

Client Alert

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ASX changes to admission requirements

The Australian Securities Exchange (ASX) has announced amendments to its Listing Rules to implement changes to its admission requirements which take effect from 19 December 2016.

In some respects, the new admission requirements are less rigorous than those previously proposed by ASX. In many respects, these changes are not materially different from the current requirements and will not pose any greater impediment or burden on entities seeking to list on the ASX. However, changes to the requirements for a minimum free float of 20% and audited accounts for companies seeking admission under the assets test may be more difficult to satisfy than the current admission criteria.

The new rules are intended to maintain appropriate listing standards and investor confidence in the ASX market, while providing a pathway for companies to list and access capital across their lifecycle.

In particular, ASX has emphasised:

ASX is making changes to a number of its listing admission requirements to ensure that the ASX market continues to be a market of quality and integrity, and remains internationally competitive given the continuing trend in cross-border international listings. ASX has also sought to ensure that its listing admission requirements continue to support and provide a pathway for early stage resources, and technology and innovation entities to list and access capital.

What are the key changes

The key listing admission rule changes are:

- increasing the requirement for profit test entities to have consolidated profits for the 12 months prior to admission from \$400,000 to \$500,000
- increasing the net tangible assets (NTA) test from \$3 million to \$4 million
- increasing the market capitalisation test from \$10 million to \$15 million
- introducing a 20% minimum free float requirement
- creating a single tier spread test of at least 300 security holders each holding at least \$2,000 of securities
- requiring asset test entities to disclose to the market two full financial years of audited accounts, and also for and any significant entity or business that it has acquired in the 12 months prior to applying for admission or that it proposes to acquire in connection with its listing
- standardising the \$1.5 million working capital requirement for those admitted under the assets test.

ASX has also enhanced the disclosure requirements for companies announcing a backdoor listing, which must be satisfied if the company wants its securities to resume trading following the announcement.

When will the new requirements take effect

The ASX Listing Rules amendments come into effect on Monday, 19 December 2016, and will only apply to applications for listing received on or after that date. A comparison of the current and new requirements is set out in the table at the end of this alert.

However, ASX is already applying the 20% minimum free float requirement under its general power to impose conditions on listing.

What are the key implications of these changes

The changes represent a balance between ensuring ASX remains an attractive listing venue, particularly for early stage companies in sectors such as resources, healthcare, biotech, and other technology and innovation companies, and ensuring listed entities have an appropriate structure, financial position and liquidity.

The most significant implications are:

- The **free float requirement of 20%**, not only because it is a material increase from the previous 10% free float policy, but also because it formalises the types of security holders who do not count towards free float. This will be significant especially for technology companies, where founders (who will be related parties) typically hold large equity stakes, and where there will usually be extensive escrow, both ASX imposed and voluntary. The requirement will affect large companies too, for example the Freelancer listing in 2013 did not have 20% free float despite having a market capitalisation of over \$200 million at the IPO price.
- The need for **audited financial accounts** for the previous 2 full financial years for entities seeking admission under the assets test will increase the cost and time of many IPOs. It is common for an IPO to involve a bolt on acquisition or other reorganisation as part of the listing, and bringing new entities into the acquisition will now require early consideration of an audit process for private entities which did not previously have to be audited.

Increase in profit test requirements

Companies will still be able to seek admission under either the profit test or the assets test. Listing Rule 1.2 will be amended to increase the consolidated profit requirement under the profit test for the 12 months prior to admission from \$400,000 to \$500,000.

The other requirements in the profit test will remain unchanged so that additionally:

- the entity must be a going concern and have conducted the same main business activity during the last 3 full financial years prior to admission; and
- the entity must have aggregated profit of at least \$1 million from continuing operations for the last 3 full financial years prior to admission.

Increase in NTA test requirements

Listing Rule 1.3 will be amended to increase the minimum NTA requirement from \$3 million to \$4 million for all entities applying for admission under the NTA limb of the assets test.

ASX had consulted on a proposal to increase the minimum NTA requirement to \$5 million and also considered retaining the lower \$3 million NTA requirement for mining and oil and gas exploration entities.

However, ASX concluded that a standardised \$4 million NTA requirement is more appropriate and should reduce the impact that a higher requirement could have on the ability of early stage mining exploration, and technology and innovation entities to list and access capital.

Increase in market capitalisation test requirements

Listing Rule 1.3 will be amended to increase the minimum market capitalisation requirement from \$10 million to \$15 million for all entities applying for admission under the market capitalisation limb of the assets test. This is an alternative to the \$4 million NTA requirement.

ASX had consulted on a proposal to increase the minimum market capitalisation requirement to \$20 million but accepted that a \$15 million minimum market capitalisation requirement is more appropriate and will reduce the impact that a higher requirement could have on the ability of early stage mining exploration and technology and innovation entities from listing and accessing capital.

New free float requirements

Listing Rule 1.1 will be amended to introduce a new requirement for an entity to have a free float of at least 20% at the time of admission. This will increase from the current ASX approach of requiring a free float of 10%.

The 20% minimum free float requirement will be determined by applying the following criteria:

- free float – the percentage of the entity's main class of securities that are not restricted securities or subject to voluntary escrow, and are held by non-affiliated security holders; and
- non-affiliated security holder – a security holder who is not a related party of the entity (such as a director), an associate of a related party of the entity, or a person whose relationship to the entity or to a related party of the entity or their associates is such that, in ASX's opinion, they should be treated as affiliated with the entity.

The increase in the free float requirement from the current 10% to 20% will potentially make it more difficult to satisfy this requirement, particularly as securities subject to voluntary escrow are to be excluded from the free float calculation. This is compounded by the changes to the spread requirement which will only count shareholdings held by non-affiliated security holders (see below). Effectively, only securities and security holders that are counted as part of the free float will be counted in determining whether the spread requirements are satisfied.

ASX considers that a 20% free float requirement is in line with other international stock exchanges which generally have a rules-based minimum free float requirement in the range of 15 - 25%.

Simplified minimum spread requirements

Listing Rule 1.1 will be amended to implement a spread test which requires a minimum of 300 non-affiliated security holders each holding a parcel of non-restricted securities with a value of at least \$2,000.

The new spread test will now only count non-affiliated security holders, so will exclude securities issued to related parties, affiliates of related parties, and any person whose relationship to the entity or to a related party of the entity or their associates is such that, in ASX's opinion, they should be treated as affiliated with the entity.

The effect of these changes is that achieving a security holder spread of 300 under the new rules may be more difficult to satisfy than satisfying the spread requirement under the current rules.

ASX had consulted on increasing the value of the minimum parcel size from \$2,000 to \$5,000, but accepted this could potentially have adverse implications for participation by retail investors in IPOs, and so retained the \$2,000 threshold.

ASX considers that the proposed change to the spread test is also broadly aligned with other major exchanges, including the Hong Kong Exchange (HKEx), the Singapore Exchange (SGX) and the Toronto Stock Exchange (TSX).

Standardised working capital requirements

Listing Rule 1.3.3 will be amended to standardise the \$1.5 million working capital requirement for all entities admitted under the assets test.

It will also require that this amount must be available after allowing for the first full financial year's budgeted administration costs and the cost of acquiring any assets referred to in the prospectus, PDS or information memorandum (to the extent that those costs will be met out of working capital). Currently, this latter requirement only applies to mining and oil and gas exploration entities so the change represents a tightening of the minimum requirement for all entities that are not mining, and oil and gas exploration entities.

All entities will continue to be required to confirm that they have adequate working capital to carry out their stated objectives (and make a statement to that effect in their prospectus or PDS).

The rationale for standardising and extending the current \$1.5 million minimum working capital requirement to all entities admitted under the assets test is to:

- provide greater certainty to investors in relation to the minimum level of working capital that an entity will have available at the time of listing; and
- increase the likelihood that the listed entity will have sufficient resources to carry on its business without coming back to the market to raise funds for working capital for a reasonable period after listing.

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New requirements for audited accounts for admission under the assets test

Listing Rule 1.3.5 will be amended to introduce a new requirement for entities seeking admission under the assets test to produce audited accounts for the last 2 full financial years prior to admission. Where an entity is more than 6 months and 75 days into the current financial year, it will also be required to produce audited or reviewed accounts for the last half year.

Listing Rule 1.3.5 will also include a new requirement for entities seeking admission under the assets test that have in the 12 months prior to applying for admission acquired, or are proposing in connection with their listing to acquire, another entity or business that is significant in the context of the entity, to produce 2 full financial years of audited accounts for that significant entity or business. An entity or business will generally be considered significant if at the time of listing it will account for 25% or more of any of the applicant's: consolidated total assets; consolidated total equity interests; consolidated annual revenue, or in the case of a mining exploration entity, oil and gas exploration entity or other entity that is not earning material revenue from operations, consolidated annual expenditure; consolidated EBITDA; or consolidated annual profit before tax.

ASX may accept less than 2 full financial years of audited accounts where:

- the entity has an operating history of less than the 2 year requirement; or
- the entity has undergone such a major and transformative change during its most recent financial year that the accounts for the previous financial year would not provide any meaningful information to investors.

ASX had consulted on a proposal to require entities seeking admission under the assets test to produce audited accounts for the last 3 full financial years prior to admission. However, ASX accepted that 2 years was more appropriate, particularly given the significant compliance costs and time associated with the preparation of audited historical information and the practical difficulties of obtaining audited historical information for some early stage entities seeking admission under the assets test.

Importantly, entities seeking admission under the profits test will still need to demonstrate a 3 year track record of profitability and that the entity has a sustainable business, and provide 3 full financial years of audited accounts.

ASX discretion to refuse admission to the official list

The Introduction to the Listing Rules and Guidance Note 1 will be amended to emphasise ASX's absolute discretion on admission and quotation decisions. Further guidance will be available by providing examples of both when the ASX will exercise its discretion and circumstances that may indicate that an applicant does not have an acceptable structure or operations.

This proposed change to Guidance Note 1 is aimed at providing greater transparency of the factors that ASX takes into account when exercising its discretion on admission and quotation decisions.

ASX has already been implementing this policy through its Policy and Listing Standards Committee (PLSC) which effectively pre-vets certain companies to determine if they are suitable for admission. This is particularly relevant to application by international companies from emerging economies.

Foreign exempt listings

Listing Rule 1.11 will be amended to provide that for a foreign entity to eligible to be listed on ASX as a foreign exempt listing it must have its primary listing on an overseas stock exchange or market that is acceptable to ASX. Guidance Note 4 will also be amended to list those home exchanges that ASX generally considers acceptable for these purposes, which will include, amongst others, the LSE, Euronext, NYSE, NASDAQ, TSX, TSE, JSE and SGX.

Listing Rule 1.13 will also be amended to introduce the requirement for foreign exempt listings to have a minimum market capitalisation of least \$2,000 million as an alternative to meeting the requirements to have an NTA of at least \$2,000 million.

Policy changes for backdoor listings

A backdoor listing or reverse takeover effectively results in the listing of a privately held company or business by way of an acquisition by an existing ASX listed entity in return for a new issue of shares in that ASX listed entity.

ASX had previously announced a policy change whereby an entity announcing a backdoor listing transaction would immediately have its securities suspended from trading.

ASX has made further policy changes which apply with immediate effect to prescribe new minimum disclosure requirements for the announcement of a backdoor listing transaction. ASX will only allow an entity's securities to resume trading after the announcement only if the announcement contains all of the information set out in Annexure A to Guidance Note 12 and ASX is otherwise satisfied that the announcement includes sufficient information about the transaction for trading in the entity's securities to take place on a reasonably informed basis.

The information required is:

- the material terms of the transaction;
- the target's principal activities and business model, including any key risks;
- the impact of the transaction on the entity's capital and structure;
- any person who will acquire control of the entity as a result of the transaction;
- whether the entity or target has issued securities in the 6 months preceding the announcement, and the details of any such issue;
- whether the entity or target is proposing to issue securities, and the details of any such issue; and
- the financial accounts of the target.

Where an entity does not meet the prescribed disclosure requirements in its announcement, its securities will be suspended from quotation and will remain suspended until a supplementary announcement disclosing the information required is given to ASX for release to the market, or the entity has re-complied with ASX's admission and quotation requirements, or has made an announcement that the transaction is no longer proceeding.

The new policy effectively provides a choice to entities announcing a backdoor listing transaction, whether to comply with the additional requirements prescribed in Guidance Note 12 and have their securities resume trading following the announcement, or to go into suspension.

Conclusion

The revised admission criteria are not materially different from the current requirements although the revised 20% free float and audited accounts requirements may impose additional burdens on some entities seeking to list. The changes represent a balanced response by the ASX and should result in ASX continuing to be an attractive listing venue, particular for early stage companies seeking access to capital.

Comparison Table of Key ASX Listing Rule Requirements Changes

| | Current ASX Listing Rule Requirements | New ASX Listing Rule Requirements** |
|------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Profit Test | Consolidated Profit of at least \$400,000 plus aggregated profit of at least \$1 million from continuous operations for last 3 full financial years | Consolidated Profit of at least \$500,000 plus aggregated profit of at least \$1 million from continuous operations for last 3 full financial years |
| NTA Test | Net Tangible Assets of at least \$3 million | Net Tangible Assets of at least \$4 million |
| Market Capitalisation Test | Market capitalisation of least \$10 million | Market capitalisation of least \$15 million |
| Free Float | No official free float requirement (but a discretionary 10% usually imposed by ASX) | Minimum 20% free float requirement (with voluntary escrowed securities now specifically excluded from free float calculation) |
| Spread Requirements | Either: <ul style="list-style-type: none"> • At least 400 holders holding at least \$2,000 (excluding restricted securities); or • At least 350 security holders holding at least \$2,000 of securities (excluding restricted securities) if shareholders who are not related hold at least 25% of securities in that class; or • At least 300 security holders holding at least \$2,000 of securities (excluding restricted securities) if security holders who are not related hold at least 50% of securities in that class | At least 300 security holders holding at least \$2,000 of securities held by non-affiliated security holders, excluding: <ul style="list-style-type: none"> • restricted securities (i.e. ASX imposed escrow) • securities subject to voluntary escrow • securities held by related parties (e.g. director) and their associates and persons that ASX considers should be treated as affiliated with the entity |
| Working Capital Requirements | \$1.5 million working capital (and for mining and exploration companies. This must be after allowing for the first full year's budgeted administration costs and cost of acquiring any assets referred to in the prospectus or PDS) | \$1.5 million standardised working capital for all entities. (This must be after allowing for the first full year's budgeted administration costs and cost of acquiring any assets referred to in the prospectus or PDS) |
| Audited Accounts | No requirement that accounts must be audited for entities admitted under the asset test. | 2 full years audited accounts for entities admitted under the asset test. |

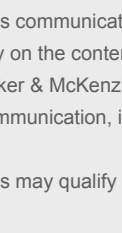
* Applications received prior to the 19 December 2016 will be assessed against these current admission requirements (other than the 20% free float requirement which the ASX is now applying).

** Applications received on or after the 19 December 2016 will be assessed against the new admission requirements.

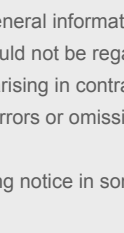
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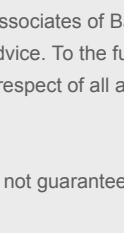
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