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READY, STEADY, IPO!

PREPARING YOUR COMPANY
FOR AN ASX LISTING

KEY TAKEAWAYS

- An IPO is a significant and transformational transaction that, if executed properly, can present substantial opportunities and benefits for a company.
- IPOs take a substantial amount of time to prepare for and execute. Accordingly, companies that are considering conducting an IPO should start planning for such a transaction well in advance.
- The recent downturn in IPO activity in Australia presents an excellent opportunity for companies that are considering going down the IPO path to begin preparing and getting their house in order for such a transaction.
- The team of advisors that a company puts together for an IPO can be critical to its success and can help the board and shareholders navigate through the various aspects of the transaction, from preliminary structuring and preparing a prospectus through to listing.

INTRODUCTION

An IPO is one of the most significant and transformational processes that a company will go through in its life cycle. As is the case with any significant investment being made by a company, it is advisable to start the IPO process as early as possible. The recent downturn in IPO activity in Australia presents an excellent opportunity for companies that are considering going down the IPO path, to begin preparing and getting their house in order for such a transaction.

Here we discuss a number of preliminary considerations for stakeholders and steps that a company can take to begin getting ready for an IPO.

This article focuses exclusively on Australian companies that propose to conduct an initial public offering of shares to raise capital and list on ASX. There are additional considerations that may need to be taken by foreign companies or entities that are proposing to issue units, stapled securities, or hybrid securities, which are beyond the scope of this article.



IS AN IPO RIGHT FOR YOUR COMPANY?

The first step for any company that is considering conducting an IPO is to conduct an analysis to determine the pros and cons of implementing such a transaction. It is important for the company's stakeholders to carefully consider three fundamental questions:

- Firstly, "why" they want to conduct an IPO;
- how much they propose to raise under the IPO and at what valuation; and
- what the funds raised will be used for.

BENEFITS OF LISTING

The benefits that can be derived from conducting an IPO and listing a company on ASX, include the following:

- being listed substantially improves a company's ability to raise capital due to the ready access to debt and equity capital markets;
- there will be an increased ability to implement equity security schemes and long term incentive plans which can enhance the company's ability to attract, incentivise and retain high quality employees;
- it provides a liquid market for shares that allows for investors to trade shares based on prevailing market prices;
- the liquid nature of the company's shares, and the fact that there is a clear market price for those shares, allows them to be used as currency with which to conduct M&A acquisitions under scrip-for-scrip transactions;
- becoming a public company can garner greater attention and better brand recognition for the company and its products or services; and
- the fact that pre-IPO shareholders, whether they be early stage or private equity investors, can exit (whether partially or wholly) and realise some or all of their investment in the company.

DISADVANTAGES OF LISTING

The benefits of listing should be considered in light of the disadvantages, which include the following:

- existing shareholders who do not sell-down their shares will have their shareholding diluted;
- there are greater restrictions around what the board can do in terms of dealing with the company and its assets, and entering into related party arrangements, which can require shareholder approval;
- there is a high degree of disclosure required, including compliance with continuous disclosure and financial reporting obligations; and
- management are required to dedicate a significant amount of time to the IPO process, which can take their focus away from day-to-day business operations.

PRELIMINARY CONSIDERATIONS AND STEPS

ENSURING SHAREHOLDERS ARE ON BOARD

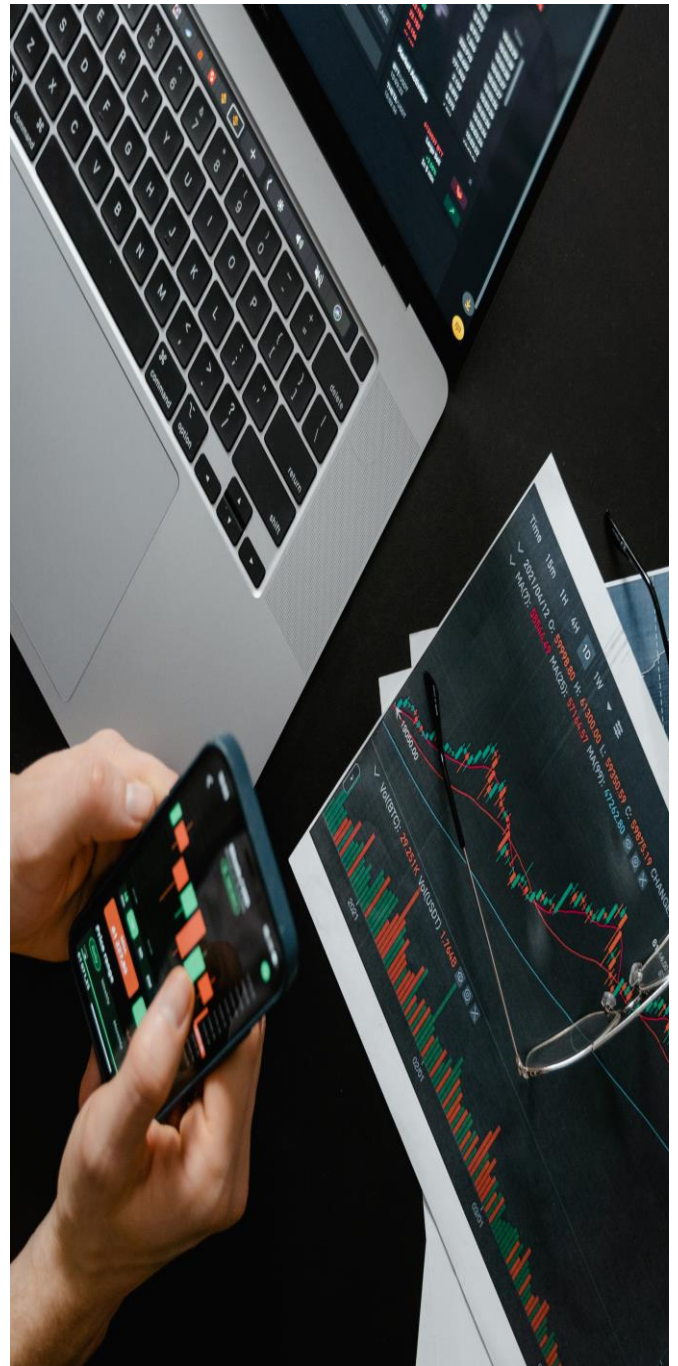
Prior to embarking on an IPO process, it is important that the current shareholders are supportive and aligned with the board's intentions and strategy. This is particularly important in circumstances where the IPO structure requires the existing shareholders to sell-down their shareholding into the IPO. If the company has any shareholders on its register who do not support the IPO, there is a risk that they may seek to frustrate the process from within the company.

Boards can manage this risk by continually engaging with shareholders and keeping them informed about the company's vision and strategy and any plans they have to conduct an IPO. Companies can further seek to reduce this risk by having shareholders enter into a shareholders' agreement that includes a provision that sets out shareholder approval thresholds that must be met for an IPO process to commence, and then binds them to participating in the process.

GET HOUSE IN ORDER AND PREPARE FOR DUE DILIGENCE

A thorough and robust due diligence process is integral to any IPO. Companies should be continually preparing for a diligence process on an ongoing basis by ensuring that they have a centralised electronic filing system for key documents that will ultimately need to be uploaded to an electronic data room for review by the company's advisors as part of the due diligence process.

Companies should undertake an internal "IPO readiness health check" to ensure that they are otherwise ready to commence the process. Their legal and accounting advisors will be able to assist with this process.



ASSEMBLING THE RIGHT TEAM OF ADVISORS

Having decided to proceed with an IPO, one of the first things that a company should do is carefully select a team of advisors. It is very important that these advisors are experienced in IPOs. Appointing inexperienced advisors can result in avoidable complications arising during the IPO process, and has the potential to give rise to ASX exercising its discretion not to permit a company to list based on the use of poor quality advisors.

WHO ARE THE KEY MEMBERS OF AN IPO ADVISORY TEAM?

- **Lawyers** - The legal advisors will be responsible for advising on all legal aspects of preparing for listing and ensuring that an appropriate due diligence process has been established and adhered to, so that those with potential exposure to liability in connection with the prospectus can rely on the due diligence or reasonable reliance defences.
- **Underwriters / Lead Managers** - The underwriter / lead manager will advise the company on the structure, size, timing and pricing of the offer. Underwriters will underwrite the offer by agreeing to acquire the shortfall of shares that are not taken up by investors under the IPO offer.
- **Accountants** - The accountant will assist the company with preparing accounts and the financial disclosures that need to be made in the prospectus. They will also be responsible for reviewing the financial information in the prospectus (including any forecasts and underlying assumptions) and conducting tax due diligence. The accountant will also be required to prepare an Investigating Accountant's Report, which will be included in the prospectus.
- **Specialist experts** - Companies operating in certain industries (for example, mining or property) may need to engage specialist experts to prepare independent reports to be included in the prospectus.

QUALITY ADVISORS ARE CRITICAL TO A SUCCESSFUL IPO

It is critical to ensure that the company has assembled a quality team of advisers and experts in relation to its IPO process. Failure to do so can be fatal to an IPO.

ASX retains absolute discretion as to whether or not to permit a company to be admitted to the official list and to quote its securities. This discretion is broad and may be exercised by ASX despite the fact that a company otherwise meets the requirements in the ASX Listing Rules that must be satisfied in order for a company to list. ASX may exercise this discretion not to permit a listing in circumstances where:

- the company has not engaged experienced legal and/or accounting advisors to assist it with the preparation of its prospectus, which gives rise to potential concerns from ASX's perspective about the quality of the prospectus and the due diligence supporting it;
- ASX is not satisfied with the qualifications and experience of any professional advisor that is providing services to the company in relation to the IPO, including any expert that may be providing a report to be included in the company's prospectus;
- ASX is not satisfied with the qualifications and experience of the company's auditor or investigating accountant;
- ASX is not satisfied with the qualifications and experience of any other expert or professional advisor providing a report to be included in the company's prospectus; or
- ASX has had prior unacceptable dealings with a promoter, broker, auditor, investigating accountant, expert or professional adviser involved in the IPO.

Accordingly, companies should ensure that they are assembling a quality team of advisers and experts who are experienced in advising and working on IPO processes. Companies should also ask its proposed advisors, before being appointed, to disclose any dealings they have had with ASX, which ASX may deem to be unacceptable.



ENSURING YOUR COMPANY WILL MEET ASX'S ADMISSION REQUIREMENTS

In order for a company to be permitted to list on ASX, there are a number of requirements that must be met under the ASX Listing Rules. The directors of a company should familiarise themselves with these requirements in order to ensure that the company will be able to satisfy them, before committing the time and incurring the costs of conducting an IPO.

MINIMUM SPREAD REQUIREMENT

In order to list, a company must be able to demonstrate that it will have an acceptable "spread" of shareholders after listing. This means that a company must have at least 300 non-affiliated shareholders, each of which holding shares worth at least \$2,000, excluding restricted securities. Before allowing a company to list, ASX will carry out a detailed forensic analysis of the company's share register to ensure compliance with the spread requirement, and to ensure that the company is not attempting to meet the requirement by artificial means, such as using multiple nominee companies that are related to the company or each other, in order to apply for separate parcels of shares to inflate the number of shareholders.

Notably, ASX released a consultation paper on 27 April 2022, under which ASX revealed that it is proposing to narrow the spread test by specifying that only shareholders who are resident in Australia or another jurisdiction acceptable to ASX will count towards the spread requirement threshold. ASX may decide to exclude shareholders resident in some emerging markets from spread calculations. ASX currently takes this approach when determining spread on an informal basis, however this proposed change will formalise this approach.



MINIMUM FREE FLOAT REQUIREMENT

The company must have a minimum "free float" at the time of listing of not less than 20%. The "free float" is the percentage of the company's shares that are not restricted securities or subject to voluntary escrow, and that are held by non-affiliated shareholders.

PROFIT TEST

In order to satisfy the profits test, the company must:

- be a going concern or the successor of a going concern;
- have been carrying out the same main business activity for the last three full financial years;
- have an aggregated operating profit from continuing operations before tax for the past three full financial years of at least \$1 million; and
- have consolidated operating profit from continuing operations before tax of at least \$500,000 for the period of 12 months prior to a date no more than two months before applying for admission.

ASSET TEST

In order to satisfy the asset test, the company must:

- have net tangible assets of at least \$4 million (after deducting the costs of fundraising), or a market capitalisation of at least \$15 million;
- have working capital of at least \$1.5 million;
- include a statement in its prospectus that the company has enough working capital to carry out its stated objectives; and
- either have:
 - less than half of its total tangible assets in cash or in a form readily convertible to cash; or
 - commitments consistent with its stated business objectives (as set out in its prospectus) to spend at least half of its cash and assets in a
 - form readily convertible to cash.

STRUCTURING MATTERS

DECIDING ON AN APPROPRIATE CORPORATE STRUCTURE TO LIST THROUGH

There are a number of structuring options that are available to a company that is proposing to conduct an IPO. These include:

- **Direct issue** - Under a direct issue to investors, the company issues new shares under the prospectus to incoming investors to raise additional capital. A direct issue can be combined with a sell-down structure, which allows existing shareholders to sell some or all of their shares into the offer in order to realise their investment.
- **Sell-down** - Under a sell-down structure, existing shareholders offer their shares for sale under the prospectus to incoming investors.
- **FloatCo** - Under a FloatCo structure, existing shareholders grant a newly incorporated entity (FloatCo) the right to acquire some or all of their shares in the company, with completion to be conditional upon completing the IPO. FloatCo issues new shares to investors under the prospectus and applies the monies raised under the prospectus to acquire the shares in, or assets of, the company.
- **SaleCo** - Under a SaleCo structure, existing shareholders grant a newly incorporated entity (SaleCo) the right to acquire some or all of their shares in the company. SaleCo then offers to sell those shares under the prospectus.

Ultimately, the structure of the IPO will largely be driven by tax considerations, and dependent on what the existing shareholders hope to achieve from a commercial perspective. If the sole objective of the IPO is for the company to raise new capital, then a direct

issue structure may be appropriate. Otherwise, if the existing shareholders intend on taking some money off the table, then one of the other structures (potentially in combination with a direct issue) may be preferable.

ENSURE THE COMPANY THAT IS LISTING IS A PUBLIC COMPANY

This may seem like an obvious point but, if left to the last minute, can lead to significant delays in listing. In order to be able to list on ASX, the company must be a public (as opposed to a private, or proprietary) company. For companies that were established as private companies, this will mean that they need to convert to a public company, which will require shareholder approval and gazettal by ASIC. The conversion process can take up to two months once you factor in the requirements mentioned. Accordingly, the conversion process should be started at least two months prior to the company lodging its prospectus with ASIC.

SECURITY INCENTIVES PLANS

A company that proposes to introduce a security incentives plan for employees may should consider having the plan in place prior to listing, making adequate disclosure of the plan in the prospectus, to avoid the need to obtain shareholder approval for the plan once the company has listed.

PERFORMANCE SECURITIES

ASX will closely examine the structure of any performance securities that the company has on issue prior to listing. Importantly, if the number of ordinary shares into which performance securities will convert is greater than 10% of the number of ordinary shares the entity proposes to have on issue at its admission date, ASX will require that the company include an independent expert's report in the prospectus.

BOARD AND SENIOR EXECUTIVE MATTERS

Having an experienced and highly regarded Board and group of senior executives is very important for any company that is considering an IPO. Putting aside the practical contributions that high quality directors and executives will be able to provide to the company, and the attraction this will have to investors in the IPO, ASX has broad discretions to refuse to allow a company to list in circumstances where they are not satisfied with, or have had prior unacceptable dealings with any of those individuals.

FIND THE RIGHT DIRECTORS, AND FIND THEM EARLY

Like recruiting for any senior position within an organisation, identifying and appointing quality directors, who have a sufficient degree of industry-specific experience and independence, can be challenging. Founders should commence the recruitment process for directors once they make the decision to conduct an IPO, particularly if they are on the lookout for high quality non-executive directors.

Practically speaking, the company will need to provide ASX with the names of the directors of the company as part of the application for in-principle advice on whether the company is suitable to list on ASX. ASX will not provide the in-principle advice without receiving the directors' details. Accordingly, in order for the company to be in a position to make this application at the early stages of the IPO process (which is recommended), the company should have appointed the directors or, at the very least, identified who they will be on listing.

From the non-executive director's perspective, those directors who are appointed at the start of the IPO process will have the ability to participate in, and provide input on, the due diligence process for the transaction. This is important because each of the directors on listing will have exposure to personal liability for any deficiencies in the prospectus. Accordingly, potential non-executive directors may be



more likely to accept an appointment to a board in circumstances where they have had the ability to provide input on, and have a degree of oversight across, the due diligence process that is carried out.

Importantly, a frantic last minute rush to appoint a director can hold up the entire IPO process as the company will need to satisfy ASX that the director is of good fame and character. This requires, amongst other things, police and bankruptcy checks to be conducted which can take time to obtain. This is discussed in further detail below.

CHECK THAT THERE ARE NO SKELETONS IN ANYONE'S CLOSET

As part of the director and executive recruitment process, it is very important to keep this requirement in mind when selecting candidates.

The ASX Listing Rules require that each director and the CEO and CFO of the company is of good fame and character. ASX will require police and bankruptcy checks, in each jurisdiction that the relevant persons have resided in the past 10 years, in order to ensure that this requirement is satisfied.

Importantly, ASX can exercise its broad discretion not to permit a company to list in circumstances where ASX has had prior unacceptable dealings with a director, CEO or CFO of the company. Accordingly, a review should be conducted to see whether any of the potential appointees have been involved with any companies that have had any insolvency related issues or have had any unacceptable dealings with ASX or have otherwise been refused listing by ASX. These issues may require disclosure in the prospectus or, worse, result in ASX

exercising its discretion not to permit the company to list.

These requirements should be communicated to each of the directors, CEO and CFO as early in the IPO process as possible, so that they are aware of what is expected and to avoid any potentially embarrassing issues coming to light, late in the process, that may result in a last minute rush to find an alternative appointment.

MAKE SURE THERE IS ADEQUATE INDEPENDENCE AT BOARD LEVEL

According to ASX's corporate governance principles and recommendations, a majority of a board of a listed entity should be independent. Companies that do not adhere to ASX's recommendation must disclose this in their prospectus and explain why they are not adhering. While smaller companies, such as junior resource explorers, may be able to justify not adhering to this recommendation based on their size, simple structures and early stage of operations. Larger companies with more substantial operations will be expected to meet this requirement. Again, companies should start thinking about this as early in the process as possible.

TAKING OUT APPROPRIATE INSURANCE

Companies should review their D&O insurance policy to ensure that it is going to provide appropriate coverage for the directors and officers, once the company lists. Depending on the size of the IPO, some directors may also decide to take out prospectus insurance which will provide additional coverage in relation to certain claims that may arise as a result of any defects in the prospectus.

CONCLUSION

An IPO is a significant and transformational transaction that, if executed properly, can present substantial opportunities and benefits for a company.

IPOs take a substantial amount of time (up to 12 months) to prepare for and execute. Accordingly, companies that are considering conducting an IPO should start planning for such a transaction well in advance. The recent downturn in IPO activity in Australia presents an excellent opportunity for companies that are considering going down the IPO path, to begin preparing and getting their house in order for such a transaction.

HWL Ebsworth has a broad range of experience in advising companies on IPOs and other forms of capital raisings and is well placed to help boards and shareholders navigate through the various aspects of an IPO process, from preliminary deal structuring and preparing a prospectus through to listing.

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