

## **HOW TO TRADE RIGHTS ISSUES part 2**

By John Atkinson and Steve Baker

Following the Noble rights trade article many readers asked for a more detailed explanation of the strategy. These notes are historical, but the same principles continue to apply.

One short term strategy on trading a Rights Issue is to buy as soon as possible after the initial announcement of the Issue, provided that the 'ex date' has not already passed and the price is rising (see in contrast ALN discussed below).

On the expectation that the share will increase in price as buyers move in to 'get set' and seek their entitlements, the aim is then to hold until the day before it goes 'ex', unless a short term signal e.g. reversal bar/candle is given prior.

In the case of HDR, it last traded at \$1.22 on 30 March 2004 prior to an early Trading Halt on 31 March. When trading resumed on 1 April after an announcement that an institutional placement had been done at \$1.10 with a corresponding 1 for 6 Rights Issue at \$1.10, an entry at about \$1.30 near the open was possible. Over the next three days, the share rose to a peak of \$1.51 i.e. up to 16% was available leading up to the day before it was originally intended to go 'ex'.

(In this case, a complication occurred in that on 5 April HDR extended by one day their key dates which had been originally announced, as shown above.)

To assist those traders who may be unaware of the calculations involved, we make available a spreadsheet to calculate, prior to the shares going 'ex entitlement' and based on the latest traded share price, the theoretical price of a share once it has gone 'ex entitlement'.

### 1) Non Renounceable Issues

Share	HDR				Issue Price
	Entitlement:	1	for	6	shares at \$1.10
Share Price (last sale 'cum entitlement')	\$1.43				
	No of shares	Price	Value		
Cum entitlement	6	\$ 1.43	\$ 8.58		
Plus entitlement	1	\$ 1.10	\$ 1.10		
Ex entitlement	7	\$ 1.38	\$ 9.66		

Yellow gives theoretical ex entitlement share price

In the case of HDR which, as shown above, last traded cum entitlement at \$1.43 on 6 April, the calculations show that the theoretical share price 'ex entitlement' was \$1.38 for the next day. In fact, the market did close at exactly this price on 7 April, having opened at \$1.41 with a low of \$1.35.

Note that HDR had a notional Rights value of \$1.38 less the \$1.10 to be paid for the new shares ie 28c. These Rights could not be traded as they were non Renounceable and this notional value was lost if the holder did not take up the Issue.

Turning now to look at Renounceable (i.e. tradeable) Rights, an investment newsletter wrote on 5 April 2004:

"Today is the last day of trading in Alinta rights (ALNR). A lot of traders will tell you that buying in the middle of a rights issue is a route to riches nine times out of ten and Alinta is in the middle of a rights issue. The stock has dropped 16% in the last two and a

half weeks. A lot of us are seeing this as a chance to buy a solid utility stock, on a 6.3% yield, at a good price, for the long term. ...."



In ALN's case, the share was uptrending and last traded at \$7.66 on 12 March 2004 before going into Trading Halt until 17 March when it fell on high volume following announcements regarding an acquisition, a placement and a Renounceable Rights Issue.

It reached a low of \$5.95 on 23 March, a reduction of 22% in less than two weeks. (This fall followed some analyst reports that they considered ALN paid too much for the acquisition.) The placement was for 29 million shares to raise \$195.75M (equivalent to av. \$6.75) and the Rights Issue details were as follows:

<i>Entitlement:</i>	3 for 7 at \$5.50
<i>Existing Shares Quoted Ex-Rights on ASX and Rights Trading Commences on ASX:</i>	19 March 2004
<i>Record Date for Entitlements under Rights Issue:</i>	25 March 2004
<i>Rights Issue Opens:</i>	29 March 2004
<i>Rights Trading on ASX ends:</i>	5 April 2004
<i>Closing Date for Renunciations, acceptances and payment in full:</i>	14 April 2004
<i>Normal trading commences for new shares on ASX:</i>	23 April 2004

In this case traders had just two days to buy the shares on a cum entitlement basis. (Wed 17 and Thurs 18 March. ALN last traded 'cum entitlement' at \$6.67 on 18 March. The calculations show that the theoretical share price 'ex entitlement' was \$6.32 for the next day. In fact, ALN peaked at this price on 19 March and closed at \$6.25.

## 2) Renounceable Issues

Share	ALN				Issue Price
	Entitlement:	3	for	7	shares at \$5.50
Share Price (last sale 'cum entitlement')	\$6.67				
	No of shares	Price	Value		
Cum entitlement	7	\$ 6.67	\$46.69		
Plus entitlement	3	\$ 5.50	\$16.50		
Ex entitlement	10	\$ 6.32	\$63.19		
Ex entitlement price is		\$ 6.32			
Less amount to pay on Rights		\$ 5.50			
Gives theoretical Rights price		\$ 0.82	Green gives calculated Rights price based on cum entitlement share price		

Yellow gives theoretical ex entitlement share price

Also included in this week's spreadsheet\* are the calculations for the value of Renounceable Rights, based on the entitlement parameters and current price of the parent share prior to it going ex entitlement.



In ALN's case, the calculations above show a theoretical Rights price of 82c, based on the last 'cum entitlement' traded share price of \$6.67 on 18 March. The ALNR Rights actually opened at 75c on 19 March 2004. The chart shows the daily prices varied between 75c and 46c before trading finished on 5 April.

Once a share has gone ex entitlement, in theory, the Rights price should track the share price minus the entitlement amount to be paid (e.g. \$5.50 for ALN ).

In practice, there is often a surprising level of market inefficiency and this makes for some real gems in this type of trading. Daryl has observed that the premium can be in the order of 10%, although with some slow moving penny stocks it can reach 20%. Next week we show how this inefficiency can be assessed and tracked.

*This article is one of a series of articles John Atkinson originally wrote for this Newsletter and are now collated into an ebook called ['The Atkinson-Guppy Articles'](http://www.sharetradingeducation.com/all-products/the-atkinson-guppy-articles.aspx) at ShareTradingEducation.com <http://www.sharetradingeducation.com/all-products/the-atkinson-guppy-articles.aspx>*