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Dear Sir / Madam

Review comments on the Corporations Amendment (Crowd-Sourced Funding) Regulation 2015 (“Regulations”)

We have now reviewed the Corporations Amendment (Crowd-sourced Funding) Regulation 2015 and its explanatory material. We set out hereunder our thoughts and recommendations on the Regulations only as requested. We have made a submission previously (8/11/15) to Treasury on the Corporations Amendment (Crowd-sourced Funding) Bill 2015 hence the focus of this paper being on the Regulations.

Overall, a good job in the drafting of the Regulations and the following suggestions may assist in finalising the Regulations.

The order of comments are in numeric sequence of the Reg numbers although the sequence seems to have a gap in it i.e.:

6D.3A.06 Section Four – information about investor rights; then the next Reg is
6D.3A.10 re Intermediary aspects – we presume there is no 6D.3A.07 to 6D.3A.09?

Regulation 6D.3A.01 prescribes that fully-paid ordinary shares are eligible for crowd-funding; and Regulation 6D.3A.02 Minimum content requirements for a CSF offer document

We concur with the above and the following regulations to protect the investors. One aspect that is paramount though is for the reader to be well informed about:

- Key terms of the Issuer Company’s constitution particularly as they may affect the ordinary shareholders – for instance are there tag and drag clauses in the constitution that could see the new shareholders dragged along without their voting / approval etc. Are there any pre-emptive rights? Many CSF issuers will have newly adopted public company constitutions most likely and prospective shareholders need this information detailed in the Offer document;
- Key terms of any other securities on issue – is there any uncalled capital – due or becoming due or in default? Are there any special class shares that provide such holders with voting rights that could adversely affect ord shareholders? Are there are options on issue? Convertible loans on issue? Verbal agreements re share entitlement, bank securities over the shares?
- Are there any shareholder agreements in place? Sometimes these clauses can conflict with the constitution or provides a party with certain rights of veto on board or ord shareholder resolutions?

We feel the Regulations need to specify that detailed disclosure of the above critical information is required in the Offer document to prospective shareholders.

Also that the constitution and shareholders agreement (if any) is available for inspection by prospective shareholders and the other material agreements can be provided under a confidentiality agreement

Regulation 6D.3A.04

At clause 6D.3A.04 1 (d) we suggest some clarification around:

- (d) the names of each of the following persons, as well as his or her skills and experience relevant to the management of the offering company:
- (i) each director of the offering company, and any person proposed by the offering company to be a director of the offering company;
 - (ii) each other officer of the offering company, and any person proposed by the offering company to be an officer of the offering company;
 - (iii) each **manager** of the offering company, and any person proposed by the offering company to be a manager of the offering company;

The word “**manager**” is not defined and in the CORPORATIONS ACT 2001 the definition of Manager is referred to S90 which covers Receivers and Managers – it may be useful to elaborate on “manager” as someone who has a manager role in the organisation such as general manager, CEO, technology manager, production manager etc.

Also we believe for each person noted per clause 6D.3A.04 1 (d) above, there should be the following additional information provided for each named person:

- a) Are they employed by the company on a written contract or on a consulting basis?
- b) If employed – details to be provided about the tenure of such appointment, remuneration and any incentives or bonuses including any share plans, or share incentives or options plan, termination provisions, restraint of trade etc
- c) If on a consulting contract, note the terms of the contract, hourly or daily rate, any share or option entitlements, non-conflict terms, and what the termination notice is

Clause 2 of Reg 6D.3A.04 we believe has a major omission in that cl 2 only mentions that in Section 1 of the offer document it must contain the most recent consolidated **statement of financial position** of the offering company in respect of a financial year prepared in accordance with relevant accounting principles.

A statement of financial position relates to AAS 36 Statement of Financial Position covering simply the Balance Sheet. It is vital the reader of any Offer document sees the complete financial statements which includes the Statement of Financial Performance per AAS 1018 and in fact the financial statements presented should be as encapsulated in AASB 101 Presentation of Financial Statements for the most recent financial year.

Also if the last financial statements are more than 6 months out of date, then a financial summary being the Statement of Financial Position and the Statement of Financial Performance should be presented current to within 60 days of the issue date of the CSF Offer document – i.e. if the CSF Offer document is dated 31 May 2017, then the Statement of Financial Position and the Statement of Financial Performance must be at least dated 31 March 2017.

This is most reasonable otherwise readers are making decisions to invest in May 2017 based on outdated financial statements at 30 June 16 which would be out of date and may be meaningless to making an informed decision.

Suggested addition to cl 2 of Reg 6D.3A.04 – forecasts

The Regulation is silent on forecasts as indeed is the Corporations Amendment (Crowd-Sourced Funding) Bill 2015. We have discussed this oversight extensively with the business community and capital markets. Many of the emerging companies undertaking a CSF round will be a start up or early stage company many with minimal or no revenue but high hopes of being a great success and a large employer to help Australia build solid foundations from the resources that are above the ground.

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To convey to the readers and prospective investors, the CSF Offer document is likely to have a forecast of future revenue / earnings. Prospective investors would most likely want some sort of timeframe and revenue profile over the next few years – i.e. is this a company that will slowly build revenue and EBIT or is the company looking to design the next “must have” app and sell it for \$100m in two years?

Our experience in reviewing forecasts of countless Information Memorandums is there can be misleading data presented such as:

- a) The Issuer will need to raise further funds (i.e. series A, B and C) in order to achieve the revenue forecast – this is not always evident to the reader;
- b) Assumptions around market penetration can be overly optimistic – e.g. “we have budgeted on selling 500 new technology baffles for nuclear reactors generating electricity” this sounds fine until one does due diligence (“DD”) and finds there are only 438 nuclear reactors in the world today – many smaller investors will not do any due diligence given the small amount of money they are subscribing so it is vital to have some clarity around key assumptions in any forecasts made in a CSF Offer document

Whilst the Intermediary has certain responsibilities and powers regarding the CSF Offer document we believe it is paramount that if a CSF offering document contains forecasts, the issuing company must set out:

- Key assumptions underpinning the forecasts
- Do the forecasts assume further capital being raised over and above the amount being sought now
- If the company’s Offer document has a Minimum Subscription and a Full Subscription then the forecasts should cover both eventualities
- Do the forecasts assume any IP e.g. a patent that has applied for at the time of issuing the Offer document needs to be granted as a patent to achieve the revenue – i.e. note what would happen if the company does NOT get its key patent application granted?
- Any other material information concerning the forecasts that the reader should be aware of.

We believe this would make for better disclosure where forecasts are included in the CSF Offer document.

Sophisticated investors subscribing for largish amounts will do DD and ask the questions BUT CSF with retail investors subscribing relatively small sums will not do any DD.

They must have sufficient information to make an informed decision from the Offer document only.

Regulation 6D.3A.06 - Section 4: Information about investor rights

All of our responses to Treasury over the past year or so re submissions has been that if the public are investing funds into an early stage public company – even if the funds subscribed are less than \$1m, **the company must be audited and produce financial statements and convene AGM's**. It is a fundamental tenet to the protection of the investing public to have audited accounts prepared and circulated or emailed to them notwithstanding the quantum of funds raised.

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There MUST be some rigour around small public companies, many directors of which have never been public company directors before. The costs are not excessive or disproportionate to the funds raised by the company and our fear is that by exempting some companies in such mission critical areas as good accounting, prudent auditing and proper shareholder engagement, companies are more likely to come to grief with loss of shareholders funds thereby tainting the CSF landscape for the detriment of those companies who do adopt proper financial reporting and shareholder engagement. It is about good practice and the government should not feel obliged to relax such critical pieces of the corporate picture simply because shareholders may be contributing smaller amounts and must be prepared to lose their investment. This should not be the attitude. We have always agreed that the CSF regime must be for comoneis prepared to transition to public status. 99% of the 2m Pty Ltd companies are happy with their tightly held, mostly family business so if a company wishes to engage with the retail and wholesale markets they must convert to public status and embrace the responsibilities that goes with running a public company. There is no point relieving such companies from aspects such as audit, accounts preparation and shareholder meetings simply to save a few thousand dollars and put at risk \$800,000 or \$2.8m – it is not a concession that should be made. The main cost saving will come about in the CSF Offer document not the relatively low audit costs or financial reporting / AGM costs.

Specifically per the Regs:

The following information must be contained in this section 4 of the offer document:

- (a) a description of the cooling off rights contained in section 738ZD of the Act;
- (b) a description of the effect of new subsection 301(5) of the Act (financial accounts not required to be audited for up to 5 years);
- (c) a description of the effect of subsections 250N(5) and (6) of the Act (company not required to hold an AGM for up to 5 years);
- (d) a description of the effect of subsections 314(1AF) and (2A) of the Act (reduced requirements for publication of annual financial report, directors' report and auditor's report for up to 5 years);
- (e) a description of the effect of subsection 738ZA(5) of the Act (responsible intermediary for CSF offer to provide communication facility).

Conclusion

We trust these comments on the Regulations assist in your efforts to finetune some of the Regulations. Hopefully groups like us at Fat Hen can galvanise the crowd and do some good for Australian businesses, technology and employment. We look forward to providing any further input as and when required. If you require anything further please contact me anytime,

Yours sincerely



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