Australian Private Equity &
Venture Capital Association Limited

07 July 2016

Mr Terence Kouts
Corporations
Australian Securities and Investments Commission
GPO Box 9827
SYDNEY, NSW 2001

Via email: policy.submissions@asic.gov.au

Dear Terence,

Thank you for the opportunity to put forward a submission in relation to the proposals outlined in ASIC Consultation Paper 257: *Improving disclosure of historical financial information in prospectuses: Update to RG228* (Consultation Paper).

The Australian Private Equity & Venture Capital Association (AVCAL) is a national association which represents the private equity and venture capital industries. AVCAL's members comprise most of the active private equity and venture capital firms in Australia, who together manage over A$28 billion on behalf of Australian and offshore superannuation and pension funds, sovereign wealth funds and family offices.

Private equity (PE) and venture capital (VC) firms provide capital for early stage companies, later stage expansion capital, and capital for management buyouts of established companies. These businesses help contribute more than 4% per annum to Australia's national output and support, both directly and indirectly, over 500,000 jobs.[1] In the financial year ending 30 June 2015 alone, PE and VC funds invested A$3.3bn into Australia.

1. Background – importance of private equity and venture capital to the proposed reforms

We believe that PE and VC funds can play a critical role in Australia's transition to an innovation-focused economy. A significant proportion of the capital invested by PE and VC funds is directed into smaller, high growth Australian companies, with a particular focus on commercialisation of research & development, and innovating and expanding established businesses.

The PE and VC business model involves fundraising, investing in portfolio companies, value-adding, and then exiting. In the case of PE, an exit is achieved by means such as a trade-sale or initial public offering (IPO). Typically the life of a PE fund is around ten years.

In February 2016, research released by AVCAL, in association with Rothschild, showed that 30 of the 67 IPOs that took place on the ASX, in the years 2013 to 2015 inclusive (minimum offer size of A$100m), were PE-backed (i.e. 45% of all IPOs).

[1] Deloitte Access Economics, *The Economic Contribution of Private Equity in Australia*, 2013

The research further showed that since 2013, PE-backed IPOs:

- have achieved an average return of 40.9% and a weighted average return of 26.4%, outperforming non-PE backed IPOs by around 15% and 8% respectively;
- have outperformed non-PE backed IPOs by around 23% on both an average and weighted average basis after the first year of listing; and
- have accounted for eight of the top ten performing IPOs (to 31 December 2015).

This data underscores the importance of a well-functioning listed market to the PE industry, both in terms of an avenue for offering high performing companies to the public, and as an exit means for PE investors.

Accordingly, AVCAL has a strong interest in ensuring that ASIC's prospectus disclosure requirements, and the associated ASX Listing Rules, set an appropriately high bar for listing – commensurate with the responsibility inherent in offering equity to retail investors – while not unnecessarily hampering the ability of companies to raise equity funding via a share-market listing.

Separately, we have lodged a submission in relation to the parallel consultation on the ASX's proposed changes to its admission requirements.

2. Summary – strong disclosure balanced with regulator flexibility

AVCAL supports ASIC's efforts in seeking to improve the disclosure of historical financial information in prospectuses with the aim of ensuring that investors are provided with appropriate information to make well-informed investment decisions.

In the IPO context, we agree that it is imperative that entities are adequately prepared and meet certain minimum standards before they are allowed to raise funds from Australian retail investors and list on the ASX, and thereby able to attract a large public investor base. Reliable and fulsome disclosure is a key part of this.

Our key points of feedback in relation to the Consultation Paper are as follows:

- ASIC should show an appropriate degree of flexibility when applying its proposed historical financial information requirements, especially to entities which an issuer intends to acquire prior to or as part of an IPO;
- Similarly, in appropriate circumstances, ASIC's guidance should be flexible on the proposed audit requirements, especially in cases where it would be unreasonable to insist on an unqualified opinion; and
- A rigid approach to disclosure of historical financial information risks distorting market behaviour, denying market participants the potential benefit of IPOs.

Our more detailed comments are outlined below.

3. Historical financial information

We note ASIC's observation that it has seen varying levels of compliance with its Regulatory Guide 228 (*Prospectuses: Effective disclosure for retail investors*) (RG228) in recent years, including some instances where ASIC believes the level of historical financial disclosure has fallen below the minimum legal requirements (see s710, *Corporations Act 2001 (Cth)*).

The Consultation Paper states that: an issuer should disclose audited historical financial statements for two-and-a-half or three years for both the issuer and any business it acquires, regardless of whether the financial statements were required by law to be produced (Proposal B1); and where an audit or review opinion included in a prospectus has a qualification or modification that indicates that the audit opinion provides limited independent assurance for investors, ASIC will likely treat the information as unaudited, and the prospectus as likely breaching s710, Corporations Act (Proposal B2).

While we support the rationale behind Proposal B1, namely to provide greater assurance to investors of the financial condition of the entity seeking funding, and greater consistency across the board, it is important that it is not applied too narrowly so as to prevent companies from listing, or raising capital, that may otherwise be appropriate candidates for an IPO (or other fundraising). This will be particularly relevant to start-up or earlier-stage companies who may be viable listing candidates, notwithstanding that they do not have three years of audited accounts at the time of applying for admission to the ASX.

Therefore, we support ASIC's guidance indicating its flexibility to allow, in appropriate circumstances, entities which do not have two-and-a-half or three years of audited accounts to fundraise. This is particularly the case where the relevant entity is an otherwise suitable entity with the potential to produce a return on investment for investors and which otherwise satisfies the relevant ASX Listing Rule requirements and Corporations Act disclosure requirements.

In this vein, we support ASIC's acknowledgement that it would not generally expect financial information to be disclosed where it is not readily to hand and is of little or no relevance to the investment decision being made (Proposal B12), such as where there has been a main business change (Table 1, para 52, Consultation Paper). Similarly, we note that in select circumstances ASIC will not insist on full disclosure where it would not be reasonable to (Proposal B13), for example on the grounds of materiality or in cases of year-one audits (Table 2, para 53, Consultation Paper).

While we acknowledge that the examples ASIC proposes to include in the amendments to RG228 provide a useful indicator of the circumstances where ASIC would be willing to accept less than two-and-a-half or three years of audited historical financial information, these examples should not comprise an exhaustive list given it is impossible, having regard to each entity's unique business circumstances, to account for all eventualities where it would be *reasonable* (having regard to the s710 test) to include less than two-and-a-half or three years of audited historical financial information.

Accordingly, we recommend that the guidance make very clear that these examples of circumstances where ASIC may accept less than the prescribed amount of historical financial information are not exhaustive, and to state that an issuer may consult with ASIC to determine whether less than the prescribed amount of audited historical financial information is likely to be acceptable to ASIC, given the particular circumstances.

We would also like to highlight that ASIC's proposals may have unintended consequences, and particular relevance, for some private equity-backed IPOs. It is frequently part of a PE fund's strategy to cause an investee company to make 'bolt-on acquisitions' (i.e. where an investee grows its business by acquiring companies/businesses in the same or similar industry which provide complementary services, technology or geographic footprint diversification) as a way of adding value. This may occur prior to or as part of an IPO process.

In some cases, the bolt-on acquisition may be an entity or business with limited record-keeping, for example a family-run business, which could prevent the provision of an unqualified audit opinion for the necessary two-and-a-half or three financial years. In other bolt-on cases, the issuer may not have been able to negotiate full access to the financial records of the complementary business to be acquired, despite its best endeavours.

In addition, in certain circumstances it is likely to be unduly onerous (in terms of cost/time) and practically impossible for an issuer to recreate two-and-a-half or three years of financial information for a business which it has acquired. This is particularly the case where:

- the business being acquired is an entity within a large consolidated group and stand-alone financial records for that entity have not been prepared and it is not possible to extract financial records which relate specifically to the entity which is proposed to be acquired from the consolidated financial information prepared by the group (either because of the way the consolidated group maintains its financial records or

because to do so would reveal commercial confidentialities of the group); or

- where the entity is a foreign entity which is not required to prepare financial statements (because of its size or the regulations which are in place in its jurisdiction of incorporation) and is not subject to requirements similar to section 286(1)(b) of the Corporations Act.

Accordingly, we recommend that any proposed changes to RG228 be accommodative of these issues and allow an issuer to approach ASIC in circumstances similar to those outlined above to determine an appropriate approach, having regard to the requirements of s710 of the Corporations Act, for disclosing financial information with respect to the entity to be acquired. For example, it may be that the issuer can satisfy the content standards prescribed by the Corporations Act by disclosing certain unaudited historical financial information which has been the subject of a review as well as additional procedures which, although when taken together with the review are not the same standard as an audit, nonetheless provide reasonable assurances (having regard to the nature of the business and other relevant circumstances).

Regarding Proposal B2, a qualified audit opinion in and of itself should not render a prospectus deficient so long as:

- the auditor does not have significant concerns regarding the integrity of the information it has examined, which would materially compromise its ability to provide a professional opinion, or the information is irrelevant to the investor's decision-making (for example, it relates to the operating history of an entity whose activities are unrelated to those the issuer intends to engage in following IPO); and

- the prospectus contains adequate disclosure in relation to the qualification and, if relevant, the issuer's plan to remedy it.

These issues will be particularly relevant where it is the first time that the auditor has audited the entity.

While we are pleased that ASIC has acknowledged that opening balance qualifications and subject to materiality, issues related to inventory inspections, will not generally make audit or review opinions unacceptable where financial statements are being audited for the first time (Proposal B4, paras 38-39), further consideration should be given to other instances where it may be appropriate to take such an approach.

Consequently, AVCAL cautions against ASIC adopting a one-size-fits-all position which could prevent suitable companies from raising funds from Australian retail investors and seeking to list on the ASX, denying them a level-playing field, and investors the potential benefits of an IPO. Indeed, adopting a strict test may have market-distorting effects including blocking otherwise value-adding transactions from taking place for fear that such an acquisition could prevent the company from later listing.

Noting that ASX is currently consulting on proposed changes to its admission requirements, we support a coordinated, consistent approach by the two regulators (ASIC and ASX).

4. Next steps

We would like to thank you for considering this submission, and look forward to continuing our engagement with you on these issues, and other matters relating to disclosure of information to retail investors in the context of IPOs. If you have any queries in relation to this submission please contact Christian Gergis, Head of Policy & Research, on 02 8243 7010, or me on 02 8243 7000.

Yours sincerely

Yasser El-Ansary
Chief Executive