ALLANGRAY
CONTRARIAN INVESTING

1 December 2015

ASX Limited
Office of General Counsel
20 Bridge Street
Sydney NSW 2000

By email: regulatorypolicy@asx.com.au
Attention: Ms Janine Ryan and Mr Gary Hobourn

Dear Ms Ryan and Mr Hobourn

ASX Consultation on Reverse Takeovers
Shareholder Approval Requirements for Listed Company Mergers

We appreciate the opportunity to make a submission to the ASX regarding changes to shareholder approval requirements in the context of reverse takeovers.

Our responses to the questions posed by the ASX appear in the Annexure. We would be happy to further engage with the ASX or other interest parties on this matter.

Yours sincerely

Simon Mawhinney
Managing Director and Chief Investment Officer
Email: simon.mawhinney@allangray.com.au
Telephone: (02) 8224 8630

Who is Allan Gray?

Allan Gray is an Australian-based investment manager. We manage money for retail and institutional clients, applying our contrarian, fundamental investment approach over the long term.

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 factors such as other sources of financing)?

Yes. It seems clear to us that the current listing rule exemptions are being exploited and could be improved upon. In fact, post our involvement in the very-public Roc Oil / Horizon Oil reverse takeover (Allan Gray owned close to 20% of ROC Oil at the time of the announcement), both the Chairman and CEO of Roc Oil conceded that the rules and their exemptions were being used in ways which lent themselves to less than ideal governance outcomes for shareholders of bidder companies.

We think that the introduction of a bidder shareholder approval requirement in takeovers is consistent with the policy objectives underlying Listing Rules 11.1 and 11.2 (ie, change to nature or scale of a company's activities, or disposal of a company's main undertaking). Guidance Note 12 seems to suggest that an acquisition which dwarfs a company's existing assets or business could raise similar issues to a back-door listing or the abandonment of a company's main undertaking.

Importantly, our primary concern is not that reverse takeovers have the potential to dilute the holdings of bidder shareholders without their consent, but rather that shareholders of bidder companies are deprived of their right to vote on what is clearly a significant matter in relation to that company. This is unusual in a global context.

We invest in markets around the globe and it is not our view that the Australian market is unique in ways that would justify adopting a different approach.

2. Do you agree with the implementation of a shareholder approval requirement for issues 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 indicia you consider should be taken into account?

No. Whilst we agree that changes to the status quo are necessary, we feel there is a better way to achieve this. The current recommendation focuses on the securities issued as part of a (reverse) takeover and is open to abuse by, for example, specifically structuring takeovers with a combination of cash and scrip so as to fall below the levels which require bidder shareholder approval. Advisors and investment banks will almost certainly abuse this loophole.

Rather than focussing on the number of shares outstanding, it would be better to base any thresholds on a percentage of a bidder company's total assets. It seems reasonable to us to expect bidder company shareholders to be entitled to vote on all company acquisitions which would be of a "transforming" nature. As an active investor in Australia and abroad, we think "transforming" would entail all acquisitions which would see a company's asset base expand by 50% or more. The asset base as at the date of the most recent company audited financial statements could be used for calculation purposes. Deals of this size should give Boards and certainly the shareholders they represent some pause.

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. Based on 2 above, this could be achieved by requiring shareholder approval for any acquisitions which increase the asset base by more than 50%, whatever the mechanism involved. It is important to link the rule to the asset base otherwise companies and their advisors will again game the system. For example, a company may acquire a company twice its size using bridging finance and only later issue shares to repay the debt. One could argue that these transactions are separate and wouldn't require shareholder approval notwithstanding that, in effect, a reverse takeover may have occurred. By requiring the acquisition itself to be approved given the expanded asset base of the bidder company, gaming of rules would be avoided.

Address Level 2, Challis House, 4 Martin Place, Sydney NSW 2000, Australia
Phone +61 2 8224 8600 Fax +61 2 8224 8601 Email info@allangray.com.au
Website www.allangray.com.au

Allan Gray Australia Pty Ltd
ABN 48 112 316 168 AFSL 298487

ALLANGRAY
CONTRARIAN INVESTING

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. Obtaining shareholder approval is discretionary today but Boards rarely avail themselves of the opportunity. In the ROC Oil situation, Allan Gray sought a special meeting that would require the company to allow a vote by its shareholders, and, even then, the company argued against giving its own shareholders a vote. We feel a bright line test is absolutely necessary.
5. Do you think that 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 to both parts of this question. Shareholder approval can easily be made a condition of any proposed transactions and can simply be obtained within the timeframes that are typical for completion. For example, 'target' company shareholders under a scheme of arrangement are already part of a shareholder approval process. Introducing a bidder shareholder approval requirement in a typically 'friendly' transaction should not be contentious. We acknowledge that doing so in the context of Chapter 6 takeovers may require more thought (but do not think the obstacles are insurmountable); we consider the bidder will have sufficient time to run a parallel process while target shareholders consider the bidder's offer. We think this is no different to, say, the introduction of the judicial advice process built into many of the recent trust scheme implementations. In those instances, seeking the court's 'approval' to proceed, while extending the completion timetable, gives some comfort that the unitholders' rights are protected.
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?
Unequivocally yes. For this reason, we strongly suggest that the proposal be amended to use the acquiring company's asset base as the determining factor with approval required for all acquisitions in excess of 50% (say) of the company's most recently audited asset base. Otherwise, bridging loans as noted above or combinations of cash and scrip will be used to get transactions over the line while still being below the threshold requiring shareholder approval. Even more worryingly, a company could issue a small amount of additional capital and buy a large, very indebted company that has limited equity value and then assume that company's debt. The ASX should ensure any new system is as unlikely to be gamed as possible and we think an asset-based threshold (which is importantly independent of capital structure) is less likely to be gamed by companies and their advisors.
7. What do you consider may be the direct and indirect costs of the consultation proposal? Do 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?
Shareholder approval in Australia is no more difficult than in other jurisdictions in which we invest. Arguably, it is much easier. We're not in a position to consider the costs of implementing necessary changes, but we find it hard to believe that the benefits would not significantly outweigh the costs. For most 'transformational' deals, the cost of getting approval would be a very small fraction of the transaction costs. Moreover, we would argue that there is a history of deals that have destroyed 'bidder' company values and imposed huge costs on shareholders, and that these deals were facilitated by the current rules.

Address Level 2, Challis House, 4 Martin Place, Sydney NSW 2000, Australia
Phone +61 2 8224 8600 **Fax** +61 2 8224 8601 **Email** info@allangray.com.au
Website www.allangray.com.au

Allan Gray Australia Pty Ltd
ABN 48 112 316 168 AFSL 298487

8. Would such a requirement make transactions more difficult to complete? If so, how? What are the potential timing and disclosure implications of requiring shareholder approval for reverse takeovers?
No, or not meaningfully so. Implementation of these necessary changes may not create further delays or complications at all. Delays are already present with, for example, "target" company shareholders being required to vote on the transaction (see response to question 5). Having the bidding company shareholders vote could most likely coincide with the timing of the votes for the target shareholders. The rule exemptions as they currently exist have created avenues for violations of shareholder rights and poor governance. Were any delays to present themselves, this would be justified in order to address the shortcomings of the rule exemptions as they are currently applied.
8A 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. We don't envisage any need to make changes to the standard voting exclusions or disclosure requirements. An independent expert's report should only be required if the acquiring company deems it necessary. The Board and management of the acquiring company will most likely make this decision based on how difficult a 'sell' the transaction is to their shareholders. Introducing rules that require independent expert's reports will most likely create unnecessary delays and costs. This should be optional.
9. Are there any other consequential amendments to the listing rules which would be required?
No. Based on the changes recommended in the responses to questions 2 and 3, we are not aware of any consequential changes.
10. Do you think such a proposal would have an impact on the willingness of issuers to list, or 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?
Unequivocally no to both parts of the question. Notwithstanding our response, "willingness to invest" should not be the litmus test for whether a rule change is necessary. A rule change would protect shareholders further, bring about better corporate governance and not be unduly detrimental to issuers. After all, Boards of these issuers exist to, amongst other things, serve the shareholders whose rights are being abused by the current rule exemptions. Change is essential.
11. Are there any additional considerations which should be taken into account?
In your consultation paper, comparisons have been raised between the Roc Oil and Federation Centres reverse takeovers which didn't result in the same level of media commentary or concerns being raised. Allan Gray was largely responsible for the concerns raised around the Roc Oil transaction. We were not shareholders of Federation Centres at the time of the Novion transaction and, though surprised once more that transactions like these could proceed without bidder company shareholder approval, we were not in a position to take any action. In any event, we do not consider that the degree of public outcry (or lack thereof) should be used as a measure of the significance of this issue.

Address Level 2, Challis House, 4 Martin Place, Sydney NSW 2000, Australia
Phone +61 2 8224 8600 **Fax** +61 2 8224 8601 **Email** info@allangray.com.au
Website www.allangray.com.au

Allan Gray Australia Pty Ltd
ABN 48 112 316 168 AFSL 298487