REPORT 641

# An inside look at mining and exploration initial public offers

December 2019

## About this report

This report sets out the findings from our review of the initial public offer process for mining and exploration entities in the Australian market. It focuses on the roles, responsibilities and conduct of directors, lead managers and corporate advisers.

The findings and better practices are relevant to Australian financial services licensees, corporate advisers, directors and investors in the mining and exploration sector.

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- explaining when and how ASIC will exercise specific powers under legislation (primarily the Corporations Act)
- explaining how ASIC interprets the law
- describing the principles underlying ASIC's approach
- giving practical guidance (e.g. describing the steps of a process such as applying for a licence or giving practical examples of how regulated entities may decide to meet their obligations).

**Information sheets**: provide concise guidance on a specific process or compliance issue or an overview of detailed guidance.

**Reports**: describe ASIC compliance or relief activity or the results of a research project.

## Disclaimer

This report does not constitute legal advice. We encourage you to seek your own professional advice to find out how the Corporations Act and other applicable laws apply to you, as it is your responsibility to determine your obligations.

Examples in this report are purely for illustration; they are not exhaustive and are not intended to impose or imply particular rules or requirements.

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# Executive summary

## Background

1 The mining and exploration industries—also referred to as 'metals and mining' or simply 'mining'—are a cornerstone of Australian equity markets representing over 25% of all ASX-listed entities with a combined market capitalisation of over $300 billion on 1 August 2019.

2 The industry is also a prolific source of initial public offers (IPOs), accounting for over 25% and 35% of IPO activity in 2017 and 2018 respectively. The majority of these listings—97%—sought to raise $20 million or less.

3 Mining IPOs are distinguishable from most others, as companies are often newly incorporated with limited operating history. Our experience is that these IPO prospectuses tend to be lengthy and contain substantial jargon so they can lack clarity. Large portions of prospectuses are usually compiled by external professional advisers, such as geologists and technical services firms. This creates challenges for investors and regulators alike.

4 For this reason, we undertook a detailed review of a sample of mining IPOs occurring between 1 October 2016 and 30 September 2018, focusing on transactions raising less than $20 million. The review considered IPO processes from transaction origination through to on-market trading after listing and involved the collection and review of over 50,000 documents received under notice and voluntary interviews with 45 individuals.

## Our findings

5 We found that:

(a) **Lead managers give preference to a select subset of investors**: There was a common design and structure to many mining IPOs that may consistently deliver positive short-term benefits for a small subset of investors—that is, those within lead manager networks who are able to secure IPO allocations. Retail investors not associated with a lead manager or their networks had limited access to IPO investments.

(b) **Lead managers can initiate the IPO process**: The microcap mining industry can be targeted by professional advisers seeking to secure deal flow by initiating transactions. These professional advisers, including lead managers, are often deeply involved at all stages of the mining IPO process, even during transaction origination and at the inception of the company.

(c) **Lead managers' arrangements often create conflicts of interest**: Common practices by small professional advisory firms and companies lead to increased conflicts of interest. Lead managers often act for both the company and investing clients, hold interests in the company and are often unable to identify whose interest, or what capacity, they are acting in. Company directors may have pre-existing business relationships with professional advisers and may be engaged to provide other services to the company, such as lead management, corporate advisory, or legal services.

(d) **Lead managers may influence the register**: Preferential allocations to investors within lead manager networks generally lead to a 'tight' register and greater levels of influence or control of the company's register by the lead manager. This may also encourage an environment which promotes short-term, rather than long-term, returns.

(e) **Promotional materials are often subject to substandard compliance controls**: Promotional materials were not always subject to control or compliance processes equivalent to the risk that these materials could be used to make misleading statements to investors. These materials include terms sheets, investor presentations, email 'blasts' from investor forums and platforms and the use of quasi-news platforms with 'sponsored content'.

(f) **IPO transaction design and structure may inflate market interest in the company in the short term post-listing:** Promotional activities are often used to increase 'news flow' and interest in a company shortly after listing before it has had an opportunity to deliver the exploration program identified in its prospectus.

## What is in this report?

6 This report outlines the findings of our review of mining IPOs. It is divided into sections based on each stage of the mining IPO process: IPO transaction origination, pre-IPO activities, the IPO, and post-IPO activities.

7 Set out in each section of this report are:

(a) our detailed findings at each stage of the IPO process to inform:

  (i) companies and lead managers of practices we identified in mining IPOs which are of regulatory concern; and

  (ii) investors of the risks that may arise at different stages of the process; and

(b) a number of better practice recommendations for companies, directors, lead managers and investors to reduce the risks of conflicts of interest, misconduct or regulatory harm.

## Next steps

8 We expect lead managers and companies to review and implement the better practice recommendations outlined in this report. We will continue to monitor lead managers’ and companies’ conduct in connection with mining transactions.

9 We may intervene or take enforcement action where we consider there is conduct that is unlawful or poses risks of harm to investors.

10 Our focus will not be limited to the prospectuses lodged by mining companies and we may review practices that occur before, or after, lodgement of a prospectus. In particular, we may focus on activities and conduct by lead managers given the significant roles many have in connection with mining IPOs.

# A Our review

**Key points**

The mining industry was a prolific source of IPOs between 2014 and 2018.

Mining and exploration IPOs are predominantly high volume and low value.

We undertook a detailed review of a sample of mining IPOs occurring between October 2016 and September 2018—the findings from our review are set out in this report.

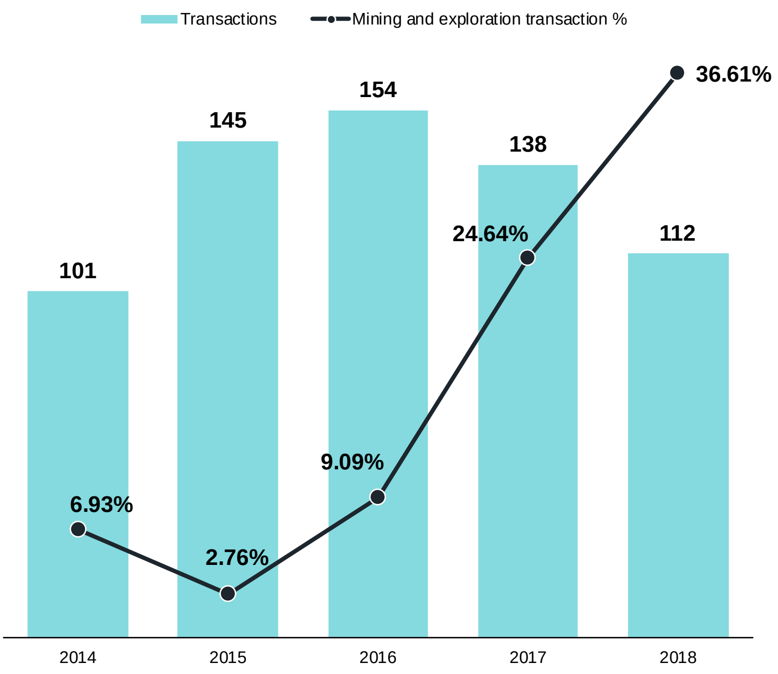
## Background

11 The mining industry—when compared to all other individual industries—was the most prolific source of IPOs between 1 January 2014 and 31 December 2018 with 15.3% of all IPOs attributable to the industry. The total number of IPO transactions for each year between 2014 to 2018 and the percentage of these transactions undertaken by mining companies are shown in Figure 1.

Note 1: Throughout this report, references to IPOs also include offerings in connection with the initial listing of mineral assets effected by reverse takeover offers (RTOs), unless otherwise identified.

Note 2: We regularly publish corporate finance reports, which outline the level of activity in the public fundraising market: see the most recent corporate finance reports on the ASIC website.

**Figure 1: IPOs between 2014 and 2018**




Note: See Table 3 for the data shown in this figure (accessible version).

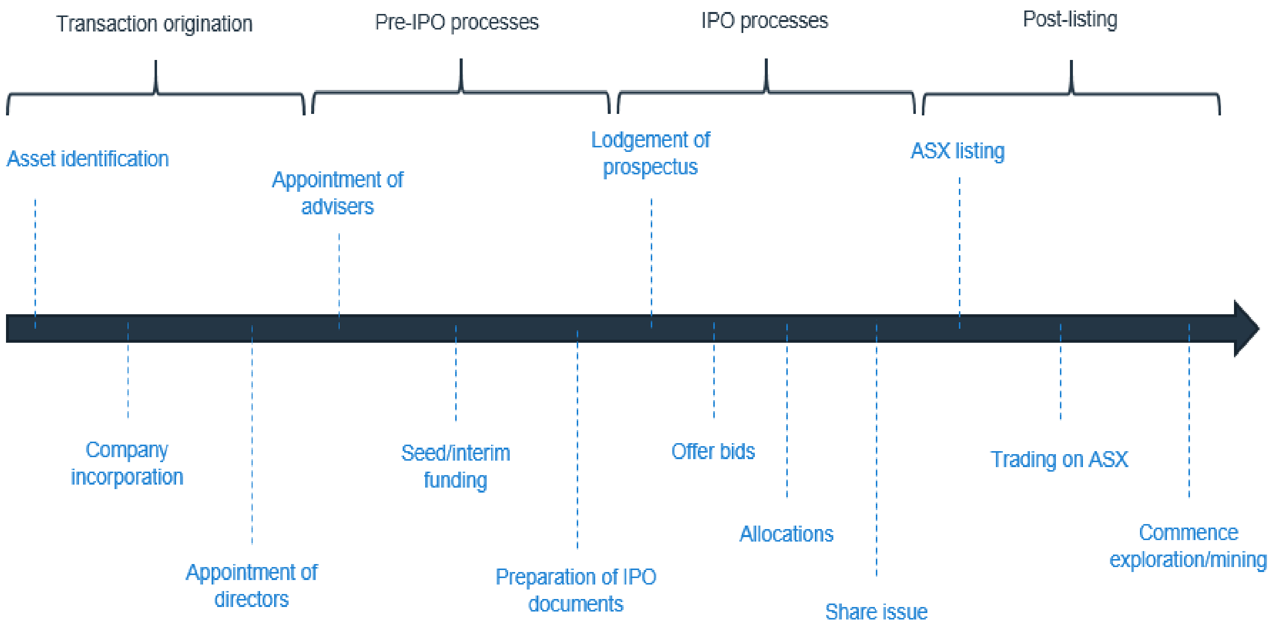
12 While the mining industry accounted for the largest number of IPOs between 2014 and 2018, this did not translate to a comparable share of IPOs by transaction value.

13 When compared to the total IPO market between 2014 and 2018, mining companies accounted for less than 5% of total funds raised. Ninety percent of all mining IPOs sought to raise less than $10 million and only 3% sought to raise more than $20 million.

## What we did

14 Our review encompassed the entire mining IPO process from transaction origination to the pre-IPO processes and the IPO process itself. We also considered some post-listing aspects of the IPO process, such as IPO investor behaviour, ongoing promotional activities and actual uses of funds. The stages of the IPO process review are set out in the timeline in Figure 2.

**Figure 2: Typical timeline for a mining company IPO**




Note: See Table 4 for the data shown in this figure (accessible version).

15 We selected 17 transactions for review from 72 mining IPOs identified between 1 October 2016 and 30 September 2018. We chose a representative sample of the most common types of IPOs in the mining industry. From the 72 IPOs identified, we specifically excluded outliers, including those seeking to raise more than $20 million or IPOs that did not involve a lead manager.

16 See Appendix 1 for further details about the methodology used to choose a representative sample of mining IPOs and lead managers, and for a list of the mining IPOs and lead managers reviewed. For clarity, each of the concerns,

findings and observations identified in this report may not be applicable to all entities named in Appendix 1.

17 We used our compulsory information-gathering powers under the *Australian Securities and Investments Commission Act 2001* (ASIC Act) to obtain information from various companies, lead managers and share registries. We also reviewed public sources of information such as company announcements, trading information and media reporting.

18 Our review also involved interviews with company officers and lead managers to gain a better understanding of their approaches to, and participation in, the IPO process.

19 We conducted a total of 18 interviews with 45 interviewees during the course of the review, including interviews with directors of eight mining companies and representatives of 10 lead managers. Participation in interviews was voluntary.

# B IPO transaction origination

**Key points**

This section outlines our findings on the origin of the mining IPO transactions we reviewed.

It covers the following key areas:

- transaction origination and triggers; and
- the appointment of company officers.

Our review revealed that lead managers can be heavily involved in transaction origination and it is common for there to be pre-existing associations between company directors and professional advisers.

This section also outlines a number of better practice recommendations to help investors understand the risks associated with mining IPOs and to support a robust decision-making process for directors.

## Transaction triggers

### Our concerns

20 Most mining IPOs are undertaken by newly incorporated companies or use the shell of an ASX-listed company. Shell companies are usually dormant and have a low market capitalisation. They are used for the initial listing of mineral assets effected by RTOs.

Note: For the purposes of our review, we classified transactions as RTOs where existing shareholders were diluted by more than 50%, the company was required to re-comply with Chapters 1 and 2 of the ASX Listing Rules and the RTO introduced new mineral assets to ASX.

21 Before listing, mineral assets are often not subject to recent physical exploration, development or production activities. This means mining companies proposing to list may have limited history to demonstrate an ability to execute a proposed business plan or exploration program. It also means that mining IPOs can be initiated without the company needing to obtain significant funding before the IPO.

22 We were concerned that the speculative nature of an investment in exploration mineral assets means the industry is at higher risk of being targeted by professional advisers seeking to generate a pipeline of transactions and associated fees.

## What we found

### An active IPO pipeline market

23 Based on interviews, we understand there is an active primary market for mineral assets where:

(a) individuals or small entities acquire and hold mineral assets and approach lead managers or other professional advisers for support for listing; or

(b) professional advisers, in particular lead managers, seek out mineral assets to put together a portfolio of mineral assets for listing.

24 Some lead managers we interviewed described being persistently approached by parties with mineral assets for prospective listing. These lead managers also described the primary market for the acquisition of mineral assets as relatively non-competitive, with advisers seldom, if ever, having to compete with other advisers to secure assets for a prospective listing.

25 When selecting mineral assets for listing, the lead managers who we spoke to and who are involved in the asset selection process described a range of considerations, including market factors such as commodity prices and the recent performance of comparable listed mineral assets. Most also expressed a preference for mineral assets where a ‘story’ could be crafted, and positive information and news flow could be generated shortly after listing.

### Advisers and transaction origination

26 We found that lead managers and other professional advisers can be heavily involved in transaction origination, including asset selection.

**Case study**

A legal adviser and lead manager approached a technical expert within their professional network to source an exploration project based on the positive outlook and recent market activity for a particular commodity.

A project was identified and a company was incorporated to acquire the project and list on ASX. The legal adviser and lead manager selected board members, including appointing the technical expert as managing director, and were engaged to provide services in connection with the IPO.

27 In one transaction we reviewed, additional mineral assets were acquired by the company undertaking the IPO at the request of the lead manager.

28 In another, a lead manager agreed to assist with an IPO on the condition that directors of the lead manager receive an interest in the mineral asset before it was acquired by the company to be listed. This gives rise to potential concerns about inadequate delineation of the roles of lead managers and the disclosure of fees: see paragraphs 42–56 for further discussion.

### Reverse takeover offers

29 We found that the trigger for undertaking a listing by way of an RTO, as opposed to a new listing, can relate to factors not commonly associated with traditional IPOs. In one RTO transaction we reviewed, the directors' primary rationale for the RTO was ASX's deadline for the company to be delisted, as the company was the subject of a long-term suspension from quotation. We are concerned that time constraints may affect the quality of mineral assets being acquired by a listed shell company and the degree of diligence performed before an RTO is launched and re-quotation occurs.

> Note: ASX-listed entities may be delisted where the company has been suspended from quotation for a continuous period of three years, and this is expected to decrease to two years from 3 February 2020: see ASX Limited, *Guidance Note 33: Removal of entities from the ASX official list*, 15 April 2019.

30 We also found that lead managers commonly have additional interests in RTOs by way of shareholdings or directorships in the listed shell company. During our review, we found some lead managers seek to secure control of listed shell companies, seemingly with the intention to hold the listed shell company for potential future transactions. This practice may limit the prospects of that listed shell company because:

(a) it no longer remains 'on market' for another acquirer or transaction originator;

(b) its funds and the attention of directors are focused on transactions and activities that are more likely to involve the lead manager.

**Case study**

A listed company ceasing operations appointed, on an exclusive basis, a lead manager to seek opportunities for recapitalisation. The company was one of a number of shell entities connected to the lead manager.

More than two years after the directors associated with the lead manager were appointed, a recapitalisation transaction was proposed. The lead manager had been involved with RTOs using other listed shell entities in the intervening period.

31 The case study above is an example of a scenario where risks may arise because the lead manager and directors associated with the lead manager, who may hold multiple directorships, may encounter conflicts when determining which shell entity should be offered RTO opportunities sourced by the lead manager.

### Better practice recommendations

**B1** Investors should be aware of the enhanced risks associated with mining IPOs where transaction originators or private investors have not funded recent exploration to demonstrate the preliminary prospectivity of the mineral assets before listing.

**B2** A robust decision on the structure of an IPO needs to be made by directors. Independent advice may be required where a professional adviser recommends an RTO using a shell company they control and where that adviser will benefit.

**B3** The involvement of lead managers and professional advisers in transaction origination, including interests in the entity being listed or assets being acquired should be clearly disclosed in the company's prospectus. Companies should note ASX's guidance for disclosure of pre-listing placements in section 4.4 of *Guidance Note 1: Applying for admission – ASX listings*, 1 December 2019.

## Company officers

### Our concerns

32 The sequence of events in mining IPO transactions may mean that many decisions at the early stages of the IPO process are effectively made by transaction originators before the appointment of company officers.

33 We were concerned that in some cases the appointment of directors may only occur on the condition that decisions made by IPO originators were ratified and supported by the incoming directors. We were therefore concerned about the independence of directors at the origination stage of the IPO process.

34 We were also concerned transaction originators taking on multiple roles—including director, lead manager and corporate adviser—could contribute to decisions being made by the company in which they had a material interest, without robust controls being in place: see also paragraphs 53–56.

### What we found

35 During our review, we found that:

(a) decisions about a mining company's business, IPO process and the appointment of professional advisers are usually made by transaction originators before a company is incorporated or a listed shell company is acquired to undertake an IPO;

(b) the directors we interviewed generally cited their role in acquiring the mineral asset or an existing relationship with a professional adviser as the origin of their appointment; and

(c) it was common to see company officers acting in other advisory capacities for the mining company, including legal, lead management or corporate advisory. This may give rise to issues with conflicts and governance: see, for example, the case study below.

36 The reasons why directors were appointed were usually not clear in prospectus disclosures. Prospectus disclosures usually failed to clearly identify directors' conflicts, the implications of those conflicts—which may also include an inability to form a quorum to make decisions—and how conflicts would be managed. Interviews with directors usually elicited more detail on the reasons for their appointment and their specific expertise relied on by other directors.

**Case study**

A company sought an ASX listing with mineral assets spun out of an existing listed company (Vendor Limited) into another company for listing (New Company Limited).

Vendor Limited, New Company Limited and the lead manager all had the same directors, raising issues under s195 of the Corporations Act as a quorum of directors of the company proposing to acquire the mineral assets could not be formed to execute the lead manager mandate.

37 During interviews we identified that companies can benefit from robust conflict management processes and procedures. We found in one case there was clear recollection by the company's directors of actions and processes introduced by the company secretary to manage specific conflicts throughout the IPO. Other company directors' descriptions of their conflict management processes during the IPO process were usually generic and relied on conflicts being obvious and common knowledge.

38 In all cases where the lead manager and other professional advisers were originators of a transaction we did not find incoming directors closely scrutinizing the decisions made by transaction originators.

39 Preliminary negotiations for assets were usually conducted by the lead manager and not challenged, appointment of the lead manager was non-controversial and without exploration of alternatives and the quantum of the funds to be raised already set and accepted. In many cases this extended to the appointment of the legal adviser who had previously worked with a lead manager or transaction originator.

## Better practice recommendations

**B4** Directors and companies should implement robust conflict management processes and procedures. Company officers should also note ASX's guidance on the appointment of officers and employees of lead managers as company directors in footnote 73 of ASX Limited, *Guidance Note 1: Applying for admission – ASX listings*, 1 December 2019.

**B5** Directors who are independent of mineral asset vendors, lead managers and other professional advisers, should be identified and appointed as early as possible in the IPO process.

**B6** Directors should ensure they are acting in the best interests of the company when making decisions, including in relation to proposals put forward by transaction originators.

**B7** Professional advisers should only be engaged by directors after considering alternatives, and directors should only engage advisers where doing so would be in the interests of the company. Directors who engage advisers in return for their appointment as a director may risk contravening their directors' duties.

# C Pre-IPO processes

**Key points**

This section outlines our findings on activities occurring before the launch of mining IPOs.

It covers the following key areas:

- lead manager mandates;
- seed funding; and
- the preparation of IPO documents.

Our review found that lead manager mandates and activities can give rise to conflicts, seed funding can be used to incentivise other parties to participate in the IPO, and prospectuses are primarily considered a compliance document by company directors.

This section also outlines a number of better practice recommendations to help enhance the quality of mandates, provide companies and lead managers with a greater understanding of conflicts and ensure IPO investors do not base their investment decision on misleading statements made outside the prospectus.

## Lead manager mandates and conflicts

### Our concerns

40 The execution of a lead manager mandate is a key milestone in the process for listing as it forms a connection between a mining company and capital markets. The mandate sets out the terms of a lead manager's engagement with the company, including the lead manager's role and responsibilities in connection with the offer and the fees payable by the company.

41 We were concerned that:

(a) lead managers may seek to include terms and conditions in their mandates with mining companies that provide them with a disproportionate amount of influence when compared to their own shareholdings in the company;

(b) the amount of fees payable to lead managers and the complexity of remuneration structures may be underestimated by companies and directors when agreeing mandates, and consideration may not be given to the behaviours certain forms of remuneration might encourage; and

(c) lead managers may have conflicting duties to different clients—their investing clients versus the company they provide lead management services to versus the lead manager as a shareholder itself—as part of the same transaction.

## What we found

### Mandates post-IPO

42 In the majority of transactions reviewed, mandates enabled the lead manager to provide ongoing corporate advisory services following listing, in addition to services during the IPO. This is consistent with general practice among other companies seeking to raise low levels of funds by way of IPO, but is less common for larger fundraisings.

43 The services offered under the mandates we reviewed were often drafted in vague terms, particularly for the ongoing corporate advisory services which were usually described as various 'support' services.

44 When we asked lead managers about their expectations of the corporate advisory services to be provided under the mandate they often cited investor roadshows and other promotional services. Most lead managers also indicated that IPO lead management services would usually not be offered without the right to continue acting as corporate adviser. The stated rationale for this was that investors expected lead managers (as promoters of the IPO) to remain involved with the company after listing—if this were not the case, investors would be less likely to invest.

45 The expectations of directors were more varied, with some referring to introductions to investors and advice on future raisings and others not identifying any specific services. Some directors referred to fees payable for corporate advisory services as a 'trailing commission' for the IPO.

### Remuneration

46 Most of the mandates we reviewed provided that lead managers were entitled to a combination of fees based on funds raised. Fees were usually a 'capital raising fee' of 4–6% of funds raised by the lead manager with an additional 'management fee' of 1–2% of funds raised. Commonly, standard fees would also include a fixed component payable for corporate advisory services of usually $5,000–$10,000 per month for a minimum of 12 months. These fees were considered industry standard by most directors and lead managers we interviewed for mining and non-mining transactions raising less than $20 million.

47 We identified that other benefits which lead managers may receive included access to discounted securities in seed raisings to pay the costs of the IPO—see paragraphs 57–66—or facilitation or advisory shares or options and preferential allocations.

48 To look into this issue in more detail, we analysed 86 mining IPOs between 2014 and 2018 where fees were publicly disclosed. On average, total fees received by lead managers represented 13.64% of the maximum funds to be raised under the IPO, with a median of 9.75%. Table 1 sets out the different

forms of benefits and the average and median percentage that each particular form of remuneration contributes to total lead manager remuneration and is divided into four quartiles based on the percentage of total fees to the maximum IPO offer.

Note: There were 97 mining IPOs raising less than $20 million between 1 January 2014 and 31 December 2018. Of these, 11 transactions had insufficient data to include in the remuneration analysis. Therefore, the population analysed included 86 companies.

**Table 1: Average and median lead manager benefits as a percentage of maximum IPO offer**

| Quartile | Quartile 1 | Quartile 2 | Quartile 3 | Quartile 4 |
|---|---|---|---|---|
| **Average equity remuneration** | 2.26% | 1.98% | 5.85% | 19.57% |
| **Median equity remuneration** | 1.94% | 1.94% | 5.24% | 14.64% |
| **Average commission** | 4.91% | 6.03% | 6.01% | 5.80% |
| **Median commission** | 5.00% | 6.00% | 6.00% | 6.00% |
| **Average fixed fees** | 1.58% | 2.11% | 2.81% | 3.11% |
| **Median fixed fees** | 0.86% | 1.59% | 2.40% | 2.16% |
| **Average underwriting fees** | 6.21% | n/a | n/a | 3.50% |
| **Median underwriting fees** | 6.21% | n/a | n/a | 3.50% |
| **Average total fees** | 5.10% | 8.12% | 13.10% | 27.97% |
| **Median total fees** | 5.98% | 8.25% | 13.33% | 22.22% |

Note 1: Equity values are based on assessed values by investigating accountants.

Note 2: The averages and medians in Table 1 are based on transactions where that form of remuneration was provided, rather than being averaged across all transactions or all transactions in the relevant quartile. For example, the average equity remuneration of 2.26% for Quartile 1 is the average equity remuneration across transactions within Quartile 1 where the lead manager received equity remuneration, not the average equity remuneration across all transactions in Quartile 1.

Note 3: Instances where averages are materially higher than medians demonstrate that there are outliers at the high end of the relevant quartile receiving significantly higher remuneration or higher levels of particular remuneration components when compared to other companies in the quartile. For example, the average equity remuneration of 19.57% for Quartile 4 demonstrates that there are outliers within this quartile which are receiving significantly more equity remuneration than the majority of companies in that quartile. Included in Quartile 4 are instances where equity remuneration represented over 50% of the funds to be raised.

49 Where lead managers' benefits represented a larger percentage of the maximum funds to be raised, it was common for a significant portion of their benefits to be in the form of equity remuneration. In Table 1 above, the average equity remuneration for Quartile 4 is 69.97% of the average total fees for Quartile 4. This can be compared to Quartile 1 and Quartile 2 where the average equity remuneration made up 44.31% and 24.38% of average total remuneration respectively.

50 A material part of equity remuneration can be 'facilitation' or 'advisory' shares and options which are generally described in prospectuses as issued in exchange for the lead manager's assistance with the IPO. The prospectus also often states that this part of the fee may be 'paid away' to other brokers or advisers of AFS licensees. However, lead managers we interviewed stated that, in practice, they would seek to limit the amount 'paid away'.

51 Our analysis indicated that transactions where lead manager fees, as a percentage of funds raised, exceed 30% are more likely to be RTOs and spin-offs. This outcome arises because lead managers generally receive a greater number of issued options and facilitation shares which are approved as part of the recapitalisation or spin-off approvals sought from existing shareholders.

52 Lead manager remuneration is usually disclosed to companies, and in investor materials, in a manner that lacks prominence or makes it difficult to determine total aggregate fees.

Note: Regulatory Guide 228 *Prospectuses: Effective disclosure for retail investors* (RG 228) sets out our guidance on disclosure of benefits to promoters in prospectuses.

### Conflicts

53 Lead managers, as AFS licensees, are subject to a range of obligations in s912A of the Corporations Act. These include obligations to provide financial services efficiently, honestly and fairly, and to have in place adequate arrangements for managing conflicts of interest. AFS licensees are also required to ensure that any authorised representatives appropriately manage conflicts of interest: see Regulatory Guide 181 *Licensing: Managing conflicts of interest* (RG 181).

Note: RG 181 sets out our guidance on disclosing conflicts of interest to investors.

54 During our interviews we found that:

(a) as previously noted in Section B, lead managers are often appointed as a result of their role in transaction origination and may as a consequence have other interests in the transaction including, for example, a pre-existing interest in mineral assets being acquired by the listing company or a substantial interest in listed shell companies used to effect an RTO;

(b) lead managers could not always identify who their client was and whose interests they were acting in when performing tasks seemingly within their mandates with the company. Similarly, directors of the company were often uncertain, particularly after listing, whether lead managers were acting as corporate advisers or as representatives of the investors they introduced to the IPO;

(c) lead managers we interviewed usually indicated they relied on an assumption that if the company does well, investor clients will do well, and for that reason there are no conflicts that require managing; and

(d) lead managers are also regularly shareholders in the company as they receive facilitation or advisory shares as part of their remuneration—this may exacerbate conflicts of interest.

55 We found it was common for smaller lead manager firms to have limited or no barriers, controls or conflict management processes between services provided to corporate clients and investor clients.

56 The case study below provides an example of activities undertaken by a corporate adviser to a company (who had previously acted as lead manager in connection with the company's IPO) which may reflect a failure to recognise conflicts between the interests of the company and the lead manager's own interests.

**Case study**

An exploration company undertook a successful IPO. The lead manager was retained as a corporate adviser after listing and was also a shareholder in the company, partly as a result of equity remuneration for lead management services. Collectively, the lead manager and its associates held more than 5% of the company's issued capital.

After trading at a discount to the IPO issue price following listing, the company received a s249D notice from the lead manager and its associates seeking to replace certain company directors with their own nominees.

The resolutions to change the company's directors were unsuccessful and a second s249D notice was issued by the lead manager. The second notice was withdrawn after the company and the lead manager reached an agreement that involved the lead manager providing ongoing advice.

### Better practice recommendations

**C1** Lead manager mandates and corporate advisory mandates should:

(a) clearly identify the obligations and responsibilities of the lead manager—vague terms to describe or quantify levels of service should be avoided;

(b) disclose any actual, potential or perceived conflicts of interest; which services are being provided under the lead manager's AFS licence and which are not; and how the lead manager intends to manage any actual, potential or perceived conflicts of interest;

(c) clearly set out the total aggregate remuneration payable for lead management and other services, including a valuation of any benefits contingent on subsequent events; and

(d) be drafted specifically for an engagement and not rely on vague or boilerplate terms, particularly regarding conflicts and services to be provided.

**C2** Lead managers should implement robust conflict management processes and procedures in relation to their roles as lead manager, company adviser, investor adviser and shareholder.

**C3** Directors should:

(a) understand what services are being provided for the remuneration payable to lead managers and corporate advisers;

(b) seek clarification if at any time they are unclear of the capacity in which a lead manager offers advice;

(c) understand the value of the total remuneration payable to lead managers and how this compares to benchmarks;

(d) assess whether post-IPO services provide value to the company before agreeing to such services;

(e) be satisfied they clearly understand the potential consequences of conflicts described by lead managers before agreeing to mandates; and

(f) assess whether the conflict management processes adopted by the lead manager are appropriate.

**C4** Prospectus disclosures should:

(a) clearly and prominently set out the total aggregate benefits payable to lead managers, including contingent remuneration. Directors should also consider ASX's guidance in section 4.3 of ASX Limited, *Guidance Note 1: Applying for admission – ASX listings*, 1 December 2019, when considering how fees are disclosed;

(b) appropriately describe fees, including appropriately describing 'trailing commissions' as such when there is no intention to deliver additional services;

(c) not obscure the total fees payable by referring to arrangements—such as 'pay away' arrangements—where the intentions of the company or lead managers are to limit such arrangements; and

(d) clearly set out the services the lead managers will be providing in exchange for the fees disclosed.

## Seed funding

### Our concerns

57 Before an IPO it is common for mining companies to raise funds specifically for the IPO process and any short-term interim business activities—this can be referred to as 'seed funding', 'seed capital' or 'interim funding'.

58 We were concerned that seed funding provides an opportunity for advisers, their associates and others in their networks to increase the benefits and returns they receive as part of the overall IPO process by selectively pricing and placing seed funding.

## What we found

59 In the transactions reviewed, most companies sought seed funding almost exclusively for the purpose of paying the costs of the IPO. There were only a limited number of exceptions to this where interim funding was intended to fund preliminary exploration activities.

### Price and volume of seed funding

60 We compared the prices at which seed capital was raised and the IPO prices for 43 mining IPOs between 2014 and 2018 to ascertain the discounts to IPO prices which seed investors may receive. This analysis revealed that:

(a) seed discounts in the transactions reviewed ranged from 25–95%;

(b) seed discounts were largely randomly distributed with a slight tendency towards a discount of 50%;

(c) in some cases, seed funding was undiscounted but incentives of free attaching options were offered instead;

(d) seed amounts raised ranged from $100,000 to over $1,000,000; and

(e) the majority of seed amount raised was less than $500,000.

Note: Mining IPOs where no seed funding was raised and where there was insufficient data were not included in the analysis.

61 Consistent with the largely random distribution of seed discounts, many of the lead managers and companies interviewed described the process for determining a price for seed capital and an appropriate discount as a ‘dark art’, with the responsibility for the structure and pricing largely left to lead managers. This results in inconsistencies in the industry for seed funding, with both the quantum of funds needed to achieve listing and the appropriate discount for that seed funding varying widely.

62 All lead managers identified the risk of an unsuccessful IPO and the impact seed raisings would have on a company’s enterprise value for the IPO as considerations when pricing seed funding. Some lead managers also considered incentives in the pricing, as most seed funding was offered to others who could assist in raising IPO funds, including select clients, other advisers or brokers of AFS licensees: see paragraphs 63–66.

### Allocation of seed funding

63 The allocation of seed capital was generally performed by lead managers and signed off by company directors. Allocations were usually to a combination of the directors of the lead manager, their associates and a few select clients, other professional advisers and brokers and advisers connected to AFS licensees.

64 Many lead managers told us the allocation of seed funding to brokers and advisers connected to AFS licensees was used as a method of de-risking the IPO as other parties with the ability to raise capital would have an interest in the outcome of the IPO.

65 The rationale for this allocation strategy was occasionally more overt with specific commitments sought in exchange for an allocation, such as an allotment of $10,000 of seed capital in exchange for a $125,000 commitment to the IPO. Several instances were identified where advisers and brokers of AFS licensees indicated they would not participate in IPOs citing their non-participation in seed funding.

66 The allocation of seed funding to incentivise advisers and brokers of AFS licensees may enhance the risk that conflicts of interest arise for those advisers and brokers of AFS licensees when advising on IPO and seed pricing or recommending the IPO to their investor clients.

### Better practice recommendations

**C5** Directors should understand the rationale behind the pricing and quantum of seed funding being sought.

**C6** Seed capital priced with an incentive element should be clearly disclosed in the prospectus. Where there are preferential allocations of ‘seed’ or preferential pricing for ‘seed’ funds, this may also need to be disclosed as a potential conflict or as remuneration if it is issued to a director, adviser or promoter at a substantial discount. For example, where promotors or AFS licensees receive seed allocations for nominal funds or at a larger discount to other seed investors this should be clearly disclosed with other remuneration and benefits. Directors should also consider section 4.4 of ASX Limited, *Guidance Note 1: Applying for admission – ASX listings*, 1 December 2019, section 2.2 of ASX Limited, *Guidance Note 11: Restricted securities and voluntary escrow*, 1 December 2019 and section 3.4 of ASX Limited, *Guidance Note 12: Significant changes to activities*, 1 December 2019.

**C7** Directors should understand the allocation strategy for seed capital before the process commences. They should consider challenging allocations where a large amount of seed capital is intended to be offered and placed with associates of the lead manager.

## Preparation of IPO documents

### Our concerns

67 As with many types of IPOs, it is common for lead managers and mining companies to prepare term sheets and investor presentations to help with the promotion of the IPO. A term sheet summarises the details of the IPO,

usually in one or two pages, and the investor presentation provides a high-level summary of the company's mineral assets and prevailing commodity trends, usually in 20 to 30 slides.

> Note: We have previously conducted a review to examine how IPOs are generally marketed to retail investors: see Report 494 *Marketing practices in initial public offerings of securities* (REP 494).

68 We were concerned that there is a material risk that term sheets and presentations may contain misleading statements and other information which is not consistent with prospectus disclosures. The significance of this risk may be heightened where terms sheets and investor presentations are promoted as the main source of information for those making investment decisions, are prepared before the prospectus and are not subject to sufficient scrutiny to ensure statements comply with the Corporations Act.

## What we found

69 It is common for term sheets and investor presentations to be prepared long before the prospectus and circulated as early as the seed funding process. These documents are then continually used throughout the pathfinder processes and roadshows. Following lodgement of the prospectus, they will also generally be circulated with the prospectus as a suite of IPO documents.

70 A number of directors interviewed expressed the view that the purpose of a prospectus was largely compliance and to demonstrate to investors the degree of due diligence the directors had undertaken in preparing the IPO. Most saw the prospectus as a templated process which, when complete, would offer protection from liability.

> Note: The Corporations Act provides a defence against s728(1) and 728(3) of the Corporations Act where a person can demonstrate that they have made all reasonable inquiries and believed on reasonable grounds that there was no omission from the prospectus and that statements in the prospectus were not misleading and deceptive.

71 This view expressed by directors is consistent with our findings that mining prospectuses were largely not typeset, lacked the stylistic features of prospectuses in other industries, were highly templated, and were long and technical.

> Note: Report 540 *Investors in initial public offerings* (REP 540) identified the length and complexity of prospectuses as challenges for retail investors.

72 While some companies and lead managers acknowledged that particularly diligent investors may read the prospectus for specific details, readability for retail investors was not the predominant consideration when prospectuses were drafted and the prospectus was not used in promotional activities.

73 Most term sheets and investor presentations we reviewed did not provide a balanced view of the proposed investments, largely ignored risks, occasionally contained misleading statements—particularly about mineralisation and 'nearology', which were inconsistent with industry standards—and contained statements inconsistent with the prospectus.

Note: 'Nearology' refers to a practice where a company refers to mineral discoveries or share price performance of another entity with tenements in proximity to those held by the company. Such statements can be misleading where there is no evidence of continuity of mineralisation and where the geological profiles of the companies' mineral assets may differ.

**Case study**

An investor presentation was prepared for an exploration company seeking to list on ASX. The presentation was used throughout the IPO process and contained numerous statements about selective high-grade intercepts from an historical drilling program. The statements did not comply with the JORC Code and did not disclose the context of the drilling, including details of the drilling program undertaken.

74 In some instances, lead managers also add their own observations and analysis to terms sheets and investor presentations which may be misleading or inconsistent with prospectus disclosures. We also sighted communications where advisers had modified prospectus information, including communications where the closing date of the offer had been changed to create a sense of urgency.

Note: See Section E of Report 605 *Allocations in equity raising transactions* (REP 605) which discusses messaging, and concerns around messaging, to investors.

75 We found that lead managers' and companies' internal controls over the preparation of term sheets and investor presentations were not always consistent with the prominent use of these materials in marketing to investors. Term sheets were drafted by lead managers and in some, but not all, instances reviewed by the company and their legal advisers before being issued. Presentations were generally drafted by the company, but not always reviewed by a legal adviser before distribution.

76 We are concerned that, where term sheets and investor presentations are not reviewed for compliance, lead managers and companies may be at significant risk of making misleading statements to investors.

77 We do not agree with the position, advised by some lead managers, that referring an investor to a prospectus when making an application for securities would remedy false and misleading statements previously circulated to that investor through term sheets and other promotional material.

78 Many lead managers told us that they believe companies have primary responsibility for term sheets, presentations and prospectuses. However, lead managers may be liable if they:

(a) are involved in a contravention of the fundraising provisions of the Corporations Act (s729 of the Corporations Act);

(b) advertise the offer or publish a statement that refers to the offer but does not comply with advertising restrictions (s734 of the Corporations Act); or

(c) are named in the disclosure document and fail to notify the company if they become aware of a material statement in the prospectus which is misleading or deceptive, there is a material omission from the prospectus or there is a new circumstance that needs to be included in the prospectus (s729 and s730 of the Corporations Act).

79 Lead managers may also be liable for making misleading representations in connection with the provision of financial services: see, for example, s769C of the Corporations Act regarding forward-looking statements.

### Better practice recommendations

**C8** When drafting and distributing promotional materials directors and lead managers should be aware of the disclosure standards required for an IPO, including balanced disclosure and compliance with industry standards for disclosure of technical information.

> Note: RG 228 sets out our guidance on how to prepare prospectuses that satisfy the content requirements in s710 of the Corporations Act, including guidance on the use of mining industry standards.

**C9** Lead managers and advisers and brokers of AFS licensees should understand their liability under the Corporations Act for IPO activities, particularly as it relates to promotional activities, and should implement controls to internally manage that liability.

**C10** Presentations and term sheets should not be used to make statements that could not be made in a prospectus.

# D IPO process

**Key points**

This section outlines our findings on activities occurring during the IPO. It covers the following key areas:

- applications and allocations;
- shareholder spread; and
- promotion of the offer.

During the review it became clear that lead managers generally prioritise allocations within their networks—potentially impacting the ability to meet spread requirements—and sometimes provide allocations on the understanding that investors will act in accordance with the lead manager's expectations following listing.

Given that the majority of IPO securities are placed with lead manager networks, the review also highlighted that the majority of promotion occurring during the IPO is intended to generate interest in secondary market trading.

This section also outlines a number of better practice recommendations for lead managers, companies and company directors in connection with mining IPOs.

## Applications and allocations

### Our concerns

80 The general public often have limited access to mining IPOs due to the way allocations are usually structured, with heavy use of firm bids. This is not communicated to, or well understood by, some investors in the market.

81 We were also concerned that, given the substantial majority of mining offers only seek limited capital from an IPO, lead managers may control the allocation process by allocating entirely within their immediate networks, particularly where a company has little involvement and relies on the lead manager's allocation recommendation.

Note: As outlined in REP 605, receiving an allocation can offer value to investors so lead managers may seek to make allocation recommendations which may further their commercial interests.

### What we found

82 We found that applications for securities in response to an IPO come from three broad sources: firms seeking an allocation (‘firm bids’ or ‘firm commitments’), individuals connected to management, and general members of the public (general retail). The substantial majority of IPO funds raised in the transactions reviewed were raised by way of firm bids. However, this was often also supplemented by a small amount of seed funding that was sought to fund the costs of the IPO: see paragraphs 57–66.

83 The firm bid process for the majority of the mining IPOs reviewed does not generally involve institutional investors, and entails AFS licensees or their representative applying, usually at the invitation of the lead manager, for an allocation of IPO securities which are then allocated among the AFS licensees’ clients.

84 Firm bid processes are common in many areas of the market. However, in mining IPOs, limited access for the general public—outside lead manager and professional adviser networks—is generally not disclosed in prospectuses. We are concerned that this may result in potential market inefficiencies where investors may review the prospectus and apply for securities in circumstances where IPO securities may not in practice be available to investors outside the lead manager’s or broker firms’ networks.

85 Companies and directors, although involved in the final signoff for allocations prepared by the lead manager, were not usually involved in the allocation process and lead managers were often acting without specific instructions from directors on the type of investor they desired on the register.

86 We identified a risk that, by having primary control over the marketing, firm bid and allocation processes, lead managers generally provide preferential access for those within their networks with whom they have a pre-existing relationship. This may also result in lead managers having influence over a significant part of a company’s share register on listing.

87 A consequence of using this selective process in offering IPO securities can be that the register becomes ‘tight’ and those invited to participate in the IPO by the lead manager may be expected, even if not bound, to behave in a certain manner after listing so they are not excluded from participation in future offers: see paragraphs 89–98 for a discussion on shareholder spread.

88 Instances of conduct and influence by lead managers over the allocation processes and companies’ share registers included:

(a) ‘blacklisting’ investors so they would not receive allocations;

(b) closely monitoring and questioning investors selling securities shortly after listing;

(c) correspondence from a lead manager to brokers and advisers of AFS licensees who had received allocations specifying daily volumes that could be traded; and

(d) lead managers communicating expectations that shareholders receiving allocations continue to hold securities after listing.

Note: Lead managers should be aware that engaging in conduct either individually or in concert to influence the trading of securities could result in allegations of market manipulation—see s1041A of the Corporations Act—and could, depending on the nature of the influence, result in the lead manager having a relevant interest in the securities under s608(1)(c) of the Corporations Act.

**Case study**

A lead manager sought share register movement reports from a company and then contacted investors to check whether they had sold their IPO allocation.

One investor responded, advising that they had sold their allocation, but they also had a potential mineral asset that could be used for a new listing.

This interaction was shortly followed by correspondence where the shareholder advised they had purchased shares on market with the comment ‘I take it this is the sort of support you are looking for from clients?’.

## Better practice recommendations

**D1** Lead managers and companies should review and implement the better practices set out in REP 605, which recommend that:

(a) lead managers should have a policy and procedures that set out their process for managing allocation recommendations. The policy and procedures should consider a range of factors to ensure a fair and efficient allocation process and avoid or minimise potential conflicts (see C1 in REP 605);

(b) lead managers should clearly articulate and document the role of compliance (or an equivalent review function) in the allocation process and consider how they ensure they are complying with their regulatory obligations on an ongoing basis (see C2 in REP 605);

(c) lead managers should discuss their approach to allocations with companies; identify, disclose and explain the management of conflicts; and only make allocation recommendations where there is a reasonable basis (see D1 in REP 605);

(d) companies should understand and engage with the allocation process, including discussing the approach to allocations with the lead manager, possibly including in mandates provisions about how allocation decisions should be made, asking the lead manager to explain how an allocation recommendation is consistent with the lead manager's allocation policy and the company's objectives, and asking questions about allocation recommendations (see D2 in REP 605); and

(e) lead managers should avoid potential conflicts by not making allocation recommendations to employees or principal accounts except where an offer is undersubscribed and the allocation is limited to the extent necessary (see F2 in REP 605).

**D2** Companies should disclose the availability of the offer to general retail investors and, if investors are required to use a particular channel to acquire securities and receive an allocation, identify the process (e.g. any relevant online market platform) for applications for securities.

## Shareholder spread

### Our concerns

89 ASX imposes a number of requirements on companies seeking a listing in order to ensure the quality of the market it operates. These requirements include a minimum 20% free float and a minimum of 300 non-affiliated investors holding at least $2,000 in shares: see ASX Listing Rules, Chapter 1 'Admission', 19 December 2016.

90 We were concerned that the promotion and allocation processes which minimise exposure to retail investors unknown to the lead manager or an AFS licensee in their network, could:

(a) provide motivation to manufacture spread requirements as part of the IPO process; or

(b) result in spread being achieved using methods where the investors allocated securities to meet spread are short-term investors—not interested in the mining company or its prospects—who will exit their holdings shortly after listing.

91 We have previously taken action to ban individuals in connection with conduct to provide false spread in relation to IPOs: see Media Release (19-209MR) *Former financial advisor and consultant charged with dishonest conduct* (12 August 2019) and Media Release (19-094MR) *ASIC bans Perth accountant from providing financial services for six years* (17 April 2019).

### What we found

92 Given the size of the funding sought in an IPO by mining companies—generally less than $10 million—lead managers could usually raise the funds required for an IPO exclusively within their immediate networks. Funds may not need to be raised from the general public if it were not for ASX's spread requirements.

93 During our review we found:

(a) it was not uncommon to see communications close to the end of the offer period between the lead manager and advisers and brokers of AFS licensees highlighting the need to obtain more shareholders to meet ASX's spread requirements;

(b) lead managers would often impose requirements on those receiving allocations to ensure that applications were received from a specified minimum number of applicants where each holding would be classified as separate holdings for the purposes of spread; and

(c) instances where communications referred to purchasing names to meet spread requirements.

94 We identified instances in some transactions reviewed where lead managers approached or considered approaching particular advisers and brokers of AFS licensees who have since been subject to enforcement action for manufacturing spread: see, for example, 19-209MR.

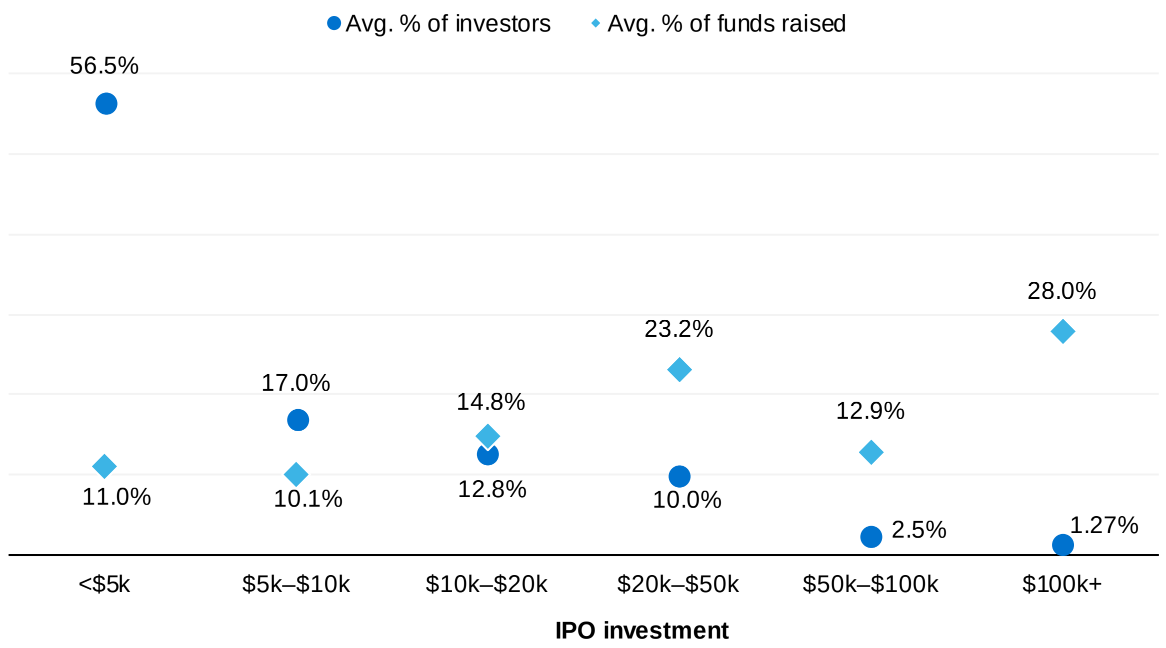
95 We analysed 16 company share registers to determine the portion of the share registers—by value and number of investors—attributable to investors holding specified amounts of shares at listing.

96 The results of this analysis are set out in Figure 3 and show that:

(a) investors with holdings less than $5,000 comprised over 50% of the register by number of investors but less than 15% of the register by value;

(b) investors with holdings greater than $50,000 comprised less than 5% of the register by number of investors but over 40% of the register by value.

**Figure 3: Percentages by number and by value of IPO investment at listing**




Note 1: Of the 17 transactions selected for review, one transaction was excluded on the basis that the relevant share register data was insufficient to include in the analysis.

Note 2: See Table 5 for the data shown in this figure (accessible version).

97 Some lead managers expressed that ‘pay per name’ and other spread services are now more readily available with the emergence of online platforms that give access to a larger number of general retail investors. These online platform services allow general retail investors to apply for securities, usually subject to caps, such as $2,000 or $5,000.

98 We found many lead managers consider meeting the spread requirements one of the most onerous aspects of the listing process. However, we also identified that issues with meeting spread were often underpinned by lead managers’ preference to place allocations with investors within their networks and maintain a ‘tight’ register (over which they might have a greater level of influence) after listing.

### Better practice recommendations

**D3** Directors should:

(a) make inquiries of the company’s lead manager to determine their strategy to achieve spread;

(b) seek to understand how the firm commitment process will be managed to ensure sufficient securities remain available to achieve spread—for example, whether the lead manager intends to scale back allocations to free up securities, whether a broad range of investors will be approached as part of the firm commitment process or whether a portion of securities will be left unallocated to help meet spread requirements.

## Promotion of the IPO

### Our concerns

99 We were of the view that many public promotional activities during the IPO period were predominantly designed to target secondary market investors. These materials tend to exaggerate prospects, lack balance against investment risks, are inconsistent with prospectus disclosures and may be misleading.

100 We were concerned that companies do not always have oversight of public promotional activities and that both companies and lead managers may have inadequate processes to ensure the accuracy and compliance of statements in public promotional material.

### What we found

101 In relation to the public promotional strategies of mining IPOs, we found that:

(a) the promotional strategy is often unclear and variable, with some stakeholders taking a ‘spray and pray’ approach;

(b) the delineation of the responsibilities of the company, lead manager and other professional promoters is usually unclear; and

(c) while the timing of public promotional activities between mining companies may vary, it was apparent that offers had often been allocated when public promotional activities commenced. Our interviews confirmed that activities were often targeted to promote trading on secondary markets rather than to promote the IPO to prospective IPO investors.

102 Company directors and lead managers usually commented that the ability to generate positive information, or news flow, in the short term following listing was key to positive share price performance and a fundamental part of the IPO process.

103 The public promotional methods used by companies and lead managers included engagement of professional public relations firms, setting up social media accounts, email ‘blasts’ from investor forums and platforms, and the use of quasi-news platforms with ‘sponsored content’.

104 We found that lead managers would often engage public promotional services on behalf of the company and that directors did not always have oversight of the final version of public promotional material, which increased the risk of misleading information being distributed to potential investors.

### Better practice recommendations

**D4** Directors should review and approve all public messages made on behalf of the company during and after the IPO process. Statements made, even to sophisticated investors, may require later correction if they are inconsistent with prospectus disclosures or are misleading.

**D5** Companies should implement compliance processes for drafting, reviewing and publishing promotional statements and documents.

# E Post-IPO offering

**Key points**

This section outlines our findings on IPO investor exits, share price performance, promotion and companies' use of funds following the IPOs.

Our review revealed that some IPO investors may have short-term objectives and exit their IPO investment shortly after listing, often with an opportunity to realise a profit.

We also found that mining companies whose post-listing expenditure materially departed from prospectus disclosures were more likely to promote at the time of the IPO relatively high exploration spend when compared to administration and other costs.

This section also outlines a number of better practice recommendations for investors, company directors and lead managers for a greater understanding of how the secondary market for a company's shares may operate.

## Post-IPO performance

### Our concerns

105 We were concerned that the way IPO allocations occur, spread requirements are met and mining IPOs are promoted, may mean:

(a) some IPO investors not genuinely interested in the company's assets or longer-term prospects may leave the register shortly after listing;

(b) there is pressure for companies and lead managers to achieve premiums to IPO prices shortly after listing; and

(c) the short-term perspective of some investors and advisers may affect how exploration programs described in a prospectus are delivered.

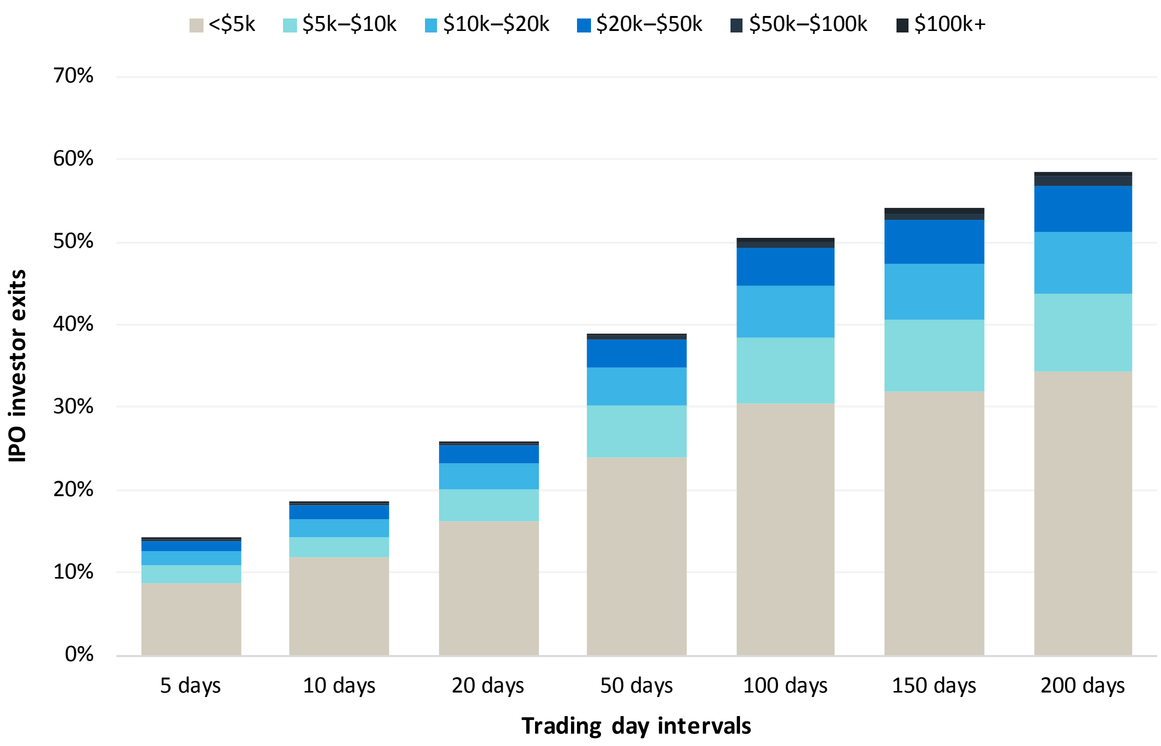
### What we found

#### Investor exits

106 We analysed the company share registers for 13 of the transactions we reviewed to determine if particular categories of IPO investors behaved in certain ways after listing, including whether certain categories of IPO investors were more likely to exit their investment soon after listing.

107 Figure 4 shows on a cumulative basis the IPO investors who exited their investment at identified trading day intervals after listing as a percentage of all IPO investors for the transactions reviewed. Adjustments were not made for shareholders whose cumulative holdings reduced to zero and who subsequently bought securities—those investors were considered to 'exit' when their cumulative holdings first went to zero.

**Figure 4: Cumulative IPO investor exits at specified trading day intervals**




Note 1: Of the 17 mining IPOs selected for review, four transactions were excluded on the basis that the relevant share register data was insufficient to include in the analysis in Figure 4 and Figure 5.

Note 2: See Table 6 for the data shown in this figure (accessible version).

108 We also conducted an analysis of the individual exits for the 2,848 IPO investors who had exited their IPO investment in the first 200 trading days after listing in the 13 transactions to determine the gains or losses those investors may have received on exit. Figure 5 shows the aggregate average and median premiums to IPO prices obtained by investors in the share transactions reviewed.

109 These analyses revealed that:

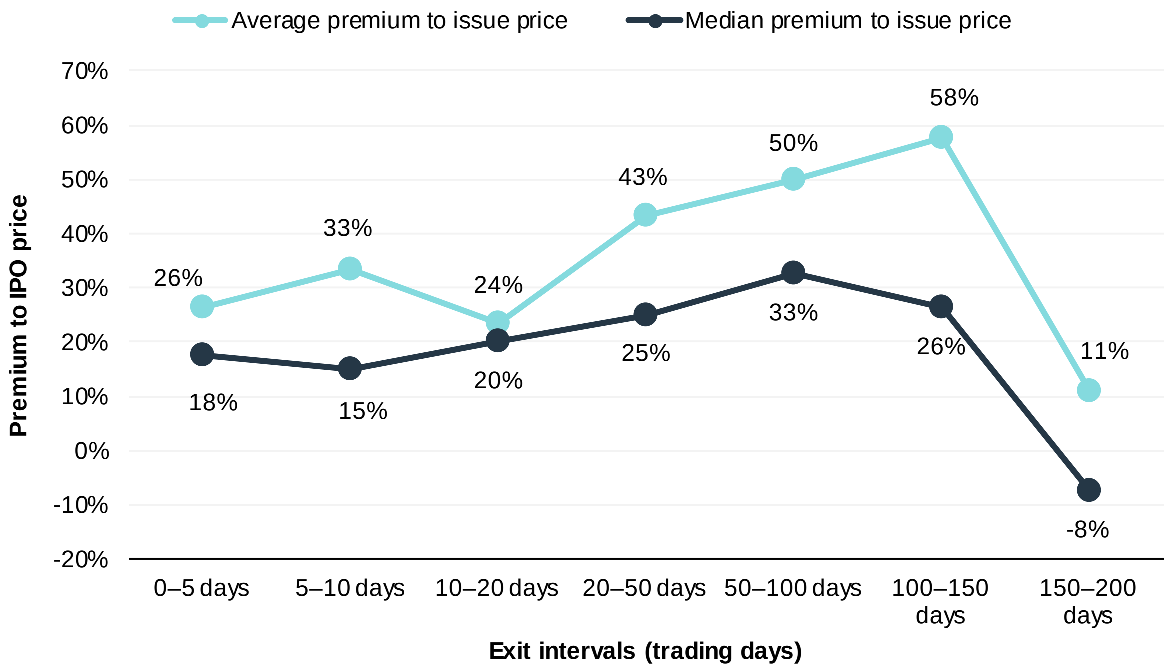
(a) on average, over 14% of IPO investors sold their IPO allocation within five trading days of listing;

(b) on average, after 100 trading days over 50% of IPO investors had sold their entire IPO allocation; and

(c) IPO investors exiting within 100 trading days were, in aggregate, able to realise a return for their short-term holding, with median returns ranging between 15% and 50%.

110 Although we recognise that our analysis may be impacted by external factors, we still consider it demonstrates that the majority of these short-term investors exit before substantive exploration activities can be undertaken by the mining company. These investors, often introduced by lead managers, may have an interest in the potential short-term benefits arising from the receipt of an IPO allocation rather than a long-term interest in the mineral assets being listed.

**Figure 5: Average and median premiums from IPO price for IPO investor exits**




Note 1: Exits were prices based on the IPO allocation being sold at the close price on the day the cumulative holdings of an investor went to zero. This calculation method was the most conservative for aggregate premiums compared to other premium analyses, such as average and total return which may include securities acquired after listing.

Note 2: Of the 17 mining IPOs selected for review, four transactions were excluded on the basis that the relevant share register data was insufficient to include in the analysis in Figure 4 and Figure 5.

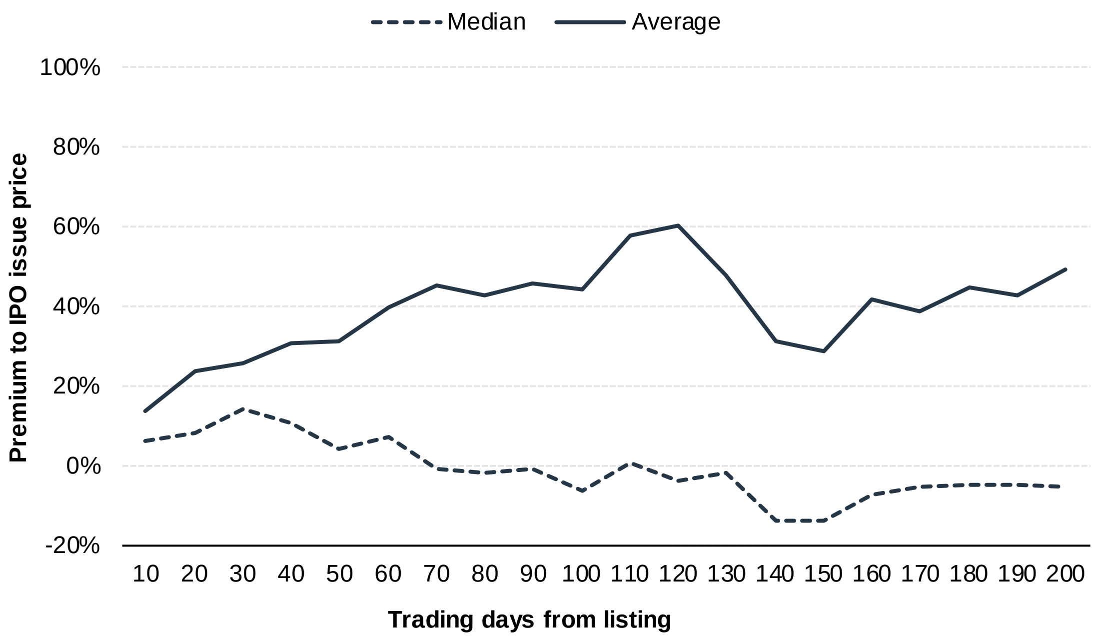
Note 3: See Table 7 for the data shown in this figure (accessible version).

111 In addition to reviewing individual IPO shareholder exits in connection with specific transactions, we also analysed the 10-day volume weighted closing share prices (10-VWAP) of all mining IPOs raising less than $20 million between 2014 and 2018 over their first 200 trading days. The outcome of this analysis is set out in Figure 6.

Note: Where a company had not been listed for 200 trading days, the analysis was conducted on the length of time the company had been listed up to and including 31 July 2019.

112 Although we recognise the limitations of this analysis, which can be affected by a number of external factors, Figure 6 is helpful to show that the majority of mining IPOs traded at a premium to IPO prices for a short period after listing, with the median premium to IPO price falling below zero after approximately 70 trading days. This may indicate that the majority of mining IPOs raising less than $20 million provide short-term IPO investors with opportunities to exit at a gain, suggesting that the findings from the analysis of the 13 transactions—see paragraphs 106–110—may apply more broadly to the mining IPO market.

**Figure 6: Post-listing 10-VWAP for transactions showing trends**




Note 1: The average 10-VWAP were substantially higher than the median, demonstrating that high-performing listings may be lifting the average 10-VWAP.

Note 2: See Table 8 for the data shown in this figure (accessible version).

### Promotion and news flow

113 We found during our review of IPO transactions that it is common for ‘good news’ to be distributed before or at the very early stages of exploration activities and there is a heightened risk of information being prematurely released or overstating progress. It was not uncommon for there to be a strategy for information releases shortly after listing, or even before listing is achieved.

**Case study**

Before lodgement of a prospectus a company had made preliminary inquiries and entered a memorandum of understanding (MOU) regarding an additional mineral asset. It was noted in correspondence to a potential

IPO investor that, even if that acquisition failed, the directors were confident another acquisition could be secured from their networks.

The specific potential acquisition was not disclosed in the prospectus even though the company had an MOU with the mineral asset vendor—references to acquisitions in the prospectus were limited to general boilerplate statements only.

114 The lead managers we spoke to during the review told us that news flow as soon as possible after listing was a key requirement to maintain investor interest in the company. Some lead managers also said that opening strongly helped to maintain the confidence of their investor clients and those in their networks that participated in the offer.

115 We found instances of tension where lead managers advised companies to release information to the market which the company considered was premature or not in the company's long-term interests.

**Case study**

A newly listed mining company had representatives of the asset vendor and lead manager on the board.

Shortly after listing, a company board member associated with the lead manager suggested the company publish an MOU with a potential commodity purchaser as another entity had recently enjoyed increased share prices after announcing a similar MOU. The board refused to take this action citing the early stage of their project.

It was unclear whether the advice provided by the board member was given to ensure investors introduced by the lead manager to the IPO could maximise their return or to advance the interests of the company.

### Use of funds

116 Efficient and effective use of funds can be an indicator of the performance of exploration companies which do not generally have cash inflows from operations or seek to achieve short-term profitability. In this regard, the exploration activities set out in a prospectus provide for the core business of exploration companies being considered by prospective investors.

117 We reviewed the proposed use of funds disclosed in prospectuses for 88 mining companies that undertook an IPO between 2014 and 2018 and compared this to the mining companies' quarterly cashflow reporting for a period of between 12 and 24 months after listing (depending on the availability of data).

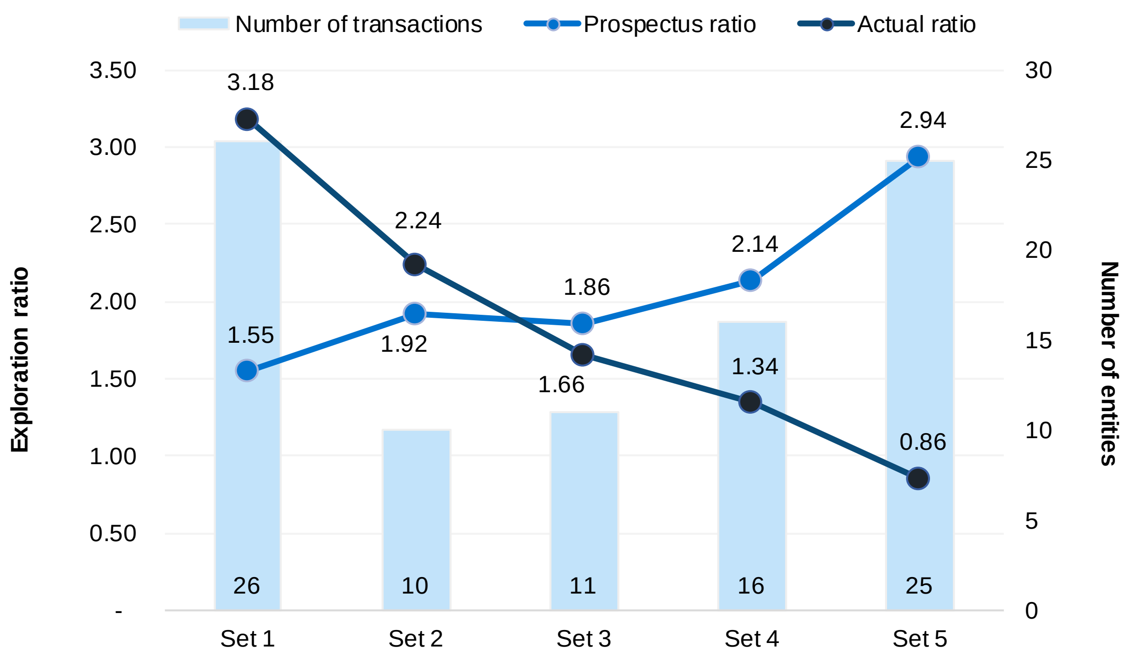
Note: Between 2014 and 2018, 100 mining companies undertook an IPO. However, some companies were excluded from the analysis where they were not engaged in exploration or where they were delisted or entered administration shortly after listing.

118 To determine the difference between what exploration companies said they would spend on exploration compared to administration and what they actually spent, we compared exploration and administration expenditure

disclosed in the prospectus to exploration and administration expenditure disclosed in quarterly cashflows. This analysis is set out in Figure 7.

Note: We compared exploration costs to administration costs, corporate overheads, directors' fees, offer costs and working capital in prospectus disclosures and exploration cashflows to staff costs and administration cashflows in quarterly cashflow reporting to determine exploration ratios.

**Figure 7: Analysis of exploration spend compared to administration expenditure**




Set 1: Actual exploration ratio 25%+ higher than disclosed in the prospectus
Set 2: Actual exploration ratio up to 25% higher than disclosed in the prospectus
Set 3: Actual exploration ratio up to 25% less than disclosed in the prospectus
Set 4: Actual exploration ratio betw een 25% and 50% less than disclosed in the prospectus
Set 5: Actual exploration ratio 50%+ less than disclosed in the prospectus

Note: See Table 9 for the data shown in this figure (accessible version).

119 Figure 7 shows companies that departed significantly from the exploration to administration split set out in their prospectus tended to disclose very high relative exploration spend. For example, Set 5 (a sample of companies whose exploration to administration spend varied by more than 50% from prospectus disclosures) had the highest proposed exploration to proposed administration spend in their prospectuses with an average of $2.94 allocated to exploration for every $1 of administration. The sets that came closest to matching disclosures in their prospectus were Sets 2 and 3 which provided for $1.92 and $1.86 to be spent on exploration for every $1.00 spent on administration in their prospectuses respectively.

120 We recognise this analysis may be skewed due to differences in quarterly cashflow reporting conventions between companies and recognise that there can be legitimate reasons for departing from the use of funds as set out in a

prospectus. However, we consider the results of the analysis to be useful in identifying the risks associated with the accuracy of the proposed use of funds set out in prospectuses. Of particular note was that over 25% of the companies reviewed spent more on administration and less on exploration by 50% or more than what was proposed in the prospectus.

121 We note the recent changes to the reporting of expenditure for new listings with Appendix 5B cashflow reporting obligations and activity reports. We encourage companies and directors to consider how companies will disclose the proposed use of funds in their prospectuses given the need to report material departures from the use of funds in quarterly activity reports.

Note: ASX has recently changed requirements for those reporting under ASX Listing Rules 5.3 and 5.5 to require reconciliation of the actual use of funds to those disclosed in a prospectus for listing and provide explanations for material differences: see ASX Limited, *Guidance Note 23: Quarterly reports*, 1 December 2019.

## Better practice recommendations

**E1** Investors should exercise caution:

- (a) when relying on use of funds disclosures set out in a prospectus as these estimates may reflect the intentions of companies at the time of listing but can significantly vary once exploration activities commence; and
- (b) when considering information and news flow from exploration companies shortly after listing and before substantive exploration activities have taken place.

**E2** Directors should:

- (a) understand the advantages and disadvantages of having the company's share register held by investors with short investment horizons;
- (b) understand any disadvantages arising from 'spread only' investors making up the majority of investors on listing; and
- (c) clearly communicate to the lead manager the types of investors the company wishes to have apply for, and be allocated, securities under the IPO.

**E3** Lead managers should take care to identify investors with an interest in the company's activities, as opposed to identifying investors on the basis of an allegiance to, or the influence of, the lead manager or another adviser.

# Appendix 1: Methodology and selection of transaction sample

## Transaction selection

122 We identified 72 mining IPO and RTO transactions between 1 October 2016 and 30 September 2018. We considered that mining IPOs between 2016 and 2018 were sufficiently recent to make inquiries but sufficient time had elapsed to allow us to consider post-listing activities.

123 For the purposes of our review, we classified transactions as RTOs where existing shareholders were diluted by more than 50%, the company was required to re-comply with Chapters 1 and 2 of the ASX Listing Rules and the RTO introduced new mineral assets to ASX.

124 We excluded 11 transactions which we considered outliers—that is, transactions seeking to raise more than $20 million and transactions that did not have a lead manager.

125 From the remaining 61 transactions we selected 17 transactions as a representative sample for review. This selected sample represents approximately 23.6% of mining IPOs between 2016 and 2018.

126 As part of the selection process we:

(a) considered financial and non-financial metrics including, but not limited to, the amount raised, capital structure, board structure, IPO costs and use of funds; and

(b) made subjective selections to obtain a representative sample of the most common types of mining IPOs and the three different lead manager classifications identified (see paragraph 129).

127 We did not select transactions based on known or suspected contraventions or misconduct by companies, directors, lead managers or other persons involved in the transaction.

## Transaction sample

128 Table 2 identifies the transaction and lead manager sample reviewed. It should be noted that findings set out in this report are based on information gathered during the review of these transactions and lead managers and other publicly available information.

**Table 2: Transaction sample**

| Transaction reviewed | Lead manager |
|---|---|
| Adriatic Metals Plc | Discovery Capital Partners Pty Ltd |
| Calidus Resources Ltd | Discovery Capital Partners Pty Ltd and Otsana Pty Ltd |
| MetalsTech Ltd | Everblu Capital Pty Ltd |
| Pursuit Minerals Ltd | Everblu Capital Pty Ltd |
| Accelerate Resources Ltd | GTT Ventures Pty Ltd |
| Marquee Resources Ltd | GTT Ventures Pty Ltd |
| Raiden Resources Ltd | Otsana Pty Ltd |
| Northern Cobalt Ltd | PAC Partners Pty Ltd |
| Technology Metals Australia Ltd | PAC Partners Pty Ltd |
| Pure Minerals Ltd | Xcel Capital Pty Ltd |
| Tando Resources Ltd | Xcel Capital Pty Ltd |
| One transaction reviewed | Aesir Capital Pty Ltd |
| Review not transaction-specific | Bell Potter Securities Ltd |
| One transaction reviewed | Burnvoir Corporate Finance Ltd |
| Review not transaction-specific | Hartleys Ltd |
| One transaction reviewed | Max Capital Pty Ltd |
| Review not transaction-specific | Morgans Financial Ltd |
| Review not transaction-specific | Patersons Securities Ltd |
| One transaction reviewed | Peak Asset Management Pty Ltd |
| One transaction reviewed | Sanlam Private Wealth Pty Ltd |
| One transaction reviewed | Viridian Equity Group Pty Ltd |

Note: Where the table states 'One transaction reviewed' we did not contact or obtain information from the company the subject of the transaction. See paragraphs 130–131 for details on review methodologies.

## Lead manager classification

129 When selecting transactions for review, the transactions were divided into categories based on the classification of the lead manager. We identified three general classes of lead manager:

(a) lead managers who did not act as lead managers for IPOs frequently—acting in the role for only one or two transactions between 1 October 2016 and 30 September 2018—and predominantly engaged in non-IPO related businesses;

(b) lead managers who acted as lead managers for multiple IPO transactions between 1 October 2016 and 30 September 2018 and where lead management and corporate advisory services for IPO transactions appeared to be a core component of their business; and

(c) lead managers with substantial financial services businesses which were not predominantly focused on lead management or corporate advisory services for IPOs.

## Review methodology

130 The review process for the transactions and lead managers selected was adjusted based on the classification of the lead manager. For example, reviews of lead managers with substantial financial services businesses may not have been based on specific mining IPOs but involved broader reviews of internal processes, management and oversight. As another example, for reviews of lead managers that did not act as lead managers frequently between 1 October 2016 and 30 September 2018, the review methodology may have been limited to a desktop review of information provided by the lead manager only.

131 Review processes included seeking documents and information under notice, voluntary interviews and reviewing publicly available information: see paragraphs 17–19 for more information.

# Appendix 2: Accessible versions of figures

132 This appendix is for people with visual or other impairments. It provides the underlying data for each of the figures included in this report.

**Table 3: IPOs between 2014 and 2018**

| Year | Total IPO transactions | Percentage of total IPO transactions by mining and exploration companies |
|---|---|---|
| 2014 | 101 | 6.93% |
| 2015 | 145 | 2.76% |
| 2016 | 154 | 9.09% |
| 2017 | 138 | 24.64% |
| 2018 | 112 | 36.61% |

Note: This is the data shown in Figure 1.

**Table 4: Typical timeline for a mining company IPO**

| Activity | Transaction origination processes | Pre-IPO processes | IPO processes | Post-listing processes |
|---|---|---|---|---|
| 1 | Asset identification | Appointment of advisers | Lodgement of prospectus | ASX listing |
| 2 | Company incorporation | Seed/interim funding | Offer bids | Trading on ASX |
| 3 | Appointment of directors | Preparation of IPO documents | Allocations | Commence exploration |
| 4 | n/a | n/a | Share issue | n/a |

Note: This is the data shown in Figure 2.

**Table 5: Percentages by number and by value of investors at listing**

| IPO investment | Average % of investors | Average % of funds raised |
|---|---|---|
| <$5k | 56.5% | 11.0% |
| $5k–$10k | 17.0% | 10.1% |
| $10k–$20k | 12.8% | 14.8% |
| $20k–$50k | 10.0% | 23.2% |
| $50k–$100k | 2.5% | 12.9% |
| $100k+ | 1.27% | 28.0% |

Note: This is the data shown in Figure 3.

**Table 6: Cumulative IPO investor exits at specified trading day intervals**

| IPO investment | Investor exit 5 days | Investor exit 10 days | Investor exit 20 days | Investor exit 50 days | Investor exit 100 days | Investor exit 150 days | Investor exit 200 days |
|---|---|---|---|---|---|---|---|
| <$5k | 8.72% | 11.76% | 16.14% | 23.89% | 30.41% | 31.98% | 34.30% |
| $5k–$10k | 2.18% | 2.57% | 3.97% | 6.29% | 8.04% | 8.62% | 9.36% |
| $10k–$20k | 1.73% | 2.12% | 2.98% | 4.67% | 6.23% | 6.81% | 7.53% |
| $20k–$50k | 1.25% | 1.60% | 2.18% | 3.31% | 4.67% | 5.22% | 5.70% |
| $50k–100k+ | 0.19% | 0.25% | 0.27% | 0.51% | 0.72% | 0.84% | 1.03% |
| 100k+ | 0.08% | 0.10% | 0.14% | 0.33% | 0.41% | 0.58% | 0.66% |
| Cum. total | 14.15% | 18.40% | 25.68% | 39.01% | 50.48% | 54.04% | 58.56% |

Note: This is the data shown in Figure 4.

**Table 7: Average and median premiums from IPO price for IPO investor exits**

| Exit intervals (trading days) | Average premium to issue price | Median premium to issue price |
|---|---|---|
| 0–5 days | 26% | 18% |
| 5–10 days | 33% | 15% |
| 10–20 days | 24% | 20% |
| 20–50 days | 43% | 25% |
| 50–100 days | 50% | 33% |
| 100–150 days | 58% | 26% |
| 150–200 days | 11% | -8% |

Note: This is the data shown in Figure 5.

**Table 8: Post-listing 10-VWAP for transactions showing trends**

| Trading days from listing | Median premium to issue price | Average premium to issue price |
|---|---|---|
| 10 days | 6.25% | 13.50% |
| 20 days | 8.34% | 23.54% |
| 30 days | 14.26% | 25.76% |
| 40 days | 10.74% | 30.54% |
| 50 days | 4.33% | 31.03% |
| 60 days | 7.25% | 39.70% |

| Trading days from listing | Median premium to issue price | Average premium to issue price |
|---|---|---|
| 70 days | -1.01% | 45.05% |
| 80 days | -1.89% | 42.84% |
| 90 days | -0.84% | 45.92% |
| 100 days | -6.13% | 44.06% |
| 110 days | 0.77% | 57.77% |
| 120 days | -3.70% | 60.00% |
| 130 days | -1.81% | 47.80% |
| 140 days | -13.77% | 31.01% |
| 150 days | -13.92% | 28.76% |
| 160 days | -7.34% | 41.75% |
| 170 days | -5.34% | 38.67% |
| 180 days | -4.68% | 44.61% |
| 190 days | -4.69% | 42.87% |
| 200 days | -5.37% | 49.02% |

Note: This is the data shown in Figure 6.

### Table 9: Analysis of exploration spend compared to administration expenditure

| Set | Number of transactions in set | Average prospectus ratio | Average actual expenditure ratio |
|---|---|---|---|
| Set 1: Actual exploration ratio 25%+ higher than disclosed in the prospectus | 26 | 1.55 | 3.18 |
| Set 2: Actual exploration ratio up to 25% higher than disclosed in the prospectus | 10 | 1.92 | 2.24 |
| Set 3: Actual exploration ratio up to 25% less than disclosed in the prospectus | 11 | 1.86 | 1.66 |
| Set 4: Actual exploration ratio between 25% and 50% less than disclosed in the prospectus | 16 | 2.14 | 1.34 |
| Set 5: Actual exploration ratio 50%+ less than disclosed in the prospectus | 25 | 2.94 | 0.86 |
| Total | 88 | n/a | n/a |

Note: This is the data shown in Figure 7.

# Key terms

| Term | Meaning in this document |
|---|---|
| AFS licence | An Australian financial services licence under s913B of the Corporations Act that authorises a person who carries on a financial services business to provide financial services<br>Note: This is a definition contained in s761A of the Corporations Act. |
| AFS licensee or licensee | A person who holds an AFS licence under s913B of the Corporations Act<br>Note: This is a definition contained in s761A of the Corporations Act. |
| ASIC | Australian Securities and Investments Commission |
| ASIC Act | *Australian Securities and Investments Commission Act 2001* |
| ASX | ASX Limited (ACN 008 624 691) or the exchange market operated by ASX Limited |
| Ch 6D (for example) | A chapter of the Corporations Act (in this example numbered 6D), unless otherwise specified |
| conflicts of interest or conflicts | Circumstances where some or all of the interests of clients to whom an AFS licensee (or its representative) provides financial services are inconsistent with, or diverge from, some or all of the interests of the AFS licensee or its representatives. This includes actual, apparent and potential conflicts of interest |
| Corporations Act | *Corporations Act 2001*, including regulations made for the purposes of that Act |
| institutional investor | Entities in the business of investing in securities, including investment banks, hedge funds, insurance companies, sovereign wealth funds, AFS licensees or equivalent overseas licence holders |
| investor materials | Any materials used to promote the IPO, including prospectuses, terms sheets and investor presentations |
| IPO | Initial public offering |
| JORC Code | The Joint Ore Reserves Committee of the Australasian Institute of Mining and Metallurgy, Australian Institute of Geoscientists and Minerals Council of Australia, *Australasian code for reporting of exploration results, mineral resources and ore reserves* (the JORC Code), 2012 edition |

| Term | Meaning in this document |
|---|---|
| mandate | The terms of the licensee's engagement by the company usually set out in a document which may be referred to as a mandate or offer management agreement |
| marketing | Any advertising and publicity relating to an IPO, including information that may affect an investment decision |
| mineral asset | A mineral asset as defined in the Valmin Code |
| personal advice | Financial product advice that is given or directed to a person (including by electronic means) in circumstances where:<br>• the provider of the advice has considered one or more of the person's objectives, financial situation and needs; or<br>• a reasonable person might expect the provider to have considered one or more of those matters<br>Note: This is a definition contained in s766B(3) of the Corporations Act. |
| professional adviser | Professional advisers can include a lead manager or corporate adviser, investment banks, legal advisers, accountants, technical specialists, and a range of other advisers, depending on the company undertaking the IPO. They may be involved in the preparation of the prospectus, and pricing of the IPO offer, assist with the marketing of the offer to investors, or provide general advice to the company throughout the IPO process |
| professional investor | Has the meaning given in s708(11) of the Corporations Act. In general terms, this is an investor who has, or controls, gross assets of at least $10 million |
| prospectus | A prospectus that is lodged with ASIC under s718 of the Corporations Act |
| REP 605 (for example) | An ASIC report (in this example numbered 605) |
| representative | A representative of an AFS licensee means:<br>• an authorised representative of the licensee;<br>• an employee or director of the licensee;<br>• an employee or director of a related body corporate of the licensee; or<br>• any other person acting on behalf of the licensee<br>Note: This is a definition contained in s910A of the Corporations Act. |

| Term | Meaning in this document |
|---|---|
| retail investor | An investor who does not qualify as a professional, experienced or institutional investor—that is, a person who invests for their own personal account rather than on behalf of other investors or entities. Retail investors in this report may include self-managed superannuation fund investors and high net worth investors (who would qualify as sophisticated investors)<br>Note: 'Experienced investor' has the meaning given in s708(10) of the Corporations Act. |
| RG 228 (for example) | An ASIC regulatory guide (in this example numbered 228) |
| roadshow | A series of presentations by the senior management of a company about an upcoming offer of securities—generally to potential institutional investors, financial advisers and research analysts |
| RTO | Reverse takeover offer |
| s912A (for example) | A section of the Corporations Act (in this example numbered 912A) |
| securities | Has the meaning given in s92 of the Corporations Act |
| sophisticated investor | Has the meaning given in s708(8) and 708(10) of the Corporations Act. In general terms, this includes an investor:<br>• who has net assets of at least $2.5 million, or gross income of at least $250,000 for each of the past two financial years; or<br>• about whom an AFS licensee is satisfied that the person has sufficient previous experience in investing in securities |
| spread | The requirement that a company have a minimum number of security holders holding a minimum number of securities to be listed on a securities exchange |
| 10-VWAP | Volume weighted average price for 10 days of trading on ASX |
| transaction | An equity raising by a company that is seeking to raise funds from investors through the issue of new securities |
| Valmin Code | The VALMIN Committee of the Australasian Institute of Mining and Metallurgy and Australian Institute of Geoscientists, *Australasian code for public reporting of technical assessments and valuations of mineral assets* (the Valmin Code), 2015 edition |

# Related information

### Headnotes

advertising, advisers, allocations, brokers, capital raisings, conflicts of interest, corporate advisers, initial public offerings, investment decision, IPOs, issuers, lead managers, marketing, prospectuses, prospectus disclosure, retail investor

### Regulatory guides

RG 181 *Licensing: Managing conflicts of interest*

RG 228 *Prospectuses: Effective disclosure for retail investors*

### Legislation

ASIC Act

Corporations Act, Ch 6D; s92, 195, 249D, 608, 708, 710, 718, 728, 729, 730, 734, 761A, 766B, 769C, 910A, 912A, 913B and 1041A

### Reports

REP 494 *Marketing practices in initial public offerings of securities*

REP 539 *ASIC regulation of corporate finance: January to June 2017*

REP 540 *Investors in initial public offerings*

REP 605 *Allocations in equity raising transactions*

### Media releases

19-094MR *ASIC bans Perth accountant from providing financial services for six years*

19-209MR *Former financial advisor and consultant charged with dishonest conduct* (12 August 2019)

### Other ASIC documents

Corporate finance reports

### Non-ASIC publications

ASX Limited, *ASX Listing Rules, Chapter 1 Admission*, 19 December 2016

ASX Limited, *Guidance Note 1: Applying for admission – ASX listings*, 1 December 2019

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ASX Limited, *Guidance Note 23: Quarterly reports*, 1 December 2019

ASX Limited, *Guidance Note 33: Removal of entities from the ASX official list*, 15 April 2019

The Joint Ore Reserves Committee of the Australasian Institute of Mining and Metallurgy, Australian Institute of Geoscientists and Minerals Council of Australia, *Australasian Code for Reporting of Exploration Results, Mineral Resources and Ore Reserves (JORC Code)*, 2012

The VALMIN Committee of the Australasian Institute of Mining and Metallurgy and Australian Institute of Geoscientists, *Australasian Code for Public Reporting of Technical Assessments and Valuations of Mineral Assets (VALMIN Code)*, 2015