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AUSTRALIAN IPO REVIEW 2021: CAN YOU FORECAST IN A PANDEMIC?

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Legal Briefings – By **Rebecca Maslen-Stannage, Malika Chandrasegaran and Mia Harrison-Kelf**

Early on in the Covid–19 pandemic, in the first half of 2020, many ASX–listed companies withdrew their guidance, concerned that the numerous pandemic–related uncertainties undermined any reasonable basis for financial forecasting. By the end of 2020, the world was looking forward to 2021 as the year the pandemic would end. The fact it is now 2022 and the pandemic is still affecting our daily lives reiterates the challenges of looking forward during a pandemic. So has IPO forecasting practice changed, with less forecasting overall, or substantially shorter forecast periods?

We compared the forecast approach in major IPOs for pre–pandemic 2019 against 2021. This revealed that:

• in fact, a significantly higher proportion of the 2021 disclosure documents – at 75% – contained financial forecasts than in 2019 (50%); and

• where financial forecasts were included, the period was slightly shorter in 2021 – at 9.4 months from the date of the disclosure document – compared to 2019 (10.2 months from the date of the disclosure document). However, this appeared explicable by the sectors / business profiles of the companies which conducted IPOs in each period and the month of launch of the IPOs in each year relative to reporting periods rather than suggesting any more significant shift of approach on the length of forecasts.

It seems that, if it makes commercial sense to list your business in a pandemic, you can probably forecast – at least if your business is of a nature where the market would expect forecasts. And if you can't forecast because of the pandemic, it probably doesn't make sense for you to pick a pandemic as the timing for your IPO because your business will have been adversely affected or investors will price in too great a discount for uncertainty. The pandemic has influenced the sector and business type which chooses to IPO more than the length of forecast period a particular sector / business decides to include in a disclosure document.

For example, in 2019, our data set included property fund IPOs Elanor Commercial Property Fund and Investec Australia Property Fund, with forecast periods finishing 20 months and 11 months respectively after the date of their product disclosure statements. In 2021, there were no major property fund IPOs, unsurprisingly given the many uncertainties around property and how we will use it as we transition into the working from home and online shopping and services world. Property fund IPOs typically forecast at the longer end of the spectrum, because locked in leases are one of the clearest forms of reasonable grounds for a financial forecast. That difference in composition of 2019 versus 2021 IPOs could in and of itself explain the minor reduction in average forecast period between the two years. Ironically, the most significant real estate sector IPO in 2021 was PEXA – which is not a real estate fund but effectively a service provider which benefited from an acceleration in the uptake of digital property settlement as lockdowns necessitated electronic transactions.

By contrast, our 2021 data set included online learning provider Keypath. Its prospectus noted that it had been "a beneficiary of an increase in demand for and acceptance of online learning", flowing out of Covid–19 restrictions. In that context, Keypath had one of the longer forecast horizons at 13.8 months, reflecting the unique drivers of its business model and the expectation that online learning would be sustained even following the pandemic. Similarly, DGL, a chemicals manufacturer operating in Australia and New Zealand, noted that it was particularly benefited by the international supply line disruptions of Covid–19, with consumers opting for trusted domestic suppliers. Its prospectus also cited the increased uptake in gardening and related home and garden products among a population locked down or working from home. Again, this positive outlook was reflected in DGL's forecast horizon of 14 months from prospectus date – the second longest of our 2021 data set. Where issuers have had positive impacts from Covid-19, the forecasting due diligence focus includes how sustainable those benefits are.

There were some exceptions. Siteminder, a hotel commerce platform sitting within the consumer discretionary sector, declined to provide any financial forecasts, citing disruptions to the global travel sector brought about by the pandemic. In particular, its prospectus highlighted the volatility brought about by new virulent variants such as Delta, which make it difficult to "fully ascertain the size and duration of the pandemic's impact on our customers' operations". Latitude, a consumer credit provider, similarly cited the impacts of Covid–19 on its business as the reason for not providing any forecasts. In contrast, Pepper Money provided forecasts, albeit for less than a year.

The minor difference in length of forecast period also appeared to be explicable in part by the timing of launch of the IPOs in each period relative to financial reporting periods. Overall, we concluded that, looking either side of the 2020 initial Covid-19 turmoil, there has been no significant change in forecasting practice.

There has always been a natural tension as to the duration of financial forecasts in an IPO prospectus. On one hand, providing forecasts that paint a positive long–term outlook for the company's financials helps generate investor confidence and drive the success of the IPO. On the other hand, if their financial forecasts are stretched into uncertain territory, ASIC may query whether there are reasonable grounds for the financial forecast, and if the forecast is ultimately not met there can be both regulatory and class action risk as well as unhappy investors. During a pandemic, those risks are particularly acute. It has been helpful to issuers that ASIC has been receptive to proactive engagement with prospective issues regarding forecasting during the pandemic, as discussed in Regulatory developments.

The legal test for whether a financial forecast is required is the general prospectus disclosure test: whether investors and their professional advisers would reasonably require that information to decide whether to invest in the IPO. As is explained in ASIC Regulatory Guide 170: Prospective Financial Information (RG 170), the issuer needs to assess whether – and if so, what period of – financial forecasts are required to meet that test. To make that assessment the issuer needs to consider whether there are reasonable grounds for a financial forecast and the risk that disclosure might be misleading. This involves balancing the value of financial forecast information with its reliability.

The investigating accountant's work tests the assumptions and reasonable basis for the financial forecasts. Consistent with ASIC's guidance, assumptions and supporting information should be clearly disclosed to help arm investors with the means to also test the financial forecasts for themselves. Without diminishing from the base required standard of reasonable grounds for a financial forecast, issuers can add protection by careful disclosure of the risks to achievement of the forecasts, including sensitivity analysis where applicable.

Virtually all the 2021 disclosure documents addressed the risk and uncertainty of Covid–19 explicitly, outlining the impact of the pandemic on the company's business as well as the wider industry. IPO issuers have cautioned about the pandemic's role in reducing the reliability of historical data and increasing the volatility of estimates as a result. Nor were such disclosures confined to a particular industry. 29Metals cautioned investors about the volatility of commodity prices and disruption of inter–state supply lines, Pepper Money noted the difficulties in anticipating consumer credit appetite as the pandemic progresses and APM Human Services observed the way in which lockdown restrictions have impaired its ability to find work placements for the unemployed.

Despite the destabilising nature of the Covid–19 pandemic, an analysis of last year's biggest IPOs shows that a wide range of businesses had sufficient confidence to include financial forecasts in their prospectuses. Whether an issuer can include financial forecasts in a RG 170–compliant prospectus needs to be assessed on a case by case basis. The extent to which the forecast can be made and the associated disclosures continues to require careful consideration. Nevertheless, if it makes sense to IPO a business in spite of the uncertain headwinds of a pandemic, it is often possible to prudently include forecasts, caveated with the appropriate protective assumptions and risk disclosure.

Average forecast period (if included)	
2019	10.2
2021	9.4

KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.

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