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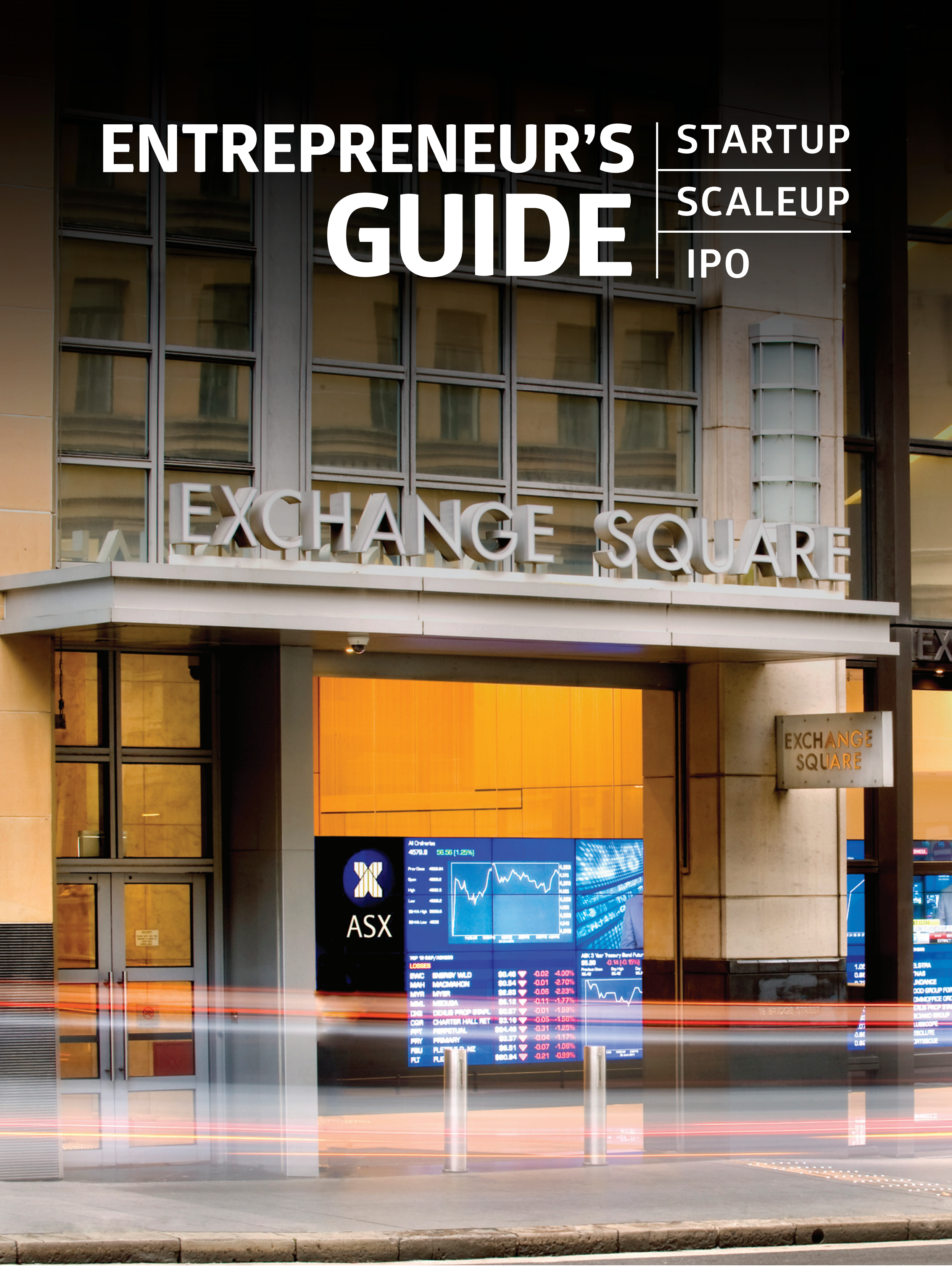

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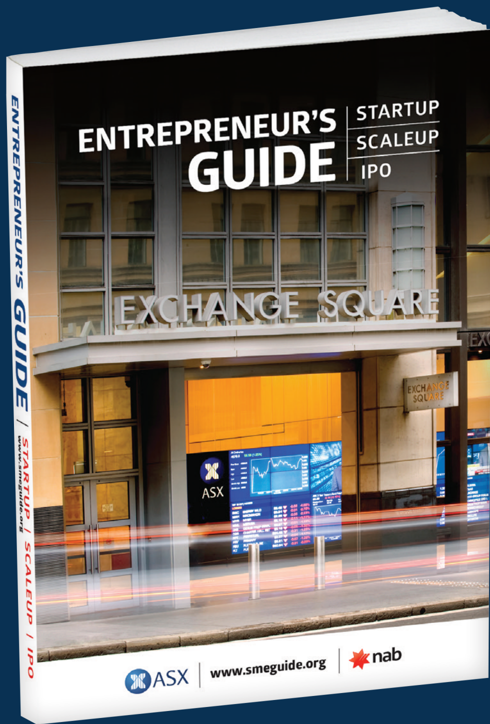

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TIPS AND TRAPS IN PLANNING YOUR COMPANY'S IPO

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Dwight D. Eisenhower once said that plans are worthless, but planning is everything. The first step in your company's initial public offering (IPO) is to plan for the journey.

PLANNING IS EVERYTHING

Early planning will help you in overcoming any twists and turns encountered during your company's IPO journey and its listing on the Australian Securities Exchange (ASX).

The first question you need to ask is: is my company ready to list? Do I, the board of directors and the company's major shareholders understand what a listing on the ASX entails and what areas I need to be aware of?

This chapter provides some practical tips that might help you in planning your company's IPO, and it also covers some traps you might encounter.

TIP 1: PREPARE YOUR COMPANY TO BE A GOOD IPO CANDIDATE

Like a good product, a good IPO will sell itself.

Not every company's IPO can be fully subscribed within 24 hours, but you should prepare your company in the best way you can to attract investors and create circumstances where investors have a 'fear of missing out' on your company's IPO.

A good candidate for an IPO and an ASX listing is a company that has several of the following features:

1. an understandable corporate structure
2. a business model that investors can easily understand and is clear on how investors will earn a return on their investment
3. a board of directors with a range of skills and experience that add value to the company
4. a good management team with experience in managing a listed company
5. a good team of advisors that includes underwriters, accountants, lawyers and tax advisors

6. an IPO price that balances the interests of existing shareholders and the interests of incoming shareholders, so that there is upside in the IPO price after listing to benefit incoming shareholders
7. a good plan for the expenditure of the money raised in the IPO
8. existing shareholders who are committed to the future of the company and have agreed to have their shares escrowed (i.e., with restrictions on sale) for a certain period.

It would be good for your company to have a profit history, but that is not a prerequisite to listing on the ASX, which allows a company to satisfy an 'assets test' as an alternative to the 'profits test'.

TIP 2: GET THE BACKING OF AN UNDERWRITER

In an IPO, it is usual to have the support and help of an underwriter. An underwriter, usually a broker, will agree to take up any shares not taken up by the investing public (whether retail or professional) in your company's IPO, subject to certain conditions. This backing of an underwriter gives confidence to the market that your company's IPO will be successful and that your company will list on the ASX in accordance with the publicised timetable.

One of your first tasks, then, is to market your company's IPO to an established broker and persuade the broker to become your underwriter.

TIP 3: GET YOUR COMPANY'S AFFAIRS IN ORDER

You can take some preliminary steps to demonstrate that your company is ready for its IPO before you approach a potential underwriter:

(a) *Have only one class of ordinary shares.* The ASX's Listing Rules only allow for one class of ordinary shares. If your company has several classes of ordinary shares (e.g., created to provide for different dividend rights or voting rights), you should consolidate them into one class. Note that the ASX, unlike some other exchanges, generally does not allow some ordinary shares to be voting and others to be non-voting.

(b) *Optimise your company's structure.* If your company is operated through a trust structure, convert to a corporate structure. It might also be desirable to set up a holding company that would hold the shares in your company and to list that holding company. Some listed groups have their intellectual property (e.g., patents and know-how) in a separate company to the operating company to protect these assets from any adverse consequences of trading in the operating company. Others have a separate company that employs all the group's employees.

(c) *Remove assets that will not be valued in the IPO.* Speak to your accountant about how an underwriter would value your business, because particular assets the company owns might not be properly valued in the valuation model used by an underwriter. For example, a real property asset not core to your business model might not be valued at its full market value. In that case, it might be better for the company to lease the real property asset rather than own it.

(d) *Remove non-business-related expenses.* Non-business-related expenses might have been put through your company because you and the other owners may have invested all your spare funds in your company, so they became the only source of available funds to pay these expenses. These expenses should be removed from your company before its IPO.

(e) *Appoint a project manager.* Management can sometimes get consumed by the IPO and listing process and forget that they need to run the company for success during and after the listing. The appointment of a project manager to manage the IPO as a separate project can be the key to the success of an IPO. This position can be an internal appointment (e.g., the company's chief financial officer) or an external appointment (e.g., a specialist project manager from an accounting firm).

(f) *Get your company's accounts in order.* In the two to three years before the proposed listing, have your company's accounts audited. Here are some requirements for a company seeking to list on the ASX:

   (i) Under the *profits test*, it would require audited accounts for the past three full financial years before the listing and a reviewed *pro forma* statement of financial position.

   (ii) Under the *assets test*, it would require audited accounts for the past two full financial years before the listing, a reviewed *pro forma* statement of financial position and audited income and cash flow statements for the past three financial years.

   There will be different accounts requirements if your company has operated for less than three financial years or if it has recently acquired a business (or will do so before the listing). Because accounts take time to prepare and audit, it is advisable to check the specific requirements for your company and speak to your accountant early in the process.

(g) *Get your company's tax affairs in order.* Make sure you have your company's tax affairs in order (e.g., tax lodgements are up-to-date).

(h) *Review related party transactions.* Related party transactions are those between the company and its directors, past directors, proposed directors and major shareholders. A public company requires shareholder approval to undertake a related party transaction unless one of the stated exceptions under the law applies. Shareholder approval should be obtained to those related party transactions that your company wishes to continue once listed, and they should be disclosed in your company's IPO prospectus.

TIP 4: RAISE PRE-IPO FUNDING

Your company's IPO will consume time and money before it receives funds from its IPO. This period could be funded by raising some funds before the listing from sophisticated investors. This step is often done by issuing convertible notes that convert to ordinary shares at listing on a favourable basis, giving noteholders a good return for the risk they took that your company might not list at all.

TIP 5: BULK UP YOUR BUSINESS

You might decide to acquire a similar or complementary business to bulk up your company for its listing.

Here are a few things to keep in mind:

1. The acquisition must be done in as tax-effective a way as possible to avoid tax issues for the sellers as well as for your company.
2. The sellers must be made aware that they might receive only ordinary shares in your company that might be subjected to escrow conditions (i.e., the shares cannot be sold or mortgaged for one to two years after listing—see further information in the section 'Trap 1: Agreeing to purchase classified assets for cash').
3. The business to be acquired might best be acquired in a subsidiary of your company. This approach might be desirable for tracking the performance of the acquired business and quarantining the effect of any downside as a result of the acquisition.
4. Consider whether the business being acquired will be a 'classified asset' (see the following section).

TRAP 1: AGREEING TO PURCHASE CLASSIFIED ASSETS FOR CASH

If a 'classified asset' has been acquired from a related party or a promoter of your company in the two years before the date of application for listing, the payment for the acquisition can only be in the form of escrowed shares (except to the extent that the payment is reimbursement of expenditure incurred in developing the classified asset). The escrow restriction might be for up to two years, depending on the circumstances.

The term 'classified asset' is interpreted broadly by the ASX and includes the following:

(a) an interest in intangible property that is substantially speculative or unproven, or has not been profitably exploited for at least three years, and that entitles the entity to develop, manufacture, market or distribute the property

(b) an interest in an asset that, in ASX's opinion, cannot be readily valued

(c) an interest in an entity with a substantial proportion of assets, held directly or indirectly, of the type referred to in items a and b.

The ASX might determine that sellers of an asset who would be future employees or executives of your company would be regarded as 'promoters'. This issue can come as a shock to the sellers if they expect to receive some cash from the sale of their assets or business. The issue should be explored at an early stage in the IPO process and discussed with the ASX.

TRAP 2: ISSUING PERFORMANCE SHARES WITH MORE THAN LIMITED RIGHTS

If your company is buying an asset or business before listing, performance shares might be used to bridge a valuation gap between the sellers and your company, or used as a form of deferred consideration (e.g., where the value of the asset is unclear or might vary materially).

A *performance share* is a share with limited rights unless and until a nominated performance milestone is achieved. If the performance milestone is achieved, then the performance share will convert into an ordinary share.

If your company is thinking about issuing performance shares, bear in mind that the ASX expects that a performance share must have limited rights, including the following:

1. It must not be transferrable (therefore, it cannot be quoted on the ASX or any other exchange).
2. It must not have any voting rights (unless required by law).
3. It must not have any dividend rights.

TRAP 3: ISSUING TOO MANY CONVERTIBLE SECURITIES

Your company may already have or may be thinking of issuing performance shares, options or other securities than can be converted into ordinary shares (*convertible securities*). If so, keep in mind that the ASX considers a company with convertible securities that could be converted into more ordinary shares than the number of ordinary shares at the date of listing as having an inappropriate structure for a listed company.

TRAP 4: NOT CONSIDERING ALL OF THE LEGAL AND TAX IMPLICATIONS WHEN ISSUING SHARES OR OPTIONS TO EMPLOYEES

You might want to reward your employees by granting them some shares or options in your company before the IPO or as part of the IPO process.

In issuing shares and options to employees, it is necessary to consider:

1. if shares or options could be legally issued to employees without a prospectus, if they are to be issued before the IPO
2. the law's requirements in relation to any loan or other financial assistance given to employees to take up shares in the company, including the related party considerations for directors of your company
3. the tax implications for employees in taking up and subsequently selling those shares
4. any requirement to disclose the terms of these arrangements in the prospectus.

These issues might seem complicated but can be worked through with appropriate professional advice.

In relation to point 3 in the preceding list, the tax concession introduced in 2015 for the benefit of employees in small startup companies might apply to your company's employees. However, certain conditions must be satisfied for this concession to apply. These include that your company must:

1. be an Australian resident taxpayer
2. have aggregate turnover not exceeding A$50 million
3. be incorporated for fewer than 10 years
4. not be listed.

Another condition is that if your company will be granting options, the *exercise price* of the option (the amount that the employee must pay to exercise the option) must be at least the market value of an ordinary share in your company at the time the option is granted. The market value can be determined using one of the 'safe-harbour' valuation methods approved by the Australian Taxation Office.

TRAP 5: NOT GIVING YOURSELF ENOUGH TIME TO CONVERT TO A PUBLIC COMPANY

Your company has probably been operating as a proprietary company, which is identified by the 'Pty Ltd' or 'Pty Limited' at the end of your company's name. A proprietary company has a limited ability to issue shares to and raise funds from retail investors. Your company will therefore need to convert to a public company before the IPO.

Although converting to a public company is a simple process of passing a shareholders' resolution, the change does not take effect until one month after the Australian Securities & Investments Commission (ASIC) publishes a notice in the *ASIC Gazette* of the intention to make this change. This one-month period must be factored into your IPO planning process.

Many listings were delayed because the planners forgot about this requirement.

TRAP 6: NOT CONSIDERING THE LEGAL RESTRICTIONS WHEN MARKETING YOUR IPO

Strict legal restrictions on advertising an IPO apply, so you need to be careful of them. Before the prospectus is publicly available, any public statement (except statements to a limited list of specific groups) referring to the IPO can *only* contain the following items and nothing more:

1. the identity of the company undertaking the IPO
2. a statement that a prospectus will be made available when the shares are offered
3. a statement that anyone who wants to acquire the shares will need to complete the application form accompanying the prospectus
4. a statement of how to obtain a copy of the prospectus.

You will have more freedom to advertise the IPO after the prospectus is publicly available, but certain requirements still need to be complied with.

TRAP 7: NOT GIVING YOURSELF ENOUGH TIME TO OBTAIN DIRECTOR BACKGROUND CHECKS

The ASX requires each director or proposed director of a company at the date of its listing to be of good fame and character. This step requires that the ASX receives criminal and bankruptcy check results for each country that these persons have resided in during the past 10 years. For instance, if a director has lived in the U.S. in the past 10 years, the ASX requires a criminal history check from the Federal Bureau of Investigation (or a third-party search provider that covers U.S. federal level offences) for that director.

These checks can take time to obtain, so they should preferably be obtained early in the IPO planning process. Otherwise, you risk delaying your company's listing date if these checks are not obtained in time.

CONCLUSION

The IPO journey is an exciting one for a company and the people involved, but it can also be a stressful time. To minimise this stress and potential disruption to your company's business, keep in mind the above tips and traps, and start planning early!

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