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The AIM Attraction

Early-stage companies continue to struggle in the pursuit of finance. ***Mark Fahy*** *and* ***Marcus Stuttard*** *of the London Stock Exchange talk to Criticaleye about AIM's enduring strength through the economic downturn and why it can be the perfect home for those growth businesses needing an injection of capital*

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It's been a familiar cycle on the public markets for the past few years. A strong and hopeful pipeline of flotations is suddenly thwarted by a new banking scandal or the sovereign debt crisis taking another turn for the worse, undermining investor confidence.

The Alternative Investment Market (AIM), London Stock Exchange's junior market for growth companies, is certainly not immune to the effects of these ongoing economic woes. New issues on the market remain slow, with 26 companies conducting an IPO (Initial Public Offering) so far this year, raising £190 million, compared to 27 companies raising over £390 million for the same period in 2011.

It's revealing to take a quick trip down memory lane to the bullish days of 2006, when in the first seven months of that year 168 companies conducted IPOs, raising over £5.2 billion in the process. Times may have changed dramatically but, as **Mark Fahy** and **Marcus Stuttard** of the London Stock Exchange reveal, AIM does continue to have the core components of advisors and institutional investors to make it an attractive proposition for the right kind of growth business.

How would you describe 2012 so far?

Marcus Stuttard: We have seen a lot of good companies coming through, particularly UK technology businesses. The positive thing is that they have reported that investor roadshows were not unduly difficult and they have high-quality investors on the shareholder register. We would have seen more money raised through new issues if the eurozone crisis hadn't hit. That's quite frustrating as I genuinely believe all of the foundations are strong.

So companies are showing an interest in a public listing?

Mark Fahy: Within the UK, we have never had as many meetings with companies as we've had this year. It has been driven by the need to access long-term finance and the unavailability of debt finance in the banking sector. It's really important that we educate companies about the benefits of flotation, either on AIM or the Main Market.

What concerns do companies have about coming to AIM?

MF: Listing is perceived to be expensive but I would argue it's not as expensive as some of the other types of financing out there. Another question is around transparency and regulation as that is often something companies haven't had to think about. Many private companies also aren't used to the idea of bringing non-executives on board and understanding how they may add real value.

There are advisory firms too that haven't done an IPO in such a long time that they are finding they don't really have people with up-to-date skills in their business. They may be advising companies to go for different options instead, such as a buy-out. It's a case of re-educating the marketplace about the benefits of flotation.

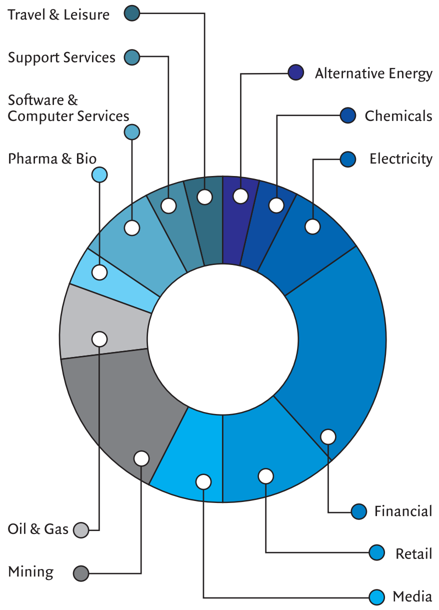
But the costs are around 7.5 per cent of funds raised, so they shouldn't be underestimated?

MS: People tend to focus simply on the cost of admission to the market, but these are similar to either a corporate undertaking due diligence for a trade sale or a venture capital investor buying a stake in the business. Opening the books, doing due diligence and being structured properly does entail a fixed level of cost, but the point about incurring that in order to float is the credibility that comes with being a public business is significant.

That credibility is not just with investors but stakeholders. They know a business has been through the rigour of due diligence, looked over by lawyers, accountants and nomads; there are real benefits associated with that outlay.

In addition to this, once you're admitted, the cost of raising further capital on AIM is significantly lower.

New Issues By Sector on AIM: Jan to July 2012



Community Comment

"The AIM Board"

Neither the executive or non-executive team should be too big, otherwise your cost of governance and overheads is unnecessarily high. For me, you ought to be running the company with two or three non-executives and perhaps the same number of senior executives.

Clive Ansell
Non-executive Director
Eckoh Plc

"Non-executive Directors"

Without a doubt, the level of responsibility and workload for NEDs is growing. No one thought being the chairman of a remuneration or audit committee were particularly demanding roles, but it's now changed with a vengeance.

Robert Drummond
Chairman
Acta S.p.a.

"Market Movers"

The following could improve AIM: less regulatory headaches for institutions and wealth managers in investing in small caps; double the current gross asset test for EIS and VCT tax schemes; eliminate barriers to VCTs and the like from buying in the secondary market; open up AIM for investment in ISAs, and do anything to reduce the buy-and-sell spreads [set by market makers].

Faisal Rahmatallah
Chairman
Plastics Capital Plc

To the end of July, £1.4 billion was raised through secondary fundraising from institutional investors. What does that tell you about the market?

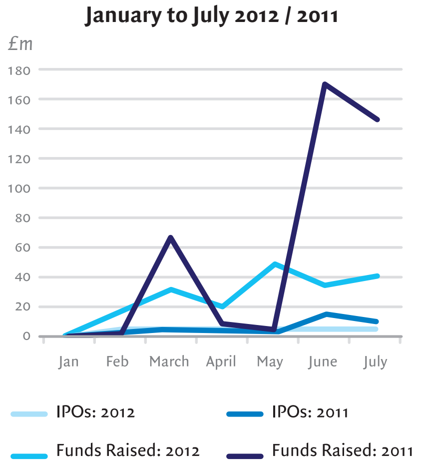
MS: One of the things that continues to set AIM aside from any other growth market in the world is that companies are still raising money, which has been consistent from 2009 when £5.6 billion was raised. For me, it demonstrates that AIM is performing its core role of providing risk equity capital for growing businesses and continues to do that. The money raised is significantly larger than money that has gone to companies through initiatives like the Business Growth Fund.

What about questions over liquidity and the so-called 'small-cap trap'?

MF: It's difficult to simply talk about a market-wide view as there are so many factors which determine levels of liquidity, such as shareholder structure, investor relations and company performance. We see very small companies that have good liquidity and the reverse for larger companies, so it really is a case-by-case basis and ultimately the company has control over their liquidity through their investor mix. Institutional investors are great providers of capital but often they don't trade shares as they're in for the long term, therefore it's important to have a blend of investors on the shareholder register so you have private clients and retail investors. It helps to generate the daily trading of shares.

MS: The most important thing is that a company's management team understand the different factors that have a bearing on liquidity. What do they want the investor base to look like? Do they want a tightly held register or a more diverse shareholder register for potentially more liquidity? I think ultimately what every company wants is access to long-term ongoing capital and a supportive investor base.

New Issues on AIM: January to July 2012 / 2011



You've been lobbying hard to encourage greater investor activity. What results have you seen?

MS: We are making progress. The changes to the EIS Scheme and VCTs (see box out, p4) have gone through and they've achieved state-aid clearance, which is really important. We have been pushing for some time for the gross assets and number of employees to be increased. As things were, the rules constrained rather than promoted growth.

What other steps could be taken?

MS: We would like to see the Stamp Duty on the trading of AIM shares abolished as it is an unnecessary barrier for investors in AIM companies. Inevitably, it means that many will opt for larger companies or not investing in equities at all, rather than incur the cost for potentially higher risks when investing in smaller companies.

The second thing we would like to see is a Capital Gains Tax regime which really encourages people to invest in smaller companies and also to reinvest the gains they make back into those businesses. We used to have Taper Relief – ideally we would like to see some kind of reversion back to that.

There are non-fiscal ways to achieve the same goals too. While there are no specific rules that say investors shouldn't invest in small caps, there is a general theme that comes out of a number of European directives that translates into UK policy, suggesting small companies carry a higher risk and only knowledgeable investors should invest in them. The reality is the risks are easily disclosable and we should all be supportive of growth and the opportunities that investing in high growth businesses can provide.

Given the current uncertainty, how do you conduct a successful IPO?

MF: The main differentiator between those companies which are successful and those that aren't is good management teams. The management is largely what investors buy into as then it follows that investor relations and communication with the market are good, there are high standards of governance and the equity growth story will be strong too.

£1.4 bn

Amount raised from secondary fundraising in 2012

In this climate, do companies need a longer than usual lead time for an IPO?

MF: Twelve to 18 months still stands as normal preparation time. The actual process is three to four months. You have to take time to get the company ready for flotation, and your rationale must be right as well concerning why you're going to market. It's not only about the nuts and bolts of the legal requirement and the accounting – there is the wider equity story too.

MS: In terms of AIM regulation and the nomad system (see box out, p4) we have in place, companies can push the button very quickly. The reality is that management need to be able to run the business in parallel with preparing for a float. If the management team want to do it quickly, the market has the flexibility to cater for that, but the danger is they take their eye off the ball.

How important are NEDs during an IPO?

MF: Investors can get worried when NEDs come in just prior to flotation because it doesn't necessarily send the right signal. In a perfect world, the management team will have been relatively stable and the non-executive directors should be very familiar with the business, rather than just coming in to make it suitable for the public market.

MS: The institutional investors will look at the quality of the deal team too, such as who the nomads and brokers (see box out, p4), lawyers and accountants are. Investors may well have a view of their previous track record and the extent of the due diligence on previous deals.

The Language of AIM

Admission Document: Put together by the company and advisors, the Admission Document contains details on the business' development, operations, financials and outlook

Broker: Every AIM company must retain a broker at all times. The broker will be a securities house that is a member of the London Stock Exchange which trades shares for the business

EIS: The Enterprise Investment Scheme provides tax relief for investors in smaller companies. Rule changes mean that the amount an individual can invest has increased from £500,000 to £1 million (see Venture Capital Trust)

Long Form Report: The company's reporting accountants will prepare an extensive financial due diligence report on the company. It entails supplying significant amounts of data and explanations concerning a company's business and financial history

Market Maker: These are responsible for ensuring that there is always a two-way – buy and sell – price in securities

Nomad: The Nominated Adviser is responsible for assessing the company, each of its directors and its potential advisers for suitability and reputation issues. A company admitted to AIM must appoint and retain a nomad throughout its time on market (the same firm can act as both nomad and broker)

Takeover Code: Revisions to the Takeover Code in 2011 have seen greater disclosure requirements, especially for bidding companies

Venture Capital Trust: Set up in 1995, VCTs are investment vehicles in high growth, smaller companies which provide tax relief to investors. Recent changes mean that for both the EIS Scheme and VCTs, the amount invested by these funds in an individual company has risen to £5 million. Furthermore, the size of company that can be invested in has increased from 50 employees to 250

So, once on the market, the key remains to hit your numbers?

MF: You have to make sure you hit your forecast, it's as simple as that. Then it's a case of being proactive about communicating, doing your investor relations properly, keeping stakeholders informed and, if you do have bad news, don't try to hide it.

Has AIM become the preserve of oil, gas and mining companies?

MS: We have companies from 40 sectors and 95 different countries. It's this broad church that allows AIM to continue to grow and develop because it's not as cyclical as other markets which may be dominated by one sector. But clearly any public market is going to be a reflection of the wider global economy and we have been through a period where commodity prices have been strong. Big oil and gas extraction companies have been looking to the companies on the junior markets to exploit new technologies or under-developed and hard-to-reach fields and then, when they come into production, often they're acquired. Again, equity has been seen as the right form of finance for these projects.

So AIM can be equally attractive for a start-up technology company, for example?

MS: The technology sector is the kind of area where equity has a really important role to play for early-stage businesses. It's more appropriate for them to have access to long-term risk equity capital and all of the benefits that come with being on the public markets.

Overall then, you both believe activity on the market can rapidly pick up?

MF: From what I can see from the events and roadshows we've held round the UK, there are lots of companies interested in coming to market. The pipeline is fairly strong, investors have got cash and there is interest in putting money into new IPOs. There are a whole raft of things that are positive, but underlying all of this is the economic volatility which causes uncertainty and the difficulties that surround this in terms of the timing of a flotation process.

MS: It is pretty hard to replicate AIM. Some markets have tried by copying the rules and the nomad system, but it takes so much more than that as there is the wider legislative environment regarding company law, the Takeover Code (see box out), and all those international gold standards that underpin the equity markets as well as the mid-tier investment banks, brokers, market makers, PR firms and the law and accountancy firms.

The components that make up the ecosystem that support the issuers and investors doesn't really exist anywhere else in the world, and I include the US in that as it's not got the ability to serve small public businesses in the way the UK can.

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1,143

Number of companies on AIM

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Mark is specifically the Regional Manager for the North of England, Northern Ireland and Scotland and as part of that role manages the Exchange's relationship with over 350 North of England, Northern Irish and Scottish companies on both the Main Market and AIM.

Marcus Stuttard
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Marcus has been with the Exchange since 1994. During this time his various roles have focused on primary markets development and the management of the Exchange's relationships with the corporate advisory community in the UK and overseas.

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