Slide Set 5

Company and Securities Law in Australia and New Zealand

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Five Phases of an IPO

Company and Securities Law in Australia and New Zealand

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Introduction

- Key Reading: Walker, Case Study of an IPO in NZ (in Handout). This is a heuristic device (learning tool). Do not follow this taxonomy blindly in your take home exam.
- In this lecture or lectures, we put together much of our previous learning.
- We blend commercial and legal considerations (one is not much use without the other).

The Liquidity Event or Exit Mechanism

- Commercial problem: we want to realise our investment and make a profit so … first
- Focus on the front end of the deal and ask such questions as: Did we buy well (top or bottom of the market)? Did we buy when the USD was strong against the AUD or the NZD (the “Green Lantern” learning)? Did we cover all bases tax-wise?

Trade Sale Option

- "Trade sale" simply means a private sale (usually to someone in the same business). We always look for a trade sale as the first option. Why? Answer: "Private ordering" of the sale. Less disclosure and we can arrange tax effect.
- Relevance of overseas Chinese networks here. Attraction of freehold land (not long leasehold).
- Trade sale to pension funds?

What are we selling?

- The shares or the assets (undertaking)?
- Vendor would like to sell shares.
- Purchaser may want to buy assets.
- Understand the implications of buying the company (the shares) as opposed to buying the assets (sometimes called the undertaking). Generally speaking, there may be a tax consequence if you buy the shares.

How to you get a trade sale?

- Mandate to a broker such as an investment bank or international real estate broker with presence in (say) Hong Kong.
- We pay a fee on the deal but we get private ordering.
- When we think of private ordering, think about the utility of off-shore entity holding shares.

Off-shore SPV

- Suppose HK domiciled SPV or similar holding shares (ultimate holding company). NB. This type of structure often used in private equity deals (Myer float on ASX and TPG).
- Usually driven by tax effect (no CGT in HK) but consider also utility of trade sale. Means you can sell the shares in the HK SPV (sell control of the company that owns the shares).

Relevance of DTA and CGT

- Australia has a DTA with the USA so …
- No CGT in Australia on sale of shares by USA parent (*Virgin Case* etc) but …
- There will be an ultimate tax effect in the USA so …
- There is a timing issue on ultimate sale of shares in USA and the question here is: are there offsetting losses at the USA end to minimise CGT on sale?

SPVs Again

- HK domiciled company (or similar) with nominee directors and shareholders and no CGT. Nominee shareholders (legal owners of shares) hold on trust for a trust SPV resident in HK or elsewhere.
- Shares in the SPV beneficially owned by a trust SPV and the trust is a *Manisty* style discretionary trust.
- An alternative is a BVI VISTA trust. But there is a TIEA between Australia and the BVI.
- On sale of shares, gains flow to the trust.

Deal Structuring

- Notice that the preceding discussion assumes certain structuring takes place on Day One.
- Relevance: we need advice from the tax desk in the firm on tax issues on Day One.
- Structure of the deal must be in place on Day One
- NZ has a DTA with HK but Australia does not.

Trade Sale not an Option

- Assume trade sale not an option and hence IPO is the exit mechanism. Much used by private equity, e.g. Myer stores on the ASX (loans in to buy, then repay loans or issue dividends to recoup purchase monies then exit and profit on an IPO). If an IPO is an option, we need to think about it on Day One. So … we need to think about the five phases of an IPO.

Five Phases of the IPO: Start-Up

- Start-up: use a Pty Ltd in Australia and a company in NZ. Who are the directors and shareholders? Are they “ordinarily resident” in NZ or Australia? Do we need to customise the Constitution if we control the Board and the share register? Is the register fragmented? How do we capitalise? 75% debt and 25% equity in Australia (60/40 in NZ). Setting up the bank accounts – who can sign?

Phase Two: Acquisition

- Consider acquisition techniques.
- Not important for your takehome but ….
- Consider conditional purchase.
- Consider deferred purchase.
- Consider part payment in shares in USA company.
- Consider nature of contract for sale and purchase and the importance of warranties and representations from vendor.

Prospectus Phase

- First take: human resources and an in-house information memorandum (IM).
- The IM is a rough cut of the proposed deal and here we consider: how much cash is needed; how much of Floatco will be sold and will issue be underwritten. We will use the IM to pitch an underwriter.

How much cash are we raising?

- Reverse engineer: we would like to end up with 30% plus of the issued capital of the listed entity and all our cash back. So first we need to value our asset.
- Assets equal AUD200m. This a market valuation.
- Cash flows AUD25m.
- At a PE of 8, cash flows worth AUD200m.

Doing the numbers

- Assume deal worth AUD400m to vendor ($200 million assets plus $200 million as value of $25 million cash flows at a PE of 8).
- Vendor then seeks to raise $300m with $200m to purchase assets and retire debt (cash back to vendor) and $100m working capital in the listed company to do “X”.
- So 300m shares offered to public and held by public (AUD300m).
- Another 200 m shares are issued as vendor consideration shares non-escrowed. These are issued in consideration of the cash flows.

Results

- Listed company has 500 million shares on issue (300m to public plus 200m to vendors)
- Vendor gets cash expended back (plus any revaluation of property) because $200 million proceeds of public offering used to buy assets and pay back debt.
- Vendor controls 40% of the listed company. Control block.
- AUD100m cash at bank in listed company.

Selling Phase: Underwriting

- Will the deal be underwritten?
- The underwriting agreement, typical clauses and fees.
- Sub-underwriting.
- If the deal is underwritten, it is (in effect) sold.

Selling Phase

- If the deal is not underwritten then the vendors must sell the issue themselves.
- Road shows.
- Dog and pony shows.

Closing Phase

- Discuss the mechanics of closing the issue.
- Monies in trust account.
- Confirmation from bank regarding minimum subscription.
- Notify exchange.
- Shift money from trust account.