business insights’ section above falls clearly within the ambits of explaining the business and prospects.

Similarly, the explanation of the use of funds (paragraph 11.13 of the Requirements) should not be vague and generic. General wording such as “*capital restructuring*” or “*pursing growth opportunities*” affords insufficient detail and transparency to the capital raising process to allow investors to effectively consider and assess what the capital raising is meant to achieve.

We ask that sponsors and designated advisors ensure that these disclosures are as comprehensive and detailed as possible.

4. Frequency of reporting

We wish to emphasise the benefit to transparent price formation of providing more regular and detailed communication to the market. Issuers are urged to publish a detailed narrative explaining the ongoing impact of the covid-19 pandemic on their businesses and operations. That narrative should, as a minimum, cover the content discussed in the business insights section above. Issuers should provide that narrative:

- in advance of paragraph 3.4(b) of the Requirements being triggered; and
- with the publication of a trading statement.

Another important consideration is quarterly reporting. Quarterly reporting is not mandatory and the JSE is not advocating a move to full detailed IFRS compliant quarterly reporting for all issuers. However, the JSE wishes to point out that more frequent updates may better assist price formation and success in capital raisings.

5. Trading statement obligations

The JSE understands that there is a fine balance in determining when there is “*reasonable certainty*” pursuant to paragraph 3.4(b) of the Requirements. Nevertheless, it is evident that uncertainty in price formation is caused when there is overreliance on paragraph 3.4(b)(iii)(3) of the Requirements.

The JSE wishes to remind issuers that the 20% referred to in that paragraph is the trigger for a trading statement. Issuers must advise the market of the actual minimum percentage change in earnings and headline earnings that they anticipate and not merely refer to the 20%. The market should be provided with an update as soon as the issuer obtains more certainty. The update could take the form of an amendment to minimum percentage (for example the initial minimum could have referred to a 50% change and a

subsequent announcement may refer to a 60% change) and then providing the required range set out in paragraph 3.4(b)(ii)(2) of the Requirements as soon as possible (for example indicating the range is between 60% and 80%).

6. Additional disclosures for capital raising

The market operated by the JSE fulfills a critical function in bringing together investors and issuers to facilitate the raising of capital. Investors have indicated that more information will be of enormous benefit to them in forming a view as to whether or not they wish to inject further capital into the issuer. The inclusion of such information will therefore be beneficial to issuers in order to assist with the demand and success of their capital raising.

Therefore, in line with the General Disclosure Principles, for the foreseeable future (being at least the next 12 months) the JSE requests the inclusion of the following additional disclosures in any capital raising documents:

- paragraph 7.A.15 (details of material loans);
- paragraph 7.F.7 (material risks) specifically in the context of risks that impact cashflows; and
- the information set out under the 'business insights' section above.

In certain circumstances issuers may be obliged to obtain prior shareholder approval (through a general meeting) to issue shares. In order to ensure that investors have all information at their disposal so as to make an informed decision the JSE requires that, at the very least, the notice of general meeting provides the detail called for in terms of paragraph 11.13 of the Requirements as well as the additional disclosures set out above.

7. Rights offer timetables

Effective December 2017, the JSE implemented amendments to reduce the rights offer timetable as much as possible. A short timetable is beneficial to all parties on the basis that (i) issuers receive their cash sooner (ii) the shorter the period minimises the risk for price fluctuations and (iii) underwriters can better price the risk of the rights offer (and they are at risk for a shorter period), which also benefits issuers in terms of reduced fees.

Concerns have been raised about the negative impact of delays the rights offer timetables brought between the announcement of the intention to embark on a capital raising exercise and the provision of the key terms of a rights offer including the total amount to be raised, the pricing mechanism / formula to apply and the actual price. Such delays can negatively impact the demand and success of a capital raising as without either or both of the key terms, uncertainty can lead to volatility and imperfection in price formation for longer

term investors. As the rights offer is typically benchmarked to the market value, firm price formation around the time of the rights offer is important.

Issuers are therefore urged to reduce this period of uncertainty and the JSE believes that this can be achieved through a combination of the following mechanisms:

- strict internal controls around the flow of information so that the issuer is not forced to make an early intention announcement when they have not finalised the key terms;
- as short a period as possible between the intention announcement and the formal declaration date in terms of the JSE corporate actions timetables;
- disclosure of all of the key terms as soon as possible;
- if it is not possible to disclose all of the key terms, disclosure of those key terms that are known;
- disclosure of the identity of any intended underwriters to the rights offer; and
- disclosure of the business insights as soon as possible.

8. Underwriting

Underwriters fulfill an important function by providing certainty to issuers regarding the demand and success in capital raising. It is important to ensure that there is full transparency with regards to the identity of all underwriters, sub underwriters and shareholders who have provided irrevocable undertakings together with the fee structure applicable for each of these parties.

The Requirements impose an obligation to ensure that these fees paid to shareholders are market related. In order to comply with paragraph 5.31 of the Requirements, there must be transparent disclosure of the fees (both underwriting and sub-underwriting) including:

- details of whether the fee is payable on (i) the entire rights offer or (ii) the portion for which irrevocables were not provided; and
- the amount payable to each party, expressed as both a rand amount and a % of the amount being underwritten.

(“the Market Related Disclosures”)

These disclosures should accompany details of any shareholdings of the underwriter/sub underwriter (or its related parties) in the issuer.

Whilst the Market Related Disclosures strictly speaking only applies when the underwriter is a shareholder, the JSE believes that in line with the General Disclosure Principles it is important to provide these disclosures regardless of whether the underwriter is a shareholder. Therefore, going forward the JSE requires that this information is provided in all instances. The Market Related Disclosures must also be provided when there is a commitment fee payable for providing an irrevocable undertaking.

Underwriting fees are not uniform and the market related rate will vary depending not only on the entity specific circumstances of the issuer but also the identity and intention of the underwriter. A merchant bank for example is providing a service. The fee they negotiate is intended to cover the fact that they are putting their balance sheet at risk. They are not necessarily long-term investors and would ultimately look to exit any shareholding position within the short to medium term. A shareholder on the other hand, that has significant influence or a controlling stake (or an entity that is looking to take a long term position in an issuer) is approaching the underwriting with a different objective. It is reasonable to expect that they would receive a lower fee. They are being paid to provide certainty to the success of the corporate action and the fee is not intended to cover a separate service.

Therefore, in order to ensure full transparency, issuers are required to include a narrative, explaining why they believe the fee is market related. That explanation should be aligned to the nature of the service as set out directly above. If the fee is being paid to a related party, there should also be an explanation of the governance process applied to the negotiation process (see the 'governance' section below). These disclosures are to be provided for underwriting, sub-underwriting and commitment fees.

9. Governance

The JSE is only one role player in the capital market governance eco-system. The strength of a capital market is inherently dependent on issuers applying good corporate governance in both their disclosures and interactions with investors and advisors.

This letter has thus far mainly emphasised the importance of the content and timing of the disclosures. Issuers must also apply the highest level of corporate governance to their processes. This applies equally to capital raising exercises. Related parties (as defined in section 10 of the Requirements) should not be placed in an advantageous position as it relates to:

- the quality of information provided in order to make investment decisions; or
- negotiations regarding fees payable.

In terms of the timing of the release of information, the JSE reminds issuers of their obligations when dealing with price sensitive information as set out in:

- paragraphs 3.4(a) and 3.5 to 3.10 of the Requirements;
- practice Note 2/2015: Price Sensitive Information; and
- the guidance letter of 23 October 2013 entitled "Discussions with journalists and Investment Analysts"

Capital raisings can be prejudiced when issuers fail to ensure the necessary governance over the flow of information both internally and externally (i.e. with advisors and investors).

10. Conclusion

The letter aims to remind issuers of important provisions of the Requirements and promote further disclosures that may contribute to transparent price formation and the success of capital raisings.

Should you have any queries with regards to the content of this letter please contact Tania Wimberley.

Yours faithfully



**A F VISSER: DIRECTOR
ISSUER REGULATION**