

## PERFORMANCE SECURITIES

<b>The purpose of this Guidance Note</b>	<ul style="list-style-type: none"> <li>To assist listed entities and entities wishing to apply for admission to the official list as an ASX Listing to understand how ASX applies the Listing Rules to performance securities</li> </ul>
<b>The main points it covers</b>	<ul style="list-style-type: none"> <li>What are “performance securities”?</li> <li>The Listing Rules applicable to performance securities</li> <li>Applying for in-principle advice about performance securities</li> <li>Base requirements for performance securities</li> <li>Appropriate and equitable numbers of performance securities</li> <li>Appropriate and equitable performance milestones</li> <li>ASX’s requirements for security holders to approve the issue of performance securities and changes to their terms</li> <li>ASX’s requirement for an independent expert’s report in some cases</li> <li>Disclosure obligations in relation to performance securities</li> </ul>
<b>Related materials you should read</b>	<ul style="list-style-type: none"> <li>Guidance Note 1 <i>Applying for Admission – ASX Listings</i></li> <li>Guidance Note 12 <i>Significant Changes to Activities</i></li> <li>Guidance Note 17 <i>Waivers and In-Principle Advice</i></li> <li>Guidance Note 21 <i>The Restrictions on Issuing Equity Securities in Chapter 7 of the Listing Rules</i></li> <li>Guidance Note 25 <i>Issues of Securities to Persons in a Position of Influence</i></li> <li>Guidance Note 30 <i>Notifying an Issue of Securities and Applying for their Quotation</i></li> <li>Guidance Note 35 <i>Security Holder Resolutions</i></li> </ul>

**History:** Guidance Note 19 amended 12/03/21. Previous versions of this Guidance Note were issued in 04/14, 12/19 and 08/20.

**Important notice:** ASX has published this Guidance Note to assist listed entities to understand and comply with their obligations under the Listing Rules. Nothing in this Guidance Note necessarily binds ASX in the application of the Listing Rules in a particular case. In issuing this Guidance Note, ASX is not providing legal advice and listed entities should obtain their own advice from a qualified professional person in respect of their obligations. ASX may withdraw or replace this Guidance Note at any time without further notice to any person.

### Table of Contents

1. Introduction	2
2. What are “performance securities”?	3
3. The different types of performance securities	3
4. The reasons for issuing performance securities	4
5. The characterisation of performance securities under the Listing Rules	5
6. The Listing Rules applicable to performance securities	5
7. Agreements to issue or transfer ordinary shares in the future	8
8. Applying for in-principle advice about performance securities	10
9. Base requirements for performance securities	13
10. Appropriate and equitable numbers of performance securities	14
11. Appropriate and equitable performance milestones	16
12. ASX’s requirement for security holder approval	18
13. ASX’s requirement for an independent expert’s report in some cases	19
14. Notice requirements	21
15. Voting exclusions	22

## 1. Introduction

ASX Limited (“ASX”) recognises that performance securities are flexible instruments that, if appropriately structured, can deliver positive outcomes to listed entities and their security holders. Hence, ASX has no fundamental objection to listed entities issuing performance securities, provided they comply with the Listing Rules. This includes, in particular, the overarching requirement in Listing Rule 6.1 that applies to all equity securities that their terms must, in ASX’s opinion, be appropriate and equitable.

Over time, ASX has observed an increasing use of performance securities, particularly (but not only) in new and re-compliance<sup>1</sup> listings, where it is not always apparent to ASX that entities and their boards and advisers have given careful consideration to the appropriateness and equitableness of the performance milestones attached to the performance securities.

This Guidance Note is published by ASX to assist entities admitted to the ASX official list, or wishing to apply for admission to the ASX official list, as an ASX Listing<sup>2</sup> to understand how ASX applies the Listing Rules to performance securities.

It should be noted that performance securities can raise issues under the Corporations Act 2001 (Cth),<sup>3</sup> as well as under the Listing Rules, including:

- whether their issue requires an amendment to the entity’s constitution under section 136(2) (listed companies) or 601GC(1) (listed trusts) or a resolution varying class rights under sections 246B and 246C(5);
- whether their issue requires security holder approval as a related party transaction under section 208(1)(a) (listed companies) or 601LC (listed trusts);

<sup>1</sup> The term “re-compliance listing” refers to the process a listed entity undergoes where the entity is proposing a significant change to the nature or scale of its activities and ASX exercises its discretion under Listing Rule 11.1.3 to require the entity to meet ASX’s requirements for admission and quotation in Chapters 1 and 2 of the Listing Rules as if the entity were applying for admission to the official list. The application the entity lodges for admission to the official list as part of this process is referred to as an “application for re-admission” and the point at which the entity is reinstated to quotation having satisfied ASX’s admission and quotation requirements is referred to as “re-admission”. See generally Guidance Note 12 *Significant Changes to Activities*.

<sup>2</sup> Most of the Listing Rules addressed in this Guidance Note do not apply to entities admitted to the official list as an ASX Debt Listing or as an ASX Foreign Exempt Listing (see Listing Rules 1.10 and 1.15.1). Unless otherwise indicated, references in this Guidance Note to a listed entity or entity mean an entity admitted, or applying to be admitted or re-admitted, to the ASX official list as an ASX Listing.

<sup>3</sup> Referred to in this Guidance Note as the “Corporations Act”. Unless otherwise indicated, references in this Guidance Note to sections of an Act are to sections of the Corporations Act.

- whether their conversion into ordinary shares requires shareholder approval under item 7 of section 611;<sup>4</sup>
- in the case of a listed company, whether their issue conforms to the statutory duties of directors in sections 180 and 181 to act with reasonable care and diligence, in good faith, for a proper purpose and in the best interests of the company; and
- in the case of a listed trust, whether their issue conforms to the statutory duties of a responsible entity in section 601FC to act with reasonable care and diligence and in the best interests of unitholders in the trust.

This Guidance Note does not address Corporations Act issues and entities should ensure they obtain appropriate legal advice on the application of the Corporations Act to an issue of performance securities, as well as on the application of the Listing Rules.

## 2. What are “performance securities”?

The term “performance security” is a generic term referring to a security that converts, or may convert, into a given number of ordinary shares with all the usual rights attached if and when a nominated performance milestone is achieved but otherwise has limited rights until then. The number of ordinary shares into which the performance security converts may be a fixed number (often it is one for one<sup>5</sup>) or it may be determined by reference to a particular formula.

Performance securities issued by a listed entity to the vendor of an undertaking<sup>6</sup> are sometimes referred to as “contingent consideration securities” or “deferred consideration securities”, as they provide a mechanism for the vendor to receive additional ordinary shares as consideration for selling the undertaking to the entity, if and when the nominated performance milestone is achieved.

## 3. The different types of performance securities

Performance securities come in a number of different forms:

- “performance shares”<sup>7</sup> – that is, shares that automatically convert, or at the election of the entity or the holder may be converted, into ordinary shares if and when a nominated performance milestone is achieved;
- “performance options” – that is, an option entitling the holder to subscribe for or purchase ordinary shares for a nominal amount or for free which requires the achievement of a nominated performance milestone before it can be exercised;<sup>8</sup> and
- “performance rights” – that is, a contractual right to receive a given number of ordinary shares, or to receive a cash payment equal to the value of a given number of ordinary shares, if and when a nominated performance milestone is achieved.

<sup>4</sup> So as to avoid breaching section 606(1), noting in particular the provisions in section 606(6)(a) that deem a person to acquire a relevant interest in voting shares in a company if securities in which a person already had a relevant interest become voting shares in the company. Listed entities should also have regard to the guidance provided by ASIC on such matters in Regulatory Guide 74 *Acquisitions approved by members*.

<sup>5</sup> That is, one performance security converts into one ordinary share.

<sup>6</sup> Listing Rule 19.12 defines the expression “undertaking” to include both assets and businesses. The term is used in the same sense in this Guidance Note. To avoid doubt, the acquisition of another entity is an acquisition of an undertaking for the purposes of this Guidance Note.

<sup>7</sup> In the case of a listed trust, references in this guidance note to “ordinary shares” should be read as references to “ordinary units” and references to “performance shares” should be read as references to “performance units” (that is, units that automatically convert, or at the election of the entity or the holder may be converted, into ordinary units if and when a nominated performance milestone is achieved).

<sup>8</sup> There may be other conditions that need to be satisfied before a performance option can be exercised (for example, in the case of a performance option issued under an employee incentive plan, a condition that the holder is still an employee of the entity at the time the option is exercised).

In each case above it is irrelevant whether the entitlement of the holder to receive ordinary shares upon the achievement of the nominated performance milestone will be satisfied by reclassifying the securities as ordinary shares, issuing new ordinary shares or transferring existing ordinary shares.<sup>9</sup>

#### 4. The reasons for issuing performance securities

Performance securities are most typically issued by a listed entity to the vendor of an undertaking as a form of contingent or deferred consideration, often where the value of the undertaking being acquired by the entity is unclear or may vary materially, depending on whether the relevant performance milestone is achieved. For example, a listed entity buying a mining tenement that has been the subject of a preliminary drilling program with promising results but that requires an in-fill drilling program and other work to confirm the size and quality of the resource, may wish to protect itself against the risk of the tenement not living up to its initial promise. To do this, it may agree to issue an initial tranche of ordinary shares to the vendor upon completion of the agreement to acquire the tenement, together with performance securities that convert into a further tranche of ordinary shares if an inferred, indicated or measured resource of a given size and quality is reported at the tenement within a given timeframe. If the milestone is not met, the performance securities will lapse worthless and the entity will only be “out of pocket” the initial tranche of ordinary shares, helping to protect the entity and its investors from overpaying for the tenement. If the milestone is met, the vendor will receive the further tranche of ordinary shares to reward it more fully for the latent value of the tenement.

Performance securities are sometimes issued to directors, senior executives, employees or contractors, either as part of their remuneration package or under an employee incentive scheme, as a means of incentivising them to achieve a particular performance milestone. They can be especially useful for cash-strapped start-up ventures that may have no other practical means of remunerating or incentivising key individuals for the substantial effort that may be required to get the venture up and running profitably.

Performance securities are also sometimes issued to promoters of, or advisers to, a new or re-compliance listing as a means of providing them with additional consideration if the listing performs particularly well and to service providers to encourage and reward a given level of performance (such as to sales agents, licensees or other distributors of a listed entity’s products to incentivise them to achieve a target level of sales).

Examples of performance milestones that have been attached to performance securities include:

- an entity achieving a particular financial target (eg a nominated level of profit or earnings per share);
- an entity achieving a particular measure of shareholder value (such as a nominated share price or total shareholder return);
- an entity obtaining a key governmental approval needed to commence operations;
- a biotech entity achieving a step in the regulatory approval process for a new drug or medical device;
- a mining exploration entity reporting an inferred, indicated or measured resource of a given size and quality at a particular tenement; and
- a mining producing entity achieving a nominated level of production at a particular mining facility.

<sup>9</sup> Accordingly, references in this Guidance Note to performance securities being “converted” into ordinary securities (and cognate expressions) include the performance securities being reclassified as ordinary shares, or the holder being issued with new ordinary shares or transferred existing ordinary shares in satisfaction of their right to receive ordinary shares under the performance securities.

## **5. The characterisation of performance securities under the Listing Rules**

Performance shares, performance options, and performance rights that confer a right or option to receive ordinary shares (“deliverable performance rights”), are both “equity securities”<sup>10</sup> and “convertible securities”<sup>11</sup> for the purposes of the Listing Rules. As equity securities, they must comply with the general requirements applicable to all equity securities in Chapter 6 of the Listing Rules, including the requirement in Listing Rule 6.1 that their terms must, in ASX’s opinion, be appropriate and equitable.

Performance options must also meet the requirements applicable to options in Chapter 6 of the Listing Rules.

It should be noted that some instruments labelled as “performance rights”, properly construed, confer an option over an issued or unissued share. Where that is the case, not only must the performance rights meet the general requirements applicable to equity securities in Chapter 6 of the Listing Rules, they must also meet the specific requirements applicable to options in that Chapter.

Performance rights that only confer a right to a payment of the cash value of a given number of ordinary shares if a nominated performance milestone is achieved and that do not confer any right or option to receive an issued or unissued share or shares (“cash-settled performance rights”),<sup>12</sup> are neither “equity securities” nor “convertible securities” for the purposes of the Listing Rules. None of the requirements in the remainder of this Guidance Note apply to cash-settled performance rights and references hereafter in this Guidance Note to performance securities or performance rights do not include cash-settled performance rights.

## **6. The Listing Rules applicable to performance securities**

Listing Rule 1.1 condition 1 requires an entity seeking admission to the official list as an ASX Listing to have a structure that is appropriate for a listed entity.

Listing Rule 12.5 also imposes an ongoing obligation on a listed entity to have a structure that is appropriate for a listed entity.

ASX takes the view that for an entity to have a structure appropriate for a listed entity, among other things, the terms of its securities must comply with Chapter 6 of the Listing Rules. This applies both to its quoted<sup>13</sup> and its unquoted securities.

In this regard, Listing Rule 6.1 expressly provides that the terms that apply to each class of equity securities of a listed entity must, in ASX’s opinion, be appropriate and equitable.<sup>14</sup> Again, this applies both to its quoted and its

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<sup>10</sup> See the definition of “equity security” in Listing Rule 19.12. Shares fall within paragraph (a) of that definition. Options over issued or unissued shares fall within paragraph (c) of that definition. Rights to an issued or unissued share fall within paragraph (d) of that definition. Thus, a performance share, a performance option, and a performance right that confers a contractual entitlement to receive ordinary shares if a nominated performance milestone is achieved, are all equity securities for the purposes of the Listing Rules.

<sup>11</sup> See the definition of “convertible security” in Listing Rule 19.12.

<sup>12</sup> ASX would emphasise that to be considered “cash-settled”, a performance right must provide for a cash payment only and neither the entity nor the holder can have any right or option – no matter how conditional, contingent or remote – to have the payment obligation satisfied by an issue or transfer of ordinary shares. If the entity or the holder has any such right or option, the performance right is regarded as a deliverable performance right for the purposes of this Guidance Note.

<sup>13</sup> Listing Rules 2.1 condition 1 and 2.5 condition 1 also make it a condition of quotation of all equity securities that the terms of the securities comply with Listing Rule 6.1.

<sup>14</sup> Note also Listing Rule 6.2, which precludes a listed entity from having more than one class of ordinary security unless ASX approves the terms of the additional class or the additional class is of partly paid securities which, if fully paid, would be in the same class as the ordinary securities.

unquoted securities.<sup>15</sup> It also applies regardless of whether the issue of securities has been approved by security holders.<sup>16</sup>

In assessing whether Listing Rule 1.1 condition 1 or Listing Rules 6.1 and 12.5 (as applicable) are met, ASX has regard to the principles on which the Listing Rules are based, as set out in the introduction to the Listing Rules. One of these principles is that securities “should be issued in circumstances, and have rights and obligations attaching to them, that are fair to new and existing security holders”.

Suffice to say, if an entity undertaking a new or re-compliance listing has, or proposes to have, performance securities on issue that do not comply with this Guidance Note, ASX may find that the entity does not comply with Listing Rule 1.1 condition 1 and therefore deny its application for admission or re-admission to the official list. Similarly, if an existing listed entity issues performance securities that do not comply with this Guidance Note, ASX may find that the entity is in breach of Listing Rules 6.1 and 12.5 and take corrective action in relation to that breach, including, if ASX considers it appropriate, suspending its securities from trading until that breach is rectified.<sup>17</sup>

Listing Rule 7.1, which broadly speaking requires security holder approval for issues of equity securities over a 12 month period in excess of 15% of an entity’s ordinary capital, may apply to an issue of performance securities.<sup>18</sup> Whether it applies will depend on the number of performance securities to be issued, the number of ordinary shares into which they convert,<sup>19</sup> and the number of other equity securities that the entity has issued, agreed to issue, or cancelled, over the preceding 12 months.<sup>20</sup> It will also depend on whether the issue falls within one of the permitted exceptions to Listing Rule 7.1 in Listing Rule 7.2.<sup>21</sup>

Listing Rule 10.11, which broadly speaking requires security holder approval for an issue of equity securities to related and other closely connected parties, may also apply to an issue of performance securities, depending on the person to whom they are to be issued.<sup>22</sup> It will also depend on whether the issue falls within one of the permitted exceptions to Listing Rule 10.11 in Listing Rule 10.12.<sup>23</sup>

Alternatively, if the performance securities are being issued under an employee incentive scheme to a director or someone closely connected to a director, their issue may require security holder approval under Listing Rule 10.14.<sup>24</sup>

<sup>15</sup> See the explanatory note at the commencement of Chapter 6 of the Listing Rules, which states that the requirements of that Chapter “apply to both quoted and unquoted securities unless otherwise stated”. Performance securities typically are not quoted by ASX (see “9. Base requirements for performance securities” on page 13).

<sup>16</sup> For example under Listing Rule 7.1 or 10.11 or under item 7 of section 611 of the Corporations Act. The fact that the terms applying to performance securities have been, or are proposed to be, approved by security holders is a factor to which ASX will have regard in determining whether those terms are appropriate and equitable but ASX may still form the opinion that those terms are not appropriate and equitable having regard to other factors.

<sup>17</sup> This only applies to performance securities issued after 28 August 2020, the date of release of the updated version of this Guidance Note containing this particular guidance. It does not apply retrospectively to performance securities issued before that date.

<sup>18</sup> See generally Guidance Note 21 *The Restrictions on Issuing Equity Securities in Chapter 7 of the Listing Rules*.

<sup>19</sup> As mentioned in the text accompanying note 11 above, performance securities are “convertible securities” for the purposes of the Listing Rules. Hence, in applying the formula in Listing Rule 7.1, ASX will count each performance security as being equivalent to the number of ordinary shares (or if that number is variable, the maximum number of ordinary shares) that may be issued to the holder if the relevant performance milestone is achieved (see Listing Rule 7.1B.1(e) and section 5 of Guidance Note 21 *The Restrictions on Issuing Equity Securities in Chapter 7 of the Listing Rules*).

<sup>20</sup> Even where an entity has sufficient placement capacity under Listing Rule 7.1 to issue performance securities without security holder approval, it will typically seek security holder approval to the issue under Listing Rule 7.1 so that the performance securities do not use up any of its 15% placement capacity under that rule. ASX will often require an issue of performance securities to be approved by security holders under this Guidance Note (see “12. ASX’s requirement for security holder approval” on page 18) and so there is no material added burden for the entity in seeking a resolution of security holders approving the issue under Listing Rule 7.1 as well.

<sup>21</sup> Note that performance securities issued under an employee incentive scheme may be exempt from the requirement for security holder approval under Listing Rule 7.1 if they fall within Listing Rule 7.2 exception 13, 14 or 15.

<sup>22</sup> See generally, Guidance Note 25 *Issues of Securities to Persons in a Position of Influence*.

<sup>23</sup> Note that performance securities issued under an employee incentive scheme may be exempt from the requirement for security holder approval under Listing Rule 10.11 if they fall within Listing Rule 10.12 exception 8 or 9.

<sup>24</sup> Note that some performance securities issued under an employee incentive scheme may be exempt from the requirement for security holder approval under Listing Rule 10.14 if they fall within Listing Rule 10.16.

Having said this, ASX will often require an issue of performance securities to be approved by security holders under this Guidance Note.<sup>25</sup> Where it does, any approval required under Listing Rules 7.1, 10.11 or 10.14 can easily be incorporated into the same notice of meeting as the resolution approving the issue of the performance securities under this Guidance Note.

Performance securities can also attract various disclosure requirements under the Listing Rules. For example, a listed entity is required to notify ASX:

- under Listing Rule 3.10.3 of a proposed issue of performance securities (other than an issue proposed to be made under an employee incentive scheme), immediately it proposes to issue them, using an Appendix 3B; or
- under Listing Rule 3.10.3A of an issue of performance securities under an employee incentive scheme, within 5 business days of the date of issue, using an Appendix 2A (in the unlikely event that they are intended to be immediately quoted on ASX) or an Appendix 3G (in the more likely event that they are not intended to be immediately quoted on ASX).

In each case above, this applies regardless of the size or purpose of the proposed issue and whether or not information about the proposed issue is “market sensitive”.<sup>26</sup>

In due course, if and when the applicable performance milestone is met and the performance securities are converted into ordinary shares, the entity must notify ASX of their conversion and apply for the quotation of the resulting ordinary shares using an Appendix 2A *Application for Quotation of Securities* within 10 business days of their conversion.<sup>27</sup>

ASX expects an entity that has a material number of performance securities on issue to make a market announcement immediately:

- upon satisfaction of the milestone that triggers their conversion into ordinary shares, indicating that the milestone has been achieved and stating the amount of ordinary shares to be issued as a consequence;<sup>28</sup> and
- if the milestone is not satisfied by the expiry date, stating that fact and what will happen to the performance securities as a consequence.<sup>29</sup>

An entity that has performance securities on issue should disclose in the notes to the statement of financial position in its annual report, preliminary final report (Appendix 4E) and half-year report:

- the number of performance securities on issue at the balance date of the report;
- a brief summary of the terms of the performance securities, including in particular the performance milestone that has to be satisfied in order for the performance securities to be converted into ordinary shares and the number of ordinary shares into which they may be converted; and
- whether any performance securities were converted or cancelled during the financial period covered by the report.

<sup>25</sup> See “12. ASX’s requirement for security holder approval” on page 18.

<sup>26</sup> Information about a proposed issue of securities is “market sensitive” if a reasonable person would expect the information to have a material effect on the price or value of the entity’s securities: see generally Guidance Note 8 *Continuous Disclosure: Listing Rules 3.1 – 3.1B*.

<sup>27</sup> Listing Rules 2.7, 2.8.3 and 3.10.3B. Where the entitlement of the holder of performance securities to receive ordinary shares is satisfied by a transfer of existing quoted ordinary shares, rather than an issue of new ordinary shares, there is no need for an Appendix 2A.

<sup>28</sup> ASX will usually impose this as a condition to any in-principle advice it gives that the performance securities are appropriate and equitable for the purposes of Listing Rule 6.1. Even if it does not impose such a condition, this information should be disclosed under Listing Rule 3.1 and/or 3.10.3B.

<sup>29</sup> ASX will usually impose this as a condition to any in-principle advice it gives that the performance securities are appropriate and equitable for the purposes of Listing Rule 6.1. Even if it does not impose such a condition, this information should be disclosed under Listing Rule 3.1.

### 7. Agreements to issue or transfer ordinary shares in the future

An agreement by an entity to issue or transfer ordinary shares in the future if a nominated performance milestone is achieved<sup>30</sup> has the same economic substance and effect as a deliverable performance right and is treated by ASX as if it were a performance security for the purposes of this Guidance Note.<sup>31</sup> This applies even though the parties to the agreement may choose to describe the right to receive ordinary shares under the agreement as something other than a “performance right”, such as a right to receive “future consideration”, “contingent consideration” or “deferred consideration”. It also applies even though the agreement may not exhibit the usual hallmarks of a traditional security.<sup>32</sup>

Consequently, ASX will expect the terms attaching to the de facto performance right embedded in the agreement (ie the right of the counterparty to receive ordinary shares in the future if the nominated performance milestone is achieved) to conform to sections 10 and 11 of this Guidance Note.<sup>33</sup>

Likewise, if the de facto performance right embedded in the agreement does not fall within one of the exceptions mentioned in paragraphs (1) to (4) of section 12 of this Guidance Note, ASX will expect the agreement to be approved by security holders in accordance with that section. To meet this expectation, the entity will need to include a provision in the relevant agreement making it a condition precedent to the right of the counterparty to receive the ordinary shares in the future that the entity’s security holders approve the agreement in accordance with section 12 of this Guidance Note and that it obtain that approval before the ordinary shares in question are issued or transferred to the counterparty.

Similarly, if the de facto performance right embedded in the agreement does not fall within one of the exceptions mentioned in paragraphs (1) to (3) of section 13 of this Guidance Note, and the conditions set out in paragraph (a) or (b) of that section are met, ASX will expect the fairness and reasonableness of the de facto performance right embedded in the agreement to be the subject of an independent expert’s report in accordance with that section.<sup>34</sup>

It should be noted that agreements providing for an issue of ordinary shares in the future if a performance milestone is achieved can also give rise to issues under Listing Rules 7.1<sup>35</sup> and 7.3.4 that need careful consideration. If the number of ordinary securities to be issued under the agreement exceeds the entity’s placement capacity under Listing Rule 7.1,<sup>36</sup> the entity will also need to make the agreement conditional on security holder approval under Listing Rule 7.1<sup>37</sup> and then seek that approval before the issue occurs.<sup>38</sup> Listing Rule 7.3.4, in turn, will require the notice of meeting seeking that approval to set out the date on or by which the entity will issue the ordinary securities under the agreement and (relevantly) that this date must be no later than 3 months after the date of the meeting. Many agreements of the type here under consideration will involve a performance milestone that is unlikely to be

<sup>30</sup> A common example would be an agreement to purchase a mining tenement where the consideration comprises the issue of an initial tranche of ordinary shares to the vendor at completion, plus an agreement to issue a further tranche of ordinary shares to the vendor if the entity reports an inferred, indicated or measured resource of a given size and quality at the tenement within a given timeframe.

<sup>31</sup> Were this not the case, it would be a relatively easy matter for parties to avoid the operation of this Guidance Note by structuring what would otherwise be regarded as performance securities as an agreement to issue or transfer ordinary shares in the future if a nominated performance milestone is achieved.

<sup>32</sup> Typically, the term “security” is used to describe a financial instrument evidencing an ownership interest or debt obligation that has value and can be traded. However, paragraph (d) of the definition of “equity security” in the Listing Rules plainly captures any right to an issued or unissued share or unit, regardless of the form that right takes (see note 10 above).

<sup>33</sup> The agreement will generally meet the base requirements for performance securities in section 9 of this Guidance Note by dint of the fact that the counterparty does not receive any up-front shares or options conferring the de facto performance right, just the contractual promise in the agreement that the entity will issue or transfer the ordinary shares in the future if the performance milestone is met. Accordingly, the counterparty is not able to exercise any rights as a security holder unless and until the performance milestone is met and the ordinary shares are issued or transferred to them in accordance with the agreement.

<sup>34</sup> Noting that under Listing Rule 19.2, listed entities have an obligation to comply with the Listing Rules as interpreted: (a) in accordance with their spirit, intention and purpose; (b) by looking beyond form to substance; and (c) in a way that best promotes the principles on which the Listing Rules are based.

<sup>35</sup> See ‘6. The Listing Rules applicable to performance securities’ on page 5 and Guidance Note 21 *The Restrictions on Issuing Equity Securities in Chapter 7 of the Listing Rules*.

<sup>36</sup> Calculated as at the date the entity enters into the agreement.

<sup>37</sup> So as to attract exception 16 in Listing Rule 7.2.

<sup>38</sup> Otherwise, the act of the entity entering into the agreement to issue the ordinary shares will breach Listing Rule 7.1.



satisfied, and therefore the resulting issue of ordinary shares is unlikely to occur, until sometime after the expiration of the 3 month period specified in Listing Rule 7.3.4. Where that is so, the entity will require a waiver<sup>39</sup> from ASX of Listing Rule 7.3.4, so that the necessary security holder approval under Listing Rule 7.1 can be obtained despite the 3 month limitation in Listing Rule 7.3.4 not being met. Hence, the entity should make the agreement conditional not only on security holder approval under Listing Rule 7.1 but also on ASX granting the required waiver of Listing Rule 7.3.4.

An entity in this position should note that ASX will generally only grant the required Listing Rule 7.3.4 waiver if the de facto performance right embedded in the agreement satisfies the applicable requirements in this Guidance Note.<sup>40</sup>

If ASX declines to grant the required Listing Rule 7.3.4 waiver (whether for the reason mentioned in the preceding paragraph or for some other reason<sup>41</sup>), the entity will not be able to obtain a valid security holder approval to the agreement under Listing Rule 7.1,<sup>42</sup> which in turn will preclude the entity from proceeding with the issue under the agreement (at least to the extent that it exceeds the entity's current placement capacity under Listing Rule 7.1).

ASX notes that listed entities will sometimes seek security holder approval to an agreement to issue ordinary shares under Listing Rule 7.1 or 7.4, even though the number of ordinary shares to be issued falls within the entity's placement capacity under Listing Rule 7.1 and therefore the agreement technically does not require any approval under that rule. Usually, the motivation for doing this is to preserve or restore the entity's placement capacity under Listing Rule 7.1.<sup>43</sup> Entities that do so in relation to the types of agreements here under consideration should note that if the relevant performance milestone is unlikely to be satisfied, and therefore the resulting issue of ordinary shares is unlikely to occur, until a date more than 3 months after the date of the meeting of security holders approving the agreement, the entity will require a waiver of Listing Rule 7.3.4 (in the case of an approval under Listing Rule 7.1) or of Listing Rule 7.5.4 (in the case of an approval under Listing Rule 7.4). This applies even though the security holder approval being sought under Listing Rule 7.1 or 7.4 (as applicable) is entirely voluntary and not a requirement under the Listing Rules.

Again, an entity in this position should note that ASX will generally only grant the required waiver of Listing Rule 7.3.4 or 7.5.4 where the de facto performance right embedded in the agreement satisfies the applicable requirements in this Guidance Note.

If ASX declines to grant the required waiver of Listing Rule 7.3.4 or 7.5.4 (whether for the reason specified in the preceding paragraph or for some other reason), the entity will not be able to obtain a valid security holder approval to the agreement under Listing Rule 7.1 or 7.4 and its placement capacity under Listing Rule 7.1 will consequently be reduced for the 12 month period following the date of the agreement by the number of ordinary securities agreed to be issued under the agreement.

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<sup>39</sup> For guidance on applications for waivers, see Guidance Note 17 *Waivers and In-Principle Advice*.

<sup>40</sup> This is not to say that ASX will necessarily grant a waiver of Listing Rule 7.3.4 just because the performance right satisfies the requirements of this Guidance Note. Generally speaking, ASX will only grant a waiver of Listing Rule 7.3.4 to allow securities to be issued outside the 3 month period required under that rule if the following two conditions are satisfied:

- (1) there is a clear and compelling commercial reason for the issue to be made at a later date; and
- (2) security holders know with reasonable certainty at the time they approve the issue under Listing Rule 7.1 the likely dilutive impact the issue will have on their holdings.

The former condition is imposed on the general principle that listed entities should have a clear and compelling commercial reason to justify any departure from the Listing Rules. The later condition is imposed to ensure that security holders have the information they need to give a meaningful approval to the issue under Listing Rule 7.1.

<sup>41</sup> See note 40 above.

<sup>42</sup> Through the combined effect of Listing Rules 7.1, 7.3.4, 14.6 and 14.7.

<sup>43</sup> Approval of the agreement under Listing Rule 7.1 or 7.4 results in the ordinary shares agreed to be issued under the agreement being excluded from variable "C" in the formula in Listing Rule 7.1. They are therefore disregarded in calculating the entity's placement capacity under that rule.

### 8. Applying for in-principle advice about performance securities

Performance securities proposed to be issued in the following circumstances rarely raise any concerns under Listing Rule 6.1 or 12.5 and therefore ASX does not require, nor does it expect, a listed entity to apply for in-principle advice about the potential application of those rules to the proposed issue:

- (1) an issue of performance securities (referred to in this Guidance Note as “arm’s length control transaction securities”<sup>44</sup>) by a listed entity pursuant to a takeover bid under Chapter 6, or a merger by way of scheme of arrangement under Part 5.1, of the Corporations Act where:
  - the takeover or merger is not being undertaken in connection with a re-compliance listing;<sup>45</sup> and
  - the terms attaching to the performance securities (including the performance milestone) conform to sections 9, 10 and 11 of this Guidance Note and have been approved by the board or a committee of the board;
- (2) an issue of performance securities (referred to in this Guidance Note as “ordinary course of business remuneration securities”<sup>46</sup>) by a listed entity as part of the remuneration package of a director or employee or under an employee incentive scheme, where:
  - the issue is not being made in connection with a re-compliance listing;<sup>47</sup> and
  - the terms attaching to the performance securities (including the performance milestone) conform to sections 9, 10 and 11 of this Guidance Note and have been approved by the board or a committee of the board; or
- (3) an issue of performance securities (referred to in this Guidance Note as “ordinary course of business acquisition securities”<sup>48</sup>) issued by a listed entity under an agreement to acquire an undertaking, where:
  - the agreement has not been entered into in connection with a re-compliance listing;<sup>49</sup>

<sup>44</sup> Takeovers and mergers are closely regulated by ASIC, the Takeovers Panel and the Courts and that fact, along with the duty of the listed entity’s directors to exercise their powers and to discharge their obligations in the best interest of the listed entity, is generally sufficient to ensure that the terms attaching to arm’s length control transaction securities do not raise issues under Listing Rules 6.1 or 12.5. ASX is also cognisant that to require a listed entity to seek in-principle advice about the application of those rules to an issue of arm’s length control transaction securities could delay the transaction and jeopardise its success.

<sup>45</sup> Performance securities issued in connection with a re-compliance listing involving a takeover or scheme of arrangement are not regarded as “arm’s length control transaction securities” for the purposes of this Guidance Note. This is because the terms of issue of those securities are, in ASX’s experience, often significantly influenced by the promoters of the re-compliance listing and tilted in their favour.

<sup>46</sup> Ordinary course of business remuneration securities may require security holder approval under the Listing Rules if the number of securities to be issued exceeds the entity’s placement capacity under Listing Rule 7.1 or if the securities are being issued to a person in a position of influence under Listing Rule 10.11 or 10.14. These requirements, along with the duty of the listed entity’s directors to exercise their powers and to discharge their obligations in the best interest of the listed entity, are generally sufficient to ensure that the terms attaching to ordinary course of business remuneration securities do not raise issues under Listing Rules 6.1 or 12.5.

<sup>47</sup> Performance securities issued in connection with a re-compliance listing to remunerate or incentivise a director or employee are not regarded as “ordinary course of business remuneration securities” for the purposes of this Guidance Note. This is because the terms of issue of those securities are, in ASX’s experience, often significantly influenced by the promoters of the re-compliance listing and tilted in their favour.

<sup>48</sup> Ordinary course of business acquisition securities may require security holder approval under the Listing Rules if the number of securities to be issued exceeds the entity’s placement capacity under Listing Rule 7.1 or if the securities are being issued to a person in a position of influence under Listing Rule 10.11. The agreement to acquire the undertaking may also require security holder approval under Listing Rule 10.1 if the vendor is a person in a position of influence and the undertaking is a “substantial asset”. These requirements, along with the duty of the listed entity’s directors to exercise their powers and to discharge their obligations in the best interest of the listed entity, are generally sufficient to ensure that the terms attaching to ordinary course of business acquisition securities do not raise issues under Listing Rules 6.1 or 12.5.

<sup>49</sup> Performance securities issued to the vendors of an undertaking being acquired in connection with a re-compliance listing are not regarded as “ordinary course of business acquisition securities” for the purposes of this Guidance Note. This is because the terms of issue of those securities are, in ASX’s experience, often significantly influenced by the promoters of the re-compliance listing and tilted in their favour.

- the issue is the, or part of the, consideration for the acquisition of the undertaking; and
- the terms attaching to the performance securities (including the performance milestone) conform to sections 9, 10 and 11 of this Guidance Note and have been approved by the board or a committee of the board.

It should be noted that under this last requirement, the performance milestone attaching to the ordinary course of business acquisition securities must be clearly linked to the value of the undertaking being acquired and not to some other measure of value.<sup>50</sup>

By contrast, performance securities issued or proposed to be issued in connection with a new or re-compliance listing frequently raise issues under Listing Rule 1.1 condition 1. ASX therefore requires an entity undertaking a new or re-compliance listing that has issued, or is proposing to issue, performance securities to apply for and receive in-principle advice that the terms of the performance securities will satisfy Listing Rule 1.1 condition 1 before it lodges its application for admission or re-admission to the official list.

ASX strongly recommends that a listed entity proposing to issue performance securities other than in connection with a re-compliance listing or in the circumstances described in paragraphs (1), (2) or (3) above, apply to ASX for in-principle advice that the terms of the performance securities will satisfy Listing Rules 6.1 and 12.5.<sup>51</sup> Preferably, the entity should apply for and obtain such advice before it makes any announcement to the market about its intention to issue the performance securities. This will help to avoid the embarrassment of having to retract or correct the announcement if ASX forms the view that the issue of the performance securities will breach the Listing Rules and therefore cannot proceed. At the very latest, the entity should apply for and obtain such advice before it enters into a legally binding agreement committing it to issue the performance securities. This will help to avoid the legal and practical complications that will arise if ASX forms the view that the terms of the performance securities breach the Listing Rules and consequently requires the entity to take action to avoid or correct that breach.<sup>52</sup>

An application for in-principle advice that the terms of performance securities will satisfy Listing Rule 1.1 condition 1 or Listing Rules 6.1 and 12.5 (as applicable) must be in writing and submitted by the applicant or a professional adviser or representative acting on behalf of the applicant. It should be addressed to ASX Listings Compliance:

- in the case of a listed entity, at the entity's home branch; or
- in the case of an entity applying for admission to the official list, at the ASX branch where the entity has lodged, or intends to lodge, its application for admission.

The application for in-principle advice should include the following information:

- (a) the party or parties to whom the performance securities are to be issued and the number of performance securities to be issued to them or each of them (as the case may be);
- (b) any relationship the recipient of the performance securities or an associate of the recipient has with the entity (eg as a promoter, director, employee or security holder of, or adviser to, the entity);
- (c) if the performance securities are being issued in connection with an acquisition by the entity of an undertaking:
  - a statement to that effect;

<sup>50</sup> For an example of a performance milestone that is not clearly linked to the value of the undertaking being acquired, see note 60 below and the accompanying text.

<sup>51</sup> This includes performance securities issued under an agreement by an entity to acquire an undertaking that do not fall within paragraph (3) of section 8 of this Guidance Note because the performance milestone is not clearly linked to the value of the undertaking being acquired.

<sup>52</sup> Pursuant to ASX's powers in that regard under Listing Rule 18.8.

- an explanation why the performance securities are being issued in connection with the acquisition, including the commercial goals the entity is trying to achieve, and the risks it is trying to manage, by imposing the relevant performance milestone;
  - details of the undertaking being acquired;
  - details of the vendor(s) from whom the entity is acquiring the undertaking and their respective ownership interests in the undertaking;
  - details of how the entity determined the number of performance securities to be issued to the vendor(s) and why it considers that number to be appropriate and equitable; and
  - if any of the performance securities are being issued to someone who does not have an ownership interest in the undertaking being acquired, or if the performance securities are being issued disproportionately to the ownership interests of the vendors, an explanation why that is the case and how that is considered appropriate and equitable;
- (d) if the performance securities are being issued to remunerate or incentivise a director or employee:
- a statement to that effect;
  - details of the role (if any) the director or employee will play in meeting the performance milestone;
  - details of the existing total remuneration package of the director or employee;
  - if the director or employee or any of their associates hold securities in the entity, details of those securities and the consideration they paid or provided for those securities;
  - in light of the above, an explanation why it is considered necessary or appropriate to further remunerate or incentivise the director or employee to achieve the applicable performance milestone; and
  - details of how the entity determined the number of performance securities to be issued to the director or employee and why it considers that number to be appropriate and equitable;
- (e) if the performance securities are being issued to reward a promoter of, or adviser to, a new or re-compliance listing if the listing performs particularly well:
- a statement to that effect;
  - details of all fees and other consideration (including securities) the promoter/adviser or an associate may receive for services provided in connection with the listing;
  - details of all fees or other consideration (including securities) the promoter/adviser or an associate may receive under any other ongoing mandate they may have with the entity;
  - if the promoter/adviser or any of its associates hold securities in the entity, details of those securities and the consideration they paid or provided for those securities;
  - in light of the above, an explanation why it is considered necessary or appropriate to further reward the promoter/adviser with an issue of performance securities; and
  - details of how the entity determined the number of performance securities to be issued to the promoter/adviser and why it considers that number to be appropriate and equitable;
- (f) if the performance securities are being issued to a service provider to encourage and reward a given level of performance:
- a statement to that effect;

- details of the services being provided;
  - details of all fees and other consideration (including securities) the service provider may receive for those services;
  - if the service provider or any of its associates hold securities in the entity, details of those securities and the consideration they paid or provided for those securities;
  - in light of the above, an explanation why it is considered necessary or appropriate to further reward the service provider with an issue of performance securities; and
  - details of how the entity determined the number of performance securities to be issued to the service provider and why it considers that number to be appropriate and equitable;
- (g) the full terms of the performance securities;<sup>53</sup>
- (h) the number of ordinary shares that the performance securities will convert into if the applicable performance milestone is met and the impact that will have on the entity's capital structure;
- (i) if the performance securities convert into ordinary shares on the basis of a formula, the impact on the entity's capital structure for different scenarios that indicate a reasonable low, mid and high case for the number of ordinary shares that might be issued based on the formula;
- (j) confirmation that the terms of the performance securities are consistent with the base requirements for performance securities set out in section 9 and an analysis of their compliance with sections 10 and 11 of this Guidance Note;
- (k) if applicable, confirmation that the entity intends to seek security holder approval for the issue of the performance securities in accordance with section 12 of this Guidance Note and an indicative timetable for doing so; and
- (l) if an independent expert's report is required under section 13 of this Guidance Note:
- details of the expert appointed or proposed to be appointed in that regard and how they meet the requirements in ASIC Regulatory Guide 112 *Independence of experts* to be considered independent;
  - if the expert has already provided their report, a copy of that report; and
  - if the expert has not yet provided their report, an indicative timetable for the production of that report.

The onus is on the applicant for in-principle advice to satisfy ASX that the terms of the performance securities are appropriate and equitable and therefore should be acceptable to ASX.

Further guidance on applications for in-principle advice can be found in Guidance Note 17 *Waivers and In-Principle Advice*.

## 9. Base requirements for performance securities

The essence of a performance security is that it has (or should have) limited rights and limited value unless and until the applicable performance milestone is achieved. ASX therefore generally expects the terms of issue of a performance security to provide that the security:

- is not transferrable (and, consequently, will not be quoted on ASX or any other exchange);
- does not confer any right to vote, except as otherwise required by law;

<sup>53</sup> This includes full details of the applicable performance milestones. ASX will not accept statements that the performance milestones are confidential or commercially sensitive information and therefore cannot be shared with ASX.

- does not confer any entitlement to a dividend, whether fixed or at the discretion of the directors;
- does not confer any right to a return of capital, whether in a winding up, upon a reduction of capital or otherwise;
- does not confer any right to participate in the surplus profit or assets of the entity upon a winding up; and
- does not confer any right to participate in new issues of securities such as bonus issues or entitlement issues,

unless and until the applicable performance milestone is achieved and the performance security converts into ordinary shares.

It is acceptable for performance securities to have a “change of control” provision allowing the holder or the entity to convert them into ordinary shares if there is a change in control of the entity, notwithstanding that the applicable performance milestone has not been achieved, but only if the change of control is triggered by a person who does not control the entity at the time the performance securities are issued achieving control of more than 50% of the ordinary voting securities in the entity – change of control provisions that trigger at a lower level of “control” are not acceptable.

It is also acceptable for performance securities to have normal anti-dilution provisions that adjust the number of ordinary shares into which the performance securities convert if the entity splits or consolidates its ordinary shares or undertakes a bonus issue, entitlement issue or other capital reconstruction, so as to preserve the proportionate value of the performance securities vis-à-vis the ordinary shares.

Any performance security that does not meet these base requirements is likely to be regarded by ASX as not complying with Listing Rule 1.1 condition 1 or Listing Rules 6.1 and 12.5 (as applicable).

## 10. Appropriate and equitable numbers of performance securities

For performance securities to comply with Listing Rule 6.1, the number of performance securities issued, and the number of ordinary shares into which they will convert if the relevant milestone is achieved, must, in ASX’s opinion, be appropriate and equitable.

ASX considers that this requires that the number of ordinary shares into which the performance security will convert if the relevant milestone is achieved must be:

- (1) fixed or calculated by reference to a formula that delivers a fixed outcome so that investors and analysts can readily understand, and have reasonable certainty as to, the impact on the entity’s capital structure if the milestone is achieved;<sup>54</sup> and
- (2) reasonably proportionate to the additional value the entity will derive if the milestone is achieved, compared to if the milestone is not achieved.

An example of conversion terms that ASX may consider not to be appropriate or equitable under requirement (1) above is a performance security where the number of ordinary shares into which it converts is determined by reference to the market price of the ordinary shares at a future date or over a future period and there is no floor on the conversion price. This is especially so if the entity has a relatively low market capitalisation and its securities have a history of significant price volatility or of periods where they have suffered a sustained fall in market price. It also applies if the entity is undertaking a new or re-compliance listing and will have a relatively low market capitalisation at listing. In these cases, there is a very real risk that the conversion of the performance securities could be highly dilutive to existing ordinary shareholders if the market price of the entity’s ordinary shares falls substantially between the issue of the performance securities and their conversion.

<sup>54</sup> As indicated in section 9 above, this requirement does not preclude normal anti-dilution provisions that adjust the number of ordinary shares into which the performance securities convert if the entity splits or consolidates its ordinary shares or undertakes a bonus issue, entitlement issue or other capital reconstruction.

Examples of conversion terms that ASX may consider not to be appropriate or equitable under requirement (2) above include performance securities that convert into a material number of ordinary shares upon the satisfaction of a milestone such as:<sup>55</sup>

- introducing a given number of new investors without any meaningful thresholds around the amount of funds invested by them;
- winning a given number of new customers without any meaningful thresholds around the amount of sales generated from them;
- launching a new product or service without any meaningful thresholds around the level of sales generated by the new product or service;
- launching a new sales outlet or channel without any meaningful thresholds around the level of sales generated by the new outlet or channel; and
- signing-up or registering a given number of new website users without any meaningful thresholds around their level of usage of the website (including counting users who are on a free trial or significantly discounted introductory offer).

Under no circumstances will ASX permit a listed entity to issue performance securities if the number of ordinary shares into which the performance securities will convert if the applicable milestone is achieved is greater than the number of ordinary shares in the entity on the date of issue of the performance securities. Otherwise, the performance securities effectively become the main class of security of the entity and ASX does not regard that as an acceptable capital structure for the purposes of Listing Rule 12.5.<sup>56</sup>

Similarly, where a listed entity has options or other convertible securities on issue, ASX will not permit it to issue performance securities if the total number of ordinary shares that will be issued if the options are all exercised, the convertible securities are all converted and the applicable milestone is achieved is greater than the number of ordinary shares in the entity on the date of issue of the performance securities. Again, ASX does not regard this as an acceptable capital structure for the purposes of Listing Rule 12.5.<sup>57</sup>

Likewise, ASX will reject an application for admission to the official list if the applicant has or proposes to have performance securities on issue at the date of its listing and the number of ordinary shares into which the performance securities will convert if the applicable milestone is achieved is greater than the number of ordinary shares the entity proposes to have on issue at the date of its listing.<sup>58</sup> It will also reject an application if the applicant has or proposes to have options or other convertible securities, as well as performance securities, on issue at the date of its listing and the total number of ordinary shares that will be issued if the options are all exercised, the convertible securities are all converted and the applicable milestone is achieved is greater than the number of ordinary shares the entity proposes to have on issue as at the date of its listing. Again, ASX does not regard these as acceptable capital structures for the purposes of Listing Rule 1.1 condition 1.

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<sup>55</sup> In each of these examples, the additional value derived by the entity if the performance milestone is met is unclear or indeterminate, making it impossible to assess whether the number of ordinary shares into which the performance security will convert if the relevant milestone is achieved is reasonably proportionate to the additional value the entity will derive if the milestone is achieved, compared to if the milestone is not achieved.

<sup>56</sup> ASX regards this as inconsistent with the policy underlying Listing Rule 6.2, which precludes a listed entity from having more than one class of ordinary security without ASX approval (see note 14 above), and Listing Rule 7.16, which provides that a listed entity cannot have more options on issue than underlying securities.

<sup>57</sup> ASX regards this as inconsistent with the policy underlying Listing Rule 7.16, which provides that a listed entity cannot have more options on issue than underlying securities.

<sup>58</sup> Taking into account any ordinary shares that the entity may be issuing in connection with its listing.

### 11. Appropriate and equitable performance milestones

For performance securities to comply with Listing Rule 6.1, the performance milestone attached to a performance security must, in ASX's opinion, be appropriate and equitable.<sup>59</sup> ASX considers that this requires the following:

- (1) there must be an appropriate and demonstrable nexus between the performance milestone and the transaction or purpose for which the performance security is being issued;
- (2) the performance milestone must be clearly articulated by reference to objective criteria so that investors and analysts can readily understand, and have reasonable certainty as to, the circumstances in which the performance milestone will be taken to have been met; and
- (3) the performance security must have an expiry date by which the relevant milestone is to be achieved and, if the milestone is not achieved by that date, either the performance security must be cancelled or bought back for no or nominal consideration only or else the total number of performance securities on issue must convert into a nominal number of ordinary shares only.

Examples of performance securities and milestones that ASX may consider not to be appropriate or equitable under requirement (1) above, and therefore not allow, include:

- performance securities issued to a vendor of an undertaking by an entity where the performance milestone is tied to the market price of the ordinary shares of the entity or to the financial performance of the entity as a whole rather than to some demonstrable measure of the value of the undertaking being acquired from the vendor;<sup>60</sup>
- performance securities issued to a director or other officer who is otherwise being reasonably remunerated for their services where the milestone to be achieved is merely that the director or officer hold office until a nominated date;<sup>61</sup>
- performance securities issued to a director or other officer which convert into ordinary shares if the director or officer is removed from office before a nominated date;<sup>62</sup>
- performance securities issued by an entity proposing to list to non-promoter seed capitalists who have limited or no ongoing involvement in managing the entity where the performance milestone is tied to the

<sup>59</sup> Again, in assessing this issue, ASX has regard to the principle set out in the introduction to the Listing Rules that securities "should be issued in circumstances, and have rights and obligations attaching to them, that are fair to new and existing security holders".

<sup>60</sup> ASX may object to performance securities issued in these circumstances with this type of performance hurdle because they potentially reward the vendor for performance that has nothing to do with the undertaking acquired from the vendor. For example, if at the time of acquiring the undertaking from the vendor, the entity has another undertaking, the reason the milestone is achieved could be because of the performance of that other undertaking rather than the undertaking acquired from the vendor. The same could also apply if, subsequent to the acquisition of the undertaking from the vendor, the entity acquires another undertaking.

However, ASX will not generally object to the issue of performance securities to a vendor by an entity with a primary and appropriate performance milestone tied to the performance of the undertaking acquired from the vendor and a secondary or supplementary performance milestone tied to the market price of the entity's ordinary shares or the financial performance of the entity as a whole.

ASX may also be prepared to allow the issue of performance securities with a performance milestone tied to the market price of the entity's ordinary shares or the financial performance of the entity as a whole to vendors in a "roll-up" listing, where the individual businesses being acquired are not material to the overall value of the entity.

<sup>61</sup> ASX may object to performance securities issued in these circumstances with this type of performance hurdle because they potentially reward the director or other officer for doing nothing more than not resigning their office. The case may be different, however, if the director or other officer is not otherwise being reasonably remunerated for their services and the performance securities are effectively being issued in lieu of director's fees or executive remuneration.

<sup>62</sup> ASX may object to performance securities issued in these circumstances with this type of performance hurdle because they have the potential to act as a deterrent to security holders exercising their right to remove the director from office, or to directors exercising their power to dismiss the officer, and therefore potentially reward the director or officer for bad performance.



post-listing market price of the ordinary shares of the entity or the post-listing financial performance of the entity;<sup>63</sup> and

- performance securities issued by an entity proposing to list to a lead manager or other adviser where the performance milestone is tied to the post-listing market price of the ordinary shares of the entity or the post-listing financial performance of the entity as a whole.<sup>64</sup>

Examples of performance milestones that ASX may consider not to be appropriate and equitable under requirement (2) above, and therefore not allow, include:

- performance milestones tied to revenue or profit for a particular period that do not expressly exclude or disregard:
  - one-off or extraordinary revenue items;
  - revenue received in the form of government grants, allowances, rebates or other hand-outs; or
  - revenue or profit that has been “manufactured” to achieve the performance milestone;<sup>65</sup>
- performance milestones tied to a projected financial measure for a particular period rather than an actual financial measure for that period;<sup>66</sup>
- performance milestones involving a financial measure that is not audited by the entity’s external auditor or some other quantitative or qualitative measure that is not signed off by another suitable expert;<sup>67</sup>
- performance milestones that are vague, uncertain, ambiguous or not transparent;<sup>68</sup> and
- performance milestones that are subjective or otherwise based on opinion.

In relation to requirement (3) above, ASX will not permit performance securities with an expiry date longer than 5 years<sup>69</sup> from their date of issue. It may also object to performance securities with a shorter expiry date than 5 years from their date of issue if ASX considers that the applicable performance milestone ought reasonably be capable of being met within a shorter timeframe.

If the applicable performance milestone is not met by the nominated expiry date, ASX will not generally permit the entity to issue replacement performance securities extending the date by which the performance milestone must

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<sup>63</sup> ASX may object to performance securities issued in these circumstances with this type of performance hurdle because they potentially reward seed capitalists for share price or financial performance post-listing that may have nothing to do with their original contribution of seed capital.

<sup>64</sup> ASX may object to performance securities issued in these circumstances with this type of performance hurdle because they potentially reward the lead manager or other adviser for share price or financial performance post-listing that may have nothing to do with the work they did for the entity pre-listing.

<sup>65</sup> An example would be a listed entity that has issued performance securities with a revenue-based milestone entering into customer contracts with large fees attached and then subcontracting most of its obligations under those contracts to third parties who charge the entity not dissimilar fees, thereby generating large amounts of revenue for no real effort by, and no real return to, the entity.

<sup>66</sup> An example would be a performance hurdle tied to an “annualised” financial measure (ie a financial measure for a period less than a full year, such as a month, quarter, half-year or other part year, which is projected out to a full year on a straight-line basis). ASX may object to performance securities with this type of performance hurdle because they reward the holder for assumed or projected financial performance rather than actual financial performance. ASX is also concerned about the incentive these types of performance securities may create to recognise financial performance in a particular period and therefore to manipulate the financial measure to achieve the performance hurdle.

<sup>67</sup> For example, in the case of a performance milestone tied to the declaration of a certain level of mineral resources or reserves, an independent geologist.

<sup>68</sup> An example of a performance milestone that ASX may not allow due to lack of transparency would be one that is not disclosed because it is claimed to be commercially sensitive (eg a milestone tied to achieving a confidential sales target) or that has not yet been determined (eg a milestone to be set by the board or a committee of the board in the future).

<sup>69</sup> In ASX’s opinion, performance securities that have an expiry date of longer than 5 years create too much uncertainty around the value of the entity’s ordinary securities.

be met. To allow this would run counter to the policy of having a nominated expiry date for performance securities in the first place.<sup>70</sup>

In those cases where it is not objectionable to have a performance milestone tied to the market price of an entity's securities,<sup>71</sup> particular care needs to be taken in framing the milestone so that it is appropriate and equitable, noting that:

- security prices can be affected by macroeconomic factors, market sentiment and other matters unrelated to the performance of the entity;
- security prices can fluctuate significantly over a short period and achieving a nominated hurdle briefly before the price falls back below that hurdle may not be a fair measure of sustainable performance; and
- security prices may be susceptible to manipulation, especially in the case of thinly traded securities or if measured at a single point in time (for example, at the close of trading on a particular day).

For these reasons, ASX recommends that a security price hurdle attached to a performance security should be based on volume weighted average market price over a reasonable period (for example, over 20 consecutive trading days on which the entity's securities have actually traded) rather than the market price at a particular date or for a shorter period.

## 12. ASX's requirement for security holder approval

ASX does not require security holder approval under this Guidance Note<sup>72</sup> for:

- (1) an issue of arm's length control transaction securities;<sup>73</sup>
- (2) an issue of ordinary course of business remuneration securities;<sup>74</sup>
- (3) an issue of ordinary course of business acquisition securities;<sup>75</sup> or
- (4) an issue of performance securities by an entity in the following circumstances:
  - the issue is in connection with a new or re-compliance listing;
  - the intention to undertake the issue is clearly disclosed in the entity's listing prospectus or PDS;<sup>76</sup>
  - the terms attaching to the performance securities (including the performance milestone) conform to sections 9, 10 and 11 of this Guidance Note,
  - if required under section 13 below, the prospectus or PDS includes a copy of an independent expert's report that accords with that section;
  - the disclosure in the prospectus or PDS includes the same details as mentioned in section 14 below for a notice of meeting to approve an issue of performance securities; and

<sup>70</sup> This applies even where the entity is proposing to obtain security holder approval to the issue of the replacement performance securities. This position is consistent with the underlying principle of Listing Rule 6.23.2, which prohibits a change to the terms of an option increasing the period for its exercise, even where the change is proposed to be made with security holder approval.

<sup>71</sup> See notes 60 and 64 above and accompanying text.

<sup>72</sup> Security holder approval may be required on other accounts under the Listing Rules (eg under Listing Rule 7.1, 10.1, 10.11 or 10.14).

<sup>73</sup> As defined in section 8 above.

<sup>74</sup> As defined in section 8 above.

<sup>75</sup> As defined in section 8 above.

<sup>76</sup> That is, the prospectus or PDS lodged with ASX by an applicant for listing in accordance with Listing Rule 1.1 condition 3.

- the issue takes place within a reasonable period of the entity being admitted to the official list.<sup>77</sup>

For an issue of performance securities that does not fall within the exceptions mentioned in paragraphs (1), (2), (3) and (4) immediately above, ASX will generally consider it appropriate and equitable, and therefore impose a condition,<sup>78</sup> that a listed entity obtain the approval of the holders of its ordinary shares to the issue of the performance securities and that a voting exclusion statement<sup>79</sup> apply in relation to any person who may participate in the issue.

A resolution to the following effect will suffice for these purposes:

“That the issue of performance securities described in the notice of meeting is approved under and for the purposes of the ASX Listing Rules.”

In addition, for an issue of performance securities that does not fall within the exceptions mentioned in paragraphs (1), (2) and (3) above,<sup>80</sup> ASX will also generally consider it appropriate and equitable, and therefore impose a condition,<sup>81</sup> that a listed entity obtain the approval of the holders of its ordinary shares to any material change to the terms of performance securities (including, without limitation, any change to the applicable milestone that has to be satisfied before the performance securities may be converted into ordinary shares) and that a voting exclusion statement apply in relation to any holder of the performance securities.<sup>82</sup>

To avoid doubt, the fact that security holders may have approved an issue of performance securities does not prevent ASX from reaching a view that the terms of the performance securities are not appropriate and equitable, if they otherwise infringe the requirements set out in this Guidance Note.<sup>83</sup>

### 13. ASX's requirement for an independent expert's report in some cases

ASX does not require an independent experts' report under this Guidance Note for:

- (1) an issue of arm's length control transaction securities;<sup>84</sup>
- (2) an issue of ordinary course of business remuneration securities;<sup>85</sup> or
- (3) an issue of ordinary course of business acquisition securities.<sup>86</sup>

For an issue of performance securities that does not fall within the exceptions mentioned in paragraphs (1), (2) and (3) immediately above and in the two situations described below, ASX will generally consider it appropriate and

<sup>77</sup> This is on the basis that investors have decided to subscribe for securities in the entity based on full disclosure of the proposed issue of the performance securities and their terms in the entity's listing prospectus or PDS and this effectively evidences their approval to the issue of the performance securities.

<sup>78</sup> This condition is imposed under Listing Rule 18.8 as a requirement to ensure compliance with Listing Rule 6.1. The entity must comply with the condition (Listing Rule 18.5A). For performance securities that do not fall within the exceptions mentioned in paragraphs (1) - (4) of section 12, any in-principle advice ASX gives that the terms of the performance securities comply with Listing Rules 6.1 and/or 12.5 will invariably be subject to a condition that security holders approve the terms of the performance securities in accordance with that section of this Guidance Note.

<sup>79</sup> See '15. Voting exclusions' on page 22.

<sup>80</sup> To avoid doubt, ASX will generally impose the condition referred to in the text (ie that a listed entity obtain the approval of the holders of its ordinary shares to any material change to the terms of performance securities and that a voting exclusion statement apply in relation to any holder of the performance securities) to performance securities issued in the circumstances described in paragraph (4) of section 12. This applies even though the initial issue of those performance securities does not require security holder approval (for the reasons set out in note 77 above).

<sup>81</sup> Again, in the case of a listed entity, this condition is imposed under Listing Rule 18.8 as a requirement to ensure compliance with Listing Rule 6.1. In the case of an applicant for listing, this condition is imposed under Listing Rule 1.19. In either case, the entity must comply with the condition (Listing Rule 18.5A).

<sup>82</sup> See '15. Voting exclusions' on page 22.

<sup>83</sup> See note 16 above.

<sup>84</sup> As defined in section 8 above.

<sup>85</sup> As defined in section 8 above.

<sup>86</sup> As defined in section 8 above.

equitable, and therefore impose a condition,<sup>87</sup> that the entity obtain a report from an independent expert acceptable to ASX<sup>88</sup> that complies with the requirements in ASIC Regulatory Guide 111 *Content of expert reports* and that opines on the matters referred to in this section.

The requirement for an independent expert's report will apply in the following two situations:

- (a) the entity is already listed, it is proposing to issue performance securities that do not fall within the exceptions mentioned in paragraphs (1), (2) and (3) above, and the number of ordinary shares into which those performance securities will convert in aggregate if the applicable milestone is achieved is greater than 10% of the number of ordinary shares the entity proposes to have on issue at the date the performance securities are proposed to be issued (taking into account any ordinary shares that the entity may be issuing in connection with the same transaction); or
- (b) the entity is applying to be listed, it has or proposes to have performance securities on issue at the date of its admission to quotation and the number of ordinary shares into which those performance securities will convert in aggregate if the applicable milestone is achieved is greater than 10% of the number of ordinary shares the entity proposes to have on issue at the date of its admission to quotation (taking into account any ordinary shares that the entity may be issuing in connection with its listing).

For the purposes of determining whether these 10% thresholds are being exceeded, in case (a) above, separate issues of performance securities are to be aggregated if they are proposed to undertaken at or around the same time or if, in ASX's opinion, they form part of the same commercial transaction. This applies even if the performance securities are proposed to be issued to different parties and on different terms.

In case (b) above, all performance securities on issue at the date of the entity's admission to quotation are to be aggregated, even where they are held by different parties and on different terms.

In case (a) above, the report must opine on whether the proposed issue of the performance securities is fair and reasonable to non-participating security holders. The report must be included in or accompany the notice of meeting seeking security holder approval to the issue of the performance securities. If the report opines that the proposed issue of the performance securities is "fair but not reasonable", "reasonable but not fair", or "neither fair nor reasonable", or that the expert "is not able to conclude that the proposed issue of the performance securities is fair or reasonable", ASX will expect that fact to be prominently disclosed in the notice of meeting.

In case (b) above, the report must opine on whether the performance securities the entity proposes to have on issue at the date of its admission to quotation are fair and reasonable to non-participating security holders. The report must be included in the entity's listing prospectus, PDS or information memorandum.<sup>89</sup> Again, if the report opines that the performance securities are "fair but not reasonable", "reasonable but not fair", or "neither fair nor reasonable", or that the expert "is not able to conclude that the performance securities are fair or reasonable", ASX will expect that fact to be prominently disclosed in the entity's listing prospectus, PDS or information memorandum (including in the investment overview section of that document).

In both cases (a) and (b) above, in determining their opinion on fairness and reasonableness, ASX would expect the independent expert to assume that the relevant performance milestone(s) have been met, assess the impact that would have on the value of the entity compared to the situation if the relevant performance milestone(s) were not met, and then determine whether the resulting number of ordinary shares to be issued by the entity to the holder of the performance shares is fair and reasonable in the circumstances.

<sup>87</sup> This condition is imposed under Listing Rule 18.8 as a requirement to ensure compliance with Listing Rule 6.1. The entity must comply with the condition (Listing Rule 18.5A). For performance securities that do not fall within the exceptions mentioned in paragraphs (1) - (3) of section 13 and that meet the 10% thresholds mentioned in paragraphs (a) and (b) of that section, any in-principle advice ASX gives that the terms of the performance securities comply with Listing Rule 6.1 will invariably be subject to a condition that the entity obtain a report from an independent expert in accordance with this Guidance Note.

<sup>88</sup> To be acceptable to ASX, the expert must satisfy the requirements in ASIC Regulatory Guide 112 *Independence of experts* to be considered independent. ASX may require the entity or the expert to confirm to ASX's satisfaction that the expert meets these requirements.

<sup>89</sup> That is the prospectus, PDS or information memorandum the entity lodges with ASX to satisfy Listing Rule 1.1 condition 3.

ASX would have no objection to an independent expert expressing a broader view on an issue of performance securities, for example, a statement that while the expert is not able to conclude that the issue is fair or reasonable (as applicable), they regard it as being in the interests of the entity and non-participating security holders to proceed with the issue.

To avoid doubt, the fact that an independent expert has opined that an issue of performance securities is, in their opinion, fair and reasonable to, or otherwise in the interests of, non-participating security holders does not prevent ASX from reaching a view that the terms of the performance securities are not appropriate and equitable, if they otherwise infringe the requirements set out in this Guidance Note.

### 14. Notice requirements

As a general proposition, a notice of meeting must include such material as will fully and fairly inform security holders of the matters to be considered at the meeting and enable them to make a properly informed judgment on those matters.<sup>90</sup>

Where a notice of meeting proposes a resolution of security holders approving an issue of performance securities under and for the purposes of this Guidance Note, ASX will expect the notice to include the following information:

- the reason why the approval is being sought and what will happen if the approval is given or not given<sup>91</sup> – a summary along the following lines will suffice for these purposes:

*“[Name of entity] is proposing to [insert a description of the proposed issue of performance securities, defining them as the “Performance Shares”, “Performance Options” or “Performance Rights” (as appropriate)].*

As is its usual practice, ASX has imposed a requirement under Listing Rule 6.1 and Guidance Note 19 *Performance Securities*, that [name of entity] obtain shareholder approval to the issue of the Performance [Shares/Options/Rights].

Resolution [n<sup>o</sup>] seeks the required shareholder approval to the issue of the Performance [Shares/Options/Rights] under and for the purposes of the Listing Rules.

If resolution [n<sup>o</sup>] is passed, [name of entity] will be able to proceed with the issue of the Performance [Shares/Options/Rights] and *[outline the consequences that will follow]*.

If resolution [n<sup>o</sup>] is not passed, [name of entity] will not be able to proceed with the issue of the Performance [Shares/Options/Rights] and *[outline the consequences that will follow]*.”

- all of the information set out in paragraphs (a) – (i) of section 8 above;
- if a report from an independent expert is required under section 13 of this Guidance Note, a copy of that report; and
- if ASX imposes a voting exclusion (as it typically will), a voting exclusion statement.

This information may be given in the notice itself or in an accompanying explanatory memorandum to security holders.<sup>92</sup>

<sup>90</sup> See *Bulfin v Bebarfalds Ltd* (1938) 38 SR (NSW) 423 and *Chequepoint Securities Ltd v Claremont Petroleum NL* (1986) 11 ACLR 94.

<sup>91</sup> Listing Rule 14.1A.

<sup>92</sup> Listing Rule 14.1.

Before a listed entity sends out a notice of meeting that includes a resolution by security holders approving the issue of performance securities, it must give ASX a copy of the draft notice for review. It must not finalise the notice until ASX tells it that ASX does not object to it.<sup>93</sup>

ASX may object to a draft notice of meeting if it appears to ASX that it does not meet the required standard of disclosure mentioned above.

### 15. Voting exclusions

As mentioned in section 12 above, ASX will generally impose a voting exclusion preventing any person who may participate in an issue of performance securities requiring security holder approval under this Guidance Note, or their associates, from voting in favour of the resolution approving their issue.<sup>94</sup>

A voting exclusion is effected in this instance by including a statement in the notice of meeting proposing the resolution to the effect that the entity will disregard any votes cast in favour of the resolution by or on behalf of any person who may participate in the issue of the performance securities or their associates,<sup>95</sup> save where it is cast by:

- a person as proxy or attorney for another person who is entitled to vote on the resolution, in accordance with directions given to the proxy or attorney to vote on the resolution in that way;
- the chair of the meeting as proxy or attorney for a person who is entitled to vote on the resolution, in accordance with a direction given to the chair to vote on the resolution as the chair decides; or
- a holder acting solely in a nominee, trustee, custodial or other fiduciary capacity on behalf of a beneficiary provided the following conditions are met:
  - the beneficiary provides written confirmation to the holder that they are not excluded from voting, and are not an associate of a person excluded from voting, on the resolution; and
  - the holder votes on the resolution in accordance with directions given by the beneficiary to the holder to vote in that way.

Guidance Note 35 *Security Holder Resolutions* has further guidance on voting exclusions and the procedures that should be followed at a meeting of security holders where a resolution to approve an issue of performance securities is being considered.

<sup>93</sup> Listing Rules 15.1 and 15.1.4. The draft notice should be sent by way of email to the entity's ASX listings adviser (Listing Rule 15.2.2) and clearly marked "not for public release" (Listing Rule 15.6). ASX generally tries to review and notify the entity whether it objects to a draft notice of meeting within 5 business days of receipt. ASX will tell an entity within 5 business days if it needs more time to examine a draft notice of meeting.

<sup>94</sup> Pursuant to its powers in that regard under the last row in the table in Listing Rule 14.11.1.

<sup>95</sup> Guidance Note 35 *Security Holder Resolutions* has guidance on who is an associate of a person who may participate in the issue of the performance securities for these purposes.