



# Guidance Note

Key Operating Milestones

February 2015



The purpose of this guidance note is to provide guidance to NXT companies who are subject to the requirement to set key operating milestones and report against targets for those key operating milestones.

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This guidance note relates to the setting of key operating milestones and the reporting against targets for those key operating milestones as required by the NXT Market Rules. NXT companies should note that this guidance note is not intended to be a definitive statement of the application of the NXT Market Rules in every situation, and is only a guide to NZX’s policy and practice. This guidance note does not limit NZX’s discretion under the NXT Market Rules. This guidance note reflects the NXT Market Rules and law as at February 2015, which are subject to change. NZX takes no responsibility for any error contained in this guidance note. NZX may replace guidance notes at any time and NXT companies should ensure that they have the most recent version of this guidance note by checking the NXT website: [nxt.co.nz](http://nxt.co.nz)

# 1. Introduction

All NXT companies and applicants for listing on NXT are required to set key operating milestones (“**KOMs**”) and targets, and must report against those targets on an ongoing basis after listing.

A KOM is a metric for measuring and reporting on the performance of an applicant’s or NXT company’s business. KOMs set by a NXT company must meet the NXT standard.

The **NXT standard** means that a NXT company’s KOMs, when taken together, address the most significant factors by which the performance of the company’s or the company’s group’s business should be assessed and monitored and will result in understandable reporting for investors.

Once KOMs have been set, a NXT company:

- must set an annual target for performance in respect of each KOM and report against each target in a quarterly business update;
- must immediately release an interim update to the market if it becomes aware that its or its group’s operational performance against a target will vary, or is likely to vary, by more than 10%;
- may reset an annual target if its performance against that annual target will vary, or is likely to vary, by more than 10% and must disclose a reset target in its next quarterly business update;
- must review its KOMs at least every 12 months to determine whether or not they meet the NXT standard and, following review, its directors must certify that the KOMs meet the NXT standard;
- must, if its directors cease to hold the opinion that the existing KOMs meet the NXT standard:
  - immediately release an interim update that states that the KOMs no longer meet the NXT standard and provide the further information described in this guidance note; and
  - restate KOMs that meet the NXT standard and are approved by NZX and disclose those restated KOMs and an annual target for each KOM in its next quarterly business update.

## 2. Setting key operating milestones

### 2.1. Understanding “key operating milestones” and “targets”

KOMs must be quantitative and measurable objectives that, taken together, address the most significant factors by which a NXT company’s or group’s business should be assessed and monitored.

NXT companies must set KOMs and a target for each KOM.

- A KOM must be measurable e.g., number of stores.

- A target is the projection for a NXT company's performance in respect of a KOM for a financial period, which must be quantitative (measuring quantity), e.g. 8 new stores opened by year end. NXT companies cannot provide a projected range for a target, e.g. 8 to 10 new stores opened by year end.

The following points have been included to assist companies in their determination of KOMs:

- A NXT company's assessment of key strategies and plans for generating returns for investors should inform the NXT company's determination of KOMs.
- KOMs should not be limited to drivers of revenue. For example, drivers of cost, customer satisfaction and product quality that may have a significant impact on potential returns to shareholders or the NXT company's or group's strategy and plans could form the basis for a KOM.
- There is no limit to the number of KOMs a NXT company may choose to report against, however it is important that KOMs are objective and measurable and together form a comprehensive basis on which to report information to investors.
- KOMs will usually be interrelated.
- NZX suggests a minimum number of 3-4 KOMs will usually be appropriate.

#### Examples of key operating milestones

In order to assist NXT companies in understanding NZX's expectations as to the nature of KOMs, set out below are some examples of KOMs. The examples are set out in relation to selected industry segments. Whether these examples are appropriate for a specific NXT company will depend on that NXT company's assessment of its key strategies and its plans for generating returns for its investors.

#### **SaaS (Software as a Service) Business**

- Number of paying users
- Average revenue per user (ARPU),
- Customer churn rate (CCR) over a given timeframe, i.e. trailing 12 months
- Customer acquisition cost (CAC)
- Months to recover CAC
- Lifetime value of customer (LTV) =  $ARPU \times Gross\ Margin / CCR$

#### **Service Provider**

- Number of customers
- Average revenue per customer
- Average cost of services provided per customer
- Bad debts as a percentage of revenue

The following are real examples of KOMs used in the public market context, and could be considered by NXT Advisors and NXT companies when developing KOMs. These examples

are from businesses that operate in a different disclosure regime to NXT, and therefore may not represent a comprehensive set of KOMs that would be sufficient to meet the NXT standard.

#### **Beverage company**

- Number of litres sold (by geography)

#### **SaaS Business**

- Number of paying users

#### **Retailer**

- Total number of stores

#### **Airline**

- Available seat kilometres
- Revenue passenger kilometres (RPK)
- Load factor
- Yield (cents per RPK)

#### **Social media**

- Daily active users (total and mobile, by geography)
- Monthly active users (total and mobile, by geography)
- Mobile-only monthly active users
- Average revenue per user (ARPU) split by payments and advertising (and geography).

#### **Examples of targets**

An applicant must set a target for performance in respect of each KOM.

For example: A service provider ("**X Limited**") with a balance date of 31 December has decided its KOMs will be:

- Number of customers
- Average revenue per customer
- Average cost of services provided per customer
- Bad debts as a percentage of revenue

X Limited sets annual targets for these KOMs as follows:

#### **Target 1 - As at the end of X Limited's current financial year**

X Limited must set a target for the number of customers, average revenue per customer, average cost of services provided per customer and bad debts as a percentage of revenue as at 31 December 2015. X Limited sets the following targets as at 31 December 2015:

1.	Number of customers	36,000
2.	Average revenue per customer	\$1,900

3.	Average cost of services provided per customer	\$1,700
4.	Bad debts as a percentage of revenue	1.5%

### Target 2 - As at the end of the following financial year

X Limited must set a target for those same KOMs as at 31 December 2016. X Limited sets the following targets as at 31 December 2016:		
1.	Number of customers	40,000
2.	Average revenue per customer	\$2,000
3.	Average cost of services provided per customer	\$1,750
4.	Bad debts as a percentage of revenue	1.5%

## 2.2. Process for setting key operating milestones prior to listing

An applicant for listing on NXT must:

- Set KOMs that taken together meet the NXT standard; and
- Set a target for performance in respect of each KOM for its current financial year and, at a minimum, the next financial year.

Both the KOMs and the target for each KOM must be included in the Listing Document and will be available on each NXT company's page on the NXT website: [nxt.co.nz](http://nxt.co.nz).

### Setting key operating milestones

#### NXT Advisor's declaration

- An applicant must consult with its NXT Advisor when setting KOMs.
- A NXT Advisor must include in its declaration to NZX a statement that it considers the KOMs meet the NXT standard.

#### NXT company responsibility

- The directors of the applicant are ultimately responsible for ensuring the applicant's KOMs meet the NXT standard.
- A directors' statement that the KOMs meet the NXT standard must be included in an applicant's Listing Document.
- The Listing Document must include commentary as to why the directors consider that the KOMs meet the NXT standard, by reference to the NXT company or group's stated key strategies and plans for generating returns for investors.

#### NZX approval

- Before approving the KOMs and accepting the applicant for listing, NZX will review the KOMs set by an applicant in accordance with NZX's usual pre-listing process.
- NZX may require information about the applicant's setting of KOMs to be provided.

X Limited's KOMs and the targets for its KOMs are disclosed in X Limited's Listing Document, as follows:

Key Operating Milestone	Target as at 31 December 2015	Target as at 31 December 2016
1. Number of customers	36,000	40,000
2. Average revenue customer	\$1,900	\$2,000
3. Average cost of services provided per customer	\$1,700	\$1,750
4. Bad debts as a percentage of revenue	1.5%	1.5%

### 2.3. Process for reviewing key operating milestones and setting targets after listing

After listing, a NXT company must have KOMs that meet the NXT standard and annual targets in respect of each KOM under NXT Market Rule ("rule") 42.

#### Review of KOMs

A NXT company must review its KOMs at least every 12 months to determine whether or not they meet the NXT standard. If, following a review, the directors are of the opinion that the KOMs meet the NXT standard, then the NXT company must, in the next business update, release a certificate by the directors that the KOMs meet the NXT standard. The certificate may be released earlier, to coincide with the release of the preliminary announcement in relation to the annual results for the just completed financial year and should comply with the following wording, which is set out in the business update template:

In the directors' opinion, [insert name of NXT company]'s key operating milestones, taken together, address the most significant factors by which the performance of [insert name of NXT company]'s or [insert name of NXT company]'s group's business should be assessed and monitored and will result in understandable reporting for investors and therefore meet the NXT standard.

NZX would expect that a NXT company has a process in place for the 12-monthly review and to enable its directors to make the NXT standard certification. As a minimum, NZX expects that process to require management to complete a full review of the KOMs against the annual accounts and internal management information and provide the NXT company's board with a recommendation as to restated KOMs or a negative assurance that the KOMs remain appropriate. Each NXT company director will nevertheless need to consider for himself or herself whether the KOMs meet the NXT standard, prior to providing the annual certification.

If at any time (including as a result of an annual review) the directors of a NXT company cease to hold the opinion that the KOMs meet the NXT standard, the NXT company must immediately make an interim update (refer to rule 50 and paragraph 8 of Schedule 5A to the rules). KOMs must then be restated following the process set out in rule 45. Guidance on the process for restating KOMs is set out in section 4.2 of this guidance note 'Restating KOMs'.

## Setting annual targets

Targets must be set as at the end of each financial year. There is no limit as to how far into the future subsequent targets may be set, but targets must be reviewed and/or set at least annually. A NXT company must release an interim update if it becomes aware that the NXT company's or its group's performance will vary or is likely to vary by more than 10% in relation to the target for the current financial year or any subsequent financial year (refer to rule 50 and paragraph 9 of Schedule 5A to the rules).

A target for a particular financial year must be released to the market no later than 2 calendar months after the end of a NXT company's previous financial year. Rule 43 permits a NXT company to release its annual targets to the market at the same time as it releases its preliminary announcement in relation to the annual results for the just completed financial year.

Using the above example, X Limited will have until 28 February 2017 to release its targets for the key operating milestones that relate to the period ending 31 December 2017.

## 3. Reporting against key operating milestones

### 3.1. Business Updates

A NXT company must report on its performance against the annual target for each KOM as at the end of the quarter in each quarterly business update.

Using the example referred to above, X Limited's Q3 Business Update for 2015 (to be released within 20 business days of 30 September) might state the following in respect of the nine-month period ending 30 September 2015:

- Number of customers: 34,000
- Average revenue per customer: \$1,850
- Average cost of services provided per customer: \$1,700
- Bad debts as a percentage of revenue: 1.5%

There is no prescribed format for reporting on performance against annual targets in a business update but here is an example that NXT companies may wish to follow:

Key Operating Milestone	Actual for nine-months ending 30 September 2015	Target as at 31 December 2015	Target as at 31 December 2016
1. Number of customers	34,000	36,000	40,000
2. Average revenue per customer	\$1,850	\$1,900	\$2,000
3. Average cost of services provided per customer	\$1,700	\$1,700	\$1,750
4. Bad debts as a percentage of revenue	1.5%	1.5%	1.5%

### 3.2. Interim Updates

If a NXT company becomes aware that its or its group's operational performance against an annual target will vary, or is likely to vary, by more than 10%, it must immediately announce this fact to the market by way of an interim update (refer to paragraph 8, Schedule 5A of the rules). A NXT company "becomes aware" of a matter at the time the matter becomes known to a director or senior manager of the NXT company.

NZX's view is that "likely to vary" should be interpreted as meaning that a variance of more than 10% is more likely than not.

For example, during October 2016, X Limited becomes aware that it will only have 35,000 customers as at 31 December 2016. This is a variance of more than 10% (as 10% of 40,000 is 4,000 customers, therefore numbers of customers of less than 36,000 customers would require disclosure). X Limited must immediately disclose this variance to the market by way of an interim update.

The interim update must contain the details of the variance and the expected implications of the variance for the NXT company and its group. NZX recommends the interim update include commentary regarding the extent to which the NXT company expects to miss the annual target, and the reasons for the variance.

The 10% variance is in respect of the financial year-end target. NXT companies should take all relevant factors into account (for example, seasonality and other business factors) when considering whether there is, or is likely to be, a variance of more than 10% from an annual target at the end of the financial year.

For example, Y Limited may project 4,000 paying subscribers as at 31 December, and only have 1,000 paying subscribers by 30 June. If on 30 June the business considers that it will still meet its 31 December target (for example, taking into account seasonal factors) there is no requirement to release an interim update and the target will remain unchanged.

Where an annual target is stated as a percentage, a variance of 10% will be calculated by multiplying the percentage target by 10%.

For example, Y Limited projects its paying subscriber churn rate to be 5% as at 31 December 2015.

The company has chosen to calculate its churn rate as follows:

- Number of customers it expects to unsubscribe over the 12 month period ending 31 December 2015 (500) divided by the total number of customers at 1 January 2015 (the beginning of the period) (10,000).

At 30 September 2015, Y Limited has lost customers and expects that 700 customers will unsubscribe over the 12 month period to 31 December 2015 (i.e. a churn rate of 7%). An interim update is required because Y Limited expects that the paying subscriber churn rate will vary, or is likely to vary, by more than 0.5% at the end of the year (which is a variance of more than 10% of the 5% target).

At listing a NXT company is required to set targets for its current and next financial year. After listing, a NXT company must set a target for its current financial year but may elect to set targets for subsequent financial years. A NXT company must release an interim update if it

becomes aware that its or its group's financial performance will or is likely to vary by more than 10% in relation to the target set for its current financial year or any subsequent financial year.

To ensure compliance with the rules, NXT companies should have a process in place to ensure that they monitor and review performance against annual targets on a regular basis. This process should ensure that a NXT company is in a position to make an immediate announcement to the market if it becomes aware that its performance against an annual target will vary, or is likely to vary, by more than 10%.

A NXT company can elect to reset a target if it has reported that a variance of more than 10% will, or is likely to, occur. If a target has been reset, the NXT company must release the reset target in the next business update (refer to rule 47).

## 4. Restating key operating milestones and resetting targets

### 4.1. Resetting targets

A NXT company may only reset a target if it becomes aware that its or its group's operational performance against the target will vary, or is likely to vary, by more than 10% or after it has completed the annual review of its targets or as a result of restating its KOMs. NZX's approval is not required to reset a target.

If a NXT company decides to reset a target, it must provide the reset target to the market in the next quarterly business update, and report against the reset target in that business update and the business updates that follow.

### 4.2. Restating KOMs

As explained above, a NXT company must review its KOMs at least once every 12 months to determine whether or not they meet the NXT standard.

If, at any time, (including after an annual review) the directors of a NXT company cease to hold the opinion that the KOMs meet the NXT standard, the NXT company must:

- release an interim update that:
  - states that the directors have ceased to hold the opinion that the KOMs meet the NXT standard;
  - explains the reasons why the KOMs no longer meet the NXT standard;
  - explains the impact on the NXT company and the NXT company's group; and
  - sets out a proposed timeline for providing the restated KOMs to the market;
- consult with its NXT Advisor (if a NXT company has a NXT Advisor) and restate KOMs that meet the NXT standard;
- obtain NZX's approval of the restated KOMs;
- release a business update that:
  - discloses the restated KOMs and a target for performance in respect of the KOMs;

- reports against the target for its restated KOMs in respect of the period ending on the most recently completed quarter;
- includes a certificate by the directors that the KOMs meet the NXT standard;
- explains how the restated KOMs meet the NXT standard by reference to the NXT company's key strategy and plans for generating returns to its shareholders.

A NXT company should consult with NZX and their NXT Advisor (if applicable) as soon as possible after the directors form the view that the KOMs no longer meet the NXT standard, in order to ensure that the NXT company is able to make the required disclosure in the next business update. Please note that NZX may take up to 10 business days to consider and approve the restated KOMs. The process for changing KOMs is set out in rule 45.

For example, on 15 August, Y Limited, which reports against a 'number of paying subscribers' KOM, changes its business model from being solely driven by paid subscriptions to being solely advertising driven. The company's financial year ends 30 December. In this case, Y Limited's directors consider that the 'number of paying subscribers' KOM is no longer relevant and as a result the directors cease to hold the opinion that the KOMs meet the NXT standard.

Y Limited should immediately release an interim update that includes statements that:

- the company's business model has changed from being driven by paid subscriptions to advertising revenue;
- the 'number of paying subscribers' is considered by the directors to no longer be relevant to the NXT company and therefore the KOMs, taken together, no longer meet the NXT standard;
- the NXT company intends to restate that KOM and is consulting with its NXT Advisor in order to determine the nature of a suitable replacement KOM and a target for that KOM; and
- the restated KOMs will be included in the next business update for the period ended 30 September, that is to be released before 29 October.

Following discussion with its NXT Advisor, Y Limited determines that it will replace the 'number of paying subscribers KOM' with a 'number of page views' KOM. Y Limited determines that the KOMs (including the 'number of page views' KOM) will meet the NXT standard.

After obtaining NZX's consent to the restated KOMs, Y Limited releases a business update that includes (in addition to the information about performance in respect of the targets for the other KOMs):

- the restated 'number of page views' KOM;
- a target for the number of page views as at 31 December (being the financial year end);
- a statement of the company's number of page views for the period ended 30 September;
- commentary as to the reason for restating KOMs; and

- a directors' certificate that the KOMs meet the NXT standard (in the form set out in the business update template, as set out in sub-section 2.3 above).

