HERBERT SMITH FREEHILLS

INITIAL PUBLIC OFFERINGS IN AUSTRALIA

LEGAL GUIDE

Published
April 2017

CONTENTS

ABOUT HERBERT SMITH FREEHILLS

We are committed to providing you innovative commercial legal advice through the expertise of more than 2,800 lawyers, including more than 460 partners, across 26 offices in Asia-Pacific, EMEA and North America. Our market leading equity capital markets practice advises issuers and underwriters on the most complex and innovative offerings of securities in Australia and globally, including initial public offerings and the full spectrum of secondary raisings.

Herbert Smith Freehills is widely regarded as the leading law firm in Australia for equity capital market transactions. We have acted on more IPOs in Australia (by deal count and amount raised) than any other top tier firm in Australia since 2007 (Thomson Reuters). We have recently acted on:

- some of the largest Australian IPOs such as Healthscope, Ingham's, Japara Healthcare, Medibank, Pact Group, Pepper Group, Regis Healthcare, Reliance Worldwide Corporation and SG Fleet Holdings, and
- a diverse range of medium to small sized IPOs, including Aconex, Adairs, Australian Finance Group, Autosports Group, Aventus Property REIT, Integral Diagnostics, Lovisa, Mitula Group, oOhMedia!, Shiro Holdings, Speedcast and Surftstich.

Herbert Smith Freehills also has a US securities law equity capital markets practice, which can assist with any US aspects of your transaction. Our US team has acted on both Australian IPOs and secondary raisings into the United States.

Our expertise has been recognised in the market:

- We have received the highest possible ranking in the equity capital markets categories of the most recent editions of *Chambers Global Guide*, *Chambers Asia Pacific Guide*, *Asia Pacific Legal 500*, *PLC Which Lawyer?* and *IFLR 1000*, with feedback such as, "*They are very client-focused, commercial and proactive in terms of identifying issues and working through solutions*" (Chambers Asia Pacific Guide 2015).
- We won Equity Deal of the Year at the 2015 Australasian Law Awards and Deal of the Year at the 2015 Law Institute of Victoria Awards for the Medibank IPO.
- We were awarded the International Firm of the Year at the 2016 Australasian Law Awards, Law Firm of the Year at the Chambers Asia-Pacific Awards in 2013 and 2015 and Law Firm of the Year at the 2015 Lawyers Weekly Australia Awards.
- At the Financial Review Client Choice Awards (previously Beaton Research + Consulting/BRW client choice awards) we were awarded Best Professional Services Firm (revenue greater than $200 million) and Best Law Firm (revenue greater than $200 million) in 2013, 2014 and 2015.

CONTACT US

If you have any questions relating to IPOs or equity capital markets transactions, please contact one of the partners in the Capital Markets team at Herbert Smith Freehills.

Michael Ziegelaar
Partner
Herbert Smith Freehills
T +61 3 9288 1422
M +61 419 875 288
michael.ziegelaar@hsf.com

Philippa Stone
Partner
Herbert Smith Freehills
T +61 2 9225 5303
M +61 416 225 576
philippa.stone@hsf.com

INTRODUCTION

You will find this guide useful if you are considering an initial public offering (IPO). It deals with the IPO legal framework and what happens in practice during an IPO.

An IPO is an important step in the development of your business. This guide will arm you with the knowledge you need to plan for your IPO, anticipate problems, minimise IPO disruption to your business and maximise the success of your IPO.

It deals with:

- whether you are IPO ready and alternatives if you are not
- preparatory IPO steps and selecting advisers
- the IPO due diligence process
- the IPO regulatory regime, ASIC and ASX requirements and the role of the regulators
- the prospectus preparation process
- employee incentive plans and dividend reinvestment plans
- the particular issues associated with large IPOs, and
- your post-IPO obligations.

An average IPO takes between 3-5 months although preparation can be quicker if you are IPO-ready. Timelines for small/medium and large IPOs are located at the back of this book.

This guide is current as at April 2017. It is a summary of the relevant law and intended only as a guide. Please do not rely on it as a substitute for legal advice.

To contact us to obtain legal advice on your IPO, please visit www.herbertsmithfreehills.com.

We wish you every success with your proposed IPO.

IPO READINESS

This chapter deals with what you need to consider in deciding whether you are 'IPO ready'.

ARE YOU LISTING FOR THE RIGHT REASONS?

You need to weigh up the advantages and disadvantages of listing. The advantages are that it could provide equity capital, provide a profitable sell-down strategy for you, create a trading facility for your securities, make your securities a form of currency (to finance future acquisitions and to reward employees) and increase your profile. The disadvantages are that you could lose control of your business, you could be vulnerable to a takeover, the IPO diverts you from running your business and you become subject to a number of new regulatory, corporate governance and securityholder influences.

ARE YOU AT THE RIGHT STAGE IN YOUR BUSINESS LIFE?

You must be sufficiently developed as a business and at the right stage of your business life cycle. It may be better to delay the IPO if you are still in the early stages of your development, have just undergone a major change (eg an internal restructure or a major acquisition) or are about to go through significant development or expansion (unless you need IPO capital to fund this). The IPO can be started once you have established or re-established a suitable track record on which investors may base their investment decision.

ARE YOUR MAJOR STAKEHOLDERS READY TO 'LET GO'?

An IPO creates more accountability to a new Board and new securityholders, and makes you subject to additional disclosure and corporate governance requirements and increased scrutiny by the market. As your market price becomes a measure of your success, you may no longer be able to take a purely long-term view when business planning. Major stakeholders must be prepared to accommodate these new influences.

DO YOUR MAJOR STAKEHOLDERS AGREE ON THE IPO STRUCTURE?

The major stakeholders need to agree on the IPO structure. If not, differences of opinion may later impede the IPO process.

Stakeholders also need to be aware that certain information about the business may need to be disclosed in the prospectus. For example, ASIC's view is that where a business has been subject to a price discovery transaction (eg the business is subject to a private sale before the IPO), you need to consider whether the market value determined by that process is material information reasonably required by investors and therefore disclosable in the prospectus.

DO YOUR KEY STAKEHOLDERS AND FINANCIAL ADVISER AGREE ON THE IPO VALUATION?

For established businesses, the IPO valuation is generally based on the price/earnings multiples at which similar entities trade on ASX and discounted by a percentage (say 5-10%). This 'IPO discount' is an inducement to new securityholders to subscribe and, in some cases, reflects a lack of a trading history. Companies in speculative industries, like early stage mining or technology industries, are usually valued at a net present value or in some instances revenue multiples, or industry-specific metrics like resources and reserves or subscriber/customer numbers, if they have no trading history.

DO YOU MEET ASX LISTING REQUIREMENTS?

You must satisfy the ASX profits test or the ASX assets test. It is preferable to satisfy the profits test as ASX will then not usually impose security trading restrictions on the existing securityholders and additional reporting obligations on the business.

You will also need to supply historical financial information to the ASX, and have an adequate securityholding 'spread' post-IPO.

The ASX's requirements are discussed in chapter 6.

DO YOU HAVE ENOUGH MANAGEMENT RESOURCES TO RUN THE BUSINESS AND THE IPO?

The IPO is likely to disrupt your business unless there are sufficient management resources to do both at the same time.

IS YOUR BOARD COMPOSITION RIGHT?

The typical make-up of a successful Board includes a reputable industry leader with listed company chairman experience as independent chairman, a managing director and other executive and non-executive directors with appropriate and complementary skill sets. Certain disclosures about directors and key managers, including past convictions and any involvement in solvent companies, need to be made in the prospectus (see chapter 20).

The ASX Corporate Governance Council's 'Principles of Good Corporate Governance and Best Practice Recommendations' for listed companies give guidance on appropriate Board composition. Under these recommendations, the Board should comprise a majority of independent directors, including an independent chair. The remuneration committee and audit committee should be comprised of non-executive directors only, a majority of whom are independent, and have independent chairs (and in the case of the audit committee, the chair should not be the chair of the Board). While these recommendations are not legal requirements (except for some audit and remuneration committee requirements), the ASX Listing Rules require a listed entity to discuss its main corporate governance practices in its offer document and each annual report (see chapter 20).

Your underwriter or lead manager will have suggestions as to your Board composition. Board members are each usually paid annual fees of $50,000-$70,000, for small/medium sized companies and $130,000-$220,000 for large sized companies. The chairman is usually paid an annual fee of 2-3 times what other non-executive directors are paid. Additional fees may be paid to Board members for attending Board committee meetings.

IS YOUR TIMING RIGHT FOR THE IPO?

The IPO should ideally be timed to maximise the level of market interest and be conducted at the right time of the economic cycle. It will also help if the industry in which you operate is in favour with the market, or if you can show links to favoured industries. Also, you should avoid a time when there are likely to be similar IPOs in the market or during the holiday period of late November to Australia Day. In international IPOs, you may want to avoid the northern hemisphere summer in July/August.

WILL YOU HAVE A SUFFICIENT AND STABLE AFTERMARKET?

Following listing, there needs to be sufficient market interest, especially by institutions, to ensure ongoing trade in your securities. Preferably, there must be at least one broker (usually your underwriter) who will provide ongoing research coverage on you and promote you to the market.

Your first decisions are whether you are listing for the right reasons and at the right time. Stakeholders, who are used to running their own business, sometimes underestimate the challenges created by the regulatory framework that applies to a listed entity. If you list too early in your business life, you run the risk of adversely affecting your growth. Also, your security price could languish, although this is less likely if you expect strong growth post-IPO. You need to carefully consider these factors in deciding whether you are ready to list.

IPO PREPARATION

This chapter deals with the key first steps you should take once you have decided to start your IPO.

APPOINT THE IPO MANAGEMENT TEAM AND ADVISERS

Your own IPO team will usually include the chairman, the managing director, the chief financial officer, your in-house lawyer and perhaps an IPO coordinator. The typical IPO advisers are an underwriter or lead manager, an accountant, a lawyer and a tax adviser. You may need other advisers. They may include an independent IPO adviser, a foreign lawyer (if you have overseas operations or your IPO will extend overseas), an industry expert (if you operate in a complex or technical industry) and a valuer (if your prospectus is to include an independent valuation of key assets). You may also need to appoint other service providers (eg the share registry, a public relations consultant, a graphic designer, a printer and a banker to the issue).

PREPARE AN IPO TIMETABLE AND DISCUSS IT

Consult with your advisers to prepare an IPO timetable. This should take into account any deadlines to complete the IPO and likely timing obstacles, as well as the availability of regulators, investors and analysts due to any holiday periods (eg Easter), reporting periods (March/April and October/November) and public holidays (eg Queen's birthday and Melbourne Cup). Once a timetable is proposed, invite all advisors to discuss the timetable and how it will be achieved.

APPOINT YOUR BOARD EARLY

Appoint new Board members at least 6 weeks before listing. While it is possible to bring on some Board members later, a 6 week period gives new Board members time to familiarise themselves with the business, any forecast, and the prospectus.

Each Board member is required to satisfy ASX that they are of good fame and character. This is in part satisfied by providing the requisite statutory declaration, criminal history and bankruptcy checks. These documents can take several weeks to obtain so request these documents as early as possible, especially if a proposed director has worked overseas in the last 10 years because you will be required to source criminal history and bankruptcy checks from the foreign country where they have worked.

IDENTIFY CONSENTS REQUIRED

The IPO may trigger a requirement for a change of control consent or a counterparty termination right in a major contract. Early identification of any consents required to conduct the IPO will ensure they are appropriately dealt with and do not delay the IPO.

MAKE ANY NECESSARY CHANGES TO THE CORPORATE STRUCTURE

If you are a proprietary company, you must either incorporate a new public company as the IPO vehicle and insert it into your structure (incorporation may be done in a day, but group restructuring can take longer) or convert the proprietary company to a public company so that it can be the

IPO vehicle (this takes about 6 weeks). If your corporate structure is not suitable for a listed entity, or if you need to separate the IPO business from other private assets, a corporate restructure may be needed. This may involve complex tax and stamp duty issues and take several weeks or even months to complete. Your constitution will usually need to be replaced to meet ASX listing requirements. All these steps may require special resolutions of members. Unless you get consent to short notice (which requires the approval of 95% of securityholders), this takes a minimum of 21-28 days.

If you are issuing units in a trust, as issuer of the units you will need to hold a financial services licence. Also, the entity whose securities are being offered must be a registered managed investments scheme. Obtaining a licence and registering a scheme is a major undertaking, which often takes several months unless the issuer already plays this role for other similar entities.

AGREE OFFER STRUCTURE AND DEBT/EQUITY MIX

You need to decide on:

- the nature of securities to offer (eg shares, units, options, convertible notes or a combination)
- whether you will offer new securities, existing securities or both
- the extent to which the interests of your existing securityholders will be diluted
- the amount you wish to raise (your brokers are likely to suggest a capital raising of at least $25 million to create adequate liquidity in your securities), and
- your preferred securityholder base (usually 60-70% institutions, 20-30% retail investors and 5-10% employees, customers and other friends of the business).

As part of this process, you need to decide how much debt your business will support going forward as a publicly listed entity, and negotiate any changes to your banking arrangements. Sometimes the ongoing facility can be 'put out to tender' to a number of banks to secure the best possible terms.

PREPARE ACCOUNTS FOR LISTING

Talk to your accountant about whether your accounts are in a suitable form for listing. There may be issues with the prospectus forecast (eg a forecast assumption may not be reasonable) or further work might need to be done on the accounts or reporting systems prior to IPO.

ASIC Regulatory Guide 228 provides guidance on how to prepare your prospectus in accordance with the Corporations Act. In particular, it includes guidance on the type, and form, of financial information that should be disclosed in your prospectus, which in recent years has become more onerous. Further information is included in Chapter 7.

CREATE A DATA ROOM

You should create a data room and make sure that all due diligence documents are ready for the IPO due diligence process. This will ensure that the due diligence process runs smoothly.

DEALING WITH SECURITYHOLDER ISSUES

You will need to consider what securityholder issues need to be dealt with prior to the IPO. For example, a securityholder meeting needs to be held to convert a private company to a public company for the IPO, to adopt a public company constitution and to approve the float process. Existing securityholder agreements may also need to be terminated.

CORPORATE GOVERNANCE REQUIREMENTS

You will need to comply with corporate governance requirements. These include directors' and officers' insurance, deeds of indemnity, committees (eg audit committee), director appointment documentation and corporate governance policies and charters (eg a continuous disclosure policy and a security trading policy).

ADVERTISING AND COMMUNICATIONS

It is useful to have a clear communication strategy to communicate information about the IPO to employees, securityholders, the public and regulatory authorities at permissible and relevant times. Regulatory relief from ASIC may be required, for example to communicate with employees. A detailed pre-offer media plan should also be formulated to avoid contravening the legal restrictions on pre-prospectus advertising.

IPO PROSPECTUS INSURANCE

You may want to take out IPO prospectus insurance. Directors' and officers' (D&O) insurance policies usually do not cover IPO liability. Targeted IPO prospectus insurance gives you and your directors protection from potential IPO liability. This is a complex area. Make sure you get legal advice on how the IPO prospectus insurance interacts with your D&O insurance so that you understand how the policies work together. IPO prospectus insurance is usually taken out in respect of about 30-40% of the amount raised in the IPO. As a general guide, $100m of IPO prospectus insurance costs approximately $400,000 with every $1 million of excess cover costing $500.

IPO COSTS

You will need to fund your IPO costs, which can be up to 5-10% of the funds raised.

We cannot emphasise enough how important it is to carefully deal with all of these matters at the very start of the IPO. Getting them right at the start helps to create a smooth IPO process. You may want to have a 'planning day' to discuss and plan for these issues.

ADVISER ROLES

This chapter deals with the roles of the IPO advisers.

The due diligence committee (DDC) usually comprises the following members and observers.

UNDERWRITER/LEAD MANAGER

Your underwriter or the lead manager in large IPOs usually coordinates the IPO process, markets the business, co-ordinates preparation of the prospectus, advises you on how to price your IPO and in many cases underwrites your IPO. The underwriter/lead manager is usually a member of the DDC but does not give an IPO sign-off.

An underwriter is contractually obliged under the underwriting agreement to apply for any securities that investors do not apply for in your IPO, subject to certain termination events such as a material fall in the market. The underwriting fee is usually between 2.5% and 5% of the amount raised by your IPO. Generally, the higher the amount raised, the lower the percentage fee. The underwriter usually appoints sub-underwriters to spread its risk and pays their fees out of the underwriting fee.

You normally appoint the underwriter/lead manager at the start of the IPO process with a short mandate letter containing the key terms of appointment. This letter deals with your ongoing relationship with the underwriter/lead manager. You should ask your lawyer to look at the mandate letter before you sign it. If your offer is to be underwritten, you will, with your lawyer, negotiate an underwriting agreement in the lead up to prospectus lodgement. It is generally signed before prospectus lodgement after sub-underwriting arrangements have been put in place by the underwriter following pre-marketing of the IPO. An offer management agreement is generally negotiated for non-underwritten offers, and also signed before prospectus lodgement.

In choosing an underwriter/lead manager, you should consider whether they will support you after the IPO. Following listing, there needs to be sufficient market interest, especially by institutions, to ensure ongoing trade in your securities. Your underwriter/lead manager can assist by providing research reports on you and by arranging for you to meet with institutional investors after the IPO.

ACCOUNTANT

Your accountant's role is to prepare the materiality guidelines used to decide whether due diligence findings are material, do accounting due diligence, assist you to prepare the financial information sections of the prospectus (such as historical accounts and pro forma accounts (the historical accounts adjusted to show how they would have looked had the IPO occurred on the previous balance date) and any forecasts) and give an investigating accountant's report, which is included in the prospectus. Your incumbent accountant will be familiar with your accounts and usually fulfils this role. The accountant is usually a member of the DDC and gives accounting related sign-offs.

LAWYER

Your lawyer's role is to prepare the due diligence planning memorandum, advise you on the IPO legal requirements and how to meet them, do IPO legal due diligence, liaise with regulators, provide legal input into the offer structure and the prospectus and coordinate verification of the prospectus. Your lawyer will usually be the secretary and sometimes provide the chair of the DDC. The lawyer gives a sign-off on the content of the prospectus and the due diligence process. In some cases, your lawyer may also prepare an expert report, for example a mining tenement report, for inclusion in the prospectus.

TAX ADVISER

Your tax adviser's role is to do tax due diligence (eg income tax, indirect taxes, GST and stamp duty) and advise on IPO-related tax issues. The tax adviser is usually not a member of the DDC but attends DDC meetings as an observer where necessary and gives an IPO sign-off.

INDUSTRY EXPERTS

You may want to engage an industry expert if the industry in which you operate is complex. The industry expert advises how complex industry issues impact on the IPO and the prospectus. The industry expert may also provide an expert report for the prospectus. The report usually explains complexities or market dynamics associated with the industry and opines on the value of an asset or existence of an asset or that a particular technological process is suitable for its intended purpose. The industry expert is usually not a member of the DDC but may attend DDC meetings as an observer and gives an IPO sign-off.

OTHER ADVISERS

Other advisers you may need to appoint are a share registry, a public relations consultant, a graphic designer, a printer and a banker. They will not be members of the DDC, although a public relations consultant may attend DDC meetings where necessary. They do not usually give IPO sign-offs.

Here are some tips you may find useful when appointing advisers:

- each adviser should be an IPO expert in their area of practice
- the form of each adviser's work program, sign-off and report should be agreed before their appointment
- read the draft engagement letters of advisers carefully and ask your lawyer to review them – they may contain unusual limitation of liability clauses and an obligation to use advisers or pay them fees in respect of subsequent transactions
- if a report by the adviser is to be included in the prospectus, make sure the adviser is willing to formally consent to that and accept responsibility for the report
- there should be no overlaps or gaps between the work programs of advisers
- the adviser responsible for project managing the IPO process and coordinating prospectus preparation should be clearly identified at the start of the IPO, and
- any regulatory requirements relating to an adviser's appointment must be identified early and followed (eg there are ASIC requirements for the appointment of independent experts).

PROSPECTUS REGIME

This chapter deals with the IPO statutory regime, the requirement to issue a prospectus, the information that must be included in the prospectus, prospectus liability and defences and potential IPO litigation.

PROSPECTUS REQUIREMENT

A prospectus is required for an offer to issue securities or an offer to sell securities off-market by a controller (ie a person who can make decisions about the entity's financial and operating policies). The prospectus requirement applies to any offer of securities received in Australia, unless the offer is to an exempt person. Anti-avoidance provisions usually require a prospectus if securities are on-sold by an exempt person to a non-exempt person within 12 months of the original issue or sale.

PROSPECTUS EXEMPTIONS

The main exemptions include:

- personal offers accepted by less than 20 investors, which raise less than \$2 million in any rolling 12-month period
- offers where the amount paid (or topped up) results in a total investment by a person of at least \$500,000 in a class of securities
- offers to sophisticated investors (who have a certificate from an accountant saying they have net assets of at least \$2.5 million or gross income of at least \$250,000 per year for each of the last 2 financial years)
- offers to professional investors (such as superannuation funds or persons controlling gross assets of at least \$10 million)
- offers to senior managers or certain affiliates
- offers to existing securityholders through a dividend reinvestment plan or bonus security plan
- offers of securities for no consideration
- offers made under a takeover bid or scheme of arrangement, or
- offers made under certain listed company rights issues.

DISCLOSURE TEST

An IPO prospectus must contain:

all information that investors and their professional advisers would reasonably require to make an informed assessment of the rights and liabilities attaching to the securities offered and the assets and liabilities, financial position and performance, profit and losses and prospects of the issuer.

The prospectus must include this information if it is known to the offeror, its directors and proposed directors, the underwriter and advisers or if it could be reasonably found out by those people. This is one reason why due diligence is conducted in relation to the prospectus. The nature of the offeror and the securities being offered, and matters that likely investors and their advisers may reasonably be expected to know, can be taken into account in preparing the prospectus.

The prospectus must also contain specific standard information including the terms of the offer, directors' and advisers' fees, consents from advisers and third parties whose statements appear in the prospectus and information about ASX listing and lodgement of the prospectus with ASIC.

The prospectus must be worded in a clear, concise and effective way. ASIC has issued guidance on this requirement (see chapter 7).

The fact that certain information is confidential may be a relevant consideration in what is reasonable for investors and their advisers to expect to see in the prospectus. However, the overriding rule is that information which would deter investors from purchasing the securities cannot be omitted from the prospectus on the basis that it is confidential.

LODGEMENT

The prospectus must be lodged with ASIC. The entity needs to lodge a listing application with ASX within 7 days of the prospectus lodgement with ASIC. The maximum life of a prospectus is 13 months.

PROSPECTUS LIABILITY

A person who suffers loss because of a defective prospectus may recover that loss from those involved in preparing the prospectus. The offeror (which may be the company or a selling securityholder or both), the offeror's existing directors, any named proposed director of the company and any named underwriter are liable for defects in the entire prospectus. An adviser is liable for each statement in the prospectus attributed to that adviser with the adviser's consent. A person involved in a contravention of the prospectus regime is liable for that contravention.

There is a statutory limitation period of 6 years for recovering loss caused by a defective prospectus.

The offeror will also commit a criminal offence if the prospectus is defective and the defect is materially adverse from an investor's point of view.

Others involved in the preparation of the prospectus may also be criminally liable if they aid, abet, counsel or procure the commission of an offence by the offeror.

Those involved in preparing the prospectus must notify the offeror if they become aware of a defect in the prospectus. Not doing this is a criminal offence.

DEFENCES

Defences to civil and criminal liability for a defective prospectus are that:

- due diligence was conducted (which requires reasonable enquiries and a reasonable belief that the relevant statement was not defective)
- reasonable reliance on others (which requires reasonable reliance on a third party such as an adviser)
- withdrawal of consent (which requires the public withdrawal of consent to be named in the prospectus), and
- unawareness of a new matter (which applies where the new matter has arisen since the prospectus was lodged).

ASIC, EXPOSURE PERIOD AND PRINTING THE PROSPECTUS

ASIC will generally not review a prospectus before it is lodged. However, ASIC may be prepared to discuss (on a non-binding and limited basis) how certain issues should be dealt with in the prospectus. Following lodgement, the prospectus is subject to an exposure period to allow any concerns about the prospectus to be raised by the market. During the exposure period, the entity may receive (but must not process) applications and the prospectus must be made generally available on an internet site and a hard copy provided to potential applicants on request. The initial exposure period is 7 clear days (for example, if you lodge on Monday it finishes at the end of the next Monday). ASIC may extend the exposure period to 14 days if it is concerned about an issue relating to the prospectus, which is not resolved in the first 7 days. You need to decide whether to wait until the end of the exposure period before printing the prospectus. The risk of printing too early is that the prospectus will have to be re-printed or a supplementary prospectus issued if ASIC requires a change to the prospectus after printing has started. For this reason, it is better to wait until the end of the exposure period before printing.

OFFERING UNITS – PRODUCT DISCLOSURE STATEMENTS

Some IPOs involve the offer of units rather than shares, and some may involve stapled securities or other more complex financial products.

Offers of units are made under a 'product disclosure statement' (or 'PDS') rather than a prospectus. While there are many similarities (in both cases the key requirement is to disclose information material to an investor), there are a number of important differences. For example, a PDS has an alternative and more prescriptive content requirement. Also, the steps required to establish and list a trust vs a company are different. See chapter 17 for more detail.

IPO LITIGATION

After the USA, Australia arguably has the second most active securityholder class action regime in the world driven predominantly by the expansion of third party litigation funding in Australia. An investor may allege that, but for the misleading or deceptive conduct and/or failure to disclose material information in a prospectus associated with an IPO, the investor either would not have invested in the IPO or would have done so on different terms. Loss is often calculated as the diminution in the entity's security price following the disclosure of the alleged material information to the market. The substance of the alleged material information will be fact specific to the IPO and could include financial forecasts or material operational matters. Frequently, such actions lead to cross claims between advisers and directors. Defendants may seek to rely on the defences outlined above.

ASX LISTING REQUIREMENTS

This chapter deals with ASX listing requirements.

PROFITS AND ASSETS TESTS AND REQUIRED FINANCIAL INFORMATION

You must meet the 'profits test' or the 'assets test' to list on ASX.

Profits test – the main requirements are:

- must be a going concern or the successor of a going concern
- same main business activity for the last 3 full financial years, and
- total operating profit from continuing operations for the last 3 full financial years of at least $1 million and at least $500,000 in the last 12 months to a date no more than 2 months before the date your listing application is made.

Assets test – the main requirements are:

- net tangible assets of at least $4 million after IPO costs or a market capitalisation of at least $15 million
- working capital of at least $1.5 million, and
- a statement in the prospectus that the entity has enough working capital to carry out its stated objectives.

Under the assets test, less than half of your total tangible assets (including any IPO proceeds) must be cash or readily convertible to cash. If you do not meet this test, you will be treated as a 'cash box' and must have commitments consistent with your business objectives to spend at least half of such assets. These objectives, together with an expenditure program, must be set out in the prospectus. A cash box will be subject to ASX quarterly reporting for at least the first 8 quarters following listing. Generally, ASX only lifts the quarterly reporting requirement once you have reported 4 consecutive quarters of positive net operating cash flows.

There are different requirements for 'investment entities' applying for admission under the assets test. Investment entities are entities, in ASX's opinion, whose activities or the principal part of its activities consist of investing in listed or unlisted securities or derivatives and its objectives do not include exercising control over or managing any entity in which it invests.

Financial information – profits test

Under the profits test, you must give ASX audited accounts for the last 3 full financial years accompanied by an audit report, which must not contain a modified opinion, emphasis of matter or other matter paragraph ASX considers unacceptable. You must also provide audited or reviewed accounts for the last half year if the last full financial year ended more than 6 months and 75 days before you apply to ASX for admission, together with the audit report or review. You must also provide a pro-forma balance sheet reviewed by your auditor or independent accountant (usually included in the prospectus).

Financial information – assets test

Under the assets test, you must give ASX the same financial information as under the profits test, except that audited accounts are required for the last 2 full financial years (and not 3 years as required under the profits test).

Additionally, if in the 12 months prior to applying for admission, you have acquired or you are proposing to acquire in connection with the IPO another entity or business that is 'significant' in your circumstances, you must also provide to ASX in respect of that other entity or business:

- audited accounts for the last 2 full financial years; and
- if its last full financial year ended more than 6 months and 75 days before you apply for admission, audited or reviewed accounts for the last half year.

Under both the profits test and assets test, ASX has the discretion to accept less than 3 full years or 2 full years (as applicable) of audited accounts (for example a start-up or business that has been in operation for less than 3 full years), or to accept a modified audit opinion. However, ASX will generally only do so in circumstances where ASIC will accept that lesser financial information. For further details about ASIC's expectations for financial information, see chapter 7.

ESCROW

If you do not meet the profits test (ie you only meet the assets test) and you do not have an appropriate profit or revenue history or level of tangible assets, ASX may impose trading restrictions on securities held by existing securityholders. The underwriter may also impose trading restrictions on securities held by existing securityholders as this makes it easier for the underwriter to market the offer. This is discussed in more detail in chapter 12.

FREE FLOAT

ASX has a 20% minimum free float requirement at the time of admission. 'Free float' is defined as the percentage of the entity's main class of securities that are not restricted securities or subject to voluntary escrow arrangements and that are held by 'non-affiliated security holders' (eg security holders who are not a related party of the entity applying for admission to ASX).

SPREAD

There must be at least 300 non-affiliated security holders, each of whom holds a parcel of the main class of securities that are not restricted securities or subject to voluntary escrow with a value of at least $2,000. ASX notes that that this requirement is not met if it is achieved by "artificial means".

CORPORATE GOVERNANCE

Following listing, you must disclose in your annual report the extent to which you comply with the Corporate Governance Council's 'Principles of Good Corporate Governance and Recommendations', and you must also disclose this on listing (most conveniently in the prospectus). If you are in the S&P/ASX All Ordinaries Index following admission, you must have an audit committee. If you are in the top 300 of that index, more stringent audit committee requirements apply and you must have a remuneration committee comprised solely of non-executive directors. All listed entities must have a securities trading policy in place, which complies with the ASX Listing Rules.

COMPLIANCE LISTING

This is when you list only to create a trading facility for your securities, ie you do not raise additional capital at the time of listing. In such cases, you may, with ASX's agreement, prepare an information memorandum which has prospectus-like disclosure and provide it to ASX. You do not have to lodge it with ASIC. However, care is needed, since if you issued securities in the past 12 months, an ASIC-lodged prospectus may have to be prepared in order to ensure that the Corporations Act resale restrictions do not apply.

BACKDOOR LISTING

This is when you become listed by 'backdooring' your business into an already listed but inactive entity. One of the advantages of a backdoor listing is that it gives you an immediate spread of securityholders (assuming that, being listed, the listed entity has the required spread). In return for transferring your business into the listed entity, your major stakeholders usually get a controlling securityholding in the listed entity. You must give prior notice of the backdoor listing to ASX who will then decide the terms on which it may proceed. You usually need to get securityholder approval for the process. You will have to comply with ASX listing requirements as if you were applying for a new listing. This includes preparing an information memorandum, which has prospectus-like disclosure. The backdoor listing process usually takes 2-3 months.

OTHER ENTITIES

Different requirements apply to other sorts of entities seeking to list on ASX (eg foreign entities and investment entities).

It is best to consider early whether your IPO will meet ASX requirements. You should confirm your understanding of the ASX requirements with ASX well before prospectus lodgement.

PROSPECTUS WRITING TIPS

This chapter has some useful tips for writing the prospectus.

RESPONSIBLE PERSON

You should confirm who will have primary responsibility for coordinating preparation of the prospectus. This is usually the lead manager/underwriter who prepares it in conjunction with the offeror.

GET THE 'LOOK AND FEEL' RIGHT

Before writing, spend some time agreeing on the 'look and feel' of the prospectus. This ensures the end result meets your expectations.

CLEAR, CONCISE AND EFFECTIVE

By law, the prospectus must be worded in a 'clear, concise and effective manner'. ASIC has issued guidance (Regulatory Guide 228) on providing clear, concise and effective disclosure in a prospectus:

- generally, the prospectus must use plain language, be as short as possible, not be repetitive, be presented logically and all information relating to a particular issue should be in the one place
- issuers may incorporate by reference information which is not key to the retail market
- the investment overview must be the first substantive section of the prospectus, setting out all key information about the offer and the issuer:
  - it must be balanced (eg key benefits and risks should be given the same prominence)
  - investors should be able to read this section and understand the investment offer (ie it should be a summary of the prospectus)
  - it should provide cross references to other relevant sections of the prospectus
  - it should be no more than say 10-15 pages long, and
  - it should not contain pictures
- the prospectus should set out the business model, how the issuer proposes to make money or capital growth for investors and otherwise meet its business objectives, as well as underlying assumptions and associated risks
- the prospectus should set out the key risks of the issuer and its securities, and the specific impacts they may have on the issuer, with the risks ranked from most significant to least significant
- the prospectus should set out the issuer's financial position, performance and prospects including a clear explanation of appropriate financial ratios
- the prospectus should set out the terms and conditions of the offer, the use of funds and the effect of the offer on the issuer, and
- the prospectus should set out the details of directors and key management including their background, track record, experience, interests, benefits and related-party transactions.

As a general rule, keep the prospectus as simple as possible. This gives you the best chance of ensuring that the market understands your business, its drivers and risks and will reduce the likelihood of regulator intervention.

DO NOT INADVERTENTLY INCLUDE A FORECAST

ASIC treats any forward looking number in a prospectus (eg even a numerical reference to future product development costs) as a forecast, which is subject to the forecast requirements discussed in chapter 9. When writing the prospectus, be careful not to inadvertently include a forecast.

INFORMATION REASONABLY REQUIRED

The prospectus disclosure test is discussed in chapter 5. It is useful to look at prospectuses prepared by other entities (particularly entities in the same or a similar industry) to understand what information meets this test.

ASIC ISSUES

When writing the prospectus you should have regard to areas likely to be of particular concern to ASIC – see chapter 13. ASIC is usually prepared to discuss with your lawyers their current views on such matters before prospectus lodgement, provided sufficient information can be provided to ASIC.

FINANCIAL DISCLOSURE IN THE PROSPECTUS

ASIC guidance on financial disclosure in the prospectus

ASIC expects the prospectus to include certain financial information, and states in Regulatory Guide 228 that failure to comply with its guidance will materially increases the risk of ASIC taking regulatory action. A brief overview of the financial information that should be included in your prospectus is set out below.

- The most recent historical accounts in the prospectus should be:
  - if the prospectus is lodged within 3 months of the entity's year-end – the previous half year audited statements; or
  - if the prospectus is lodged within 75 days of the half year end – the previous full year audited statements.
- A consolidated audited statement of financial position for the most recent financial year (or audited or reviewed half-year depending on the date of lodgement of the prospectus) should be included in the prospectus, showing the major assets and liabilities and equity and a corresponding pro-forma statement of financial position showing the effect of the IPO and any acquisitions.
- Two and a half or three years of audited financial statements should be presented in the prospectus (ie including statements of income and statements of cash flows).
- Your financial statements presented in the prospectus should include any significant business that has been acquired in the 12 months before lodgement of the prospectus, or is to be acquired in connection with the IPO, and should be audited. An acquisition of a business is 'significant' where it will account for more than 25% of your consolidated annual revenue, annual income (NPAT, EBIT or EBITDA), total assets or total equity.
- To the extent required, audited financial information should be disclosed regardless of whether your existing business or any business you are acquiring was required by law to produce audited financial reports or was in a

corporate form that would facilitate an audit being undertaken. This means that during due diligence, you should ensure that you have access to the financial information of any business you are acquiring so you can use that financial information to prepare the disclosure in the prospectus.

- If the IPO business has changed materially since the date of the half year or full year financial statements required to be included in the prospectus, you may be required to prepare and audit more up-to-date financial statements and include them in the prospectus.
- The preparation and audit of financial statements should be in accordance with Chapter 2M of the Corporations Act, or for foreign businesses, in substantial compliance with Chapter 2M.
- If the audit opinion is materially qualified, ASIC may regard the financial information as effectively unaudited. This does not include emphasis of matter paragraphs in an audit option, which ASIC will generally accept.
- As forecast assumptions need to be reasonable, each assumption must have a reasonable basis.

Other financial disclosure tips

- To the extent the prospectus forecast refers to the achievement of future synergies, those synergies should only be recognised in the forecast at the time they are likely to be achieved (you could however say what the effect there would have been on the forecast had those synergies been achieved from the beginning of the forecast period).
- One off adjustments (such as impairments, restructuring costs, bad debts, and provision releases) should not be treated as pro forma adjustments because they are typical accounting estimates which occur each financial year. ASIC has however stated that contracts lost by a business should be a pro forma adjustment as this is part of day to day business.
- ASIC considers that pro-forma adjustments to the forecast financials (eg for one-off restructuring costs) are not appropriate because the forecast then becomes 'hypothetical' and cannot be realised.
- ASIC considers adjustments to the historical financial statements should reflect truly one-off costs, and has given guidance that where an entity's business model is to make multiple acquisitions each year ASIC does not consider it appropriate to make pro forma adjustments to the historical financial information for these acquisitions.
- An IPO restructure may mean that it is not possible (because the relevant assumptions relating to interest and tax would be hypothetical) or meaningful to calculate profit in the historical financials down to the net profit after tax level, given the differences between the pre and post IPO structure. Any decision to calculate profit down to earnings before interest and tax in the historical financials should be discussed with ASIC prior to prospectus lodgement.
- Certain accounting entries in the prospectus financials may be of interest to ASIC, for example, on the basis that the forecast is therefore not reasonable. ASIC may be concerned if pre-IPO senior management incentives are not repeated in the forecast. This is on the basis that a listed entity does need to incur such expenses, especially if the entity incurred them pre-IPO. Similarly ASIC may be

concerned if private equity owner management fees are not replaced by equivalent other management expenses in the prospectus forecast. Also, if the entity's strategy is in part to continue to grow through acquisition, then some level of future acquisition costs should be forecast (and if related costs had been incurred historically then they should not be a pro forma adjustment).

- Where the IPO involves the insertion of a new entity above the current business, the resulting total fair value impact may need to be considered and disclosed in the prospectus depending on the circumstances.

VERIFIABLE LANGUAGE

You should ensure each material statement in the prospectus is verifiable and start collecting verification materials during the prospectus writing process. Avoid overly flowery language and consider whether statements can be rewritten so that they are easier to verify. For example, instead of saying 'the company is Australia's leading manufacturer of widgets', say 'the company is one of Australia's leading manufacturers of widgets' (provided this can be verified).

INCORPORATION BY REFERENCE

To reduce the length of the prospectus, you may incorporate information by reference. This may be a useful way to deal with technical and detailed information. Instead of including the information, you may simply include in the prospectus a reference to a separate document that contains the information.

Where the information is primarily of interest to professional investors, the prospectus must state this and provide a description of the content of the incorporated document. In all other cases, the prospectus must provide sufficient information to allow investors to decide whether to obtain a copy of the document.

The incorporated document must be lodged with ASIC and investors must be given a free copy on request.

DEAL WITH LIKELY EVENTS DURING OFFER PERIOD

If an event is likely to happen during the IPO offer period, you should consider including a section in the prospectus that deals with the possibility of that event occurring and its consequences. This may prevent the need for a supplementary or replacement prospectus if the event occurs during the offer period.

The only changes that can be made to a prospectus post-lodgement and before printing, without the need for a supplementary or replacement prospectus, are trivial errors (eg typographical errors), which do not change the meaning of the prospectus.

CONSENTS

Consent must be obtained from a third party if a statement is included in the prospectus that is said to be made by that third party or is said to be based on a statement made by that third party. There are limited exceptions to the consent requirement which relate to statements by official persons (ie government officials), statements in a public official document (ie government publications such as statistics published by the Australian Bureau of Statistics), statements in books and journals and statements available on the internet (as long as they are in a form and of a similar standard to statements contained in a book or journal).

Even if not required by law, it may be advisable to obtain the consent of all third parties referred to, or whose information is referred to, in the prospectus. This may avoid disputes later about ownership of that statement or breaches of confidentiality. Consents must be obtained by prospectus lodgement.

Make sure you agree the content of your prospectus with your advisers early in the process to avoid delays in sourcing that information later in the process.

DUE DILIGENCE AND VERIFICATION

This chapter explains the due diligence and verification processes, which ensure the prospectus contains correct information and meets the prospectus disclosure test.

DUE DILIGENCE

Due diligence is done to meet the prospectus disclosure test and to maximise your ability to rely on the prospectus due diligence and reasonable reliance defences.

PLANNING MEMORANDUM

A planning memorandum is usually prepared by your lawyer. It sets out the due diligence framework and the due diligence committee (DDC) terms of reference. It deals with the prospectus regulatory regime and suggests a due diligence process (including work programs and materiality guidelines), roles, responsibilities and composition of the DDC and sign-offs from management and advisers. The planning memorandum is usually agreed by the DDC at the beginning of the IPO process but is not signed until just before prospectus lodgement. This is because it might change during the IPO process (eg if the IPO structure changes).

MATERIALITY GUIDELINES

The due diligence findings are assessed based on the materiality guidelines. The guidelines are quantitative and qualitative. The quantitative guidelines are usually 5-10% of a meaningful profit or income measure and 5-10% of a meaningful balance sheet measure. If the due diligence finding is below the quantitative guideline, it is usually disregarded unless it is material from a qualitative perspective. Qualitative guidelines deal with matters such as loss of reputation.

DDC

The DDC coordinates the due diligence process. Its chairman is usually a director of the company or one of your lawyers, and its secretary is usually a lawyer. Typical members of the committee are one or two Board members and representatives of the company, any major selling securityholder, the underwriter, the lawyers and the accountants. In some cases, other experts may also be members. Other Board members, management and experts are invited to attend DDC meetings as observers. The DDC meets periodically (eg every 2 weeks at the start of the process and weekly towards the end) and each member contributes to the DDC process in relation to their area of expertise. Decisions of the DDC are usually made unanimously.

Nominated members of the DDC are responsible for discrete work streams (eg writing the prospectus or marketing the offer) and report back to the DDC on progress.

PRESENTATIONS AND REPORTS

Your management team will usually provide a presentation at the start of the IPO to the DDC to bring the DDC up to speed on your business, its drivers and associated risks. Your advisers undertake due diligence and provide periodic updates to the DDC and the DDC asks them questions as appropriate. All major items of due diligence should ideally be presented in writing to the DDC, though care should be taken to minimise the risk of losing legal professional privilege.

SIGN-OFFS

Immediately before the prospectus is lodged, the advisers and management provide sign-offs to the DDC confirming the accuracy of the prospectus and the adequacy of the due diligence process. Advisers do this in relation to their respective areas of expertise. The DDC then provides a sign-off to the Board confirming the accuracy of the prospectus and the adequacy of the due diligence process. After this, the prospectus is signed by a director or secretary, must be approved by all directors and lodged.

Continuing due diligence is carried out from prospectus lodgement until the issue of the securities. This is to ensure the prospectus remains accurate during the offer period. Before the securities are issued, management and advisers, and the DDC, provide updated sign-offs or otherwise confirm their sign-offs. The securities are then issued.

VERIFICATION

Your lawyer will coordinate verification of the prospectus in the 1-2 week period before prospectus lodgement (or often before finalisation of the 'pathfinder' prospectus for institutional pre-marketing). The authors of material statements in the prospectus verify the accuracy of each of their statements either by a source document or a certificate signed by them. Folders containing evidence of verification should be kept, as ASIC may review the verification process as part of a random ASIC post-vet or following a specific query.

RECORDS

The planning memorandum, DDC minutes, reports and presentations, sign-offs and verification materials all help to show a process designed to:

- get the prospectus right, and
- establish due diligence and reasonable reliance legal defences.

These records should be kept for at least 7 years.

Your lawyer should ensure that the due diligence process, including the terms of key sign-offs, is agreed at the outset and well documented in the due diligence planning memorandum. Also, make sure you allow enough time (at least 1 clear week) for verification.

FORECASTS

This chapter deals with when a prospectus should contain a forecast and forecast preparation requirements.

A prospectus must include all information that investors and their advisers reasonably require to make an informed assessment of the prospects of the issuer. The prospects may be described in words (commonly called a management discussion and analysis or an MDA) or in numbers (a forecast) or both. This chapter deals with forecasts.

ASIC treats any forward-looking number in a prospectus (eg future product development costs) as a forecast, to which the forecast requirements discussed below apply. When writing the prospectus, you need to be careful to not include a forecast inadvertently. ASIC's policy and views on forecasts are contained in ASIC Regulatory Guide 170.

WHEN A FORECAST SHOULD BE INCLUDED

ASIC considers that forecasts should only be included in a prospectus where there are reasonable grounds for doing so. Forecasts that are based on hypothetical assumptions, rather than reasonable grounds, are likely to be misleading and provide little informational value to investors.

In deciding whether or not to include forecasts in a prospectus, the informational value of what is being disclosed must be balanced against the likelihood that it may be misleading. While it may be inappropriate for a start-up company to have a forecast in its prospectus, an established company with predictable earnings is more likely to be expected to do so.

FORECAST TIME PERIOD

ASIC's view is that in the absence of contrary evidence, a forecast that extends beyond a 2-year period may not have a reasonable basis. As a result, forecasts in prospectuses are typically for periods of between 6 and 18 months.

Your underwriter may want a long forecast period (to make marketing of the IPO easier) while you may want a shorter forecast period (to ensure you can meet it). You will need to discuss the forecast period with your underwriter. The market punishes the security price of companies who do not meet their IPO forecasts, and regulators may also have concerns (about the accuracy or reasonableness of forecast disclosures in the prospectus as well as subsequent disclosures).

FORECAST PREPARATION REQUIREMENTS

ASIC's view is that a prospectus should contain sufficient information to enable investors to assess whether the forecast is relevant and reliable (ie to form their own view about the reasonableness of the forecast) and should clearly identify the facts, circumstances and assumptions that support the forecast. Forecasts need to be supported by:

- full details of the underlying assumptions, which must be based on reasonable grounds (eg the existence of agreements that lock in future expenses and revenue)

- the forecast period and any specific considerations that affect that time period (such as cyclical or seasonal factors that may mislead investors as to how representative that forecast period is)
- often, an independent expert's sign-off on the reasonableness of the forecast and the forecast assumptions
- an explanation of how the forecasts were calculated and the reason for any departure from accepted accounting standards that investors might expect to have been followed in preparing the forecast
- a discussion of the risk that the forecast will not be achieved (eg a clear warning that forecasts are predictive in nature and actual results may differ), and
- a sensitivity analysis showing how changes in material assumptions used in preparing the forecast are likely to affect the forecast outcome.

FORECAST ASSUMPTIONS

The material forecast assumptions must be disclosed with sufficient information to allow investors to assess:

- the validity of the assumptions on which the forecast is based
- the likelihood of the assumptions being met, and
- the effect on the forecast if the assumptions vary.

The prospectus does not have to disclose very general assumptions (such as the absence of war or natural disasters) unless the forecast takes these events into account. Similarly, the prospectus does not need to disclose assumptions that are immaterial to the forecast.

The forecast and associated materials (eg assumptions, sensitivity analysis and forecast risks) must be located together and be given equal prominence in the prospectus.

The prospectus forecasts section is closely scrutinised by ASIC. Prepare it with great care. Look at prospectus forecasts made by businesses similar to yours to get a feel for what should be in your forecast. Ask your accountant to raise any likely forecast issues early. Ask your accountant to present to the DDC on the forecast and underlying assumptions so that the DDC can 'sanity check' the forecast and related assumptions before prospectus lodgement. Also, make sure you are comfortable with the forecast period and your ability to meet the forecast. A failure to meet your prospectus forecast is likely to result in a material fall in your security price, and can also lead to regulatory action.

SUPPLEMENTARY OR REPLACEMENT PROSPECTUSES

This chapter deals with the requirement for a supplementary or replacement prospectus if there is a defect in the original prospectus or a new development.

NEED FOR SUPPLEMENTARY OR REPLACEMENT PROSPECTUS

During the offer period, your prospectus may become inaccurate or misleading or a new circumstance may arise requiring supplementary disclosure. The ASIC review during the exposure period may also require supplementary disclosure (see chapter 13). If supplementary disclosure is needed, you need to issue and lodge with ASIC a supplementary prospectus (which amends part of the original prospectus) or a replacement prospectus (which replaces the entire original prospectus).

Offers made after lodgement of a supplementary prospectus must be accompanied by copies of both the original prospectus and the supplementary prospectus. Offers made after lodgement of a replacement prospectus must be made by the replacement prospectus.

While not common, on very large IPOs, ASIC has given relief to allow a supplementary prospectus to be issued by a newspaper advertisement.

RIGHT OF REFUND

If the prospectus deficiency or new disclosure is materially adverse to an investor, you must either repay application moneys or give investors a one-month period during which they can choose to be repaid their application moneys.

ASIC is unlikely to give relief to reduce this one-month period. From a marketing perspective, this is likely to severely prejudice an offer and its underwriting (a supplementary prospectus usually triggers an underwriting agreement termination event).

LODGEMENT MECHANICS

A supplementary or replacement prospectus must be signed by one director or secretary, lodged with ASIC and a copy provided to ASX. There is no ASIC exposure period for a supplementary or replacement prospectus.

AVOIDING A SUPPLEMENTARY OR REPLACEMENT PROSPECTUS

If there is a risk that an event may occur during the offer period that would require supplementary disclosure, you should consider including in the prospectus a section to deal with that risk. It would identify that event and its potential consequences (eg there is a threat that someone may bring legal proceedings against you in relation to a certain matter and the likely consequences of that litigation). This may prevent the need for supplementary disclosure if the event occurs (or at least ensure any supplementary disclosure is not materially adverse). Even if you do include such wording, depending on the severity of the event, you may still need to lodge a supplementary prospectus if the event occurs. You should also plan to 'go quiet' (ie not make any significant changes to your business) during the offer period as this will reduce the risk of a need for any supplementary disclosure.

Not all supplementary disclosure is bad. Positive news during the offer period may serve as an impetus to your offer. Such news may be disclosed by a supplementary prospectus and does not require a right of withdrawal to be offered.

TRIVIAL ERRORS

If you become aware of errors in the prospectus after it has been lodged with ASIC, you can only make changes to correct trivial errors (eg typographical errors) that do not change the meaning of the prospectus. Any other changes require supplementary prospectus disclosure.

> As you prepare the prospectus, think about what could happen during the offer period that may need a supplementary or replacement prospectus. Either refer to that in the prospectus or try to stop it from happening during the offer period to reduce the possibility of having to lodge a supplementary or replacement prospectus.

IPO MARKETING

This chapter deals with the legal restrictions that apply to marketing the offer before and after the prospectus is lodged with ASIC.

PRE-PROSPECTUS PUBLICITY

Subject to limited exceptions, you cannot advertise the offer before lodging the prospectus. This is to stop the public applying for securities without reading the prospectus. Before prospectus lodgement, you may only advertise the offer by a tombstone advertisement, which identifies the offeror and the securities and says that the prospectus will be made available when the securities are offered and that anyone wanting to acquire the securities will need to complete the application form in the prospectus. Nothing more can be said other than an optional additional sentence on how to receive a copy of the prospectus.

POST-PROSPECTUS PUBLICITY

You can advertise the offer after the prospectus is lodged. However, the advertising must not be misleading and must be consistent with the prospectus. It must also include a statement that the securities are offered under the prospectus and that applicants must use the application form in the prospectus to apply.

EXCEPTIONS

The exceptions to the prospectus publicity restrictions are:

- notices or reports of general meeting
- reports about the entity, which do not contain information that materially affects the business and do not refer to the offer
- genuine media reports or commentary about either of the above, or about a prospectus which has already been lodged
- distribution of 'pathfinder' drafts of the prospectus to professional or sophisticated investors to assess market interest in the offer and support sub-underwriting
- roadshow presentations to exempt investors such as professional or sophisticated investors before prospectus lodgement
- market research that complies with ASIC requirements and is designed to assist in marketing the offer, and
- ASIC relief in large offers permit a prospectus pre-registration campaign (where people who pre-register for a prospectus receive a benefit such as a guaranteed allocation of securities).

IMAGE ADVERTISING

These advertising restrictions do not stop you continuing your normal business advertising. Such advertising must relate only to your business (rather than to the IPO). ASIC is concerned about 'image advertising'. This is advertising designed to generate interest in the entity in the lead-up to the IPO.

ASIC's concern is that image advertising may be a way to get around the pre-prospectus advertising restrictions as it indirectly creates interest in the IPO. ASIC is unlikely to view business advertising as image advertising if the business advertising is consumer focused, part of your normal advertising, not related to the proposed IPO, does not have the effect of 'drip feeding' the market with prospectus-type information and does not increase in the lead-up to the IPO.

Talk to your lawyer at the outset to make sure you and your public relations consultant do not breach these restrictions. This ensures you do not get into trouble with ASIC before you lodge the prospectus.

ROADSHOW

Your underwriter will usually market your IPO for 1-2 weeks before prospectus lodgement. This is to ensure there is sufficient demand for the IPO. This process is called the roadshow. The underwriter will need a near final prospectus for the roadshow. The underwriter usually signs the underwriting agreement and agrees to prospectus lodgement after a successful roadshow. There is a roadshow exemption from the prospectus publicity restriction.

RESPONDING TO QUERIES

Before the IPO, your management may be asked about the proposed IPO by employees, business associates and the public. They need to be careful in responding. ASIC monitors compliance with the advertising restrictions and has sent 'please explain' letters to entities which appear not to have complied.

You may apply to ASIC for standard form relief to allow you to talk to your employees about the proposed IPO. For other third party enquiries, it is preferable to say 'no comment' or to explain that the law does not allow you to discuss any proposed IPO.

ESCROW RESTRICTIONS

This chapter deals with post IPO trading restrictions that may be imposed on existing securityholders either by ASX or the underwriter.

TYPES OF ESCROW

ASX escrow is imposed by ASX and voluntary escrow is imposed by the underwriter.

ASX ESCROW

ASX escrow often applies if you:

- do not meet the profits test, or
- do not have a revenue history, profit history or level of tangible assets acceptable to ASX.

Escrow restrictions are designed to prevent the founding securityholders unfairly profiting (at the expense of new securityholders) by selling their securities shortly after the IPO before you have established a track record of profitable operations.

If ASX escrow is likely to apply, one of the first steps is to ask your advisers for advice on how ASX escrow applies to your various classes of securityholders. You should then confirm with ASX that they agree with your advisers' views.

The type of ASX escrow will depend on the type of holder, eg whether the holder is a seed capitalist, a vendor of assets or a consultant. Depending on the type of holder and the circumstances in which they acquired their securities, the escrow period is either 12 or 24 months beginning either from the date they acquired their securities or the date of ASX quotation.

The proportion of securities escrowed depends on the circumstances in which the securities were acquired and/or the price paid for them compared to the IPO price. As a rule of thumb, the lower the price paid by the holder, the greater the number of securities escrowed.

If escrowed securities are transferred before listing, the escrow restrictions continue to apply to the transferee. Escrow restrictions may also restrict securityholder sell-down in the IPO.

The holder of escrowed securities must sign an escrow agreement in the form of Appendix 9A to the ASX Listing Rules. This prevents the holder, and any person who controls that holder, dealing in the escrowed securities for the escrow period. The only exceptions are a takeover or scheme of arrangement that is accepted by holders of a majority of non-escrowed securities. Early on in the IPO process, you should confirm that each relevant securityholder is prepared to sign the escrow agreement and lodge it with ASX. This will avoid delays.

The escrowed securityholders must give their security certificates or other documents of title to a bank or trustee to hold in escrow or a trading lock must be placed on the securities by the security registry.

VOLUNTARY ESCROW

The underwriter may want to escrow the securities of the major securityholders. This makes it easier for the underwriter to market the IPO. Applicants will have the confidence that major securityholders will not sell down their securityholdings immediately after the IPO, thereby depressing the security price. Voluntary escrow is usually anywhere between 6-18 months and often ends when the prospectus forecast period ends and results for the period are announced. The actual period is negotiated between the underwriter and the major securityholders.

The form of voluntary escrow agreement is usually the ASX escrow agreement in Appendix 9A of the ASX Listing Rules or a variation of it.

Specific relief from ASIC under the Corporations Act may be required where more than 20% of total number of securities are subject to voluntary escrow arrangements to avoid breaching the takeover provisions. While this type of relief is common in IPOs where the voluntary escrow arrangements expire 2 years after the IPO, you should speak to your lawyer early on in the IPO to ensure ASIC (and ASX) will be comfortable with the voluntary escrow arrangements, especially if securities subject to voluntary escrow amount to more than 20% of all securities and the total number of securities is still in escrow 2 years after the IPO.

DISCLOSURE

The prospectus must disclose the number of escrowed securities and the escrow period.

You need to disclose the end of the escrow period to ASX at least 10 days before the end of any escrow period (whether ASX-imposed or voluntary). You also need to include details of escrowed securities in your annual report.

Check early in the process (with your advisers and, if relevant, ASX) whether any of your securities will be subject to ASX escrow or voluntary escrow by the underwriter. If they are, you should check early that the relevant securityholders are prepared to sign the escrow agreement and will be available to do so prior to prospectus lodgement.

DEALING WITH THE REGULATORS

This chapter has tips on dealing with ASIC and ASX.

ASIC

You may need to apply to ASIC for modifications to the law (eg to allow you to inform employees of the IPO despite the pre-prospectus publicity restrictions). These applications are made in a submission to ASIC. For standard applications, ASIC usually grants relief in the form of a formal instrument in about 1 to 2 weeks. As an alternative, ASIC may grant a 'no action' letter saying that it does not intend to take regulatory action against you over a particular state of affairs or conduct. If the matter is novel, ASIC may have to put the matter to its Regulatory Policy Group, which meets periodically – this process can take weeks or even months.

If you are concerned about an issue in the draft prospectus, you should consider asking your lawyers to discuss the issue with ASIC before the prospectus is lodged. While ASIC may be prepared to give its indicative view on the issue, ASIC will not be bound by it.

In reviewing the prospectus during the 7 day exposure period following lodgement, ASIC typically focuses on:

- balanced disclosure throughout the prospectus (eg to ensure that the prospectus deals with both positive and negative information in a balanced way – ASIC usually requires that the negatives are dealt with, at least in summary, early on in the prospectus and given the same prominence as the positives)
- forecasts and reasonableness of underlying assumptions
- whether complex issues have been clearly and simply explained and information has been organised in a clear and logical way
- the length of the prospectus and whether it is clear, concise and effective (ASIC's rule of thumb is that the prospectus should ideally not exceed 120 pages)
- the implications of certain accounting treatments (especially if they lead to unusual consequences)
- whether the prospectus adequately deals with an issue of which ASIC is already aware (say through a prior ASIC lodgement or media coverage)
- whether you have considered the different needs of retail and institutional investors
- inconsistencies between different parts of the prospectus, or between the prospectus and other public statements by the company or promoters
- apparent errors (ie it may be worthwhile explaining in the prospectus why something (say an accounting treatment) that appears to be an error is not)
- whether material market or industry statistics are supported by verifiable evidence, and
- clear presentation and labelling of diagrams.

The exposure period lasts for 7 clear days after lodgement (eg if you lodge the prospectus on a Monday, the exposure period finishes at the end of the next

Monday). ASIC may extend the exposure period to a maximum of 14 days if it has concerns about the prospectus.

While concerns are typically raised by ASIC towards the end of the exposure period, ASIC may also raise concerns afterwards. ASIC has broad powers to issue notices requiring the compulsory production of documents and to require a person to attend a compulsory oral examination under oath. You need to carefully consider the consequences of providing documents or information to ASIC, whether in response to a formal ASIC notice or voluntarily. You may wish to claim legal professional privilege over information you provide to ASIC. If so, you should say this to ASIC when responding to their request. There are two ways to protect the privilege in the documents. The first is not to provide the privileged documents to ASIC. The second is to produce the privileged documents to ASIC in a sealed envelope with a letter claiming privilege. ASIC might contest your claim to privilege. If that happens, you may have to go to court to sustain your claim. An individual who receives a notice to attend an ASIC examination may be entitled to take certain protective steps if answering questions would expose the person to criminal prosecution or proceedings for the recovery of a penalty. As it is important to protect your interests in these situations, you should obtain prior external legal advice before responding to any information requests from ASIC.

If ASIC considers a prospectus is defective, it may issue an interim stop order to prevent the entity from offering, issuing or selling the relevant securities. ASIC must hold a hearing within 21 days of issuing the interim order, during which all interested parties will be given a reasonable opportunity to make submissions to an independent delegate.

After the hearing, the interim stop order will either be lifted or made final.

A meeting with ASIC may help you to understand ASIC's concerns. These concerns may have an impact on the timetable and in particular the decision on when to start printing the prospectus. If you cannot convince ASIC that its concerns are unfounded, the most expedient way to deal with any ASIC concerns, and ensure the IPO timetable is met, is generally to issue a supplementary or replacement prospectus.

If ASIC is agreeable to this, you should ask ASIC to confirm it is satisfied with your supplementary or replacement prospectus disclosure before you lodge it.

You may find it easier to issue a replacement prospectus (rather than a supplementary prospectus) when dealing with ASIC's suggested amendments to the prospectus.

You should try to deal with any ASIC concerns in the first 7 days of the exposure period. If the issue continues beyond this period, ASIC may extend the exposure period up to 14 days (generally ASIC will not extend the exposure period by less than 7 days).

ASIC may post-vet the prospectus. This is when ASIC randomly picks an entity after the securities have been issued and requests copies of the IPO-related materials such as prospectus drafts, due diligence materials and verification materials. It may also want to check the materials relating to a particular issue it identifies in its prospectus review or which is raised with it by third parties or in the press. This is why you should have well-ordered folders containing these materials.

ASX

ASX's primary focus is on ASX Listing Rule compliance, satisfaction of the ASX admission requirements and the logistics of the listing, rather than prospectus content. It is good practice for you to meet with ASX early in the IPO process and discuss with it the features of the proposed IPO, any novel and complex issues relating to ASX Listing Rule requirements and the listing timetable.

This is usually followed by a submission to ASX dealing with matters such as:

- compliance with the relevant admission test (ie the assets or profits test)
- any required listing rule waivers or confirmations (eg confirmation of escrow terms)
- the entity's current and proposed capital structure
- the form of accounts that will be provided to ASX to meet the admission requirements
- whether the IPO timetable is acceptable to ASX
- any securities trading formalities (eg if the entity will have conditional and deferred settlement trading)
- the entity's constitution and its compliance with the Listing Rules
- the entity's ASX code on listing (ASX will generally not allow you to use a code that is currently in use or has been used in the last 10 years, the first letter of the ASX code typically will be the first letter of your company name and ASX has recently allowed numbers to be used in codes)
- confirming that the entity's structure and operations are appropriate for a listed entity, particularly in circumstances where the entity is incorporated, has its main business operations, or has a majority of its board or a controlling securityholder resident in an emerging or developing market (ie Africa, Asia (excluding Hong Kong, Japan, Singapore and South Korea), Eastern Europe, the Middle East, Oceania (excluding New Zealand) and South America). ASX has established a committee which reviews listing applications from such entities, and
- any ASX-related matters dealt with in the prospectus.

You must apply to ASX for quotation of the securities within 7 days of the date you lodge the prospectus with ASIC. Entities typically lodge a copy of the prospectus and listing application with ASX at the same time the prospectus is lodged with ASIC.

The listing application to be submitted to ASX requires detailed information to be provided in relation to directors, including criminal and bankruptcy checks. As these checks may take some time to obtain, apply for them as early as possible.

ASX management meet every Wednesday and Friday to discuss listing applications and Listing Rule waivers. If the matter is urgent, ASX may set up a special management meeting on other days. ASX will notify issuers of the outcome of the listing application within a few days of its meeting. The listing approval is granted subject to standard conditions (eg the close of the offer, the issue of the securities, the satisfaction of the spread requirements and the provision of certain information to ASX when the offer closes) and any other specific conditions sought by ASX.

It is good practice to talk to your ASX case officer (who will process your listing application) in the lead up to the listing application being lodged with ASX management for approval. This ensures the case officer has all relevant information.

Listed entities must pay ASX initial and annual listing fees. Initial ASX listing fees are based on the market capitalisation of the entity (ie the number of securities quoted and the value per security). Approximate fees are $105,000 for a float of $50 million, $135,000 for a float of $100 million and $295,000 for a float of $500 million.

Liaising with the regulators early (especially on contentious or complex issues) reduces the risk of unforeseen regulatory issues delaying the IPO.

It is generally best to cooperate with the regulators (eg by voluntarily handing over documents they need). Try to deal with any ASIC concerns in the first 7 days of the exposure period. Otherwise, if the issue drags on, ASIC may extend the exposure period to 14 days.

Meet with ASX early to discuss any Listing Rule related issues. Also make sure you lodge the listing application within 7 days of prospectus lodgement.

EMPLOYEE EQUITY INCENTIVE PLANS

This chapter deals with the main features of employee equity incentive plans designed to retain and reward employees and executives in a tax effective manner.

TYPES

Employee equity incentive plans take many forms, including security plans, option plans and performance right plans.

ADVANTAGES

Employee equity incentive plans:

- encourage alignment of the interests of employees and owners of a business
- are a non-cash form of remuneration (important for entities without excess cash who are competing to attract and retain the best executives and employees)
- provide above-average returns if you have a strong potential for growth and are an effective remuneration tool if you pay cash salaries at market rates, and
- are normally structured to provide benefits over a period (such as 1, 3, 5 or 7 years) and encourage executives and employees to take a longer term view and to stay with you for longer to realise the potential benefit.

Broad based employee equity incentive plans are usually structured to take advantage of the relevant tax laws. These allow for up to $5,000 of tax deferral or, in limited circumstances, for up to $1,000 of tax free benefits per employee per annum.

HOW THEY WORK

A very common form of broadly based employee equity incentive plans is the '$1,000 tax free plan'. It allows full-time employees, permanent part-time employees and directors up to $1,000 of securities at no cost. To take advantage of this 'tax free' benefit, employees must elect to be taxed on the 'benefit' in the year of grant (which means that they cannot also participate in tax deferral plans). To attract the tax-free benefit, the offer must be non-discriminatory. The same offer must be made to each employee invited to participate, the securities may not be sold or otherwise dealt with by employees for 3 years (unless their employment ends earlier) and the employee must not have a risk of forfeiting the securities. Some issuers require an employee to sacrifice some or all of the $1,000 from their salary in return for the tax-free benefit, while others confer this as an additional benefit.

More sophisticated equity incentive plans are extended to senior employees and executives.

Option and performance right plans are more complex and are typically used for executives. Executives do not pay for the grant of an option or performance right. The option or performance right usually vests after the relevant performance hurdles are met. An executive may need to pay an 'exercise price' on the exercise of the option. This is usually set by reference to the market price of the underlying securities on the date the option is granted. Once an option vests, it is generally exercisable over an extended period (of up to 15 years from the date of grant) and no security is issued until the executive exercises the option. In contrast, if a performance right vests, usually no amount is payable by the executive and a fully paid security is automatically received upon vesting (ie no exercise is required).

For a long term incentive, the period over which performance hurdles are measured is usually 3 years or longer. You will need to decide whether some or all of the options and performance rights should vest (and in what circumstances) upon cessation of the executive's employment or if the entity is taken over.

To satisfy your obligations under an employee equity incentive plan, you may issue securities or acquire securities on-market. If securities are acquired on-market, the insider trading laws apply. You may wish to synchronise the operation of your employee equity incentive plan with 'trading windows' after the announcement of half-year and annual results or your AGM to minimise the risk of the entity breaching the insider trading laws.

An employee equity incentive plan is governed by its rules, which set out the general plan terms. Specific terms of each employee equity incentive plan offer are set out in an invitation document and related employee communications.

REGULATORY CONSIDERATIONS

A prospectus is not required for securities issued under an employee equity incentive plan where the securities have been quoted for 3 months if the requirements of ASIC Class Order 14/1000 are met, including lodgement of a "Notice of Reliance" with ASIC. Before that, other means (eg certain limited or alternative forms of disclosure documents) may be used to issue securities in connection with an employee equity incentive plan. In the case of an IPO, the employee equity incentive plan offer will usually 'piggy back' off the main IPO prospectus. Often this can be done by preparing a separate 'wrap around' to the IPO prospectus that includes the 'employee specific' terms of the offer.

Various aspects of an employee equity incentive plan may require approval from your securityholders:

- an issue of securities to a director or his/her related parties under an employee equity incentive plan requires securityholder approval under ASX Listing Rule 10.14 and an issue of performance rights or options may require securityholder approval depending on how the underlying securities are sourced
- an issue of securities to a related party such as a director requires securityholder approval under ASX Listing Rule 10.11 (unless securityholder approval has already been obtained under ASX Listing Rule 10.14 or is not required under ASX Listing Rule 10.15B) and potentially also the Corporations Act
- ASX Listing Rule 7.1 (the '15% in 12 months' rule) does not apply to employee equity incentive plan issues if a summary of the employee equity incentive plan terms is in the IPO prospectus or if the plan is approved by securityholders following listing, and

- financial assistance to employees in connection with an employee equity incentive plan does not require securityholder approval under the Corporations Act unless it materially prejudices the interests of the entity or its securityholders or its ability to pay creditors.

The total number of securities offered under an employee equity incentive plan is generally limited to a proportion of total issued capital. ASIC Class Order 14/1000, which allows securities to be issued under an employee equity incentive plan without a prospectus, sets this limit at 5% of the total issued capital.

You should get legal and tax advice before introducing an employee equity incentive plan.

DIVIDEND REINVESTMENT PLANS (DRP)

This chapter deals with the main features of dividend reinvestment plans, which give securityholders the option of reinvesting part or all of their dividends for new securities.

ADVANTAGES

A DRP retains cash in the business while still distributing profits (and potentially franking credits) to securityholders.

HOW A DRP WORKS

Holders of fully paid securities may choose to participate in the DRP in respect of all or part of their securityholding. Generally, securityholders may join or leave the DRP at any time.

On each dividend payment date, the dividend payable to participating securityholders is automatically reinvested in securities. New securities issued to satisfy the DRP are typically priced on a volume weighted average of the market price (VWAP) of the quoted securities during a period of between 5 and 10 days around the record date for the dividend (ie the date on which the entitlement to the dividend arises). Alternatively, securities may be acquired on-market to satisfy the DRP requirements.

The rules of the DRP may allow directors to resolve that securities allocated under the DRP will be allocated at a discount to the VWAP, with the amount of the discount to be determined by the directors.

Securities allocated under the DRP rank equally with existing securities. Subject to the entity's security trading policy, there are no restrictions on their future sale. The DRP securities are allocated free of brokerage, commission, stamp duty and other costs to participating securityholders.

The rules of the DRP usually allow the directors to decide that foreign securityholders are not entitled to participate in the DRP if the DRP offer is unlawful under the relevant foreign laws.

The DRP may be suspended, modified or terminated by the directors at any time by giving notice to participants in accordance with the DRP rules.

The entity may wish to impose a limit on the level of participation. This can be done by imposing a cap (by dollar value or number of securities) on DRP participation. A limit reduces the extent to which institutional securityholders can affect the security price during a DRP pricing period. However, as stated below, imposing a limit on participation adversely affects your ability to rely on certain exceptions under the Listing Rules.

REGULATORY CONSIDERATIONS

ASX Listing Rule 7.8 provides that issues of securities may only be made under a DRP if the securities rank equally with a class of quoted securities and the plan allows participants to choose whether to participate for part or all of their holdings. The DRP may limit participation provided the same limit applies for all participants (except brokers, trustees and nominees).

A prospectus is not required for securities issued under a DRP.

Issues of securities under a DRP will not require securityholder approval (even where securities are issued to related parties) and will not be included in the '15% in 12 months rule' in ASX Listing Rule 7.1 provided the DRP does not impose a limit or cap on participation. However, issues of securities to an underwriter will count towards the '15% in 12 months' rule in ASX Listing Rule 7.1.

You should get legal and tax advice before introducing a DRP.

If you propose paying dividends, introducing a DRP as part of your IPO may increase the attractiveness of your IPO to investors. However, you need to think about how a DRP will affect your capital structure, ie while you do not have to pay out cash as dividends if you have a DRP in place and issue new securities to participants, a DRP affects your earnings and capital management ratios which are calculated based on the number of securities on issue. It is best to ensure that your DRP has flexibility for the Board to 'turn it on or off', as the capital needs of the issuer change.

LARGE IPO FEATURES

This chapter deals with the additional complexities associated with larger IPOs that raise over $200 million or that have an international component.

MORE THAN ONE BROKER

Large IPOs usually have more than one broker and are not underwritten (see 'Bookbuilds and offer management agreements' below). Due to the size of the offer, there is a syndicate of brokers. The top tier of brokers (equivalent to the underwriter in a smaller offer) are referred to as 'joint lead managers' or 'joint global coordinators', the second tier of brokers who market the offer to institutions are known as 'co-lead managers' and the third tier who market the offer to the retail market are known as 'co-managers'. Syndicate rules of engagement apply to the syndicate.

INTERNATIONAL OFFERS

Large IPOs may include international offers, usually limited to overseas institutions and not extended to the overseas retail market (except sometimes the New Zealand retail market). This is because international institutional offers are subject to less strict regulatory requirements compared to international retail offers. International offers give rise to issues such as consistency of offer document disclosure and marketing activities across different jurisdictions and the need to synchronise Australian and overseas regulatory timetables.

US RULE 144A OFFERS

Herbert Smith Freehills has a US securities law equity capital markets practice, which can assist with any US aspects of your IPO.

Overview of US Rule 144A offers

Where there is expected to be substantial demand for the securities in the United States, offers may be extended into the United States to institutional investors pursuant to Rule 144A or another available exemption from the registration requirements under the US Securities Act of 1933. However, many international offers are not extended into the United States because of the additional work and cost that needs to be undertaken and the complex US regulatory system (see below for further details).

In the US, if an offer of securities is to be made to the general public, the offer document needs to be registered with the US Securities Exchange Commission and comply with US disclosure requirements. Rule 144A provides an exemption from the registration requirement under the US Securities Act of 1933 where there is a resale of securities through an intermediary to qualified institutional buyers (QIBs). A QIB is a large or professional institutional investor (eg large pension funds, mutual funds, hedge funds and institutional investors) that own and invest at least US$100 million on a discretionary basis. The intermediary is usually the lead manager to the offer. The lead manager acquires the securities from the issuer and immediately resells them to QIBs.

Additional work streams for US Rule 144A offers

US Rule 144A offers will typically involve the following additional work streams:

- preparation of detailed publicity procedures that will need to be followed so that there is no general solicitation, general advertising or directed selling efforts, according to US securities law
- consideration of US disclosure standards customary for a Rule 144A offer. A base disclosure document that meets the disclosure requirements for both the US and Australian markets is usually prepared and, for example, may include more specific and detailed risk factors and management discussion and analysis of the financials drafted to US standards. In addition, for US specific items, like tax and US securities law transfer restrictions, a US 'wrap' is typically prepared. The US wrap and the disclosure document become the US offer document. One of the key challenges that arises in these deals is to reconcile any more extensive US disclosure requirements with ASIC's 'clear, concise and effective' prospectus disclosure requirements
- preparation of US legal counsel sign-off on the disclosure in the offer documents (known as a 10b-5 disclosure letter), which states that based upon their due diligence investigations, no material misstatements or omissions have come to their attention. Your lead managers may require the benefit of a 10b-5 letter from their own US legal counsel, in addition to a 10b-5 disclosure letter provided by the US legal counsel acting for the issuer
- preparation of a negative assurance comfort letter regarding subsequent changes in specified financial statement items from your accountant (known as a SAS-72 comfort letter), which can only be delivered by the accountant within 135 days after the date of the issuer's last audited or reviewed financial statements. If timing is such that the accountant cannot deliver the SAS-72 comfort letter within the 135 day time period, you should discuss other arrangements with the accountant, such as asking the accountant to review additional financial information to reset the 135 day clock
- including certain provisions of the underwriting or offer management agreement to reflect a US Rule 144A offering, for example additional representations and warranties from the issuer to ensure the availability of the Rule 144A exemption, and a change to the indemnity provisions in line with US practice, and
- providing advice to the directors and officers of the issuer of their potential liability for disclosure violations under US federal securities law.

IPO TIMETABLE

The offer period is typically divided into a longer retail offer period (say 3-4 weeks), which occurs first and a subsequent shorter institutional offer period (several days) to determine the IPO price, often within a range that was set at the start (see 'Bookbuilds and offer management agreements' below).

BOOKBUILDS AND OFFER MANAGEMENT AGREEMENTS

The lead managers enter into an offer management agreement with the issuer rather than an underwriting agreement. Offer management agreements deal with the management of the offer (including the bookbuild and allocation processes) and underwrite the settlement obligations of bookbuild participants but not retail applicants. Lead managers do not generally underwrite large IPOs because of the risk associated with agreeing to fully underwrite a large IPO. This risk is dealt with by the flexible bookbuild process, which is similar to an auction. Institutions are invited to 'bid into the book' indicating how many securities they are prepared to buy at certain prices within a pre-set indicative price range. The bids are used by the lead managers and the entity to decide allocations to institutions and the institutional IPO price that will be paid by institutions. In deciding the number of securities to be allocated to each institution that has bid at or above the final institutional IPO price, the lead managers will take into account factors such as the price and number of securities bid for, the timeliness of bids, whether the institution is expected to be a long-term holder, the type and size of the bidder's funds under management, and the desire for an informed and active market in the securities with a wide spread of holders. The final retail IPO price may be at a discount to the institutional IPO price and is usually capped to give retail applicants certainty. Retail applications, and also 'broker firm' allocations from brokers on behalf of their retail clients add competitive tension to demand for securities, which may achieve better pricing.

INDEX INCLUSION

Large IPOs may result in the issuer being included in an ASX index such as the S&P/ASX 100, S&P/ASX 200, S&P/ASX 300 or the S&P/ASX All Ordinaries Index (the top 500 companies on ASX). Index inclusion is based on the issuer's free-float market capitalisation (ie any tightly held securities are excluded in determining the applicable index). In addition, the trading in your securities must meet certain relative liquidity requirements and in most cases over 30% of your securities must be freely tradeable. Depending on the index, inclusion is assessed each quarter, half year or annually. Index inclusion usually means more research coverage, a higher profile and more demand for your securities (eg the S&P/ASX 200 is the institutional benchmark index and index-weighted fund managers seek to mirror it in their portfolios).

MORE COMMITTEES

Rather than one DDC for the IPO process, there may be several committees to deal with the additional work and complexity associated with large IPOs. Examples of additional committees are an offer structure committee, a prospectus drafting committee and a marketing committee.

RETAIL INCENTIVES

Retail incentives are designed to maximise public participation in the offer. Examples are a guaranteed allocation or some other form of incentive for applicants who pre-register for a prospectus and a retail discount to the institutional IPO price (say 5-10% or capping of the retail price). Where the offer involves payment for securities by instalments, a loyalty discount may be offered to retail applicants who satisfy certain requirements (eg hold their securities for a certain period).

GREENSHOE/STABILISATION/ OVER-ALLOCATION ARRANGEMENTS

These arrangements are designed to create optimal offer pricing and an orderly aftermarket following the commencement of trading on ASX. They enable the lead managers to 'soak up' excess securities on-market in the month after the IPO and stabilise the security price if it weakens.

The lead managers do this by allocating to institutions more securities than are available under the IPO. This 'short position' is initially covered by the lead managers borrowing securities from institutions or an existing major securityholder. If the aftermarket performance of the securities is weak, the lead managers may make on-market purchases that stabilise the price. The securities purchased are used to reduce the short position created by the over-allocation (ie the short position is initially created so that the lead managers have the means to dispose of securities acquired by stabilisation purchases). If on-market purchases are not required, the lead managers exercise an option previously granted by the issuer or an existing major securityholder, allowing them to close their short position.

As the over-allocation arrangements could be seen as market manipulation, they need to be approved by ASIC and ASX in advance. A 'no action' letter is obtained from ASIC confirming that ASIC will take no action against the issuer in relation to the stabilisation. The 'no action' letter is given on conditions including disclosing the stabilising arrangements in the prospectus, limiting the arrangements to 15% of the offer, limiting the stabilisation period to a maximum of 30 days after the IPO, stabilisation trades occurring at the lower of the institutional offer price or market price and clearly identifying on ASX any stabilisation purchases that occur.

PARTLY PAID SECURITIES AND INSTALMENT RECEIPTS

These arrangements make it easier for applicants to pay for their securities by delaying the obligation to pay the entire purchase price. They are usually called instalment receipt structures. Typically, there are two instalments, with the first instalment (usually no less than 50% of the entire price for regulatory and enforcement reasons) payable at the time of application and the second instalment payable say 12-18 months later. There may be a pre-payment facility for those who want to pay the second instalment early. If an instalment receipt (IR) structure is adopted, the issuer enters into an IR trust deed with the instalment receipt trustee setting out the IR arrangements. The securities underlying the IRs are transferred to the trustee after the IPO and held by the trustee until the final instalment is paid. When the final instalment is paid, the securities underlying the IRs are transferred to the IR holder. Until the transfer to the IR holder, the IR trust deed arrangements seek to treat the IR holder as a securityholder (ie the IR holder attends company meetings, receives dividends and receives annual reports as if it were a securityholder).

The instalment receipt trustee needs to be appropriately licensed to carry out its duties. Obtaining relevant licences could take a few months.

Care is needed with all partly paid or instalment arrangements to ensure the risk of default in payment of instalments (especially if there is a risk of the security price falling) is adequately addressed.

STAPLING

Securities can be stapled to each other (eg a share in a company can be stapled to a unit in a trust). Stapling allows the benefits of different structures to be offered to investors as one investment. For example, it allows one entity (such as a company or a public trading trust taxed like a company) to conduct a trading business with associated assets held in a trust so that distributions related to the trust assets may be made to investors out of the trust on a pre-tax 'flow through' basis. The stapling arrangements require the stapled securities to be traded together under the terms of a stapling deed and the constitutions of the entities. Stapling raises complex issues including securityholder approvals and tax consequences for existing securityholders. Standard waivers need to be obtained from ASIC and ASX. Stapling is common in the property and infrastructure sectors.

CONDITIONAL TRADING AND DEFERRED SETTLEMENT

A conditional market allows the issuer to be listed and trading in the securities to commence on ASX even though the securities have not yet been issued to securityholders. The issue of securities is conditional on the occurrence of a specified event (eg the acquisition of a business by the entity or completion of a corporate restructure). ASX will only allow a conditional market for a short period. Deferred settlement lets successful applicants trade their securities before they have received their holding statement. This is because it takes the registry a few days to issue the holding statements after the securities are issued. While a period of deferred settlement will follow conditional trading, deferred settlement commonly occurs without a period of conditional trading. Unlike deferred settlement, conditional trading can theoretically be unwound if any of the conditions are not met.

SETTLEMENT UNDERWRITING ARRANGEMENTS

The lead manager will usually underwrite the settlement obligations of institutional applicants under a bookbuild (see 'Bookbuilds and offer management agreements'). This means the lead manager will pay the issuer the application money payable by institutional applicants (including broker firm applicants) if those applicants do not pay it. Such payment is usually settled through the delivery versus payment (DvP) system so that the securities are not issued until there is a simultaneous payment of the application money. Settlement is conducted through CHESS. DvP settlement enables institutional investors to pay for their securities after they have made their application, unlike retail investors who have to pay at the time of their applications.

BROKER RESEARCH

The publication and distribution of IPO broker research about an issuer needs to be controlled to prevent inadvertent disclosure of the research or of the offer to the retail market that may breach the advertising restrictions on IPOs. Guidelines are agreed between the lead managers and contain restrictions on the distribution and content of broker research. They also regulate interaction between the deal team of the lead manager and the research analysts of the lead manager to manage conflicts of interest.

ADMINISTRATION OF THE OFFER

Large IPOs require more administration than smaller IPOs. For instance, ASX generally requires you to publish the final price and basis of allocation in national newspapers. The advertising space in the newspapers will need to be booked in advance. ASX may also require you to set up information telephone lines for investors to call with queries about the offer.

Large IPOs are complex and need careful organisation from the outset. It is crucial to appoint advisers who are experienced in large IPOs.

LISTING AS A FOREIGN ENTITY

This chapter deals with the considerations foreign entities should note when listing on the ASX.

ASX FOREIGN EXEMPT LISTING OR STANDARD ASX LISTING

If you are foreign entity, you may list securities on the ASX as an ASX foreign exempt listing or as a standard ASX listing.

ASX foreign exempt listings are for those entities listed on another securities exchange which is a member of the World Federation of Exchanges (WFE) who wish to have a secondary listing on the ASX and who meet certain eligibility criteria. For foreign entities (excluding New Zealand entities), eligibility requires having at least $200 million operating profit before income tax for each of the last 3 years or net tangible assets of at least $2,000 million. There must also be at least 1,000 holders each having a parcel value of at least $500. The threshold requirements for New Zealand entities wishing to list on the ASX are lower and mirror those of Australian entities.

The key advantage of listing as an ASX foreign exempt listing is that the process for admission is significantly more streamlined compared to a standard ASX listing, as the entity will be exempt from complying with most of the ASX listing rules.

An entity applying for an ASX Foreign Exempt Listing must be listed on an overseas exchange which is 'acceptable to ASX' (rather than just being a member of WFE), and have either net tangible assets of at least $2,000 million or a minimum market capitalisation of at least $2,000 million.

If you do not meet the eligibility criteria to be admitted as an ASX foreign exempt listing or you wish to have the ASX as your primary listing venue, a standard ASX listing is the process you have to follow. Under a standard ASX listing, you will be subject to the full range of ASX listing rules (including continuous disclosure obligations) even if you are listed on another securities exchange overseas.

REGISTRATION AS A FOREIGN COMPANY

Whether you chose to do a foreign exempt listing or standard listing, you will need to register as a foreign company in Australia under the Corporations Act. As part of the registration process, you will need to appoint a local agent in Australia and have a registered office in Australia to which all communications and notices must be addressed and which must be open during specified hours. This is typically the local agent's office.

As a foreign company registered in Australia, you will be subject to various ongoing requirements including notifying ASIC in relation to changes to your company name, constitution (or any other document lodged in relation to it), directors, the powers of any directors resident in Australia, local agent (including its name and address), registered office and principal place of business in its place of origin. Unlike an Australian public company, you are not required to have any Australian directors.

As the application requires original documents to be lodged with ASIC and ASIC can take 2 to 3 weeks to process an application for registration, we recommend starting the process at least 6 to 8 weeks before your prospectus is to be lodged with ASIC.

FINANCIAL REPORTING IN AUSTRALIA

You will be required to file financial reports under both the Corporations Act with ASIC and the ASX Listing Rules with ASX. Lodgement of the reports with ASX will constitute lodgement with ASIC as well.

Under the ASX Listing Rules, which are the more onerous of the requirements, you must lodge the following:

- half year reports and half year statutory accounts – within 2 months of half year end (the accounts must be audited or subject to review)
- preliminary final reports – within 2 months of year end, and
- Annual reports – within 3 months of year end (the accounts must be audited).

Foreign companies may prepare information in accordance with Australian accounting standards or other accounting standards acceptable to ASX. For example, ASX has confirmed that US GAAP is acceptable.

OTHER REPORTING

You will be required to prepare and lodge with ASX an annual report to securityholders. The annual report must include specified information including:

- a statement disclosing the extent to which you have followed the best practice recommendations set by the ASX Corporate Governance Council during the reporting period and an explanation and reasoning for the extent to which you have not followed those recommendations (see also chapter 20)
- the names of substantial securityholders and the number of equity securities in which each substantial holder and the substantial holder's associates have a relevant interest
- various details about the equity securities, including substantial securityholder details and any escrow details, and
- a review of operations and activities for the reporting period.

ASX LISTING RULES

As an entity listed on ASX, you are required to comply with all applicable ASX Listing Rules, unless you are granted a specific waiver from ASX. The ASX Listing Rules govern a number of areas including continuous disclosure obligations, related party transactions and a 15% limit on issuing equity in an entity over a rolling 12 month period.

CORPORATE GOVERNANCE RECOMMENDATIONS

You will also be subject to the ASX Corporate Governance Council Principles and Recommendations as they apply to all ASX listed entities, regardless of the legal form they take and whether they are established in Australia or elsewhere.

The governance practices an entity chooses to adopt are fundamentally a matter for its board of directors. Under the Corporate Governance Principles and

Recommendations, if the board of a listed entity considers that an ASX Corporate Governance Council recommendation is not appropriate to its particular circumstances, it is entitled not to adopt it. If it does so, however, it must explain why it has not adopted the recommendation – the "if not, why not" approach.

Furthermore, if a listed entity is included in the S&P/ASX 300 Index at the start of its financial year it must also have an audit committee and a remuneration committee which complies with the composition requirements set out in the ASX Listing Rules.

AUSTRALIAN RESIDENT DIRECTORS

Australian resident directors do not need to be appointed to the Board of a foreign entity.

CDIS/SECURITIES

If the laws of the jurisdiction in which your company is incorporated do not allow the Clearing House Electronic Sub-register System (CHESS) to be used for holding legal title to securities, then CHESS Depository Interests (CDIs) will be listed and traded on ASX rather than the underlying securities. CDIs are held by CHESS Depository Nominees Limited, a subsidiary of ASX, which issues CDIs as a trading instrument over securities for use on ASX.

A CDI is a financial product which is a unit of beneficial ownership in an underlying financial product which is quoted on the ASX market. A CDI confers a beneficial interest in the underlying financial product to which it relates and CDIs can be settled electronically through CHESS.

Practically, this means your Australian securityholders will trade CDIs rather than securities. As they are not the legal holder of the company's securities, they will not be entitled to attend the company's general meetings and vote. However they can direct CHESS Depository Nominees Limited (as the legal holder of the securities) on how to vote.

APPLICABLE LAW

You will principally be governed by the laws of the jurisdiction in which you are incorporated rather than by Australian law. Other than issuing securities in Australia, general corporate activities (eg amending the constitution, takeovers, securityholder meetings) will be governed by the laws of your home jurisdiction and not by the Corporations Act or ASIC. You will still be subject to the ASX Listing Rules as well as any other Australian laws applying to foreign companies.

It is important you have a clear understanding of the requirements and ongoing obligations you will be subject to as a foreign entity listed on the ASX. It is crucial to appoint advisers who are experienced in IPOs of foreign entities and can assist you in determining the right course of action for such a listing.

PRODUCT DISCLOSURE STATEMENT REGIME

This chapter deals with the product disclosure statement (PDS) requirements that apply where the interests offered are interests in a managed investment scheme.

PDS REQUIREMENT

You must prepare a PDS if you offer for subscription or issue, or if a controller offers for sale or sells, interests in a managed investment scheme (as compared to shares, which are covered by the prospectus regime) to a retail investor. Like prospectuses, there are anti-avoidance provisions designed to ensure that a PDS must be given in respect of a resale of financial products to a retail investor within 12 months of issue if such products were issued, or sold by a controller, without a PDS.

PDS EXEMPTIONS

As the issuer of units or other securities under the PDS, you must hold an Australian financial services licence and the entity whose securities are being offered must be a registered managed investments scheme.

A substantial body of ongoing regulations applies to licence holders and schemes.

Exemptions from the PDS requirements are similar to the prospectus exemptions. However, because a PDS needs to be given to retail investors, there are no specific exemptions for wholesale and professional investors.

There are additional exemptions where:

- the investor has already received an up-to-date PDS for the same product, or
- the investor is an existing holder of the product and the issuer reasonably believes that the investor has received, or has access to all of the information that a PDS for the product would be required to contain.

DISCLOSURE TEST

The content requirements for a PDS and a prospectus are similar.

A PDS must contain the specific information required by a reasonable retail investor for the purpose of making a decision whether to acquire the relevant product. This includes:

- information about the significant benefits associated with the product
- information about any significant investment risks
- information about the cost of the product and various specific fee disclosures
- significant taxation implications of the product, and
- dispute resolution systems, cooling-off regimes (if any) and, if the product has an investment component, information about whether certain considerations are taken into account in investment decisions.

A PDS must also contain:

any other information that might reasonably be expected to have a material influence on the decision of a reasonable person, as a retail client, whether to acquire the product.

The PDS does not have to contain information that:

- a retail client considering whether to acquire the relevant product would not reasonably expect to see in the PDS, and
- for PDSs relating to quoted securities, is included in the issuer's financial reports and ASX continuous disclosures.

INCORPORATION BY REFERENCE

Issuers may incorporate into a PDS by reference, information that is publicly available in another document lodged with ASIC. The PDS must describe the information so that a person can decide whether to further consider the information and the offeror must make available a free copy of the incorporated information in case it is requested.

Some information must be contained in a PDS (eg information about significant benefits, risks, fees and costs and dispute resolution) and such information cannot be incorporated by reference into a PDS.

PDS LIABILITY

If the issue or offer requires a PDS, it is an offence for the issuer to issue, or offer to issue, the product without giving a PDS.

Criminal and civil liability attaches to a PDS if the information in the PDS is defective (whether by content or omission). Those liable include the person who prepared the PDS and the person who is required by law to give the PDS to investors (usually the issuer but it may also be a person giving the PDS on the issuer's behalf).

People such as directors, underwriters and advisers may be criminally liable for a defective PDS if they are wholly or partly responsible for the relevant offence.

DEFENCES

Where a person may otherwise be liable for a defective PDS, there is a defence (for both criminal and civil liability) if the person has taken reasonable steps to ensure that the disclosure document or statement would not be defective.

ASIC REVIEW

Unlike prospectuses, a PDS need not be lodged with ASIC unless it relates to a managed investment product and either the product can be traded on a financial market or the PDS states or implies that the product will be able to be traded on a financial market. In all other cases, the issuer has to lodge an 'in-use' notice with ASIC. An in-use notice is a notice naming the relevant product and saying a PDS for the product will be in use from a particular date. Issuers must also lodge an 'out-of-use' notice with ASIC after a financial product is no longer available.

If a PDS is lodged with ASIC, it is subject to the prospectus-type exposure period.

IPO PDSs must generally be lodged with ASIC as they will generally state that listing on ASX will be sought.

OTHER

The requirements of ASX in relation to PDSs for listed products are similar to those for prospectuses for listed securities.

Unlike prospectuses, PDSs do not have a maximum life. However, there is an obligation that they be up-to-date when given to an investor and at the time the interests are issued.

There are numerous small differences between PDSs and prospectuses. For example, different updating methodology (eg a PDS may in certain cases be updated on a website) and PDS-specific content requirements.

IPO ALTERNATIVES

This chapter deals with the following alternatives if the entity is not IPO ready:

- a private equity investment
- dual-track processes (trade sales and IPOs run together as alternatives)
- high yield debt
- a listing on a smaller alternative Australian or overseas exchange, or
- an offer information statement.

PRIVATE EQUITY

A private equity investment is one way to fund your operations in the lead up to an IPO. Private equity funding does not always require servicing by regular repayments such as dividends, as the private equity investor usually seeks its returns through realisation of the investment. The investor may also be able to bring you benefits, such as expertise and contacts. However, the injection of new equity may dilute your existing equity holders or remove their control over the business. Over the longer term, private equity is usually a more expensive form of financing than debt.

The expected rate of return of a private equity investor will reflect the relative risk associated with your business. This could range from an annual internal rate of return of around 20-25% for pre-listing capital or expansion funding provided to an established business (comparatively low risk) to an annual internal rate of return exceeding 40% for investment in a start-up business (comparatively high risk).

You need to be well prepared before approaching potential private equity investors. Less than 5% of businesses successfully obtain private equity funding. You need to prepare a detailed business plan that allows the potential private equity investor to make an informed assessment of the investment proposal. The plan should contain your current business activities, ownership structure, financing arrangements, historic financial performance, level of funding required, how funding will be used, plans and strategies for the future, forecast earnings and cash flows, and key risks associated with the proposal.

Private equity investors will provide funding if they receive the appropriate degree of comfort that your business is capable of generating sufficient cash flow and profits to deliver a rate of return which compensates them for the level of risk involved, and their investment can be realised within a reasonable timeframe (say 3-5 years).

On IPO, the private equity arrangements are unwound and the private equity investor will make a full or partial exit by selling their interest. There are a number of tax complications that can arise on a private equity exit. It is important to structure the initial private equity investment so that these tax complications do not arise on exit.

DUAL-TRACK PROCESSES

A dual-track process is appropriate when you are considering a complete exit from your business. It involves running a trade sale process and an IPO at the same time. This has a number of benefits. For example, it creates pricing tension between the two processes. Potential purchasers in the trade sale process may bid higher prices in the belief that if you do not receive the trade sale price you want you will switch to an IPO instead. Another benefit is that if one process falls over you can switch to the other process relatively quickly. However, there is also a risk that if a trade buyer does not emerge, this may adversely affect the IPO value.

Here are some tips to running a successful dual-track process:

- Give early consideration to whether there may be any difficult disclosure issues which, if disclosed publicly in a prospectus, could adversely affect the marketability of the IPO (if this is likely to be the case, you may have to favour the trade sale or have no option but to do a trade sale).
- Even though you may favour one process over the other, maintain the other process at a sufficient level so that you can reactivate that process relatively quickly if the favoured process falls over.
- Structure each major task in each process so that you receive its benefit for both processes (for example, when you set up the data room, set it up in a way that you can use it both for the IPO due diligence as well as for providing access to potential trade buyers, and when writing the information memorandum for the trade sale write it in a way that allows you to quickly convert it to a prospectus).
- When preparing documentation in respect of each process, be aware that you might have to disclose it to a party to the other process (for example, due diligence reports prepared in respect of the IPO process may have to be later disclosed to potential purchasers in a trade sale process).
- If you want to preserve the ability to market any IPO overseas (particularly in the United States), seek early advice on any requirements or restrictions you need to factor in to your process to ensure that this can be done within your timeframe if you proceed with an IPO rather than a trade sale.
- Be conscious of the risk that would-be trade buyers may 'talk down' your business, both to damage the IPO and to discourage other trade buyers. Sometimes if a trade sale is unlikely to be successful, it may be best to discontinue it early to avoid damage to the IPO.

HIGH YIELD DEBT

Issuing debt instruments that are high yield (to compensate the holder for the higher risk associated with a non-listed company) and subordinated to your senior bank facility may be another form of alternative funding. Examples are hybrids, including convertibles, and preference securities. However, if you are a proprietary company, your ability to widely raise capital by these means may be limited.

SMALLER AUSTRALIAN STOCK EXCHANGES

If you are not ready to list on ASX or not able to satisfy ASX listing requirements, you may consider listing on an alternative stock exchange, such as Asia Pacific Exchange (APX) or National Stock Exchange of Australia (NSX). These smaller exchanges are designed to accommodate the particular features of smaller companies. They have lower admission requirements (eg a minimum of 50 securityholders and minimum market capitalisation requirements of between $500,000 and $2 million), lower fees and lower compliance requirements. They may accommodate features associated with smaller companies (eg voting and control restrictions) that ASX may not be able to accommodate. They also provide a support network of advisers and brokers who specialise in advising smaller companies.

US LEVEL II ADR PROGRAMS

The principal US stock markets for listing are the New York Stock Exchange, the American Stock Exchange and the NASDAQ quotation system. An Australian company that meets the listing requirements of these markets (which are based on distribution of security holdings, income levels and trading volumes) may elect to list its securities on one of these trading markets without conducting a new offering of securities. An Australian company listing its securities on one of these markets usually lists in the form of American Depositary Receipts (ADRs). ADRs are instruments issued by a depositary that represent deposited ordinary securities of the Australian company in the depositary's ADR facility. In order to list ADRs, the Australian company has to satisfy the minimum listing criteria, prepare and file a listing application and execute a listing agreement with the exchange, and register the ADRs and underlying ordinary securities with the US Securities and Exchange Commission (SEC). Registration with the SEC involves the preparation of a detailed disclosure document (including a US GAAP reconciliation of the company's AIFRS financial statements) and review and comment by the SEC on the disclosure document.

Listing of ADRs with a US stock exchange and registration with the SEC subjects the Australian company to the listing rules of the exchange as well as the SEC's ongoing disclosure, audit committee, auditor independence and Sarbanes-Oxley corporate governance and reporting requirements. A Level II ADR program provides Australian companies with ready access to retail investors in the US for future capital raisings, acquisition currency for corporate transactions in the US and often a US analyst following that increases your profile which enhances the US investor base.

AIM LISTINGS

AIM (the English Alternative Investment Market) is proving increasingly popular with non-UK companies. Listing on AIM involves the offeror's Australian lawyer undertaking due diligence, verification of the admission document and any pre-listing reorganisation. The offeror's Australian lawyer needs to work closely with UK counsel (who is primarily responsible for the admission) in ensuring that the offer is suitable to list (Herbert Smith Freehills can perform both these roles). Key listing conditions include:

- an admission document (or if there is an offering of securities to the public, a prospectus) containing details of the business, historic financial information and plans going forward
- the appointment of a nominated adviser (nomad) and a broker (in practice, the same bank will perform both roles), and
- a working capital adequacy statement (with a 12-month forecast) from directors.

Unlike many stock exchanges, there is no requirement for a minimum period of trading.

An offeror seeking admission to AIM must appoint and retain a nomad whose role is similar to a sponsor on a listing, except the nomad remains in place following admission. The nomad initially advises on the offeror's suitability for admission to AIM and advises on producing an admission document to comply with the AIM Rules. The nomad oversees the admission process and acts as the offeror's point of contact with the London Stock Exchange after admission.

If there is no offer to the public, the admission document does not have to be vetted by a regulatory authority. An offer to the public will require a prospectus, which will need to be vetted by the UK Financial Services Authority. This has additional cost and time implications. An offeror that has been listed on a recognised overseas exchange at least 18 months prior to the date of admission to AIM can apply to be fast-tracked to admission without having to publish an admission document. The offeror is simply required to provide an announcement 20 days prior to the date of listing (including a form of working capital statement).

If, however, a fundraising is also proposed in conjunction with the listing, it is market practice for the nomad and broker to insist on the production of an admission document.

Generally, the time required to obtain admission to AIM is 2 to 4 months.

OFFER INFORMATION STATEMENT

A listed or unlisted entity can raise up to $10 million using an offer information statement (OIS). OISs can be used for interim fundraisings or for the offer of securities to employees. An OIS is only specifically required to include limited 'checklist' type disclosure relating to matters such as the offeror, the securities being offered, the use of proceeds, the amounts payable, the risks associated with the investment and a warning that the disclosure provided is limited. The OIS must also include an audited financial report prepared in accordance with the accounting standards which covers a 12 month period and has a balance date within the last 6 months. An OIS must be lodged with ASIC and is subject to an exposure period. An OIS is subject to the same liability regime as a prospectus, and the same defences are available (except that a lack of knowledge defence applies instead of the due diligence defence). While an OIS can be used to raise funds, it cannot form the basis of an ASX listing. Because the specific disclosure requirements of an OIS are limited, you should take care to ensure you are not breaching the insider trading provisions when using an OIS. An entity may only raise $10 million during its life (including through related bodies corporate) through the OIS mechanism.

IPO alternatives are worth exploring if you are not ready to make an IPO. You may lose too much of the ownership of your business under the private equity scenario. Alternative funding (eg bank debt or high yield debt) or listing on a smaller exchange may be better alternatives, although private equity investment may help support your business in other ways, such as business development and strategy.

POST-LISTING OBLIGATIONS

This chapter deals with your post-listing obligations.

ASX LISTING RULES

After listing, your primary Listing Rules obligations are to:

- Immediately disclose to ASX any materially price sensitive information the entity becomes aware of, unless each of the following apply:
  - disclosing the information breaches the law, the information concerns an incomplete proposal or negotiation, the information is speculative or is insufficiently definite to warrant disclosure, the information is generated for internal management purposes or the information is a trade secret
  - the information is confidential and ASX has not formed a contrary view, and
  - a reasonable person would not expect the information to be disclosed.

  ASX also has the power to require an entity to respond to market or media speculation to correct a false market.

- Notify ASX of the occurrence of certain events such as the AGM date, changes of officers and auditors, dividends, new issues of securities, securities coming out of escrow, lodgement of a disclosure document with ASIC, presentations to analysts, presentations to be delivered at a general meeting and results of voting at meetings.
- Ensure that each director (other than a managing director) stands for re-election at least every 3 years and that a director election/re-election occurs at every AGM.
- Give ASX annual, preliminary annual and half-yearly financial documents, generally within 2 months of the relevant reporting period (this is a shorter period than applies under the Corporations Act and often requires adjustment of financial reporting schedules).
- Give ASX details of director's securityholdings and interests and notify any changes to ASX within 5 business days of the change occurring.
- Give ASX drafts of certain documents for prior approval (eg proposed amended constitution and certain notices of general meetings) before these are sent to securityholders.
- Obtain securityholder approval for certain transactions (eg issue of securities to a director, issue of securities exceeding 15% of the entity's capital in any rolling 12-month period or issue of securities up to an additional 10% (above the 15%) of an entity's capital if market capitalisation is less than $300 million, and certain transactions with related parties).

In addition, the ASX Corporate Governance Council has published 'Corporate Governance Principles and Recommendations (3rd edition)' (Recommendations) that apply to listed entities. The governance practices an entity chooses to adopt are fundamentally a matter for its board of directors. Under the Recommendations, if the board of a listed entity considers that a Recommendation is not appropriate to its particular circumstances, it is entitled not to adopt it. If it does so, however, it must explain why it has not adopted the Recommendation – the “if not, why not” approach. A listed entity must discuss its main corporate governance practices in its annual corporate governance statement and to disclose whether or not the entity has complied with each of the Recommendations. Where an entity has not followed a Recommendation, it must disclose in its corporate governance statement the reason for not doing so.

Compliance with the Recommendations is expected by ASX, institutional investors, associations such as the Australian Securityholders Association and proxy advisers. The Recommendations relate to matters including the structure and composition of the Board and certain Board committees (in particular, the independence of directors), financial reporting and risk management systems, performance assessment and remuneration of the Board and management, systems for complying with disclosure requirements and communication with securityholders and other stakeholders. Prior to IPO, you should implement structures and adopt corporate governance policies and charters to address these issues. The policies and charters are then made available on the entity’s website and a summary is included in the prospectus.

If a listed entity is included in the S&P/ASX 300 Index it must also have an audit committee and a remuneration committee which complies with the composition requirements set out in the ASX Listing Rules.

BOARD MEETINGS

Newly listed entities are often surprised by the time and resources required to plan for Board meetings. Board meetings usually deal with standard matters such as reports from the CEO and CFO, strategy, monthly management accounts, risk, compliance and continuous disclosure issues, full and half year accounts approval, the AGM and annual report approvals. Special rules relating to fiduciary duties and conflicts of interest apply if the matter before the Board meeting relates to related parties of the entity or a director. Minutes must be kept of Board meetings and signed by the chairman. Copies of Board papers must be kept as part of the entity’s records and in case they are needed later (eg if a director requests them under a director’s indemnity and access deed).

AGM

The AGM is your main opportunity to interact with your securityholders. There are a number of formal requirements for an AGM, including laying the financial, directors’ and auditor’s reports before the meeting, giving members an opportunity to ask questions of management and the auditor, electing directors and considering the remuneration report. The AGM also usually includes a report from the chair and/or CEO on your activities over the previous year and your expected future direction.

INSIDER TRADING AND SECURITIES TRADING POLICY

The insider trading laws in the Corporations Act apply to all persons and prohibit a person dealing in your securities if they have confidential materially price sensitive information about the entity. While these laws also apply before you list, there is heightened risk and scrutiny post-IPO. Under the Listing Rules, you are required to have in place a securities trading policy which covers certain matters. The purpose of this policy is to ensure that public confidence is maintained in the reputation of the entity, the directors and employees of the entity and in the trading of the entity's securities, as well as to put in place processes for the buying and selling of securities to assist the entity's directors and employees to manage inside trading risks. The policy will typically contain blackout periods during the year in which directors and certain members of management are prohibited from dealing in the entity's securities (eg in the lead-up to the announcement of half year and full year results).

INVESTOR, MEDIA AND ANALYST CONTACT

Following listing, you will need to liaise with securityholders, the media and analysts. This is an important task, as it assists in creating a market for your securities. This usually requires a significant commitment from your managing director. You may appoint a specialist investor relations manager to assist. You must have regard to your continuous disclosure obligations in such dealings. You must not selectively disclose to any person (including to the media, the public or an analyst) any confidential price sensitive information unless it has first been disclosed to the ASX. ASIC has released a number of public papers warning entities on giving selective briefings and ensuring fair access to company information.

OTHER DISCLOSURES

You will be subject to additional periodic disclosure requirements in your Annual Reports. This includes disclosures such as the number of Board and Board committee meetings held each year and the number attended by each director, details of each director's and the company secretary's experience and qualifications and details of each director's other public company directorships – both current and held during the past 3 years.

You are also required to prepare and disclose a remuneration report containing your remuneration policies, the relationship between your performance and remuneration and the elements of remuneration of each director and each of the key management personnel. Additional disclosure is also required relating to performance-based remuneration and equity-based remuneration. At each AGM you will be required to seek an advisory (ie non-binding vote) from securityholders in relation to the adoption of your annual remuneration report. If you fail to obtain a 75% majority in support of the remuneration report in 2 successive years the entire Board must stand for re-election at a separate general meeting of the entity (known as a "spill meeting").

EQUITY CAPITAL RAISING POST LISTING

Once you are listed, there are a number of ways you can access additional equity capital by issuing new securities.

- Placement – you can place securities with institutional and sophisticated investors without the need for additional prospectus disclosure. In order for the placement investors to trade the placement securities, you must lodge a 'cleansing statement' with ASX within 5 business days after the issue of the securities setting out any material matters not previously disclosed to ASX on the basis of an exception to your continuous disclosure obligations. You must be listed for three months before you can lodge a placement cleansing statement.
- 'Low documentation' rights issue – you can offer existing securityholders the opportunity to buy a certain number of securities based on the number of securities they hold at the relevant date without the need for additional prospectus disclosure. The issue price is generally at a discount to the market price on the date the rights issue is launched. You must lodge a 'cleansing statement' with ASX before the rights issue is launched and, in addition to setting out any material matters not previously disclosed to ASX, the statement must also set out the impact of the rights issue on control of the entity.
- Transaction specific prospectus – you can offer securities under a transaction specific prospectus which contains less disclosure than a full IPO prospectus. The disclosure is limited to material matters not previously disclosed to ASX and certain other matters relating to the offer and its effects. You must be listed for three months before you can lodge a transaction specific prospectus. Most companies now rely on the 'low documentation' process rather than using a transaction specific prospectus.
- Security purchase plan – a security purchase plan (SPP) allows you to raise capital from existing securityholders (up to a maximum of $15,000 in 12 months in respect of each individual securityholder) without issuing a prospectus.
- Dividend/distribution reinvestment plan - as discussed in Chapter 15, a DRP allows you to raise capital from existing securityholders by giving securityholders the option of reinvesting part or all of their dividends for new securities.

You should prepare for your post-listing obligations before you list. Talk to your lawyer and accountant and ask them for publications that explain your post-listing obligations. You could also attend relevant courses run by bodies like ASX and the Australian Institute of Company Directors. This will allow you to 'hit the ground running' when you list.

IPO TIMELINES

TIMELINE FOR SMALL/MEDIUM IPOs[1]

(CAPITAL RAISING OF APPROX < $200M)

Say, 2 weeks

Commence preliminary preparations

1. Consider whether ASX listing requirements are satisfied.
2. Appoint advisors.
3. Prepare due diligence planning memorandum including materiality thresholds, sign-offs and due diligence checklist.
4. Consider offer structure eg. will there be selldown too? ESOP? tax issues? stamp duty issues?
5. Consider need for capital restructure or amendments to constitution (obtain shareholder approval - allow 21/28 days).
6. Convert to public company if necessary (allow 6 weeks).
7. Agree basis on which prospectus to be drafted (eg. committee approach vs comments to one person).
8. Negotiate executive service agreements.

Say, 4-8 weeks

Commence due diligence and prospectus drafting

1. Agree planning memorandum.
2. Commence due diligence.
3. Due diligence committee usually meets on a weekly basis.
4. Liaise with customer/suppliers/landlords/financiers to extent necessary (eg to obtain any consents to IPO).
5. Advisers brief management on role/responsibilities/obligations.
6. Distribute management questionnaires.
7. Management presentation.
8. Commence prospectus drafting.
9. Prepare prospectus forecasts (if any).
10. Draft ESOP prospectus wrap around (if any).
11. Identify any “supplementary prospectus” events or timing risks.
12. Comply with prospectus publicity restrictions pre-lodgement (strict) and post-lodgement (relaxed).
13. Put in place appropriate corporate governance structures.
14. Sign executive service agreements.
15. Discuss with regulators any required modifications/waivers.
16. Discuss with ASIC any contentious prospectus disclosure issues.
17. Discuss with ASX issues such as listing conditions and escrow periods.
18. Discuss voluntary escrow position with underwriter.
19. Negotiate underwriting agreement.
20. Prepare roadshow marketing materials.
21. Put in place appropriate corporate governance structures.
22. Make banking arrangements to receive application money.

Say, 0.5-1 week

Verify content of prospectus and finalise pricing/capital structure details (last date for changes)

1. Verify prospectus.
2. Finalise Board structure.
3. Institutional roadshow.
4. Finalise pricing.

Mandatory 7 day exposure period (ASIC may increase by 7 days)

Lodge prospectus and ASX listing application

1. Sign planning memorandum.
2. Obtain advisor and due diligence committee sign-offs.
3. Board meeting.
4. ASIC filing fee is approximately $2,320 (updated regularly).

1. If ASX conditions are met, there can be an accelerated timetable with just 14 days between prospectus lodgement and commencement of trading.

Say, 3-4 weeks

Offer period commences

1 Print prospectus.

Say, 3-7days

Offer period ends

1 Lodge application money in separate bank account.
2 Monitor need for supplementary prospectus.

Say, 3-7days

Bring down due diligence and issue shares

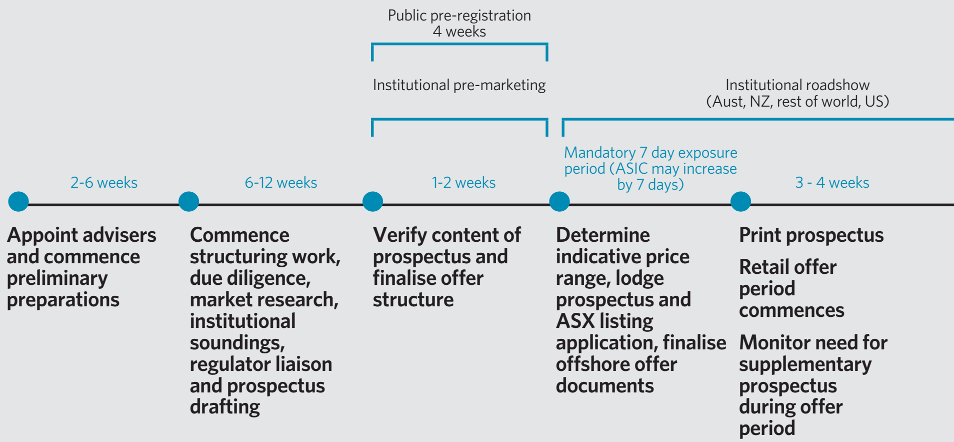
1 Liaise with share registry to ensure holding statements dispatched.
2 Withdraw application money.

ASX listing and commencement of trading

1 Satisfy ASX spread requirements.
2 Pay ASX listing fee.

TIMELINE FOR LARGE IPOs[1]

(CAPITAL RAISING OF APPROX > $200M)



1. If ASX conditions are met, there can be an accelerated timetable with just 14 days between prospectus lodgement and commencement of trading.


Institutional bookbuild
Pricing weekend
Market stabilisation (if needed)
30 days
3-7 days
5 days
3 days
Retail offer period ends and institutional offer period commences
Institutional offer period ends
ASX listing
Conditional and deferred settlement trading begins
Settlement of the offer
Conditions for conditional market satisfied
Trading starts on an unconditional but deferred settlement basis
Despatch of holding statements and refunds
Normal trading starts

NOTES