Linklaters

March 2016

# Latest Market Developments for Equity-Linked Structures

The recent Cheung Kong Infrastructure (CKI) and Vodafone equity-linked transactions have raised a number of interesting issues.

We summarise below the key talking points from these transactions:

We would welcome any queries on these structures. Please feel free to contact any of your usual Linklaters contacts if you wish to discuss further.

## 1. CKI US$1.2bn Perpetual Securities with Equity Swap Agreement

### a. Deal Structure

- US$1.2bn in subordinated Perpetual Securities issued by an orphan SPV and guaranteed by CKI
- The SPV is an orphan and is not owned by CKI and there is no lender/borrower relationship between CKI and the SPV
- Proceeds from the Perpetual Securities used by the SPV to subscribe for new CKI Subscription Shares at the current market price
- The SPV and CKI enter into a Swap Agreement – whereby CKI guarantees the Perpetual Securities and pay all amounts due under the Perpetual Securities and the grants CKI certain rights in respect of the CKI Subscription Shares (including the right to receive amounts paid to the SPV as dividends and the right for CKI to direct the sale/transfer of the CKI Subscription Shares)

### b. Treasury Shares

- Through the Swap Agreement the CKI Subscription Shares effectively function as CKI's treasury shares even though legally the CKI Subscription Shares are issued and held by the SPV (which is an independent 3rd party)
- As the Swap Agreement gives CKI the right to direct the sale/transfer of the CKI Subscription Shares, CKI is able to take an exposure in its own shares and benefit from any increase in the share price
- But the CKI Subscription Shares will not be available for voting so long as they are held by the SPV and will be disregarded for public float calculation purposes

- The structure benefits from 100% equity accounting treatment and the CKI Subscription Shares will receive 100% equity credit – which would not have been possible with just the Perpetual Securities

### c. Regulatory Issues

- HKEx will treat these structures as a “look through equity placing” – so usual equity marketing restrictions should apply
- No prohibition in Bermuda for companies to give financial assistance to assist buyer to purchase its shares – but this may be a problem for HK incorporated companies
- The SPV is not a subsidiary of CKI – so not a connected person for HKEx Listing Rules purposes
- Guarantee to a 3rd party constitutes a notifiable transaction under HKEx Listing Rules

## 2. Vodafone £600m Senior Zero Coupon Equity Linked Bonds

### a. Deal Structure:

- Vodafone issued £600m Senior Zero Coupon Equity Linked Bonds in November 2015
- The Equity Linked Bonds are senior ranking debt securities with an embedded cash settled equity option
- Concurrently Vodafone hedged its equity exposure under the Equity Linked Bonds by buying an equity call option
- Similar to other equity neutral bonds issued by National Grid, Fresenius, Iberdrola and Technip – which essentially allows issuers to tap equity-linked investors without the obligation to issue any equity

### b. Equity Neutral

- If the Equity Linked Bonds are converted by the investor, Vodafone will pay the cash settlement amount based on the 20 day VWAP following conversion
- At the same time, Vodafone purchased a cash settled call option to allow it to hedge against any share price increase (and any increase in the amounts paid out to converting investors under the Equity Linked Bonds)
- If no conversion, the Equity Linked Bonds will be redeemed at par on maturity
- The initial conversion price was set over the 10 trading days following pricing – which allows the hedging banks to hedge their positions by buying stock
- Conversion is generally limited to a short period (3-4 months) prior to maturity
- The Equity Linked Bonds will be subject to adjustment/settlement according to the ICE Futures Europe Corporate Actions Policy – other than for extraordinary dividends which will be adjusted in accordance with the terms of the Equity Linked Bonds

### c. Rating, Accounting and Tax Treatment

- From a rating, accounting and tax perspective, the Equity Linked Bonds should be treated as debt securities for the issuer – but this will depend from country to country
- Mark-to-market accounting impact from the Equity Linked Bonds and the cash settled call option to be considered

### d. Other Regulatory Issues

- Potential market abuse issues to consider – generally the call options on these structures will be automatically settled following a conversion to remove any issuer discretion

## 3. Vodafone £2.88bn dual tranche Subordinated Mandatory Convertible Bonds

### a. Deal Structure:

- Vodafone issued £2.88bn dual tranche Subordinated Mandatory Convertible Bonds in February 2016
- The Subordinated Mandatory Convertible Bonds rank pari passu with any preference shares
- The Subordinated Mandatory Convertible Bonds compulsorily convert into equity at maturity but the dilution impact is offset by Vodafone separately entering into a cash settled equity option strategy to allow it hedge for the share buyback price and execute on-market share buybacks following any conversion of the Subordinated Mandatory Convertible Bonds

### b. Equity Dilution Offset

- The Subordinated Mandatory Convertible Bonds will be compulsorily converted into Vodafone shares on maturity and may be voluntarily converted into Vodafone shares at the option of the investors generally at any time prior to maturity
- The initial conversion price was set at the higher of (i) the closing price on 17 February and (ii) 3 day VWAP from 19 February
- At the same time, Vodafone purchased a cash settled call option and sold a cash settled put option to hedge any future share price movements
- If Vodafone decides to buyback shares following any conversion under the Subordinated Mandatory Convertible Bonds, the call and put options will provide a hedge to the share buyback price
- The cash and put options are scheduled for settlement on 55 consecutive trading days beginning 3 days after maturity
- The Subordinated Mandatory Convertible Bonds will be subject to adjustment/settlement according to the ICE Futures Europe Corporate Actions Policy – other than for dividends which are adjusted on a full pass through basis in accordance with the terms of the Subordinated Mandatory Convertible Bonds

### c. Rating, Accounting and Tax Treatment

- Rating and Accounting – treated as equity from an accounting and rating perspective
- Tax – interest payments may be tax deductible as the Subordinated Mandatory Convertible Bonds are legally debt securities prior to conversion but this will depend from country to country
- Mark-to-market accounting impact from the Subordinated Mandatory Convertible Bonds and the cash settled call and put options to be considered

### d. Other Regulatory Issues

- Potential market abuse issues to consider – generally the call and put options on these structures will be automatically settled following a conversion to remove any issuer discretion

- Any on-market share buyback by Vodafone following conversion will also be subject to inside information considerations

* * * * *

Linklaters is a market leader on equity linked structures, having recently advised on:

- The CRRC US$600m H Share Convertible Bonds;
- The Baosteel Group US$500m Exchangeable Bonds exchangeable into CCB H Shares; and
- The equity neutral offerings by Vodafone (£600m Senior Zero Coupon Equity Linked Bonds and £2.88bn Dual Tranche Subordinated Mandatory Convertible Bonds), National Grid (£400m Non-Dilutive Convertible Bonds), Fresenius (€500m Equity Neutral Convertible Bonds), Iberdrola (€500m Zero Coupon Guaranteed Equity Linked Bonds) and Technip (€375m Non-Dilutive Convertible Bonds).

For further information please contact:

**William Liu**
Partner
Tel: (852) 2901 5257
Email: william.liu@linklaters.com

**Hwang Hwa Sim**
Partner
Tel: (852) 2842 4103
Email: hwang_hwa.sim@linklaters.com

**Michael Ng**
Partner
Tel: (852) 2842 4172 / (86 10) 6535 8643
Email: michael.ng@linklaters.com

**Gloria Cheung**
Counsel
Tel: (852) 2842 4830
Email: gloria.cheung@linklaters.com

**Terence Lau**
Managing Associate
Tel: (852) 2842 4182
Email: terence.lau@linklaters.com

**Jonathan Horan**
Managing Associate
Tel: (852) 2901 5318
Email: jonathan.horan@linklaters.com

Linklaters

.

Authors: William Liu, Hwang Hwa Sim, Michael Ng, Gloria Cheung, Terence Lau, Jonathan Horan

This publication is intended merely to highlight issues and not to be comprehensive, nor to provide legal advice. Should you have any questions on issues reported here or on other areas of law, please contact one of your regular contacts, or contact the editors.

© Linklaters. All Rights reserved 2016

Linklaters Hong Kong is a law firm affiliated with Linklaters LLP, a limited liability partnership registered in England and Wales with registered number OC326345. It is a law firm authorised and regulated by the Solicitors Regulation Authority. The term partner in relation to Linklaters LLP is used to refer to a member of the LLP or an employee or consultant of Linklaters LLP or any of its affiliated firms or entities with equivalent standing and qualifications. A list of the names of the members of Linklaters LLP and of the non-members who are designated as partners and their professional qualifications is open to inspection at its registered office, One Silk Street, London EC2Y 8HQ, England or on www.linklaters.com.

Please refer to www.linklaters.com/regulation for important information on Linklaters LLP's regulatory position.

We currently hold your contact details, which we use to send you newsletters such as this and for other marketing and business communications.

We use your contact details for our own internal purposes only. This information is available to our offices worldwide and to those of our associated firms.

If any of your details are incorrect or have recently changed, or if you no longer wish to receive this newsletter or other marketing communications, please let us know by emailing us at marketing.database@linklaters.com.