10 December 2014

Lauren Donnellan
Takeovers Panel
PO Box 1171
Wellington 6011

Dear Lauren,

Re: Small Code Companies and the Code Consultation Paper

This submission is in response to the request for written submissions in respect of Small Code Companies and the Code, a consultation paper issuers by the Takeovers Panel ("the Consultation Paper").

By way of background, Armillary Private Capital which traces its history in the New Zealand private capital markets back to 1992, where we began as part of a multidisciplinary financial intelligence services firm. We are one of New Zealand's most active independent corporate financial services teams focused primarily on the private capital markets. We work with a range public and private businesses across the full spectrum of the business life cycle ranging from start-up to failure. Additionally, we work with a number of financial and educational institutions, corporations, and government agencies in the area of financial training.

We also manage the Unlisted unlicensed financial product market and Crowdcube, an equity crowd funding business operated by Crowdarm Limited, which has recently been licensed by the FMA and is a joint venture between Armillary Private Capital and the UK-based Crowdcube Limited.

This submission is on behalf of ourselves and Crowdcube.

Capitalised terms used in this response but not defined herein have the same meaning as prescribed in the Consultation Paper.

Specific Questions

1a. Is there a problem with the cost of Code compliance for small Code companies?
We agree that there is a problem with the cost of Code compliance for small Code companies.

The Panel has identified the cost of the independent adviser report as a key cost, however other direct costs, including document preparation, legal advice and arranging and hosting a shareholder meeting are all quantifiable and can be significant. Additionally there are also significant indirect costs, including the costs of time taken to complete the transaction and, for many small companies, the cost impact of this on management and directors can be significant, especially when a small team is involved.

Often for small companies these transactions also happen when the company is facing a cash shortage and need to be able to move quickly through the process to stave off a pending insolvency situation which can create further issues for directors.

1b. Do you think the Panel has correctly identified the problem?

We agree that the cost of compliance is a major problem, but as noted above the indirect costs can be just as major and also need to be taken into account.

Further, in our opinion, the concept of companies using structes to position themselves outside the ambit of the Code is counter intuitive. The Code was developed to ensure all shareholders are treated fairly. Certain structures such as non-voting shares dis-enfranchise shareholders and using a holding company merely moves the issue and additional compliance costs to that entity. Using a nominee again does not solve the issue as shareholders should be able to instruct the nominee how to vote, which the Code should in theory look through.

1c. If not, how would you describe the problem?

As noted above in our opinion the problem is twofold.

Firstly, the costs of compliance are a problem however these costs are not just the direct costs of documentation but also the indirect costs of time and impact on the company; and

Secondly, structuring to fall outside of the ambit of the Code is counter-intuitive and disenfranchises shareholders.

2. Do you agree with the Panel's definition of small Code company? If not, how would you define "small Code company"?

We agree with the concept of including some form of value test combined with the 50 shareholders and 50 share parcels test, however do have some concerns about using an enterprise value methodology. This may require the directors to procure a valuation as that may not always be implied by the transaction itself which may mean additional costs for the company.

We are inclined to recommend that the Panel consider a test of $20m to Total Net Operating Assets being the sum of current and non-current assets, less current and

non-current liabilities excluding debt and shareholder advances or to put it another way the sum of total debt, total equity and shareholder advances. This could be calculated on a post money basis and be as at the last set of annual or interim financial statements or even the most recent management accounts as certified by the directors.

3. Do you agree with the Panel's policy objectives? If not, what policy objectives would you suggest instead?

Yes but we would add objectives of:

- allow small companies to undertake transactions within the Code in a timely manner; and

- ensure shareholders in companies are not disenfranchised by the Code itself.

4. Which of the Panel's preferred options do you agree with – preferred option 1 or preferred option 5? If you think there is a better alternative, please describe it, along with your reasons for suggesting that option.

We do not agree with either of the preferred options. Option one is not consistent with the objectives, nor is suggesting that small companies structure themselves to fall outside of the ambit of the Code. Option 5 merely focuses on the cost of the independent adviser report and not the overall costs of Code compliance. While this is better than option 1 it only potentially removes part of the costs. If the Panel elects to stay with only option 1 or option 5 we would favour option 5 over option 1.

We believe that a better alternative is to borrow from the NZAX and MXT market rules and utilise the pre-break announcement concept.

The Code captures two types of transactions – shareholder led and company led. The later includes share issues, buy-backs etc whereas the former includes full or partial takeover offers and transfers of shares between shareholders.

The pre-break alternative should only apply to company led transactions and shareholder led transactions other than a full or partial takeover offer.

Under this pre-break alternative non-associated shareholders would be given the opportunity to vote whether they wish to receive the full disclosure under the Code to be made available. To do this Directors would need to disclose certain required information to shareholders in a prescribed form that would set out the transaction, the implications of the transaction and their reasons for wanting the company to opt-out of Code compliance. This information would be subject to the requirement that it is true and fair and not mis-leading or deceptive. Non-associated shareholders would then have say 15 days to vote on whether they want full disclosure under the Code and if more than 10% vote in favour then the company would then need to comply with the Code process.

As noted above we would prefer to see companies complying with the Code as the shareholder protections in the Code are a valuable device to ensure all shareholders are treated fairly. Structuring a company to be outside of the ambit of the Code is inconsistent with the objectives of the Code.
5. If the Panel grants a class exemption to solve the problem, do you think that there is any risk of inappropriate reliance? If so, can you suggest ways that this might be mitigated?
If the Panel adopts the recommendation above we do not think that there is a risk of inappropriate reliance. The pre-break concept is already accepted by the capital markets through the NZAX and NXT market rules. Further the Panel could retain visibility into the activities of small Code companies through appropriate disclosure of the above and possibly vetting of the prescribed form prior to being sent to shareholders for a vote. Directors will still be required to confirm the information provided is true and fair and not mis-leading or deceptive and non-associated parties are the only shareholders that are able to vote for the opt-in to the requirements of the Code if they wish to receive greater disclosure combined with the cost impact that the company will need to assume. Further as the process is only able to be used on certain types of transactions the use of the usual Code processes for partial and full takeover offers would still apply.

We would be happy to discuss any or all of the above with yourselves should you so require.

Yours sincerely

David Wallace
Director
Armillary Limited

Phone: *64 4 974 9269*
Mobile: *64 21 419 440*
Email: *david@armillary.co.nz*

Craig Weise
Director
Armillary Limited

Phone: *64 4 974 9269*
Mobile: *64 21 747 170*
Email: *craig@armillary.co.nz*