OWNERSHIP MATTERS

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Gary Hobourn
Office of general counsel
ASX Limited
Email: regulatorypolicy@asx.com.au

RE: Submission on 'Reverse Takeovers: Consultation on shareholder approval requirements for listed company mergers'

Dear ASX,

Thank you for the opportunity to comment on this consultation reviewing securityholder approval requirements for reverse takeovers. Ownership Matters (OM), formed in 2011, is an Australian owned governance advisory firm serving institutional investors. This submission represents the views of OM and not those of our clients.

The ASX should be commended for undertaking this consultation process in response to investor concerns over the existing Listing Rules being exploited to disenfranchise investors by structuring transactions to create 'bidders' whose securityholders will own a minority of the merged entity.

OM considers however that the ASX's proposed remedy, while a significant improvement on the existing rules, would still leave considerable room for exploitation through deal structuring by listed entity management and their advisers and leave ASX a significant laggard to the rules of other global peer exchanges. To this end OM recommends the ASX adopt a more stringent set of tests modelled on those of exchanges such as LSE and HKEx requiring bidder securityholder approval for significant transactions. This would allow investors to veto proposed value destructive acquisitions, impose few impediments on transactions viewed favourably by securityholders and remove ASX's status as a significant laggard relative to comparable global exchanges.

Our detailed response to the 'Questions for consultation' is below. Please feel free to contact us regarding any aspect of our submission.

Yours sincerely,

Dean Paatsch & Martin Lawrence

Ownership Matters Pty Ltd

Annexure: Questions for consultation

1. Do you think there is a gap in the Australian regulatory framework that warrants a change from the status quo? Do you consider that there are characteristics of the Australian market which justify a different approach to other jurisdictions (taking into account other factors such as other sources of financing)?
Yes. Since 2014 there have been at least six transactions within the ASX 300 structured as reverse takeovers: - **Horizon – ROC Oil:** Horizon shareholders were the 'target' shareholders but would have owned 58% of the merged entity (this transaction ultimately did not proceed after significant pressure from ROC Oil shareholders and an alternative cash takeover offer). The largest shareholder in Horizon Oil, with a 25% interest, was supportive of the transaction while the largest shareholder in ROC Oil, Allan Gray, with a 20% interest, was opposed. - **Federation Centres - Novion Property Group:** Novion securityholders were the 'target' securityholders but ultimately held 64% of Federation Centres (now 'Vicinity Centres) after the takeover completed. The largest holder in Novion, Gandel Group with a 27% interest, was in favour of the merger. - **Independence Group – Sirius Resources:** In this transaction, Sirius was the 'target' despite its shareholders emerging with 54% of the merged group. The largest holder in Sirius, Mark Creasy with 35%, was in favour of the transaction which was promoted as offering Sirius shareholders a substantial premium. - **Programmed Maintenance – Skilled Group:** Programmed was the 'acquirer' despite Skilled shareholders emerging with 52.4% of the merged group. The transaction was also promoted as offering Skilled Group securityholders (who voted on the transaction) a substantial premium. - **Vocus – Amcom:** In this transaction, Vocus was the acquirer despite Amcom shareholders owning 52% of the merged entity. The transaction retained its structure despite TPG Telecom emerging as an opponent of the deal on the Amcom register. - **Vocus – M2 Group:** This announced but not yet completed transaction would again see Vocus acting as the acquirer despite M2 shareholders emerging with 56% of the merged group. M2 does not have any substantial shareholders listed. This list shows there have been at least three announced transactions since mid-2014 where the deal structure appears explicable at least in part by a desire to ensure the success of the transaction through ensuring the 'target' company has a significant and supportive investor backing the deal (given the apparent impunity with which schemes of arrangement now are used to conduct takeovers the threshold for approval from a target is significantly lower making a major supportive investor attractive in ensuring certainty of completion). It should be noted that this rationale was explicitly denied by the boards and management in the case of Horizon-ROC and Federation Centres-Novion. The current regime makes a mockery of the notion of shareholder primacy in takeovers by allowing boards and their advisers to subvert this principle in the interests of ensuring a deal closes regardless of the wishes of shareholders of the notional 'bidder'. In some cases reverse takeovers have been undertaken with unlisted companies – for example, listed company Condor Metals (now Inca Minerals) 'acquired' unlisted Inca Minerals in early

2012. Under the terms of the transaction Inca Minerals shareholders owned 61% of Condor post-takeover but the only shareholder approval required from Condor shareholders was at a general meeting after the merger in order to change the name of the company.

There is no feature of the Australian market that makes it unique relative to the US, UK, Hong Kong, Singapore, Canada or South Africa that would justify the ongoing gap in shareholder protections embodied by exceptions 5 & 6 to Listing Rule 7.1. The chief characteristic of the Australian market that enables this gap appears to be a takeovers regime increasingly run for the benefit of would-be acquirers.

The consultation paper states that the ASX policy underlying exceptions 5 & 6 to Listing Rule 7.1 is "that the imposition of a requirement for shareholder approval would put a listed bidder at a significant disadvantage to a non-listed bidder in a contested takeover situation". OM notes that this policy appears difficult to justify when viewed against other comparable markets.

2. *Do you agree with the implementation of a shareholder approval requirement for issue of securities in excess of 100% of existing capital as consideration for a merger? If not, why not? If you consider an alternative threshold would be more appropriate, what would that threshold be? Are there any alternative indica you consider should be taken into account?*

No. The introduction of any rule limiting the capacity for deals to be structured as 'reverse takeovers' allowing one set of investors is disenfranchised is welcome. In this context the ASX's proposal of a 100% threshold is an improvement on the status quo. This threshold is however far too high especially by the standards of exchanges with which ASX seeks to compare itself globally such as the TSE, NYSE, Nasdaq, HKEx, JSE & LSE and would easily allow transactions to be structured so that the threshold is narrowly avoided: For example, the Oxiana-Zinifex 'merger of equals' where each set of shareholders held 50% of the merged entity required approval only from Oxiana shareholders as the 'notional' target. The proposed threshold would not have required approval from Zinifex shareholders as the number of shares issued did not exceed 100% of issued capital.

Jurisdictions such as LSE, HKEx & SGX, to avoid transactions being structured to ensure securityholder approval is not required, instead impose a variety of tests based on assets, profits or market capitalisation where if any of the tests is triggered approval is required. OM considers a test similar to those adopted by these exchanges (see, for example, HKEx Listing Rule 14) would be more appropriate with a similar threshold set at 25% of either assets, market capitalisation, issued capital, revenue and profits (with shareholder approval being required if the 25% ratio is exceeded for any of these categories).

Should ASX, unlike these other peer exchanges, consider this too complicated, OM would recommend adopting a test based on the book value of assets or, if purely based on securities on issue, at 20% of securities on issue (in line with the NYSE and Nasdaq). Alternatively, ASX could simply remove exceptions 5 & 6 to Listing Rule 7.1.

3. *If a shareholder approval requirement is implemented, do you think it should also be applied to other issues of securities in excess of 100% that are used to fund cash consideration for a takeover or scheme of arrangement? For example, rights issues under Listing Rule 7.2, exception 1?*

Yes. As noted under question 3 above, one of the reasons OM considers a more robust

test than issue of greater than 100% of issued securities is required is to avoid transactions being structured to avoid this threshold – for example, as a cash bid. Any rule adopted by ASX to prevent reverse takeovers being used to subvert securityholder primacy in takeovers should ensure securityholder approval is required for significant equity issues to fund cash consideration.

4. Do you agree that, if a shareholder approval requirement is implemented, it should be a 'bright line' test rather than a discretionary test?

Yes, any test should be a bright line test requiring minimal discretion from ASX. OM has observed that rules requiring any exercise of discretion by ASX have usually seen this discretion exercised in favour of issuers rather than their securityholders. For example, the recent decision by ASX to waive the requirements of Listing Rule 10.1 so that Beach Energy shareholders would not vote on the proposed acquisition of Drillsearch Energy despite the transaction triggering a rule designed to prevent the issue of securities to a related party without shareholder approval.

5. Do you think the proposal would have a material impact on the ability of ASX listed entities to compete effectively in the market for corporate control? Do you think any particular sectors of the Australian market would be more significantly affected than others?

No. There is no evidence to suggest that entities listed in jurisdictions that require bidder securityholder approval – at much lower thresholds than those contemplated by ASX – are disadvantaged in the market for corporate control. In the past two years at least two major ASX companies, David Jones and Recall Holdings, have been acquired (or been subject to takeovers) from companies listed in jurisdictions requiring shareholder approval of the offer (JSE and NYSE). Significant acquisition activity by LSE & NYSE companies also does not appear to have been unduly restrained by shareholder approval requirements.

There is also no reason to suspect that any particular sector of ASX listed entities would be more significantly affected by the requirement to seek bidder securityholder approval for major transactions. The requirement for a separate meeting may impose relatively higher costs on smaller listed entities than on larger entities but given small listed companies frequently hold meetings 'out of cycle' for a variety of purposes, including to seek shareholder approval for director & executive remuneration (see, for example the January 2015 general meeting for Medusa Mining and the February 2015 meeting for Acrux), holding additional meetings to approve transformative transactions does not seem to create an undue additional burden.

6. Do you think that the proposal would lead to transactions being structured to avoid security-holder approval? If so, how might this be done and what would be the consequences of such restructuring?

Yes. See item 2 above – for this reason, OM recommends ASX adopt a more rigorous set of 'tests' for significant transactions requiring securityholder approval modelled on that at peer exchanges such as the LSE or HKEx.

It would be relatively simple to evade the '100% issue' test, for, by example, structuring a deal to involve the issue of securities representing 99.9% of securities presently on issue with the remainder cash consideration. The existing use of reverse takeovers to exploit an

existing 'gap' in Australian regulation shows the willingness of management and their advisers to structure deals to avoid the impact of regulations designed to protect securityholders.

7. What do you consider may be the direct and indirect costs of the consultation proposal? Do you think those costs outweigh the potential benefits? If so, please provide the basis for that view? Are there any characteristics of Australian shareholder approval requirements that may make it more difficult to obtain shareholder approval than other jurisdictions?

The direct & indirect costs of implementing approval requirements for 'bidders' are unlikely to be significant in the context of the already significant costs involved in merger & acquisition activity. As noted above, the most significant direct costs will involve holding additional investor meetings which are a minor expense in the context of adviser fees, restructuring costs, management redundancies and the costs of refinancing debt obligations.

Indirect costs, such as greater uncertainty of transactions completing (and fees being crystallised), are likely to be viewed as material by advisers to listed entities but this is not in and of itself likely to be of any concern to owners of these entities. As noted above, the 'costs' associated with increased uncertainty due to the requirement to seek approval of two sets of securityholders appear surmountable in other jurisdictions that are comparable to Australia.

OM is not aware of any characteristics of the Australian market that would make it more difficult for securityholder approval to be obtained.

8. Would such a requirement make transactions more difficult to complete? If so, how? What are the potential timing and disclosure requirements of requiring shareholder approval for reverse takeovers?

Bidder securityholder approval would simply require one additional securityholder meeting to enable a transaction to complete. For transactions viewed favourably by securityholders of the bidder this is unlikely to impose any major difficulty although it may see less attractive transactions rejected.

The timing and disclosure requirements for requiring bidder securityholder approval – namely, ensuring 28 clear days' notice of a meeting and time to prepare an explanatory memorandum - would seem to fit easily into most transaction timetables. Given that shareholder meetings for both bidders and targets could be run in parallel there ought to be no additional time required to complete such transactions.

9. If a shareholder approval requirement is implemented, do you consider any changes to the standard voting exclusions or disclosure requirements would be required? For example, should target shareholders who also hold shares in the bidder be permitted to vote, subject to the usual exclusions for interested or related parties? Should an independent expert's report be required?

No. Securityholders of both the bidder and the target should be free to vote. Any securityholder with a specific interest in the transaction completing – including staff or directors who will crystallise benefits such as redundancy payments, equity vesting or with remuneration outcomes linked to the success of the transaction – should be prohibited

from voting.

Some minor amendments to Listing Rule 14 may be required to ensure certain minimum information regarding the proposed transaction is included in the notice of meeting. There should be no requirement to prepare an independent expert's report given it is not clear these add significant value to investors presently. Boards should be free to choose to have such a report prepared.

10. Are there any other consequential amendments to the listing rules which would be required?

Amendments to Listing Rule 7.2 (exceptions 5 & 6 at minimum) would likely be required under any change designed to require bidder securityholder approval.

11. Do you think such a proposal would have an impact on the willingness of issuers to list, or to remain listed, on ASX? Alternatively, do you consider failure to implement any changes would impact on the willingness of investors to invest in entities listed on ASX?

No – it would be unlikely that any entity listed or seeking to list on ASX would seek an alternative listing solely as a result of the proposed change. Any jurisdiction with comparable attractiveness to existing or likely investors has similar or more stringent rules.

OM is aware of international institutional investors who, as a result of being exposed to the lack of any requirement for bidder securityholder approval for ASX listed entities over the past two years, are now explicitly allowing for a 'forced dilution' discount when valuing Australian listed entities. This makes Australia relatively less attractive as a jurisdiction to these investors than those where this discount is not applied.

12. Are there any additional considerations which should be taken into account?

Not at this time; OM assumes that approval requirements imposed on listed companies would also be imposed on listed trusts.