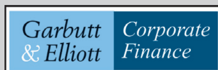
12 years on: the state of AIM in 2007

in association with:

Phil Adams
0161 831 9133
phil.adams@altium.co.uk

Mike Jeffrey
01534 822370
mike.jeffrey@careyolsen.com



Richard Feltham
0113 2739 600
rfeltham@garbutt-elliot.co.uk

Russell Kelly
01624 681000
russellkelly@kpmg.co.im

Richard Metcalfe
0207 220 3379
richard.metcalfe@mazars.co.uk

Mark Chambers
01534 784030
mark.chambers@ozannes.com

Clive Brook
0161 832 5481
clive.brook@uk.pkf.com

Smith & Williamson

John RL Cowie
020 7131 4333
john.cowie@smith.williamson.co.uk

Peter Bradley
020 7809 2156
peter.bradley@shlegal.com

AIM's 12th birthday was crowned in style when, for the first time, the total market cap of companies listed on the market smashed the £100 billion mark. Fuelled by an influx of international companies and large property funds, the average market cap on AIM now stands at over £60 million, a far cry from the growth company market it was intended to serve. In this in depth analysis Corporate UK talks to a group of leading AIM advisers about the key developments of 2007.

Despite AIM's total company market cap passing the £100 billion mark, new admissions have faltered this year. Between 2003 and 2006, the number of companies listed on AIM doubled, such was the demand from the UK and overseas, and the apparently insatiable appetite of AIM investors. However, the IPO frenzy did not please all and by the end of 2006, concerns were growing amongst investors over the quality of the companies that had come to the market.

Being a dynamic and flexible market, AIM quickly reacted to these concerns. Last year the AIM team codified the rules for nomads ensuring that the focus of admissions was on quality and not quantity. Phil Adams, managing director of Altium Capital, said: "The move by the LSE was as a result of concerns about the quality of companies on AIM. Nomads have to understand a company in order to take it to the market, and some of the complications were perceived to have arisen when certain more cavalier firms may not have taken full steps to understand the company and therefore did not have fully addressed the risks associated with their clients.

"Investors in AIM are not totally risk averse, many invest in AIM in order to take a risk and potentially the reward that comes with that risk. Provided a company is properly described, investors can make informed decisions."

A rise in secondary listings

After the IPO boom seen between 2003 and 2006 it is perhaps not surprising that 2007 saw a significant reduction in the number of admissions. Indeed, in H1 2007, only 174 companies listed on AIM, compared with 236 in H1 2006 and 226 in H2 2006.

Despite there being fewer admissions, AIM companies look set this year to raise more money than in any previous year. To the end of August, over £12 billion has been raised in 2007, compared with £15.6 billion in the whole of 2006.

Mazars floated Burani Designer Holdings this year. The company, which invests mainly in operating companies active in the Italian lifestyle luxury market, raised over £67 million giving the firm a market cap of £440 million, making it one of the largest flotations this year outside the fund sector.

Richard Metcalfe of Mazars explained the motivations for the company choosing AIM over the Official List: "The company operates in the luxury designer clothes market in countries such as Russia, China and Japan. AIM has a good track record of attracting interest from

these emerging economies in terms of both consumers and investors. The roadshow was international and AIM is a truly international market attracting investors across the world."

According to statistics released by Grant Thornton, secondary issues have generated more than £2.62 billion in April and May alone, equivalent to 46% of all AIM secondary issues for the whole of 2006. At the half way point of 2007, secondary issues are set to exceed the £4.3 billion raised during the whole of 2006 as successful AIM issuers returned to the market for new capital.

John Cowie of Smith & Williamson said that this was a positive sign in the market: "The rise in secondary fundraisings is a sign of the good health of the market as it is indicative that companies are following their business plans and retaining the confidence of their investors."

Mr Adams agreed: "The rise of secondary fundraisings is a positive for AIM. The market goes in cycles where fund raising becomes more difficult. This year has been good for secondary fundraisings, but it is not necessarily a bad thing if the bottom 30% of companies looking to float on AIM cannot access the market."

The trend towards secondary listings is a sign of investors' faith in their existing portfolios as much as their reluctance to take on new companies. By its very nature AIM is a market for growth companies and many need to return to the market for financings in order to explore new markets or continue their expansion.

Funding the funds

During April, May and June, property and private equity investment funds dominated the amount of capital raised on AIM with almost 50% of new funds raised at admission for investment vehicles, in particular in the property sector. This figure is, in part, due to their size, with many raising up to £500 million upon admission but it reflects investors' appetite for such funds which has enabled 57 financial companies to come to AIM, accounting for 33% of all listings.

However, the glut of listings has not come without some concern. Property funds listed on AIM do not have the same debt restrictions as those on the Official List meaning that some companies are listing with loan-to-value ratios of nearly 100%, which could spell trouble with rising interest rates.

Mr Metcalfe explained: "Property investment funds are heavily geared to enable them to invest in more property. The key issue is to what extent property prices will rise in different countries. Eastern Europe was hot last year as was Germany but these markets have cooled, Germany's growth rates have flattened and Eastern Europe has had an enormous amount of money invested there.

"It is no coincidence that we have seen a drop in funds in Eastern Europe as property funds stabilise. In its place are property funds focusing on emerging economies in Asia where standards of living are improving in line with wealth creation. There is still scope for a number of property funds operating in China."

Mr Cowie agreed but said there will be a slowdown in admissions: "There will come a time when the market is saturated, as happened in the resource sector. Despite high natural resources prices, there came a time when investors moved away from new listings. I think the same may happen with property funds if they continue to list at the current rate."

AIM sailed into stormy waters in 2003 when the trend for cash shells, companies incorporated to acquire others, soured leaving many shells on the market leaking cash to its directors with little or no acquisition activity. There is a concern that property investment funds could go the same way.

However, Mr Cowie argued that the market had matured since the cash shell debacle: "The cash shell legislation that came into force in 2005 was designed to clean up the growing number of inactive or 'dirty shells'.

"The property funds that are coming to AIM now are led by directors with a proven track record and a solid business plan, raising substantially higher sums than the problematic cash shells. AIM investors are also more sophisticated than they have ever been."

Clive Brook of PKF (UK) LLP said: "Property funds are a major feature of the FTSE market consequentially I do not see why they should not be so on AIM. Companies that have too much debt will fail wherever they are listed and it is a fault with the company and not the market. The United States property market serves as a warning to property investors across the globe."

It may well be that soon AIM investors will not have to consider these concerns. In November this year the LSE will launch the Specialist Funds Market (SFM). The SFM will be dedicated to highly specialised investment entities that wish to target institutional, professional and highly knowledgeable investors.

The LSE sees the establishment of the SFM as an alternative to a full listing on the Main Market in light of the consultation on the proposed closure by the Financial Services Authority (FSA) in March 2008 of the light-touch Chapter 14 listing regime for foreign based investment funds.

The initiative represents a bid by the LSE to uphold London's attractiveness as a venue for the listing of alternative asset funds and take the competition to Euronext Amsterdam which has attracted the likes of Apollo Management, Boussard and Gavaudan, KKR and Marshall Wace.

Mr Metcalfe said that the impact of the SFM on AIM will prove interesting: "Many of the funds that have listed on AIM will certainly look at SFM as an alternative. The LSE will be keen to attract investors' and advisers' interest in the market, which may well lead to a drop off of funds coming to AIM."

International companies

In October 2004 AIM celebrated the listing of its 100th overseas company. It took a little over 12 months to double the figure that had taken almost a decade to reach. Since then, overseas companies have flooded to the market.

To the end of July this year, 51 companies had listed on AIM from outside the UK. If we include all overseas companies including those listed through a UK umbrella company, well over 400 international companies are currently listed on AIM.

John Cowie said: "The increase in average market cap of companies coming to AIM has continued in 2007 driven principally by the influx of larger international companies. Only one of the last eight companies we have taken to AIM has been UK-based. AIM is seeing more and more interest from overseas."

After a slow start to 2007, with just 10 overseas companies listing on the market in the first quarter, May proved to be a busy month with 14 listings, the third highest number in the last 18 months and, more significantly, the first month ever where overseas listings exceeded those from within the UK.

Russell Kelly of KPMG in the Isle of Man said: "Sarbanes-Oxley is one of the drivers of AIM's interna-

tional success. There is an expensive cost of compliance at the moment. Quarterly filing, the use of US GAAP, a US lawyer and accountant all add significantly to the audit costs which means that a company has to be of a certain size in order to list in the US."

Indeed, US interest in AIM has defined the rise of its international reputation. The number of US quoted companies doubled in 2005 and almost doubled again in 2006. Today, there are 48 US companies listed on AIM and a further 15 or so listed through a UK holding company. Nasdaq has proved the traditional home of US growth companies but, recently, AIM has been stealing a march on its US rival.

However, SOX is often given too much credit for the US interest in AIM. According to statistics released by Cannacord Adams, the cost of listing a $200 million market cap company on AIM is only 25% less than that of Nasdaq. In addition, a US company with a certain number of US shareholders listed on AIM will also be bound by SOX.

Mr Metcalfe added that there has been a slowdown in US listings on AIM this year: "It will be interesting to see what happens when Nasdaq gets its teeth into Alternext. Most US companies would initially look to the home market to fulfil their needs and use AIM to diversify their international investor base.

"The US is reviewing the regulation issue and trying to persuade US companies to stay on home soil. Having said that we are still getting a number of enquiries from the US and there has been an uplift in Asia, Africa and South America."

International law firm Stephenson Harwood has been at the forefront of AIM's internationalisation and recently taken a number of Indian companies to AIM. In June the firm advised on the Indian film industry's first ever AIM listing, a £55 million IPO of The Indian Film Company Limited. The fund was launched by the Indian media and entertainment group TV18 to make investments in both Indian films and films primarily targeted at Indian audiences.

Peter Bradley of the firm said: "AIM's success in India and the Far East is largely down to the work that the AIM team have put in. They have been actively marketing AIM across the world and AIM's consquential success internationally is testament to their efforts.

"In July we took two Malaysian businesses to AIM. This is an interesting growth area and we expect to see more interest from the country. Malaysian companies are attracted to the prestige of a London listing and we are able to serve their needs from our network of office in Singapore."

Move to the main market

AIM was initially perceived and designed as a stepping stone towards the Official List. The idea was that smaller growth companies would learn the ropes on AIM before moving up to the main market to attract the funding capabilities of the institutional investors.

Despite this intention, AIM companies proved reluctant to move to the Official List, and who could blame them? As AIM became more successful investors moved to AIM meaning that a company could list on a more flexible and less expensive market and still attract significant investment.

Indeed, companies moving from the Official List to AIM became the overwhelming trend after the dotcom bust. Between 2001 and 2006 212 companies moved down compared with only 20 who moved up. 2007 has seen a dramatic turnaround in this trend. To the end of July, eight companies have moved up, with three going the other way.

John Cowie explained the trend: "Bigger businesses are being persuaded to go to the Official List by their investors. The regulatory requirements of AIM suit smaller companies but, once a company grows to a certain size, a lot of the differentiators between AIM and the Official List fall away. There is an increased ongoing cost associated with being on the Official List but this becomes less of an issue the larger you become.

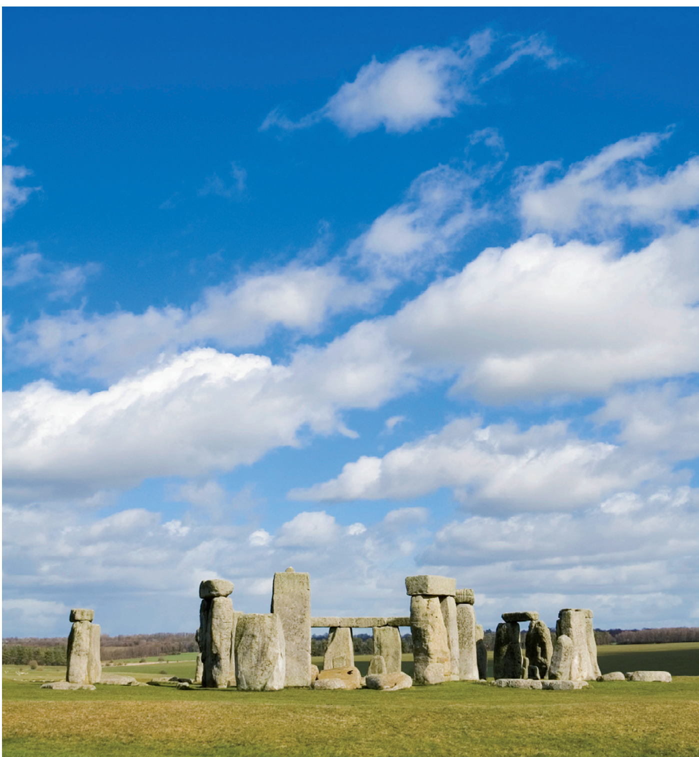
"A large investment fund may have a mandate to invest in AIM but the proportion of its fund earmarked for AIM is likely to be considerably smaller than that earmarked for Full List companies. As a consequence, by moving up to the Official List, a company may get access to a far greater proportion of its investor's funds under management."

However, it is unlikely we will see an exodus. Last year Altium floated May Gurney, an integrated support and construction service provider. With a market cap of over £200 million, May Gurney would not be out of place on the main market. Mr Adams believes that, considering the tax advantages on AIM, there is still a significant advantage for a company such as May Gurney on AIM:

"AIM is a riskier market than the full list and companies that are solid and profitable have high PE multiples as a result," he said. "The larger insti-

With the right team, anything is possible.

Garbutt & Elliott Corporate Finance



Garbutt & Elliott Corporate Finance - Aiming High

■ Contact Richard Feltham ■ Leeds 0113 273 9600 ■ Web www.garbutt-elliott.co.uk ■ Email rfeltham@garbutt-elliott.co.uk

tutions look for the gems on AIM and therefore some of the more successful companies on AIM have benefited more than they would on the main market."

Squeezing out the smaller companies?

As has been noted, the influx of funds and international companies, as well as the traditional reluctance to move to the Official List, has led to a significant increase in the size of companies on AIM. As the size of the companies increases, so too does the cost.

A recent study by Trowers & Hamlins has found that the average cost of listing on AIM has increased to 6.23% of all funds raised. On the surface not a substantial increase from the 6.11% the previous year. However, at the lower end the cost has rocketed. The study found that a company looking to raise less than £2 million can expect to pay 37.3% of total funds raised, an increase of 58% on the previous year.

As a result, many critics have argued that AIM has shut its doors to the UK market that it was intended to service. Mr Brook said that this criticism was not valid: "I don't think it is the case that UK companies are not getting a look in on AIM. As AIM has been around for 12 years many of the companies that are suited to AIM have already listed on the market, it is not the case that suitable UK companies are being squeezed out. We are still seeing UK companies coming to AIM."

Mr Metcalfe agreed: "It is unlikely that there are any hidden gems in the UK. Those companies that are suited to AIM would undoubtedly have considered it and discussed it with their advisers. This will mean that we will continue to see a higher percentage of international companies on AIM."

However, Mr Brook added that the move away from early stage technology investment was unfortunate: "AIM has a big role to play in the development of these companies and if nomads are getting nervous about putting these companies on to AIM, that is of detriment not only to these companies but also to the market as a whole."

Phil Adams believes there is still scope for smaller companies to list on AIM: "Although many brokers such as ourselves have primarily focused on larger listings there should still be scope for a company to raise below £10 million on AIM. AIM works well; there is a good mix of businesses in terms of sector and size.

"There are a lot of regional private equity funds that are active at the moment and they have filled the gap that AIM left in the smaller listings. AIM remains a viable market for companies looking to raise £2 million as well as for companies such as May Gurney for whom we raised £45 million and who are now valued in excess of £200 million."

12 years on AIM is almost unrecognisable from the market that was founded in 1995. It has matured from a market for early stage companies to the world's leading growth market hosting over 1600 companies from across the globe. Its critics will say that it has betrayed the early stage market it was intended to serve, that its regulation is too lax to protect investors' interests, and that its current exposure to the property market threatens to destabilise the market as interest rates rise.

However, AIM has weathered many a storm and come back stronger each time the clouds have cleared. Its dynamism and flexibility have stood it in good stead and enabled it to attract quality companies from across the globe. Its 13th year may well prove to be unlucky, market conditions may worsen still and international stock market consolidation may see Alternext, its European rival now in the control of the NYSE, challenge for its crown but AIM's dominance will prove a very tough nut to crack.

A special relationship:
AIM and the UK offshore industry

As AIM attracts more and more international companies, offshore listings become increasingly popular. An international company will want to access the London market to raise funds, without falling into the UK tax net. In addition, investors are wary of loose legislature in some jurisdictions and unwilling to invest in some companies as a consequence. We talked to some leading offshore advisers about the relationship between AIM and offshore jurisdictions.

Many larger international companies and funds, which are predominantly incorporated to invest in overseas assets especially in overseas property, are structured through offshore jurisdictions to take advantage of the tax benefits and to be incorporated in a well respected jurisdiction. UK jurisdictions are more reliable and transparent than many other jurisdictions and are ever more popular with companies and investors alike.

Tax benefits

"The Channel Islands are well known and well (but not over) regulated jurisdictions," said Gavin Farrell, partner at the Channel Islands based law firm, Ozannes. "The Channel Islands regulatory framework is clear and well known to AIM investors and, by virtue of their strong back-office industry, the Channel Islands have developed a high level of expertise in administering AIM admitted products."

Mike Jeffrey, a partner at Channel Islands firm, Carey Olsen agreed and said that Jersey had experienced a boom of AIM related work over the past few years: "We work with companies from across the globe.

"However, different countries have different regulations. In India, for example, a company looking to list overseas must list in India first as a general rule. By putting a Jersey company on top of the Indian company we can overcome this rule. This is just one way that we can offer a tax neutral vehicle in order to enable the company to access AIM."

Russell Kelly of KPMG in the Isle of Man said that there had also been an upturn of interest in the Isle of Man over the last 18 months as a result of the new taxation regime that has been introduced: "Companies are attracted to the tax regime of a tax efficient jurisdiction such as the Isle of Man which also has a well respected legal and regulatory framework. For example a property company can trade without paying Isle of Man tax and therefore can pay a dividend gross without withholding tax.

"In recent years the offshore industry has grown significantly and the advisory community has grown to support it. All the major accounting firms are based offshore and there is also a large number of quality legal advisers.

"Our AIM work is varied, we deal with trading companies that are looking to expand or where owners wish to partially exit, and in addition we also do a lot of fund related work. Over the last 12-18 months we have worked with fund managers specializing in the emerging markets which is an interesting growth area."

Reassurance for investors

Aside from the tax benefits of listing overseas, for emerging market companies, there are also other considerations creating a keen interest in AIM. Investors are less likely to invest in such a company where issues such as corporate governance are unfamiliar or unclear, and it would not otherwise comply with the AIM regime.

Mark Chambers, partner of Ozannes said: "There was a vogue last year for Chinese companies to list on AIM through holding companies based in Jersey. They are attracted to the tax efficiency but also to Jersey and Guernsey because they are well regulated jurisdictions. In the Channel Islands we have a pool of sophisticated directors that are available to sit on the boards of companies that can bring experience and add value to the board."

Switching sides

One other interesting trend that is gathering pace is the tendency for some AIM listed companies to restructure their group through the Channel Islands, essentially delisting and relisting the company under a different domicile jurisdiction through scheme of arrangement.

One such company is the International Marketing and Sales Group, which switched its listing from Ireland to Jersey in June. Mike Jeffrey, who advised the company explained: "Essentially the deal saw all the shareholders swap their shares in the Irish company to shares in the Jersey company. That was interesting as it is an example of a company that began life on shore but moved offshore. It is a complex process but the potential benefits are huge."

Mr Chambers said that he expected to see more of this type of transaction: "Some UK listed companies have found that it is more efficient to structure their company through a Jersey holding company. We have had a number of enquiries from UK groups looking to move ownership of their structures to Jersey.

"This interest is driven in part by the regulatory requirements placed upon them by the UK, in particular in relation to pension plans and employee benefit schemes, and the capital requirements that these regulations bring.

"A company has to be of a certain critical mass in order for listing through Jersey to be viable. There is a degree of cost and Jersey has a well developed regulatory framework. However, mid sized companies may find it cost effective due to the tax efficiencies available."

The same has also been seen in the Isle of Man, with a number of AIM listed companies currently in the process of moving to the Isle of Man

The UK offshore industry has boomed over the past five years as the local advisers develop ever more complex and beneficial structures and products for their clients. The relationship between AIM and these offshore centres has blossomed due to the interest from overseas in AIM. However, more and more UK-based companies are choosing to restructure their assets offshore to harness the tax benefits and fully streamline their operations.