

**CAPITAL BEAT**

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 PRINT

# Capital Migration



Foreign exchanges persist in a drive for U.S. listings. They're a venue for small-cap IPOs that's tough to find at home.

February 2010 | by [Dave Beal](#)

For much of the past decade, stock exchanges in Toronto and London have tried to attract small-capitalization companies based in the United States. They don't have much to show for their efforts, but don't expect them to stop trying

anytime soon.

Consider TMX Group, which includes the Toronto Stock Exchange and its baby sister, the TSX Venture Exchange. Last November, TMX brought its road show back to Minneapolis for an event that featured two panel discussions and private meetings with listing prospects. TMX plans to send its recruiters to the city again in 2010.

Then there's Mark McGowan, who runs AIM Advisers, a California-based consultancy that represents AIM, the London Stock Exchange's Alternative Investment Market for small caps. McGowan is crisscrossing the country to explain the workings of AIM in face-to-face meetings with small-business executives and the professionals who handle their legal and financial affairs. He has penciled in a visit to the Twin Cities this spring.

These two exchanges differ in many ways. "Small" is larger for AIM, where listed companies' average capitalization is around \$69 million. It's only \$16 million on Toronto's Venture Exchange, where companies are generally in earlier stages of development.

But advocates for both AIM and TSX Venture have one thing in common: They share a belief that for many reasons, the U.S. capital markets for publicly traded companies are not functioning well enough at the smaller end of the market. Both want to be the needed alternative.

## Minding the Gap

"We see a gap in the capital markets that we're filling," says Ungad Chadda, senior vice president of the Toronto Stock Exchange.

Studies of initial public offerings, done for the Grant Thornton accounting firm this year, define the gap. The latest of these reports is highly critical of the U.S. capital markets.

David Weild, founder of the New York firm Capital Markets Advisory Partners and a former vice chairman at Nasdaq, co-authored the reports. He found that by 2008, listings on the three major U.S. exchanges (New York Stock Exchange, Nasdaq, American Stock Exchange) had fallen 55 percent, adjusted for growth in the economy, from their peak in 1996. That was by far the worst showing among eight of the world's leading stock exchanges.

The near extinction of small IPOs—those raising less than \$25 million—has caused much of the decline in exchange listings in Minnesota and the rest of the country. Weild calls this a “market structure” problem—the unintended consequence of a series of industry, regulatory, and technological shifts that sharply lowered investors’ trading costs and in turn choked off the resources that paid for research and trading in the stocks of small companies. This was the mother’s milk that enabled tiny companies to go public and allowed a fortunate few to morph into tomorrow’s Medtronic and Best Buys.

Weild concludes that the U.S. faces a first-class market failure that’s costing America millions of jobs. He is urging U.S. securities leaders to create a new market custom built to serve smaller companies.

## **A Hard Sell**

So far, moving into the vacant space that the public market isn’t serving in the U.S. has proven difficult.

AIM, born in 1995, worked with the Faegre and Benson law firm to make presentations in Minneapolis in 2004 and again in 2005. Today, McGowan says, only about 60 of AIM’s roughly 1,320 listings are U.S. companies, none from Minnesota.

Toronto’s Venture Exchange got started in 2002, after TMX acquired the Canadian Venture Exchange in Calgary. Both of the TMX exchanges have targeted Minnesota because of its strong suits in technology and life sciences and its proximity to Canada. At present, 62 U.S. companies are among the 2,184 listed on the Toronto Venture Exchange, and only one—Rapid Brands in Chanhassen—is from Minnesota.

Rapid Brands, a franchisor that refurbishes and remanufactures printer and laser toner cartridges, went public in May of 2007 on the Toronto Venture Exchange. It was the first U.S. company to participate in the venture exchange’s “capital pool company” program. Under this program, Black Mont Capital, a Toronto investment firm, raised \$4 million for Rapid Brands in a deal that enabled the company to become public by merging with a shell entity already listed on the venture exchange.

Rapid Brands (TSX: RAP-V) has been hit hard by the recession, which led to store closings. Early on, its stock reached a high of \$3, but in November it was trading for only seven cents a share.

## **Getting More Attractive**

Companies on the Toronto Venture Exchange are subject to many of the same disclosure rules as in the U.S., but Rapid Brands CEO Roger Block estimates that his company would have spent \$500,000 more a year for compliance costs had it been listed in the U.S. rather than in Canada.

“It would have been out of the question to even discuss going public in the U.S.,” Block says.

Several mining companies active in Minnesota have raised money from the Toronto exchanges, including Washington-based Franconia Minerals Corporation, which hopes eventually to mine copper and nickel deposits near Babbitt. Franconia (TSX: FRA) went public on the venture exchange and then graduated to the Toronto Stock Exchange, raising a combined \$30 million from the two markets. New York investment bankers “won’t get out of bed for less than \$50 million,” says Franconia CEO Brian Gavin.

AIM Advisers’ McGowan used to be CFO of DDD Group, an AIM-listed company in California. He says the number of U.S. companies that have gone public on the AIM market “hardly scratches the surface” of what’s possible. In his prospecting efforts, McGowan targets companies with potential valuations ranging from \$80 million to \$400 million.

“Fear of the unknown” is one factor that foreign exchanges have to contend with, says Rick Brimacomb, a Twin Cities financial adviser who helped TMX drum up attendance for its latest Minneapolis event. But he believes that small companies locally are now more receptive to the pitches of foreign exchanges than they were five years ago, given the difficulty of doing IPOs domestically.

If he’s right, persistence might eventually bear fruit in Minnesota for foreign stock exchanges.

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Dave Beal has more than 30 years of experience writing for daily newspapers about business and corporate finance. He is semiretired from the *St. Paul Pioneer Press*.

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