GUIDE

Cash box structures for convertible bond issues

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A guide to the use of Jersey cash box structures to facilitate convertible (or exchangeable) bond or note issues by UK PLCs

Given the global cash flow crisis arising from the COVID-19 outbreak, many UK listed companies (**UK PLCs**) will be looking at options for raising emergency capital. One such option is a convertible bond issue. Structuring a convertible bond issue using a Jersey cash box structure can make it easier to implement the bond issue and may offer other benefits too.

This guide describes how cash box structures work in relation to convertible (and exchangeable) bond issues and some of the reasons why Jersey companies are particularly well suited to these cash box structures.

What is a convertible bond cash box structure?

There are two principal types of cash box structure used in connection with the issue of convertible or exchangeable bonds:

- the UK PLC Issuer structure under which the bonds are issued by the UK PLC in consideration of the transfer to it of shares issued by the Jersey cash box company; and
- the Cashbox Issuer structure under which the Jersey cash box company issues the bonds which are guaranteed by the UK PLC. The bonds are convertible into preference shares in the Jersey cash box company which are then exchanged for the securities which the UK PLC wishes to issue (or transfer, in the case of an exchangeable bond).

The appropriate structure for any particular issue will be determined by a number of different factors. They may include investor preference as to the issuer of the bonds (the UK PLC or the Jersey cash box company), whether or not the UK PLC wishes to create distributable reserves and whether flexibility is required in relation to pre-emption rights. In our experience the Cashbox Issuer structure is more commonly used.

If the UK PLC wishes to have the benefit of the provisions allowing for merger relief, so as to be able to create distributable reserves when the bonds are converted, the Cashbox Issuer structure is likely to be the more suitable form because the shares of the UK parent company are issued in return for the transfer of shares in the Jersey cash box company rather than directly upon conversion of the bonds.

In relation to pre-emption rights, the restrictions applicable in relation to the issue by the UK PLC of shares for cash apply to the issue of convertible bonds for cash in the same way as they do to the issue of shares for cash. Where flexibility is required in relation to pre-emption rights, either type of cash box structure can help, as the convertible bonds will be issued for a non-cash consideration under both the UK PLC Issuer structure and the Cashbox Issuer structure.

Incorporation of a subsidiary

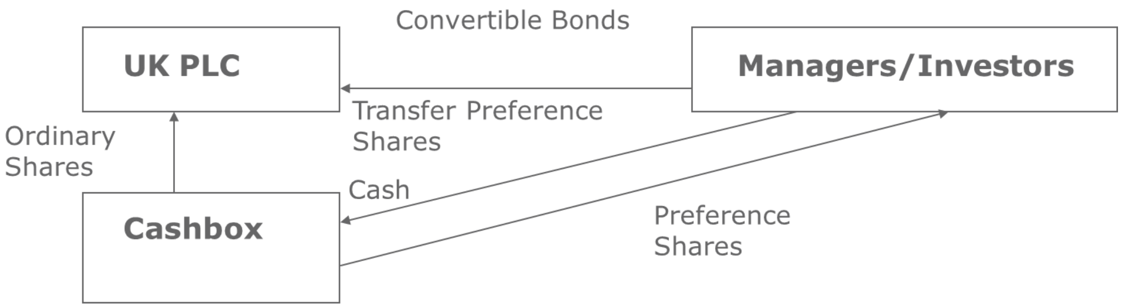
In respect of either type of structure, UK PLC needs first to incorporate a subsidiary to act as the "cash box" (**Cashbox**). Cashbox is usually incorporated in Jersey (see Advantages of using Jersey companies below), but may be managed and controlled (and therefore tax resident) in the UK.

If UK PLC is to be the issuer of the bonds, Cashbox can be a private company because its shares will be held only by UK PLC and the managers for the issue (**Managers**). If the bonds are to be issued by Cashbox, it will usually be a public company and it will typically need regulatory approval in Jersey to issue the bonds and to circulate the offer for the bonds. UK PLC may also need regulatory consent in Jersey for raising money in Jersey. These consents are relatively straightforward to obtain. If the bonds are being offered to a small number of investors then Cashbox can be a private company and the above consents may not be required.

Issue of Cashbox shares and bonds

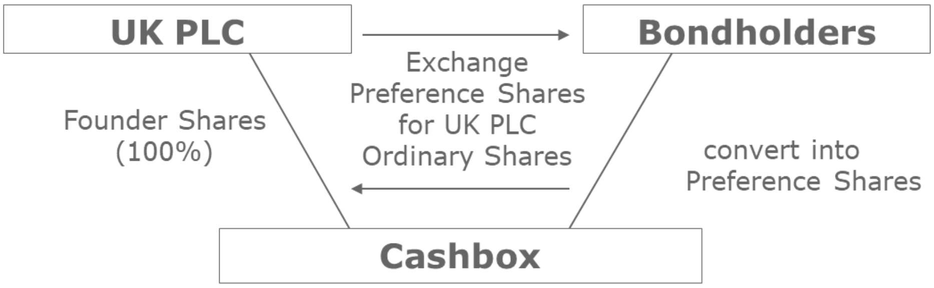
In a UK PLC Issuer structure, the key steps are:

- subscription for the ordinary shares in Cashbox by UK PLC;
- the Managers subscribe for the redeemable preference shares in Cashbox, which are issued fully paid for an amount equal to the net proceeds of the issue of the bonds;
- the Managers transfer to UK PLC all of the shares in Cashbox held by them in return for the issue by UK PLC of the bonds to the investors identified by the Managers;
- once Cashbox has become a wholly owned subsidiary of UK PLC, it pays the proceeds of the issue of its preference shares (equal to the net proceeds of the bond issue) to UK PLC (see - Payment of cash to UK PLC) and, unless it is to be used for future issues, Cashbox may be wound up because it has no continuing role in relation to the bonds; and
- the bonds are converted into shares or securities of UK PLC (or exchanged for other securities in an exchangeable bond) in accordance with their terms.



In a Cashbox Issuer structure, the key steps are:

- subscription for founder shares in Cashbox by UK PLC;
- the bonds, guaranteed by UK PLC, are issued by Cashbox to the Managers or to investors identified by the Managers in accordance with the terms of the subscription agreement;
- the bonds perform like ordinary non-convertible bonds paying interest until conversion occurs;
- the subscription price paid to Cashbox for the bonds is applied by Cashbox so as to generate enough income to meet the interest obligations under the bonds (commonly by way of a loan to UK PLC);
- upon conversion of the bonds, generally at the option of the bondholder, they are converted into preference shares of Cashbox in the hands of the former bondholders and then immediately and automatically exchanged for the securities issued by UK PLC (or securities owned by UK PLC in an exchangeable bond issue). If merger relief is required the preference shares must qualify as equity share capital for the purpose of the UK Companies Act;
- once Cashbox has become a wholly owned subsidiary of UK PLC, the preference shares may be redeemed; and
- if Cashbox is not required for further issues, once the proceeds of the issue have been paid or distributed to UK PLC it can be wound up.



Payment of cash to UK PLC

The treatment of the cash raised by the issue of the bonds depends upon the type of structure used.

In a UK PLC Issuer structure, Cashbox becomes a wholly owned subsidiary of UK PLC when the Managers transfer the Cashbox shares that they hold to UK PLC and the bonds are issued.

From that time, Cashbox has no obligations of its own to meet in relation to the bonds and accordingly, although there may be circumstances in which it is appropriate for the funds to be lent by Cashbox to UK PLC, it is usual for them to be paid to UK PLC by way of redemption of the preference shares or in a winding up of Cashbox.

In a Cashbox Issuer structure, until conversion or exchange of the bonds, Cashbox has continuing liabilities in respect of the bonds. Initially, therefore, the proceeds of the bond issue need to be invested by Cashbox so as to produce sufficient income for it to be able to meet its obligations under the bonds. This is commonly done by way of a loan of the net proceeds of the bond issue to UK PLC on terms that enable Cashbox to meet its bond obligations. Upon conversion of the bonds into preference shares of Cashbox and their exchange for the securities issued or, as the case may be, owned by UK PLC, Cashbox has no continuing obligations in respect of the converted bonds it issued and is a wholly-owned subsidiary of UK PLC. The net proceeds of the issue of the bonds that have been converted can then be paid to UK PLC by redemption of the preference shares issued in respect of the converted bonds, setting off the amount payable in respect of the redemption against UK PLC's obligations in respect of the loan from Cashbox or, if all of the outstanding bonds have been converted or exchanged, in a winding up of Cashbox.

Listing bonds on The International Stock Exchange

Convertible bonds are commonly listed. This may be for a number of reasons, including to demonstrate governance and transparency, to increase exposure and visibility and to provide a price and create a market.

Convertible bonds will often need to be listed on a recognised stock exchange so that the bonds qualify for the Quoted Eurobond Exemption (meaning that no UK withholding tax is payable on interest payments on the bonds). The International Stock Exchange (TISE) has been designated as a recognised stock exchange by Her Majesty's Revenue and Customs (HMRC), the UK tax authority. TISE is increasingly seen as the exchange of choice for listing convertible bonds because it not only fulfils the requirement of being a recognised stock exchange but also because it has a pragmatic admission process which provides for speedy and cost-effective listings. A guide to the listing process is available on request.

Uses of Cashbox structures

Convertible and exchangeable bond structures offer benefits to issuers and to investors. For issuers the benefits include:

- simpler and more flexible issuing structures than for straight equity: listing requirements for convertibles are less onerous than they are for equity;
- cheaper borrowing: issuers can pay lower coupons because of the facility of converting into equity when the shares get to a certain price;
- balance sheet: upon conversion the issuer can replace debt with equity in its balance sheet;

- equity can be issued by UK PLC at a premium to its current market price and immediate funds can be raised on undervalued equity;
- holding of shares in a block sale would generally be at a discount but an exchangeable bond allows it to be at a premium;
- some tax advantages: interest may be deductible and there may be benefits in relation to liability for gains on assets that are exchanged; and
- less dilution for existing shareholders than there would be for a direct issue raising the same amount of money because the conversion takes place at a premium to the market price at the time of issue.

For investors the benefits include:

- access to the underlying asset (whether shares in UK PLC or securities issued by another entity) at a known price;
- the potential benefit if the value increases beyond the conversion or exchange price;
- fixed income until conversion by way of the coupon on the bonds rather than a distribution under the underlying securities; and
- structured protection of exchange rights and PLC guarantees.

Advantages of using Jersey companies

Jersey companies are suited for use in cash box structures for a number of corporate and tax reasons.

- Jersey companies can be incorporated within a short timescale (within two hours of submission of the incorporation papers, though relevant KYC and incorporation information / documentation will need to be collected first).
- Jersey companies are typically incorporated on a bespoke basis and are not shelf companies; incorporating a bespoke company makes it easier to demonstrate that Cashbox is a subsidiary of UK PLC with UK management and control from incorporation.
- Jersey company law allows flexibility in relation to the drafting of share rights.
- Jersey companies can be managed and controlled in the UK: there is no requirement for board or shareholder meetings to be held in Jersey or for there to be Jersey resident directors.
- Jersey companies must maintain their share registers and registered offices in Jersey so that shares are transferred outside the UK.
- A Jersey company can redeem shares from any source of funds, including share capital, making Jersey companies more flexible in this regard than UK companies.
- Jersey company law enables Jersey companies to issue no par value shares. These are shares that do not have a specified par value but are issued for an agreed price recorded in a stated capital account.
- Winding up solvent Jersey companies (for example at the end of the life of Cashbox) is a simple and quick procedure and it is not necessary to appoint a liquidator.
- Jersey companies can be tax neutral. The Jersey tax position of Cashbox can be summarised as follows:
  - no Jersey income tax is payable;
  - no Jersey capital gains tax;
  - no Jersey withholding tax;
  - no Jersey duty payable on the issue or transfer of shares;
  - Jersey companies are not resident for tax purposes in Jersey if the business is centrally managed and controlled outside Jersey in a country or territory where the highest rate at which any company may be charged to tax on any part of its income is at least 10%; and
  - transfers of shares are carried out on the register which is required to be maintained in Jersey and all transfers and share certificates can be executed and retained in Jersey, outside the UK.
- Jersey has an experienced professional infrastructure accustomed to managing the regulatory, technical and practical demands of cash box structures.

How can Mourant help?

Mourant is able to provide all of the Jersey services needed to implement the cash box structure, including:

- legal advice on the establishment of the structure through our law firm Mourant Ozannes;

- corporate administration support (incorporating the company and assisting with filings and other company secretarial services) through Mourant Governance Services; and
- if required, assisting with the listing of bonds on TISE through our listing agent, Mourant Securities Limited.

All of these services are provided in a seamless manner with a single point of contact, offering efficiency and certainty in the execution process.

Contacts

A full list of contacts can be found here.