Video #2: U.S.-Canadian cross-border IPOs

SPEAKERS

Robbie Leibel

Chris Bornhorst

11:35

In the second video of our IPO essentials series, Robbie Leibel and Chris Bornhorst of our Capital Markets group explore a number of key items to keep in mind for companies looking to complete a cross-border IPO in Canada and the United States, including:

- general processes and the time it takes to complete a cross-border IPO;
- engaging in publicity;
- prospectus and regulatory review;
- financial statement requirements; and
- testing the waters before publicly announcing an IPO.

Click here to visit the main IPO series page.

Video Transcript

Robbie Leibel (00:10): Hi everyone. My name is Robbie Leibel and I'm a Partner in the Securities Group at Torys in Toronto. Today, I'm joined by my colleague, Chris Bornhorst, a Partner in our Securities Group in New York. We'd like to welcome you to the second installment of our IPO webinar series. In the first video of the series, our colleagues discuss some key gating items that companies will need to be mindful of at the beginning of the IPO process in order to become IPO-ready. In today's installment, Chris and I will highlight a number of key items to keep in mind for companies looking to complete a cross-border IPO in Canada and the United States.

Chris Bornhorst (00:44): Given the similarity between Canadian and US securities laws, there's quite a bit of overlap. So our goal here today is to focus on the important differences and considerations involved when there is a potential to be regulated in both jurisdictions.

Robbie Leibel (00:57): Earlier in the webinar series, we discussed the key steps and work streams for a Canadian-only IPO. To recap, a Canadian IPO typically takes about four to six months to complete assuming favorable market conditions and no significant regulatory issues. This includes the time necessary to prepare financial statements for prospectus disclosure, complete due diligence, go through regulatory review, marketing the IPO, and then pricing and closing the offering.

Chris Bornhorst (01:23): If a company is looking to complete a cross-border IPO in the United States, with the US Stock Exchange listing, for example, on the New York Stock Exchange or NASDAQ, much of the same work for a Canadian IPO can be applied towards the US IPO and the process can be made streamlined and efficient. Potentially a cross-border IPO can be completed in the same timeframe as a Canadian-only IPO. However, it's important to consider some of the legal considerations that arise in the US, as well as in Canada, in order to ensure a smooth process. One issue I'd like to start off with, because it is relevant early on in the process, is what to do about publicity. For example, the company's press releases and website content once the company has kicked off an IPO process. Any information the company makes available to the public has the potential to be deemed offer material under US securities laws. Thankfully, there are some exceptions. For example, ordinary course trade press that is not targeted directly at investors and communications made more than 30 days prior to the public filing of the SEC registration statement. For these reasons, companies seeking to kick off an IPO should consult with counsel regarding the press releases, IR and website content early on in the process.

Robbie Leibel (02:35): That's a great point, Chris, and it's not too dissimilar from the general advice we'd be giving our Canadian clients who may be looking to complete an IPO in the near term. That is, to generally avoid public statements and public disclosures outside of the ordinary course of business as you're gearing up to launch an IPO. Chris, why don't you speak now a bit about the key differences between US and Canada as it relates to preparing and settling the primary disclosure document for an IPO, being a "prospectus" as it's referred to in Canada, and a "registration statement" as it's referred to in the United States?

Chris Bornhorst (03:06): Sure. The US and Canadian forms contain many of the same disclosure requirements. For example, financial statements, MD&A, description of the business, executive compensation and risk factors. And as a result, the prospectus ultimately will be substantially the same in both jurisdictions. One complication, however, is that the prospectus is subject to review by two sets of regulators: one in Canada and the SEC in the United States. And these regulators operate according to different timelines and procedures. The SEC, for example, takes 30 days to issue their initial comment letter, as compared to 10 days in Canada. In addition, the SEC requires IPO companies to file a formal response letter to comments and file an amended registration statement along with it, although the SEC staff may take a more informal approach and closer to the IPO pricing. By contrast, the Canadian review process is a bit more casual with opportunities to have wide discussions with the regulator if needed, even early on in the process. Thankfully, companies are permitted in both jurisdictions to set up regulatory comments on a confidential basis before any prospectus or announcement about the IPO is made public.

Robbie Leibel (04:16): That's a good point. Now, turning to financial statement requirements, the general rule for IPOs in Canada is that you need three years of audited historical financial statements that have been audited in accordance with IFRS. In addition, IPO companies must include interim financial statements as well as any required financial statements for recent significant acquisitions.

Chris Bornhorst (04:37): Unlike in Canada, only two years of audited financial statements are required for most IPO companies in the US. However, in a cross-border IPO, issuers end up needing to file three years of financial statements because of the Canadian requirements. Another important consideration is to examine the significance of recent or probable acquisitions under the US rules, which differ from the Canadian rules and may increase the

likelihood of needing to file financial statements for target companies as well as pro forma financials. One key difference between the Canadian and US rules is that the minimum significant threshold in the US is only 20% versus 30% in Canada. And only one of the three signficance tests—assets, income or investments—needs to be tripped in order to be deemed significant, versus two out of the three tests in Canada. Additionally, Canadian companies that are "foreign private issuers" under the US rules are permitted to file IFRS financial statements with the SEC registration statement. However, if they fail to qualify as a "foreign private issuer", then the company will need to include US GAAP financial statements. The "foreign private issuer" test, I should mention, is failed if more than 50% of Canadian company's shareholders are in the United States—what we call a "shareholder test"—and the company also fails the "business contacts" test. Now the "business contacts" test is failed if any of the following are true: (1) the company is headquartered or administered in the United States; (2) more than half of its directors are US citizens or residents; (3) more than half of its executive officers are US citizens or residents; and (4) more than 50% of its assets are in the United States. The "foreign private issuer" test is important for companies to consider early on in the process, as it has a lot of consequences under US securities laws, not the least of which is the requirement for US GAAP financial statements.

Robbie Leibel (06:25): That's right. And in this situation, the Canadian regulators will permit you to prepare your financial statements in accordance with US GAAP. However, recently, given the way that the technical rules are drafted, the Canadian regulators have been requiring the issuers looking to do a cross-border IPO actually apply for exemptive relief in order to be able to audit their financial statements in accordance with the US GAAP. This has become a fairly standard form of relief and should not be an issue to obtain. However, issuers should be mindful of this requirement as fairly to apply for the relief could lead to delays to your timeline.

Chris Bornhorst (07:02): Either way, whether IFRS or US GAAP, the financial statements for a cross-border IPO must be audited under US auditing standards by an auditor that is registered with the US Public Company Accounting Oversight Board, or the PCAOB. Canadian companies should confirm that their Canadian audit partner is in communication with their US counterparts very early on in the process to ensure that the US audit is completed, which may take several months. Also, a Canadian company completing a US IPO must ensure that its auditors are independent under US rules, as this analysis may differ between the US and Canada.

Robbie Leibel (07:37): Turning to marketing for a second, you know, issuers looking to do a cross-border IPO will also need to be mindful of the different timing requirements under various securities law regimes on both sides of the border. And an example of this really does relate to marketing of the IPO to potential investors. In both Canada and the US, issuers have the ability to confidentially "test the waters" before publicly announcing an IPO in order to see if there's sufficient interest in the IPO. However, there's a cooling off period in Canada, where issuers are required to stop all Canadian "testing the waters" meetings and then wait an additional 15 days before the issuer can publicly file that preliminary prospectus.

Chris Bornhorst (08:18): There's no equivalent restriction in the US, and technically US "testing the waters" can continue all the way up until the roadshow. However, the US has a different "cooling off" period whereby an issuer is not permitted to commence the public roadshow until these 15 days after the first public filing of the SEC registration statement. As such, issuers and underwriters will want to give some consideration to organizing their "testing the waters" and roadshow schedules on both sides of the border in order to be able to maximize the number of days that they're able to be out marketing the IPO, while still complying with the various "cooling off" periods under Canadian and US rules.

Robbie Leibel (08:55): And usually issuers will wait until they and the underwriters are reasonably certain that the IPO will actually proceed before filing that prospectus publicly. Because once that public filing has been made, it can't be taken back down. Another important factor that comes up from time to time in assessing where to IPO relates to where your existing shareholders reside. For example, if you have a number of Canadian pre-IPO shareholders, unless you were to file a prospectus in Canada, those pre-IPO Canadian shareholders will have permanently restricted stock. That stock will never become freely tradable until a prospectus has been filed in Canada. So in cases where a Canadian company is looking to do a US IPO, and has a number of existing Canadian shareholders, it has become fairly commonplace for the company to also file a prospectus in Canada, even if it's just a "non-offering" prospectus, in order to ensure that their existing Canadian shareholders will have freely tradable stock on closing of the IPO.

Chris Bornhorst (09:55): This is a good point, and a similar but related issue arises under US securities laws. If a Canadian company is looking to only do a Canadian IPO, it may actually need to register with the SEC if the company is not considered a "foreign private issuer", because otherwise the shares issued in Canada would be restricted from

resale back into the United States for a period of one year. This is an issue that we sometimes refer to as "flow back". In the event the "foreign private issuer" test has failed, it is technically possible to complete a Canadian-owning IPO without SEC registration, but it becomes practically very challenging to manage because brokers will need to notify their customer accounts of the one year "flow back" restriction. The TSX, for example, would give the stock a ".s" designation for "Regulation S", which is the applicable US regulation in order to help enforce this. As such, many Canadian companies that are not "foreign private issuers" end up needing to register with the SEC to avoid a ".s" designation. This does not mean, however, that the company needs to be listed on a US stock exchange, but it does require the filing of an SEC registration that is subject to review and comment by the SEC.

Robbie Leibel (11:02): Thanks, Chris. I think that's probably a good place for us to pause. I mean, it's obviously quite challenging to summarize the multitude of considerations involved in deciding on which jurisdictions to take your company public. But we hope that this segment has at least put some of the key issues on your radar as you are considering the ideal markets for your IPO. We thank you for taking the time to listen to our segment today. Stay tuned for the next installment of our IPO webinar series coming very soon.

Chris Bornhorst (11:28): Thanks, everyone.

Robbie Leibel (11:29): Thanks.

To discuss these issues, please contact the author(s).