FINANCIAL MARKETS AUTHORITY

GOING PUBLIC

A director's guide

FMA
FINANCIAL MARKETS AUTHORITY
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CONTENTS

INTRODUCTION

A public offering is a transformational event for an organisation. Preparing for, and being listed on, a licensed market can bring both opportunities and associated challenges.

The number of companies looking to access the equity markets continues to grow. This guide is intended to help directors assess whether going public is the right choice for their company and provide an insight into the process of becoming a public company. It is not a comprehensive account of the legal obligations of directors during an initial public offering (IPO). Your professional advisers can help you understand those details.

A company will face new requirements as a publicly owned company. This may require new skills, additional resources and changes to the business to meet these challenges.

Before deciding to go public, a company should consider whether it is at an appropriate stage of its development to benefit from public financing or having publicly tradable shares. Any decision to undertake an IPO should be based on a realistic assessment of the company's business, its management resources, and its prospects. Directors should also consider what the new environment might look like, and the specific changes that will be required to get there. Alternative options for raising capital, such as seeking private investment, may also be considered, potentially in advance of a later public listing. This level of analysis in advance of the public offering is essential. It will enable a smooth offering process and minimise the risk of unexpected post-IPO issues.

This guide should be read alongside the handbook Corporate Governance in New Zealand: Principles and Guidelines which is a resource for directors, executives and advisers to help them understand what is expected of them more generally in their governance roles.

We hope you find this guide useful.

WHAT IS A PUBLIC OFFERING?

In an initial public offering (IPO), a company's shares are first offered to the public with the intention of subsequently listing the shares on a licensed market. This guide will also be relevant for companies undertaking a 'compliance listing' on a licensed market, where no new capital is raised but the company's existing shares are listed, then traded.

QUESTIONS TO ASK

In this guide we outline six important questions for directors of companies considering an IPO to think about:

1. Do I understand the company's business?
2. Is the board doing its job?
3. Have we chosen the right advisers and do I understand their roles?
4. Are we giving investors the right information?
5. Is the price right?
6. Do I understand the impact going public will have on the company?

The decision to go public and the timing of going public are important strategic considerations.
We recommend these decisions are made in the context of a well-developed business plan and a clear understanding across the management and board of the company's strategic direction. If directors can't answer the questions in this guide positively, they should resolve their concerns with their fellow directors or professional advisers before proceeding with an IPO.

1. Do I understand the company's business?

A director of a company undertaking an IPO must understand the company's business, the characteristics of the industry and markets that the company operates in, the company's strategy, and related risks. This understanding is essential so directors can assure themselves of the quality and integrity of information provided to prospective investors.

Some important questions directors may wish to consider in this context include:

- Does the company have attractive products or services with a competitive advantage and a sufficiently large market?
- Is there an experienced, capable and committed leadership team?
- Is there a positive trend of historical financial results and/or compelling financial prospects?
- Does the business have a well-developed and focused business plan?
- Are there strong financial, operational and compliance controls?
- Does the company have a sound risk management framework that enables it to identify key risks?

We encourage directors to spend a reasonable period of time fully assessing these matters ahead of an IPO. They should also be considered during any due diligence for any potential directorship appointment. We expect directors who receive invitations to join the board of a company close to listing to ensure they have sufficient time, and access to sufficient information, to adequately understand the company's business, including its risks and opportunities, before the IPO.

Companies thinking about listing should consider well in advance of the IPO whether additional directors, with new or different skills, are needed to strengthen the board. Experience with the company will allow new directors to become familiar with the usual business of the company and use that knowledge to add value to an IPO process.

2. Is the board doing its job?

The board of directors should take ownership of the company's strategy and lead the long-term success of the company.

The purpose of the board will not change as a result of an IPO. However, there is a greater emphasis on good corporate governance for boards of public listed companies. Directors should review the company's existing practices against the standards expected of public listed companies and consider what changes are required. For example, directors should consider whether the board and its members:

- have the right balance of skills, experience, independence and knowledge of the company to enable them to govern well in the new environment
- regularly review their performance and are committed to continuous improvement
- set high standards of ethical behaviour, model that behaviour and hold management accountable for delivering it throughout the organisation
- understand the key risks the business faces and the steps being taken to address those risks, ensuring that rigorous risk management processes are implemented throughout the business
- have established board committees (depending on the size of the business) such as an audit and risk committee and a nominations committee, which are chaired by independent directors
- are aware of, and are applying, the principles set out in the Corporate Governance Handbook.

It may take some time for you to feel confident that your board has the skills, expertise and competency to take the company to market.

3. Have we chosen the right advisers and do I understand their roles?

Advisers and other service providers will play an important role in helping to bring the company to market. However, the responsibility for decision-making remains with the board, not with advisers, and it is important to understand your respective roles.

Key advisers and service providers

The management team

It is important to understand the level of time and commitment a public offering will require from the company's staff and the depth of knowledge they must have about the company to help you prepare the company for market. This preparation needs to take place while staff are also continuing to run the business as usual. The business may need extra staff to enable key people to work on the offer.

The lead managers

They will help you assess the marketability of the company, advise you on preparing the business for listing, and manage the marketing and sale of the shares to investors. They will also play a key role in advising on the price at which shares will be sold in the IPO. However, where new shares are being issued the board is responsible for the decision on pricing, and it is one of the key decisions the board needs to make. Where existing shares are being sold in an IPO the sellers will usually make the decision on the sale price.

The legal adviser

Technical ability is important. Your legal adviser must represent your interests robustly in negotiations with other parties, including with other advisers and with management. Most importantly, your legal adviser must:

- be able to explain the due diligence, public offer and listing process to you
- explain the roles and responsibilities of management and advisers in that process
- provide you with guidance on how best to design the due diligence process
- be able to advise you on what your obligations are at the various stages of the process – pre-offer, during the offer period, and once listed
- understand and be able to explain the FMA's expectations of financial markets participants, so they can help you comply with current laws and requirements
- provide the advice needed to enable you to explain the offer and the company's business in your offer documents in a clear, concise and effective way that helps investors to make informed investment decisions.

The auditor

Your auditor should have been appointed well in advance of the IPO so that any accounting and financial reporting issues have been resolved long before the offer process begins. As well as being technically competent, your auditor should also be able to explain complex financial issues to you. The auditor can help ensure investors have access to credible and reliable financial information on which to base their investment decisions.

The advisory accountant

An accounting adviser will help you resolve complex technical issues in relation to financial reporting and financial strategy, and help test any prospective financial information intended for the offer documents. Like the auditor, your advisory accountant should be able to explain complex issues to you in a clear, concise and effective way.

You may also consider appointing other advisers, such as a communications adviser or an independent IPO adviser, to provide impartial guidance throughout the IPO process, including to test and advise on the pricing recommended by the lead managers.

Some lead managers may be able to arrange for research reports to be published about your business and its sector. These reports can enhance the understanding of investors and help your offer. We encourage you to ask questions about how widely those reports will be shared. In general, you would benefit from information about your business and sector being shared as widely as possible.

Appointing the appropriate professional advisers can add significant value to the process of bringing a company to market. While technical competence and market experience of advisers is important, if an adviser can't explain what's going on in terms you can understand, then consider finding another adviser.

4. Are we giving investors the right information?

An issuer of shares must provide prospective investors with the information they need to make an informed investment decision.

The new offer information requirements in the Financial Markets Conduct Act mean potential investors will receive a Product Disclosure Statement (PDS) with a key information summary containing important information they need to make an investment decision. After a short transitional period, the PDS will replace the investment statement and prospectus that were produced under the previous Securities Act regime.

An issuer must prepare and present the information contained in their PDS in a clear, concise and effective manner. Directors should ensure there is a robust process to ensure the contents of the PDS are not false or misleading, or likely to mislead. Other material information not already included in the PDS must be lodged on an online register. This information must be kept up to date during the term of the offer.

We encourage you to ask yourself how you know that the information the company is providing to prospective investors is true and complete. Does it clearly provide the information investors need to make informed investment decisions? The quality and integrity of information provided to prospective investors is key to ensuring investors make informed investment decisions, and is the primary objective of an effective due diligence process.

The importance of a due diligence process

We expect directors to play a key role in the design and monitoring of a thorough and robust due diligence process that identifies issues and ensures the adequacy and accuracy of information provided to investors. A due diligence process designed and implemented with these objectives in mind will also more effectively protect directors from legal liability.

The due diligence process needs to involve people who have knowledge of the company, its business, and the offer process. Their job is to ensure the information provided to investors is true, complete, is not misleading, and meets regulatory requirements. It is common practice to create a due diligence committee to oversee this process and for advisers to document how this committee will operate, including the roles and responsibilities of committee members. This committee will usually involve members of the board (particularly independent directors), as well as key members of company management and key advisers.

Key members of company management

This category might include the chief executive and chief financial officer, and other senior staff who have sufficient knowledge. This group should ensure the right information is provided about the company and its business. This applies not only to each individual statement made in the offer documents and register, but to the information provided when viewed as a whole.

Key advisers

This group would usually include a representative of the lead manager/s, the company's auditor and the legal adviser — each of whom have sufficient oversight of the offer structure and process. This group helps oversee the preparation and verification of information to be included in the offer documents and on the register.

Establishing the due diligence committee

Membership of the due diligence committee should be based on the person's ability to supervise preparation of offer information that meets the required standards. Offer information should enable investors and the market to assess both the issuer and the offer, and to then make informed investment decisions.

When determining the membership of the due diligence committee, we encourage directors to think about who has the substantive ability to supervise preparation of high-quality offer information. The substance and clarity of the role of each individual in the process is important. Directors should satisfy themselves that their due diligence committee has the right mix of skills and expertise, and that the processes are adequate, robust and reliable.

Being a member of the due diligence committee does not necessarily mean you have increased your liability for the offer document. Rather, it shows that you have taken the lead in ensuring that investors receive the information they need.

The nature of directors' involvement in any offer of financial products will depend on the circumstances of the offer. For IPOs, which are not 'business as usual', we expect directors to take a more active role in reviewing and approving the offer information, and ensuring they are satisfied that the preparation process has been adequate.

We acknowledge and understand that errors will sometimes occur in the information provided to prospective investors. We will take a balanced and pragmatic regulatory approach to issuers and their directors who make mistakes despite having made genuine, competent attempts in good faith to ensure the information they provide is true, complete and meets regulatory requirements.

Ultimately, directors and companies who place their own interests ahead of those of investors, or who decide not to co-operate with the FMA (or to co-operate at a minimal level), can expect a robust regulatory response.

5. Is the price right?

For IPOs that involve the sale of new shares, one of the key decisions you will need to make is the price at which the shares will be issued. This is fundamental to the success or failure of your IPO.

In setting the price, your primary guidance will come from the lead managers. As part of the IPO marketing process, the lead managers are likely to have conducted a 'book build' involving institutional investors and retail brokers. The lead managers are likely to recommend a price on the basis of the 'book build' result. This price may not always be the highest price that is achievable at IPO, due to the consideration given to the appropriate allocation of shares to different types of investors and the likely performance of the shares after the IPO.

As a director you need to robustly examine the recommendations of the lead managers, and to ensure you understand the trade-offs associated with the various price-setting options. While the recommendation of the lead managers will be a very important consideration, as a director you are ultimately responsible for setting the price at which new shares will be issued. You must be satisfied the price is fair and reasonable to the company and to all existing shareholders.

If you are not comfortable having these discussions with your lead managers, you may consider appointing an independent IPO adviser to represent your interests or evaluate the lead managers' recommendations.

6. Do I understand the impact going public will have on the company?

The IPO is not the end of the company's journey as a listed company — it is only the beginning.

Once listed, a company will:

- be under far greater public scrutiny
- have a new set of stakeholder relationships, including with public shareholders, media, analysts and regulators
- have a range of continuing obligations to comply with.

The way the company goes about managing these relationships and obligations will have a real and enduring impact on its reputation and value. We encourage directors of listed issuers to set the appropriate tone across the organisation and to:

- understand the standards of behaviour expected by the law and by the FMA, and to hold management accountable for delivering those standards
- give appropriate weight to the interests of customers and shareholders in all decision-making
- hold management accountable for raising organisational compliance standards above the bare minimum.

In our view, building a viable and sustainable business by placing key stakeholders at the forefront of a company's operations is consistent with a director's duty to act in the best interests of the company.

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