

A photograph of a lighthouse with a black base, a red middle section, and a white top section, situated on a rocky outcrop overlooking the ocean under a blue sky with scattered clouds.

Viewpoint

Corporate finance

You've heard that 'the market is still going strong', so is this the time to consider an initial public offering (IPO), and how do you set about it?

To float or not to float – What do you need to know?

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Challenge area

The hard work is paying off and business is going well, and there are now opportunities available that will help you take the company to the next level and achieve its maximum potential. However, additional funds are needed – where do you source those funds from?

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New perspectives

For the uninitiated, an IPO is the “process of taking a privately owned organisation and making the transition to a publicly-owned entity whose shares can be traded on a stock exchange”. Source: ASX

The main stock exchange in Australia is the Australian Stock Exchange (ASX). The ASX operates Australia's primary stock exchange for equities, derivatives and fixed interest securities. Recently the Newcastle stock exchange (NSE) has been established specifically for the listings of small to medium sized companies.

The current IPO climate

The tech boom period of the late 1990s saw a hive of IPO activity in the market. However, the now infamous 'dotcom crash' that followed in 2000/01 led to a decrease in public capital raisings and an increase in regulatory requirements for IPOs, especially in the area of disclosures of forecasts.



The decision to undertake an IPO needs to be made after a detailed assessment of the strategic benefits and pros and cons of becoming a listed company.

For the past few years, through the strong performance of the Australian economy and increase in funds available for investing, there has been a resurgence in IPO activity across all industries as shown in Table 1.

| | YE 31 Dec 2003 | YE 31 Dec 2004 | YE 31 Dec 2005 | 2006 YTD |
|------------------------------|----------------|----------------|----------------|----------|
| Number of IPO's | 94 | 168 | 168 | 50 |
| Average amount raised (\$M) | 94 | 58 | 94 | 38 |
| Median amount raised (\$M) | 7 | 8.5 | 9 | 5 |
| Average 1st day movement (1) | 17% | 18% | 10% | 26% |
| Median 1st day movement (1) | 6% | 8% | 3% | 15% |

Table 1. - IPO activity in Australia 2003-2006

Meeting the IPO tests

Once companies are successfully listed on the ASX they are required to comply with all ASX Listing Rules. The ASX Listing Rules set out a significant number of ongoing disclosure and approval requirements for all companies. However, the ASX Listing rules also set out the requirements that need to be met before a company can even be considered for an IPO.

Chapter 1 of the ASX Listing Rules (available from the ASX) specifies that an entity must satisfy one of two tests to be considered appropriate for listing – the “profit test” and the “assets test”. The profit test sets minimum aggregate profit levels for the past three years (\$1 million), and the assets test sets out minimum net tangible asset value for listed entities of approximately \$15 million for companies. Full details of these tests are set out in the ASX listing rules.

Why consider an IPO?

The reasons to consider undertaking an IPO can be varied and depend on the specific circumstances of the company. Some of these reasons may include:

- to reduce debt levels of the entity that may be impacting on the company's ability to take advantage of current opportunities through restrictive covenants
- to raise funds required to allow for current identified expansion opportunities that will enhance the value of the underlying business:
 - to provide an available source of capital for opportunities identified in the future
 - to provide existing owners with an exit strategy.

On the latter point, owners of privately held companies cannot realise the value of their investment in a timely manner. The benefit of being a listed entity is that it would provide an active market for shares in the company to act as such an exit strategy.



Ensuring an efficient IPO process is carried out is critical for the success not only of the float itself but of the ongoing business...

The decision to undertake an IPO needs to be made after a detailed assessment of the strategic benefits and pros and cons of becoming a listed company. At this stage, ensuring that appropriate advisors are appointed to assist in the consideration of an IPO strategy is critical. Whatever the reason for undertaking an IPO the decision needs to be based on a thorough understanding of how the market will impact on the future performance of the overall business and what exactly is involved in the IPO process.

For and against the decision

There can be a number of attractive advantages to becoming a listed entity, but these need to be weighed up with the disadvantages that may also arise. Some key pros and cons of undertaking an IPO are summarised in the Table 2

| Advantages | Disadvantages |
|---|--|
| Greater access to equity capital providing more funding options for the company | Change in control (quite often founding investors will lose controlling interests) |
| Higher public and investor profile | Greater continuous disclosure requirements under ASX Listing Rules |
| Potential improved valuation | Greater public scrutiny |
| Active market for trading | Initial costs of listing can be significant as well as ongoing costs of listing and compliance |
| Exit strategy of founding investors | Value of business will also be impacted by general market movements |

Table 2. - Advantages and disadvantages of undertaking an IPO

What are the alternatives?

An IPO is not appropriate for every company. There are several alternatives for businesses that require funding to drive the value of their business and take advantage of expansion opportunities. The consideration of whether or not to undertake an IPO inherently needs to be determined after an assessment of any alternative to listing. Such alternatives may include:

- debt funding
- private equity funding
- strategic merger
- listing on an alternative exchange to the ASX.

Particularly in recent years, a number of Australian companies have raised capital through the Alternative Investment Market (AIM) in the UK. AIM was set up to be a secondary market to the London FTSE.

The IPO process

The IPO process is strictly monitored by regulatory bodies and involves a number of disclosures and representations to be made by the directors

The IPO process does not stop with the lodging of the prospectus and admission to the ASX.

of the company. For an uncomplicated IPO it is critical to form a group of expert advisors with the skills and knowledge to ensure all regulatory requirements are met and the process of capital-raising is not halted at the end due to foreseeable disclosure issues.

The process is quite rigorous and can also be costly. Ensuring an efficient IPO process is carried out is critical for the success not only of the float itself but of the ongoing business as time spent preparing a company to list can impact on key personnel's ability to manage ongoing day-to-day activities.

A summary of the critical stages of the overall IPO process are set out below.

Assess the strategic benefits of an IPO and appoint advisors

Careful consideration needs to be made at the onset as to whether or not the IPO path is appropriate for the company. As discussed previously, the reasons for considering an IPO need to be discussed and debated upfront before any further work is performed.

The initial advisory team should comprise accountants, lawyers and investment bankers/underwriters. Further experts may also be required (such as property valuers, other industry experts, share registries etc.).

Establish a due diligence committee and process

Once the decision has been made to embark on an IPO it is important to establish a due diligence process. A due diligence committee should also be set up to oversee the IPO process and ensure that all regulatory requirements are adhered to.

Prepare offer disclosure document to support the IPO

The key output of the IPO process is an offer disclosure document, commonly referred to as a prospectus or product disclosure statement (PDS). The disclosure requirements of prospectuses are set out in detail in the Corporations Act.

The inclusion of misleading or deceptive information in an offer disclosure document carries harsh penalties for those involved in making such statements. The Corporations Act requires a prospectus to include all information that a potential investor would reasonably expect to see. This information should typically cover:

- company background and history as well as future identified initiatives
 - details of key management expertise and qualifications
 - financial information for the company, both historical and forecast.
- The inclusion of forecast information also requires detailed explanation of the key assumptions underlying any forecasts and

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adherence to regulatory guidelines on what forecast information can be included in offer documents:

- disclosure of key terms of any material contracts in place at time of listing
- disclosure of any related party interest in the company
- relevant reports from experts on information included in the prospectus. For example, an independent review of directors' forecasts or independent accountant's report on historical financial information.

Lodge prospectus and apply to list with ASX

Prospectuses are required to be lodged with ASIC and the ASX who will review and approve the IPO. The ASX will, at this time, ensure compliance with its Listing Rules Admission tests as described previously.

The way forward

The IPO process does not stop with the lodging of the prospectus and admission to the ASX. Once listed the company must continue to comply with all ASX listing rule requirements, including continuous disclosure across a range of areas not just financial reporting.

As with any business decision, the benefits of undertaking a thorough process far outweigh the initial cost and the future costs to the company of not having gone through a proper due diligence in the first place. Although the IPO process is complicated, ensuring that the process is effectively managed and that you get the right advice at the right time can provide a wealth of opportunities to the business.

About the author

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