What about the rest of us?

Thundelarra, exploring some of Australia's most prospective ground for copper and gold, suffered an 18% share price fall as soon as it announced a share purchase plan on May 10, 2016.

John Robertson* | 03 Aug 2016 | 20:11 | Opinion

Share purchase plans are convenient but anger shareholders who don't appreciate their value destructive potential

Share purchase plans are convenient, sometimes effective but also potentially disruptive capital management tools.

Australia's corporate regulator allows ASX-listed companies to offer shares to existing holders without the need for a prospectus provided the issuing company is complying with its reporting obligations.

A company using the prospectus exemption cannot raise more than A$15,000 (US$11,360) from a single shareholder over any 12-month period.

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Under ASX listing rules, furthermore, the number of new shares issued through a share purchase plan is limited to 30% of the total already outstanding and any price discount must not exceed 20%.

Individual investors can top up existing holdings with attractively discounted shares free from brokerage. The plans help deflect criticism of companies by small shareholders peeved at well-connected investors receiving preferential access to discounted offers via placements.

Whether share purchase plans can contribute meaningfully to the funding needs of an exploration company will depend critically on the track record of the issuer and resulting shareholder expectations.

Despite the attractions of a discounted offer, only a minority of shareholders typically participate.

Thundelarra estimated in early May that the improbable upper end of its capital raising potential from a share purchase plan would have been $5.06 million.

"The company faces the risk of any explorer that the results from its current exploration programme fail to excite investors"

At the conclusion of the offer period seven weeks later, the company had received A$1.81 million. The average subscription of about $6,000 meant that around 300 of the company's 3,250 shareholders would have subscribed.

The adverse share price reaction experienced by Thundelarra through the offer period is not surprising.

The choice of quotation period played a role. Knowing the issue price, shareholders can reasonably decide to sell a part of their holdings being confident of buying the same amount back without cost at a lower price.

Particularly near the end of a financial year, a wish to tidy up capital gains liabilities may encourage this reaction.

What is not to say that a majority or even a large number of shareholders react in this way. With prices being set at the margin, only a small number of more trading-oriented investors are needed to force the price lower.

The market value of Thundelarra declined by $3.7 million as it sought to raise $1-2 million, making this a potentially expensive financing at the cost of the large majority of the company's shareholders who would not be receiving any direct benefit.

The relatively depressed market conditions created by the offer would also hinder anyone among the majority of shareholders wishing to realise the value of their investment.

A decision by Thundelarra to extend the offer period aggravated the market disruption and loss in value.

Someone always thinks he has not received offer documentation in a timely fashion. Understandably, companies want to react sympathetically but should consider dealing with complaining shareholders separately, unless there has been a systemic failure in the mail-out.

Thundelarra chief executive Tony Lofthouse, technically astute as well as being a former banker and stockbroking analyst, has a broader perspective of markets than most of his executive peers in the industry. His analysis of the disruptive market impact of the offer is more sanguine.

While some shareholders may discard existing holdings, according to Lofthouse, their actions permit new shareholders who would not have been eligible to participate in the offer to engage with the company.

More importantly, from a strategic perspective, Thundelarra's offer allowed the company to maintain its funding buffer as it pursues its exploration objectives.

Overall, Lofthouse was pleased with the result.

Thundelarra runs a more conservative capital management model than many explorers.

Rather than betting on a successful drilling result from which to launch a funding round, Lofthouse aims to maintain a financial cushion that allows for around 12 months of upcoming planned activity even at the expense of raising capital at low prices.

Since completion of the share purchase plan, the company has also raised $2.5 million through a share placement to professional investors.

Lofthouse does not want to find himself in a weak market unable to press ahead with his exploration plans. He is especially critical of companies opting out of further exploration because of market conditions.

The company faces the risk of any explorer that the results from its current exploration programme fail to excite investors. With its established capital buffer, the company will retain the wherewithal to continue building the body of data needed to underpin an eventual mining development and an ultimately attractive investment return.

At the top of its exploration agenda is the Red Bore copper-gold project, which the company has characterised as replicating the DeGrussa and Monty deposits in the same region of Western Australia.

At Red Bore, adjacent to Sandfire's DeGrussa mine, a series of vertically oriented copper-mineralised bodies had been identified without the deeper potential being tested. That is now the focus of attention.

The company has also commenced drilling at its Garden Gully gold prospect in the Murchison.

On the last trading day of July, it reported assays showing a 7m intercept grading 24.5g/t Au after previously reporting visible gold from sampling at the property.

Further results could prove highly variable but this was an encouraging beginning.

In an implicit endorsement of the company's efforts, investors have supported a rise in its market value from $20.6 million at the end of April to $25.5 million at the end of July.

The Thundelarra example shows how share purchase plans can enhance the capital management practices of companies able to demonstrate a value proposition behind their exploration efforts.

Nonetheless, companies should do more to minimise the potentially disruptive market effects of the share plans in fairness to the bulk of their shareholders who choose not to participate.