



Corporate group

An introduction to AIM - the most successful growth market in the world

This guide is designed to give you an overview of AIM and to highlight the key issues to consider in deciding whether or not, and how, to participate in this dynamic market.

AIM, the secondary market operated by the London Stock Exchange, is now larger than the Official List, the principal London equities market. That, of course, is in terms of numbers of companies rather than size. It is the most active IPO market in the world.

WHY HAS AIM BEEN SUCH A SUCCESS?

A number of factors are behind AIM's success. The costs of entry, while not insignificant, are lower than on the Official List. By way of comparison with the Official List, there is no minimum proportion of shares that needs to be in public hands, no minimum market capitalisation requirement, no requirement for a

trading history (although the lack of a trading record may affect marketability) and the continuing obligations are less onerous.

THE NOMINATED ADVISER PLAYS A KEY ROLE

The rulebook for AIM companies is short and pretty straightforward; once on the market there are only a handful of rules to be observed. However, underlying these rules is the market practitioners' rule book – the Rules for Nominated Advisers. Every company whose shares are traded on AIM must have a nominated adviser. Nominated advisers need to be approved by the London Stock Exchange and are regulated by the Financial Services Authority (FSA).

By way of comparison with the Official List, the London Stock Exchange (which is not connected with, but is regulated by the FSA) delegates most of the regulatory function to the nominated adviser. Nominated advisers have to meet the standards imposed on them by the London Stock Exchange and, because of their regulated status, must comply with the FSA's Handbook. The success of the market depends on the proper commercial application of the rules by the nominated advisers; they are practitioners, not functionaries.

LIGHTER REGULATION

Significant changes in the operation of equity capital markets have resulted from the Financial Services Action Plan, which has brought us the Transparency Directive, the Prospectus Directive and the Market Abuse Directive (among other things). This created a concern that the level of regulation of AIM would increase and make it too expensive and onerous for small businesses. In fact, the London Stock Exchange decided to deregulate AIM so that it is not subject to the full rigours of the new laws.

Although AIM is not a regulated market, players in the market are bound by legislation concerning, among other things, financial



‘Nabarros have been our corporate lawyers all the way through and we also use them for commercial activities. The people must be capable of understanding our business, our attitude towards deals and anticipating what the principals are likely to require. Nabarro satisfy all these criteria’.

Chief Executive, Quoted Company.

promotions, misleading statements and practices and market abuse.

SO WHY WOULD A COMPANY BE INTERESTED IN GOING TO AIM?

A quotation is not an exit in itself, it used to be uncommon for shareholders to realise all or part of their investment at the time of the flotation, the focus being on raising new capital for companies to fund their development programme. Attitudes are changing somewhat, but the ability to cash in at flotation depends on the strength of the offering of the company and the market at that time. That said, post-flotation, management and substantial shareholders will generally find it difficult to realise their holdings. This is partly because they will often be locked in due to their being in possession of price-sensitive information, partly because their brokers require them to be locked in, so as to maintain an orderly market, and partly because, in many cases, these are people-based businesses where the investment by management is a fundamental attraction to external investors.

There is a significant institutional presence in the AIM market. An AIM quote enables a company to raise working capital from a wider pool of financial resources than in a private equity situation, thus diluting the

control of external investors. An AIM quote will also raise a company's profile.

Expansion by acquisition is far more feasible on AIM than as a private company, with the shares of the AIM company being acceptable tender. This means that companies can make acquisitions without diminishing their cash pile.

It is also a good environment for encouraging employee participation with share options.

BUT WHY AIM AND NOT THE MAIN MARKET?

Although there are a number of billion pound companies on the market, AIM is geared to young, growing businesses unlike the main market, which is geared largely to established businesses. There are also conditions to entry onto the main market, including, generally, a three-year trading history and a minimum capitalisation.

That said, an AIM flotation is not necessarily a cheaper option. Extensive legal and financial due diligence has to be undertaken as well as a detailed working capital exercise. Professional fees will rarely be less than £500,000 and are more likely to be northwards of £800,000. This is before taking account of commission that will typically vary

between 3% and 5% of the monies being raised.

Once on the market, the continuing obligations are less onerous than on the main market. One example is that acquisitions can more readily be sanctioned at board level, rather than requiring the approval of shareholders.

The costs of maintaining an AIM quotation are markedly lower than on the Official List.

SO WHAT ARE THE ESSENTIALS?

Every company going to AIM has to have a nominated adviser (a corporate finance house) and a broker. These must be maintained throughout its listing.

The flotation process will generally take about three months. Reporting accountants will be instructed to carry out financial due diligence on the business. There will also be a legal due diligence exercise.

An admission document needs to be produced. The admission document, to all intents and purposes, is a prospectus. It is a detailed document requiring significant input on all fronts and including the financial history and legal information on the group, its management and substantial shareholders. This document needs to be verified and the verification process can be quite extensive. AIM has escaped the brunt of the Prospectus

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Head of Corporate Finance, Investment Bank.

Directive. This means that the content of admission documents is less prescriptive and the document does not usually need to be cleared with the regulatory authorities - thus making it both faster and cheaper than the main market.

To meet good governance expectations, the constitution of the company is likely to require an overhaul and the terms of engagement of directors and other senior management conformed.

Employee share incentive plans will probably need drawing up. For overseas companies, legal opinions as to capacity and status will be required.

There will also be a multitude of comfort letters.

The admission document is the ultimate responsibility of the company and its directors who will be responsible at common law to investors for errors and omissions. Those directors will generally be expected to enter into contractual arrangements with the nominated adviser and broker.

INTERNATIONAL FOCUS

The market has proved attractive to foreign issuers, particularly from Australia, North America and Israel. These companies previously might well have sought a listing on NASDAQ or the Toronto Stock Exchange.

To encourage AIM overseas companies which were already listed elsewhere, the London Stock Exchange introduced a fast track means of entry for them. The designated markets include NASDAQ and the NYSE, the Toronto Exchange, the Deutsche Börse and Euronext.

Provided that companies have at least an 18 month trading history on such overseas exchange, they are excused from preparing an admission document (unless admission is combined with a fundraising exercise) and are required only to produce a detailed pre-admission announcement. As with the traditional route, a working capital exercise will need to be undertaken and confirmation needs to be given that the company has complied with local laws and regulation, meaning that legal due diligence may be required.

PUBLIC LIFE

The nominated adviser is responsible to the exchange for ensuring that a company complies with the AIM rules. Where the nominated adviser cannot do so, it must resign, the shares will be suspended and, unless an alternative nominated adviser can be found within one month, the listing will be cancelled.

The company will need to have an appropriate board. Even though AIM companies are not necessarily required

to comply fully with the guidelines set out in the Combined Code on Corporate Governance, a minimum of two non-executive directors (preferably independent) will normally be required. Good non-executive directors can be difficult to come by. In the wake of the renewed interest in corporate governance arising out of Enron and similar corporate collapses, the level of input from, and fees payable to, non-executive directors have started to inflate.

If the company has less than a two year trading record, all significant shareholders and employees with stakes in excess of 0.5 per cent of the equity will be barred from disposing of their interests for a year following admission. In addition, the standard practice among brokers is to require directors and significant shareholders to enter into two year dealing constraints, the second year often being a soft prohibition enabling share dealings but generally on a matched bargain basis. Even in the absence of these constraints, the AIM rules impose restrictions on dealings whenever a connected person is in possession of price-sensitive information. This will automatically include the two months immediately preceding publication of financial results. In practice, it is often very difficult for the founders to realise their shareholding.



N A B A R R O
CLARITY MATTERS

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FINANCIAL REPORTING REQUIREMENTS

AIM companies are required to report twice annually: once in interim unaudited form and then with year-end audited results. The figures need to be published within a given timescale if the listing is to be maintained.

Companies are now required to apply IFRS with effect from the end of 2006. US, Canadian, Japanese and Australian corporations can report under local GAAP/IFRS.

TRANSACTIONS

Generally, transactions do not require to be put to shareholders for approval. The exception to this is where the transaction constitutes what is known as a reverse takeover. A reverse takeover occurs where certain ratios of assets to assets, profits to profits, market capitalisation to consideration and the like exceed 100 per cent or where there is going to be a significant change in the nature of the underlying business or board control. In such a situation, the company will have to reapply for listing as if it were a new applicant.

That new applicant would include the business being reversed in, and on which there would need to be financial reporting. Reverse takeovers

can be expensive and it is relatively easy for a small AIM company to fall foul of the consideration to market capitalisation test.

The other situation where shareholder approval is quite commonly required is where the consideration would give the vendors and connected person holdings in excess of 29.9 per cent of the equity of the listed company. In this case a "whitewash" under the City Code on Takeovers and Mergers would be required and for that an independent vote of the shareholders would be necessary.

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