

PERFORMANCE SHARES

<p>The purpose of this Guidance Note</p>	<ul style="list-style-type: none"> To assist listed entities in structuring the terms of performance shares to comply with the Listing Rules
<p>The main points it covers</p>	<ul style="list-style-type: none"> What are “performance shares”? The Listing Rules applicable to performance shares Applying for in-principle advice about performance shares Base requirements for all performance shares Appropriate numbers of performance shares Appropriate and equitable performance milestones ASX’s requirements for security holder approval for the issue of performance shares or for changes to their terms Disclosure obligations in relation to performance shares
<p>Related materials you should read</p>	<ul style="list-style-type: none"> Guidance Note 1 <i>Applying for admission – ASX Listings</i> Guidance Note 17 <i>Waivers and In-Principle Advice</i>

History: Guidance Note 19 introduced 28/04/14. It replaced a withdrawn Guidance Note entitled *Non-Business Days and Non-Trading Days*.

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.

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1. Introduction

This Guidance Note is published to assist listed entities in structuring the terms of performance shares to comply with the Listing Rules.

It should be noted that performance shares can raise issues under the Corporations Act 2001 (Cth),¹ as well as under the Listing Rules (including, for example, whether their issue requires security holder approval as a related party transaction under section 208 or their conversion into ordinary shares requires shareholder approval under item 7 of section 611²). This Guidance Note does not address Corporations Act issues and listed entities should ensure they receive appropriate legal advice on the application of the Corporations Act to an issue of performance shares, as well as on the application of the Listing Rules.

2. What are “performance shares”?

The term “performance share”³ is a generic term referring to a share that has limited rights unless and until a nominated performance milestone is achieved, but that converts into a given number of ordinary shares with all the usual rights attached if and when the milestone is achieved. The number of ordinary shares into which the performance share converts may be a fixed number (often it is one for one⁴) or it may be determined by reference to a particular formula.

A “performance share” is to be differentiated from a “performance option” (that is, an option to subscribe for or purchase ordinary shares that has achieving a nominated performance milestone as a condition for its exercise) and a “performance right” (that is, a contractual right to receive a given number of ordinary shares if a nominated performance milestone is achieved). Each of these is regarded as an “equity security” under the Listing Rules.⁵ However, since they do not involve an initial issue of shares that might otherwise confer rights as a shareholder, they tend not to raise the same level of concerns as performance shares under the Listing Rules.

¹ 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.

² 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*.

³ In the case of a listed trust, references in this guidance note to performance shares should be read as including references to performance units (that is, units that have limited rights unless and until a nominated performance milestone is achieved and that convert into a given number of ordinary units if and when the milestone is achieved).

⁴ That is, one performance share converts into one ordinary share.

⁵ See the definition of “equity security” in Listing Rule 19.12. Options specifically fall within paragraph (d) of that definition. Performance rights fall within any or all of paragraphs (c), (d) or (f) of that definition. Note that most performance rights are regarded by ASX as options under and for the purposes of the Listing Rules and therefore have to meet the requirements applicable to options in Chapter 6 of the Listing Rules.

This Guidance Note relates specifically to performance shares and does not generally apply to performance options or performance rights – although ASX may apply some or all of the guidance in it to performance options or performance rights if it considers that the parties are attempting to use them to achieve an outcome that ASX would not consider appropriate and equitable in the case of performance shares.⁶

3. The reasons for issuing performance shares

Performance shares are sometimes issued to a vendor selling an asset to a listed entity as a form of contingent deferred consideration, often where the value of the asset being sold 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 in case the tenement does not live up to its initial promise. To do this, it may agree to include as part of the consideration for the purchase an issue of performance shares to the vendor with a performance milestone attached that an indicated or measured resource of a given size and quality is confirmed. From the perspective of the entity and its investors, this will help to avoid overpaying for the tenement if it does not live up to its initial promise. From the perspective of the vendor, this will help to ensure that it is appropriately compensated if the tenement does live up to its initial promise.

Performance shares are sometimes issued to directors, senior managers or contractors 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 key individuals for the substantial efforts that may be required to get the venture up and running profitably.

Performance shares are also sometimes issued as part of an employee incentive scheme, although for tax and other reasons it is more common for employee incentive schemes to utilise performance rights rather than performance shares.

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

- an entity achieving a particular financial target (eg a nominated level of EBITDA, profit, EPS or some other financial measure);
- an entity obtaining an environmental or other governmental approval needed to commence operations;
- a biotech entity achieving a step in the regulatory approval process for the licensing of a new drug; and
- a mining producing entity achieving a nominated level of production at a particular mining facility.

ASX understands that appropriately framed performance shares can benefit listed entities and their security holders and is willing to allow them, provided they comply with the Listing Rules.

4. The Listing Rules applicable to performance shares

Listing Rule 6.1 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.⁷ This applies regardless of whether the securities are quoted⁸ or unquoted.⁹

⁶ As mentioned above, performance options and performance rights are equity securities for the purposes of the Listing Rules (see note 5 and the accompanying text). Accordingly, under Listing Rule 6.1, their terms must, in ASX's opinion, be appropriate and equitable. In practice, this tends to be more of an issue for performance options or performance rights granted to a vendor selling an asset to a listed entity. It tends not to be an issue for performance options or performance rights granted to directors, employees or contractors under an employee incentive scheme since, in the ordinary course, it would be unusual for them to constitute a significant part of the capital of a listed entity or to have inappropriate milestones.

⁷ 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.

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

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

In assessing whether Listing Rules 6.1, 12.5 and 1.1 condition 1 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 have rights and obligations attaching to them that are fair to new and existing security holders”.

Listing Rule 7.1 will apply to an issue of performance shares. This rule (subject to certain exceptions) requires security holder approval for issues of securities over a 12 month period in excess of 15% of an entity’s ordinary capital. Hence, an issue of performance shares may require security holder approval under that rule, depending on the number of performance shares to be issued, the number of ordinary shares into which they convert,¹⁰ and the number of ordinary shares that the entity has issued, agreed to issue, or cancelled, over the preceding 12 months.

Listing Rule 10.11, which (subject to certain exceptions) requires security holder approval for an issue of securities to a related party or anyone whose relationship with the entity or a related party is, in ASX’s opinion, such that security holder approval should be obtained, may also apply to an issue of performance shares, depending on the person to whom they are to be issued.¹¹

Having said that, ASX will generally require the issue of performance shares to be approved by security holders in all cases¹² and that approval can be bundled with any approvals required under Listing Rules 7.1 and 10.11, if applicable.

5. Applying for in-principle advice about performance shares

It is strongly recommended that a listed entity which is proposing to issue performance shares apply to ASX for in-principle advice that the terms of the performance shares will satisfy Listing Rules 6.1 and 12.5 before it issues the shares or enters into any legally binding agreement to do so. This may help to avoid the legal and practical complications that will arise if ASX subsequently forms the view that the terms of the performance shares breach the Listing Rules and it requires the entity to take action to avoid or correct that breach.¹³

It is also strongly recommended that an applicant for listing which has already issued, or which is proposing to issue, performance shares prior to listing, apply to ASX for in-principle advice that the terms of the performance shares will satisfy Listing Rule 1.1 condition 1.

An application for in-principle advice that the terms of performance shares are acceptable to ASX under Listing Rules 6.1 and 12.5 or Listing Rule 1.1 condition 1 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:

⁸ 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.

⁹ 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”. Note that ASX generally will not quote performance shares (see “6. Base requirements for all performance shares” on page 5).

¹⁰ In applying the formula in Listing Rule 7.1, ASX will count each performance share 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(c)).

¹¹ As mentioned previously, an issue of performance shares may also require security holder approval under the Corporations Act, for example, as a related party transaction under section 208 or under item 7 of section 611.

¹² See “9. ASX’s requirements for security holder approvals” on page 8.

¹³ Pursuant to ASX’s powers in that regard under Listing Rule 18.8.

- in the case of a listed entity, at the home branch of the listed entity; and
- 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 details:

- the party or parties to whom the performance shares are to be issued and the number of performance shares to be issued to them or each of them (as the case may be);
- any relationship between a recipient of the performance shares and the entity (e.g. vendor, promoter, director, employee etc);
- if the performance shares are being issued in connection with a particular transaction, an explanation of the transaction;
- if the performance shares are not being issued in connection with a particular transaction, an explanation of the purpose the entity is seeking to achieve by issuing them;
- the full terms of the performance shares;
- the number of ordinary shares that the performance shares will convert into if the applicable performance milestone is met and the impact that will have on the entity's capital structure;¹⁴ and
- a submission as to why ASX should not object to the terms of the performance shares.

The onus is on the applicant for in-principle advice to satisfy ASX that the terms of the performance shares 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*.

6. Base requirements for all performance shares

The essence of a performance share is that it has limited rights unless and until the applicable performance milestone is achieved and limited value if that milestone ultimately is not achieved. ASX therefore expects that a performance share generally will not:

- be transferrable (and, consequently, not be quoted on ASX or any other exchange);
- confer any right to vote, except as otherwise required by law;
- confer any entitlement to a dividend, whether fixed or at the discretion of the directors;
- confer any right to a return of capital, whether in a winding up, upon a reduction of capital or otherwise;
- confer any right to participate in the surplus profit or assets of the entity upon a winding up; or
- 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 share converts into ordinary shares. Otherwise, ASX is unlikely to consider that a performance share meets the requirements of Listing Rules 6.1 and 12.5 or Listing Rule 1.1 condition 1.

¹⁴ If the performance shares convert into ordinary shares on the basis of a formula, then the impact on the entity's capital structure should be shown 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.

It is acceptable for performance shares to have a “change of control” provision allowing the holder to convert it into ordinary shares if there is a change in control of the entity that issued the performance shares, notwithstanding that the applicable performance milestone has not been achieved, but only if there is a term that limits the total number of ordinary shares that the performance shares in aggregate convert into to no more than 10% of the issued ordinary capital of the entity as at the date of conversion. If they were able to be converted ahead of the relevant performance milestone being satisfied into a higher percentage of the ordinary share capital, then the performance shares may act as a deterrent to a future change of control transaction and ASX does not regard that as appropriate.

It is also acceptable for performance shares to have “anti-dilution” provisions that adjust the number of ordinary shares into which the performance shares convert if the entity splits or consolidates its ordinary shares or undertakes a bonus issue, entitlement issue or other capital reconstruction.

7. Appropriate numbers of performance shares

ASX generally will not permit a listed entity to issue performance shares if the number of ordinary shares into which the performance shares will convert if the applicable milestone is achieved is greater than the number of ordinary shares in the entity on the date of issue. Otherwise, the performance shares 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 12.5.¹⁵

Likewise, where a listed entity has options or other convertible securities on issue, ASX generally will not permit it to issue performance shares 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 shares. Again, ASX does not regard this as an acceptable capital structure for the purposes of Listing Rule 12.5.¹⁶

Similarly, ASX will reject an application for admission to the official list if the applicant has or proposes to have performance shares on issue at the date of its listing and the number of ordinary shares into which the performance shares 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.¹⁷ It will also reject an application if the applicant has or proposes to have options or other convertible securities, as well as performance shares, 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.

8. Appropriate and equitable performance milestones

To meet the requirements of Listing Rules 6.1 and 12.5 or Listing Rule 1.1 condition 1, the performance milestone attached to a performance share must be appropriate and equitable. ASX considers that this requires the following:

- (1) there must be an appropriate link between the performance milestone and the transaction or purpose for which the performance share is to be 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;

¹⁵ 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 7 above), and Listing Rule 7.16, which provides that a listed entity cannot have more options on issue than underlying securities.

¹⁶ 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.

¹⁷ Taking into account any ordinary shares that the entity may be issuing in connection with its listing.

- (3) the number of ordinary shares into which the performance share will convert if the relevant milestone is achieved must be 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;¹⁸ and
- (4) the performance share 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 share must be cancelled or bought back for no or nominal consideration only or else the total number of performance shares on issue must convert into a nominal amount of ordinary shares only.

Examples of performance milestones that ASX has considered inappropriate under requirement (1) above, and therefore not allowed, include:

- a performance share proposed to be issued to a vendor by an entity where the performance milestone was tied to the market price of the ordinary shares of the entity issuing the performance share rather than to the performance of particular assets vended in;¹⁹
- a performance share proposed to be issued to a vendor by an entity where the performance milestone was tied to the financial performance of the entity as a whole rather than to the performance of particular assets vended in;²⁰
- a performance share proposed to be issued to a director where the milestone to be achieved was that the director simply hold office until a nominated date;²¹ and
- a performance share proposed to be issued to a director which converted into ordinary shares if the director was removed from office before a nominated date.²²

An example of conversion terms that ASX has considered inappropriate for failing to meet requirement (3) above was a performance share where the number of ordinary shares into which it converted was calculated by reference to the market price of the ordinary shares at the time of conversion, without any floor on the market price for these purposes.²³

In relation to requirement (4) above, ASX does not usually permit performance shares with an expiry date longer than 5 years from the date of issue.

¹⁸ As indicated above, this requirement does not preclude "anti-dilution" provisions that adjust the number of ordinary shares into which the performance shares convert if the entity splits or consolidates its ordinary shares or undertakes a bonus issue, entitlement issue or other capital reconstruction.

¹⁹ ASX objected to this because it potentially rewarded the vendor for performance that had nothing to do with the performance of the asset vended in. Note that ASX would not generally object to a performance share proposed to be issued to a vendor by an entity with a primary performance milestone tied to the performance of the assets vended in and a secondary or supplementary performance milestone tied to the market price of the ordinary shares of the entity issuing the performance share.

²⁰ Again, ASX objected to this because it potentially rewarded the vendor for performance that had nothing to do with the performance of the asset vended in. Note again that ASX would not generally object to a performance share proposed to be issued to a vendor by an entity with a primary performance milestone tied to the performance of the assets vended in and a secondary or supplementary performance milestone tied to the financial performance of the entity as a whole.

²¹ ASX objected to this because it rewarded the director for doing no more than staying in office and therefore was not a meaningful performance hurdle.

²² ASX objected to this because it had the potential to act as a deterrent to security holders exercising their right to remove the director from office and potentially rewarded the director for bad performance.

²³ ASX objected to this because it meant that the number of ordinary shares that might be issued if the performance milestone was achieved could increase to a very large number if the market price of the entity fell significantly. This also raised concerns in terms of the issues discussed under "7. Appropriate numbers of performance shares" on page 6 above.

ASX has no objection, in an appropriate case,²⁴ to having a performance milestone related to the market price of an entity's securities. Care, however, 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 share 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).

9. ASX's requirements for security holder approvals

Having regard to the unusual features of performance shares, subject to the one exception mentioned below, ASX will generally consider it appropriate and equitable, and therefore impose a condition,²⁵ that a listed entity obtain the approval of the holders of its ordinary shares to the issue of the performance shares and that a voting exclusion statement²⁶ apply in relation to any person who may participate in the issue.

The notice of meeting seeking such approval should disclose:

- the party or parties to whom the performance shares are to be issued and the number of performance shares to be issued to them or each of them (as the case may be);
- any relationship between a recipient of the performance shares and the entity (eg vendor, promoter, director, employee etc);
- if the performance shares are being issued in connection with a particular transaction, an explanation of the transaction;
- if the performance shares are not being issued in connection with a particular transaction, an explanation of the purpose the entity is seeking to achieve by issuing them;
- the full terms of the performance shares; and
- the number of ordinary shares that the performance shares will convert into if the applicable performance milestone is met and the impact that will have on the entity's capital structure.²⁷

The one exception that ASX allows to its requirement for security holder approval to an issue of performance shares is where:

- the intention to undertake the issue was clearly disclosed in the entity's listing prospectus or PDS;²⁸

²⁴ Although see the example in the text accompanying note 19 above where ASX considered a performance share with a milestone tied to the market price of the ordinary shares of the issuer to be inappropriate and unacceptable.

²⁵ This condition is imposed under Listing Rule 18.8 as a requirement to ensure compliance with the Listing Rules. Any in-principle advice ASX gives that the terms of performance shares comply with Listing Rules 6.1 and 12.5 will invariably be subject to a condition that such approval is obtained.

²⁶ Pursuant to Listing Rule 14.11 and the final row in the table to Listing Rule 14.11.1.

²⁷ Again, if the performance shares convert into ordinary shares on the basis of a formula, then the impact on the entity's capital structure should be shown 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.

²⁸ That is, the prospectus or PDS lodged with ASX by an applicant for listing in accordance with Listing Rule 1.1 condition 3.

- the disclosure in the prospectus or PDS included the same details as mentioned above for a notice of meeting to approve an issue of performance shares;
- the issue takes place within a reasonable period of the entity being admitted to the official list; and
- ASX otherwise considers the terms applicable to the performance share to be appropriate and equitable.

This exception recognises that the fact that investors have subscribed for securities in the entity based on such a disclosure effectively evidences their approval to the terms of the performance shares.

In all cases,²⁹ ASX will also generally consider it appropriate and equitable, and therefore impose a condition,³⁰ that the terms of the performance shares, including (without limitation) the applicable milestone that has to be satisfied before the performance shares may be converted into ordinary shares, must not be changed without the prior approval of the holders of the entity's ordinary shares and that a voting exclusion statement apply in relation to any holder of the performance shares.³¹

10. Disclosures about performance shares

An entity that has performance shares on issue should make an 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.³² It should also make an announcement immediately if the milestone is not satisfied by the expiry date, stating that fact and what will happen to the performance shares as a consequence.³³

An entity that has performance shares 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 and also in any Appendix 5B quarterly report it may give to ASX:

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

The entity should also disclose in item 9 of each Appendix 3B it lodges while any of the performance shares remain on issue the number of performance shares on issue at the time of lodgement of the Appendix 3B.

²⁹ Including those that fall within the exception mentioned above to ASX's requirement for security holder approval to an issue of performance shares.

³⁰ Again, in the case of a listed entity, this condition is imposed under Listing Rule 18.8 as a requirement to ensure compliance with the Listing Rules. In the case of an applicant for listing, it can also be imposed under Listing Rule 1.19.

³¹ Again, pursuant to Listing Rule 14.11 and the final row in the table to Listing Rule 14.11.1.

³² Under Listing Rule 3.1 and/or 3.10.3.

³³ Under Listing Rule 3.1 and/or 3.10.3 (the final paragraph requiring an entity to notify ASX if there is any change in any information it has given to ASX in connection with an issue of securities).