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# AIM: A True Alternative for US Companies?

By
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## Introduction

2005 was another record year for AIM (formerly known as the Alternative Investment Market), the junior market of the London Stock Exchange. Past criticisms of the market—lack of liquidity, insufficient number of companies and lack of credibility—are for the most part no longer justified. Originally intended to be a stepping stone for smaller growing companies onto the main market of the London Stock Exchange (LSE), a number of mature, mid-cap companies (as well as others) have selected AIM as the appropriate market for their initial public offering (IPO). A number of companies have in fact moved from the LSE to AIM.

AIM was established to accommodate the needs of smaller high-growth companies (the majority of companies listed on AIM have a market capitalization of less than £250 million) and its regulatory regime is tailored to those issuers. AIM has no minimum market capitalization requirements (except in the case of investment companies) and does not impose any requirements on the company's trading history, the number of shares in public hands, or the pre-vetting of admission documents (unless an offer of securities is being made to the public, as described below).

AIM is now becoming increasingly international. Of the 1,579 companies listed on AIM, 282 companies are international. In the first eight months of 2006, 298 companies joined AIM, of which 80 were overseas companies (35 of which are US companies), raising approximately £6 billion. Of the companies joining AIM during such eight-month period, approximately 50 were in the technology and life sciences sector, raising approximately £429 million. On October 8, 2006, *Financial Times* reported that over 100 technology companies based in the Silicon Valley have been considering listing on AIM.

## A reaction to Sarbanes-Oxley?

Non-US companies that may have previously listed on Nasdaq now routinely consider AIM as a potential market for an IPO. The much discussed demands and costs of compliance with Sarbanes-Oxley and other US securities laws, particularly for small- and medium-sized companies, now make listing on AIM an attractive alternative for US companies.

In comparison to US securities laws and regulations, AIM has a lightly regulated reporting and corporate governance regime, which can reduce the costs and

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time in effecting an IPO and ongoing compliance. In addition, AIM is also attractive to companies that are seeking to go public at a much earlier stage than companies that may be considering an IPO on Nasdaq.

## Other Reasons to List on AIM

Many companies choose AIM because they can enjoy many of the benefits of a company listed on the LSE's main market but with less onerous disclosure and regulatory requirements.

In addition, the principal reasons for a company to admit its shares to trading on AIM are:

- To provide opportunities for raising equity both at the time of admission and in the future. Indeed a number of venture capital-backed companies have chosen AIM as an alternative to raising further funding by way of another private venture round.
- To enable existing shareholders to realize all or part of their investments. For example, an AIM listing provides venture capital investors with an exit route. However, where the IPO is used as a further venture financing round, then the venture capital investors will often not be seeking an exit at that stage. In any event, venture capital investors and certain substantial shareholders may be restricted from selling their shares for a period after admission, as described below.
- To place a value on the company.
- To raise the company's profile in the industry in which it operates.
- To strengthen employee commitment through the participation of employee share ownership schemes. Options to own tradable securities are generally more appealing to employees.
- To secure analyst coverage. While Nasdaq has grown into a very successful market, small to mid-cap US companies are not getting the attention they once did from analysts. Given that AIM mainly comprises small to mid-cap companies, a company is likely to be much more visible when listed on AIM than it would otherwise be if it listed on Nasdaq.

## Eligibility for AIM

Before being admitted to AIM, and at all times after admission, a company must comply with all of the following:

- It must be legally established under the laws of its place of incorporation and able to offer shares to the public.
- The shares to be admitted must be freely transferable, eligible for electronic settlement and all other issued shares of the same class must be admitted.
- It must publish accounts that conform with International Accounting Standards. If company is incorporated outside the European Union, it can publish accounts that conform with US GAAP, Canadian GAAP or Australian International Financial Reporting Standards.
- It must appoint and retain at all times Nominated Adviser ("Nomad") (as described below) and at least one broker.

In certain cases (for example, where a company has not earned revenue for at least two years) it is a condition of listing that all directors (and their families) and certain employees who hold any interest in the company and certain substantial shareholders must agree not to dispose of their shares for at least twelve months following admission to AIM. In any event, even where the company has revenue and is independent, the Nomad will usually require, in order to maintain an orderly market, directors and substantial shareholders to agree not to sell their shares for a certain period of time, often at least 12 months.

## Nomads

Companies seeking a listing on AIM must appoint a sponsor, called a "Nominated Adviser" or "Nomad," to assess the suitability of the company for listing. Nomads have a duty to review companies before approving the application for admission to AIM.

Once admitted, the company must retain a Nomad to ensure the company is aware of its continuing obligations: principally, the disclosure of information

to investors. The Nomad will also review the company's trading performance and financial conditions against any profit forecast, estimate or projection that has been made public.

## The Admission Process

**Prospectus Rules**

On July 1, 2005, new laws and related regulations were introduced (based on the EU Prospectus directive), which regulate the issue of prospectuses in the UK. The Prospectus Rules require that any company wishing to:

- Offer transferable securities to the public in the UK (i.e., essentially a retail offering) or
- Seek the admission of transferable securities to trading on a regulated market in the UK (which for these purposes, excludes AIM)

must publish a prospectus relating to those securities which has been approved by the Financial Services Authority (FSA), which is the UK equivalent of the Securities and Exchange Commission (SEC).

However, the publication of a prospectus is generally not an issue on AIM flotation because most are effected by way of an "institutional placing" (effectively a private placement) and as a result, a prospectus is not required. Instead, the AIM Rules require a prospective AIM company to publish an admission document.

**Admission Document**

An admission document contains much of the information that would generally be included in a prospectus although important from a timing and costs perspective, it does not need to be approved by the FSA. Instead the admission document is reviewed by the Nomad, the company and its advisers with the directors of the company taking legal responsibility (and corresponding potential liability) for contents of the document.

The admission document must contain all such information as is necessary to enable investors to make an informed assessment of:

- The assets and liabilities, financial position, profit and losses, and prospects of the company and of any guarantor and
- The rights attaching to the securities.

One disadvantage of preparing an admission document as compared to an FSA approved prospectus is that, subject to compliance with certain formalities, an FSA approved prospectus will be treated as having been approved by the authorities of other European Economic Area states and it may therefore be published in such states without the need to obtain any further approvals. Therefore an FSA approved prospectus, but not an AIM admission document, could be used by a company to also list on other European Exchanges.

**Timetable**

As noted above, admission to AIM is usually structured as a private placement, and the admission document therefore does not have to be vetted and approved by the FSA. A company which meets the AIM criteria and is seeking to raise funds by way of a private placement can feasibly be admitted to trading within three months of first appointing its advisers.

## Specific Issues for US Companies

**Structure**

Provided that a US company is eligible to list on AIM, it may list regardless of its actual domicile. Some US companies have introduced a UK public holding company structure before listing, in order to create European credibility. However, a UK holding structure will not be appropriate or advisable in all instances and may have significant tax issues for some of the existing US resident shareholders.

**"Fast Track" for International Companies**

As a further incentive to attract more companies, AIM has introduced a "fast track" listing procedure for overseas companies already trading on Nasdaq and other selected worldwide markets. It has yet to be seen whether this procedure will result in many US public companies listing on AIM, either by way of a dual listing (on Nasdaq and AIM) or a complete migration

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(by way of a dual listing followed by Nasdaq delisting). Because US public companies may still have significant continuing US compliance requirements following a Nasdaq delisting, it seems unlikely that there will be a flood of US public companies migrating exclusively to AIM.

### Other Considerations

Prior to listing on AIM, a US company should consider the impact of inadvertently becoming a US reporting company. If a US company listed on AIM (and not listed in the US) has 500 or more shareholders worldwide and its total assets exceed $10 million, then it will be required to register under the Securities Exchange Act of 1994 with the SEC. Once a company registers with the SEC, it must file the periodic reports required of any US public company.

US companies seeking to list on AIM therefore need to evaluate, with the assistance of their advisers, the commercial impact these regulatory obligations may have on the marketing of an IPO and on the future liquidity of the company's shares following an IPO on AIM.

### Settlement

The restrictions on sales and resales of a US company's shares on AIM vary depending upon whether the shares were issued prior to or at the time of the IPO on AIM.

US companies listing on AIM typically have two different pools of shares:

- The shares issued by a US company prior to an IPO on AIM are typically issued pursuant to an exemption from registration with the SEC. Generally, such shares are restricted securities and not freely tradeable. Following such an issuer's IPO, such shares may remain subject to resale restrictions and share certificate legend requirements, as prescribed under the exemption under which the shares were initially issued.
- The shares issued by a US company in an IPO on AIM will be exempt from registration with the SEC pursuant to Regulation S (Reg S). However, to ensure that such shares do not re-enter the US through resales, the share certificates must be marked with legends that describe the transfer restrictions during the one-year after issuance.

Trades of shares listed on AIM are typically made through the CREST electronic settlement system (similar to settlement system of the Depository Trust Company in the US).

To address the transfer restriction issues created by these distinct pools of shares, the shares of US companies had to be traded in certificated form and could not be placed into CREST while the transfer restrictions existed. This need for certificated shares has, in the past, had a negative impact in the trading liquidity of a US companies shares. This is now less problematic as UK investors have become more familiar with this requirement.

### New Settlement System

Earlier this year, the LSE announced the introduction of new rules which facilitate electronic settlement of trades on AIM in shares of US companies that are subject to Reg S. The new electronic settlement service is being offered by SIS SegaInterSettle AG (SIS).

Only brokers participating in SIS will be able to use this system. The purchasing broker is required to enter the nationality of the purchaser into a special field, known as a "nationality tag," into its computer system. This information, together with the rest of the settlement instructions, will be transmitted to SIS. If the information in the nationality tag confirms that the purchaser is not a US person, the trade will be permitted to settle; otherwise, the trade will be rejected.

Under the terms of the agreements between SIS and its participants, the transmission of information in the nationality tag constitutes a representation that:

- The information is true and accurate
- The person transmitting the information maintains information systems sufficient to permit the accurate identification of the nationality of the

person on whose behalf the securities are being acquired

- In addition, the agreements provide that the transmission of information in the nationality tag other than "US" constitutes a certification and an agreement by or on behalf of the purchaser in the precise terms required by Reg S

It should be noted that while the new settlement service will facilitate compliance with the non-US purchaser certification and agreement provisions of Reg S, it will not affect the substance or compliance with the other Reg S requirements. Compliance still remains the responsibility of the issuer.

## Continuing Obligations

Once listed on AIM, the ongoing reporting and corporate governance requirements are not particularly onerous when compared with Nasdaq and the main market of the LSE.

The general duty of disclosure for AIM companies is that they must announce without delay any new developments which are not public knowledge concerning a change in the company's financial condition, its sphere of activity, performance of its business or its expectation of its performance which, if made public, would be likely to lead to a substantial movement in its share price. Such information must be notified to a Regulatory Information Service (otherwise known as being "sent down the wire") no later than it is published elsewhere. The company must ensure that such information is not misleading, false or deceptive and does not omit anything likely to affect the import of such information.

Other key requirements include:

- Retention of a Nomad and at least one broker at all times
- Preparation of half-yearly and annual report and accounts. There is no requirement to report quarterly results
- Restrictions on buying and selling of shares by directors and applicable employees during blackout periods
- Announcement of share trades by directors.

On October 2, 2006 the LSE published a consultation document on proposed amendments to the AIM Rules (as well as rules relating to Nomads). The proposed amendments would require any company listed on AIM to publish certain information on its website, which would include the following:

- Directors' biographies and an explanation of their individual responsibilities
- Details of the company's country of incorporation;
- Details of any other stock exchange on which the AIM company's shares are traded
- The percentage of shares not in the public's hands and details of any significant stockholder
- In respect of non-UK companies, a statement that the rights of stockholders may be different from the rights of stockholders in a UK company
- Details of any restrictions on the transfer of shares
- The company's annual report and accounts
- All regulatory announcements made by the Company within the last 12 months
- Any prospectus, circular or admission document issued by the company in the last 12 months and
- Details of the Nomad and any key adviser.

The consultation ends on December 1, 2006, and any new changes are likely to be effective in the early part of 2007.

## The Benefits of Listing on AIM

The benefits of listing on AIM can be summarized as follows:

- Global market
- As it is a market designed for innovative, high growth companies, AIM companies tend to attract a greater level of interest among investors and

analysts than similar companies on the main market or Nasdaq

- No minimum market capitalization
- Admission documents are not required to be pre-vetted and approved (reducing time to market and costs)
- No minimum number shares need to be held by the public
- No trading record requirement
- No prior shareholder approval for acquisitions (other than reverse takeovers or transactions that result in a fundamental change of business)
- Fast admission process
- Low cost of admission
- A more relaxed regulatory environment than the LSE's main market; and
- Tax breaks for UK investors.

## The Drawbacks of Listing on AIM

AIM listing may have drawbacks, as follows:

- AIM has a reputation for being illiquid and as a result investors may only achieve a partial exit. However, recent studies have shown that AIM is increasing in liquidity and is a highly liquid market for small-cap companies.
- Difficulty in raising further funds. In the past, some companies have, after listing on AIM, experienced difficulties in effecting further fundraisings. However, this again has become much less of a market issue over recent years and now has become, as on other markets, an issue of whether or not a particular company is doing well.
- Poor post-IPO performance. A recent study of technology companies listed on AIM suggests that the post IPO price of AIM shares does not hold up as well as companies on Nasdaq.
- Some commentators have noted that after an initial spike, the valuations for AIM companies are generally lower than those achieved on Nasdaq.
- As AIM is maturing, the investment profile is also changing to larger, less risky companies.
- AIM requires the directors and substantial shareholders of companies with a less-than-two-year trading history to be locked-in for one year from admission.
- Unlike Delaware law, UK statute provides pre-emptive rights to existing shareholders in connection with most issuances of stock. The Nomad may require a contractual agreement that a US company listing on AIM offer pre-emptive rights to existing shareholders.
- US companies listed on AIM are not subject to the UK Takeover Code. However, anti-takeover provisions common in Delaware may not be viewed favorably in the UK.

## Transparency Directive

It should be noted that companies listing on AIM may soon be subject to the EU Transparency Directive. All EU Member States are required to implement the Transparency Directive no later than January 20, 2007. The purpose of the Transparency Directive is to enhance transparency in the European markets in order to improve investor protection and market efficiency. This is to be accomplished by establishing rules on periodic financial reports and other continuing reporting obligations, and the disclosure of major shareholdings for issuers whose securities are admitted to trading on a regulated market in the EU.

Under the proposed regime, an issuer of securities admitted to trading on a UK-regulated market would be liable to pay compensation to a person who has acquired such securities and has suffered loss in respect of them as a result of untrue or misleading statements in, or omissions from, periodic information required to be disclosed by the Transparency Directive.

The Transparency Directive itself applies only to companies listed on the main market of the LSE. However, on August 9, 2006, legislation was proposed to extend the new form of statutory liability of the Transparency Directive to all publications made by AIM companies.

Some industry organizations are campaigning against the proposed application of the new liability regime to AIM companies, and it remains to be seen if this will actually be brought into force and if so, what effect it will have on the attractiveness of AIM.

### Can AIM Compete with Nasdaq?

Through the collapse of other junior markets in Europe, the widening of its potential investor base and increased liquidity, AIM has become the primary market in Europe for growth companies, and has positioned itself as a potential alternative for companies that would previously have considered Nasdaq as a natural home. However, if AIM is to establish itself as a true competitor to Nasdaq for growth companies it faces the challenge over the coming years of ensuring that it retains its attractiveness in light of the increasing pressure on the European Union to impose stricter regulation and disclosure requirements on its markets, such as the Transparency Directive. Whether or not this happens, more and more US high-growth companies are now looking to AIM as a serious alternative to Nasdaq. ◎

## Private Equity Investments in China

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a Chinese identity card or passport or who habitually resides in China because of economic interests. Circular 75 defines "control" broadly (without any qualification) to include the right to operate, *to benefit from*, or to decide the policies of an SPV or a Chinese company. In addition, Chinese management has an ongoing obligation under Circular 75 to disclose any material corporate transactions completed at the offshore holding company level. A violation of any of these rules may not only subject a Chinese management member to a penalty by SAFE for foreign exchange evasion, but may also potentially hamper the onshore operating company's remittances of dividends to the offshore SPV.

### Exit

As in all other private equity markets, a private equity investor in China must carefully consider and employ the most flexible and efficient structure for various possible exit scenarios from the commencement of an investment transaction. In light of extensive government involvement (i.e., required approvals) and the potentially applicable taxes (e.g., 10% capital gains tax on the sale of shares of a Chinese company), however, such consideration is even more critical in Chinese private equity deals. Typically, this requires forming an offshore investment structure prior to making the Chinese investment. Such a structure usually involves formation of one or more holding companies in a tax haven (such as the Cayman Islands or British Virgin Islands) or in a jurisdiction with a favorable tax treaty with China (such as Barbados or Mauritius) to acquire and hold the Chinese target company. Although such a structure entails some additional administrative burdens, they do not exceed those typically incurred by foreign private equity funds investing in other jurisdictions (e.g., U.S. private equity investors investing in European target companies via structures involving holding companies in the Cayman Islands and Luxembourg). Because in such a structure either a trade sale or an initial public offering exit occurs at the holding company level, it