The Route to AIM

CHARLTONS

易周律師行

Solicitors

Hong Kong **Shanghai** **Beijing** **Yangon**

www.charltonslaw.com

THE ROUTE TO AIM

WHAT IS AIM?

AIM is the London Stock Exchange's Market for the listing of smaller, growing companies whatever their country of incorporation. Although it has an extensive rule book and the activity and behaviour of its members is monitored by its nominated adviser (Nomad) it is structured to provide the flexibility that companies require to facilitate their growth by way of fundraising and/or acquisition. Since AIM opened in 1995 approximately 1,300 companies have been admitted to it and these companies have raised approximately £10 billion on or subsequent to admission.

WHAT ARE THE PROS AND CONS OF A LISTING?

The Pros: Reasons for Going Public

The relative importance of each argument in favour of a listing depends on the company's precise circumstances.

Access to capital for growth: A listing brings a company the opportunity to raise equity finance, both at the time of the initial listing and through further capital-raising at a later stage.

Providing a market for your company's shares: The creation of a public market at an externally agreed price stimulates liquidity in the shares, and gives shareholders the opportunity to realise the value of their holdings. This can help to broad the shareholder base, and enables existing investors – whether venture capitalists or other owners – to exit, if they so choose, either on flotation or at a later date. A key advantage of an AIM listing for your Company when compared with the Main Market is that it is less regulated. There are no minimum limits on capitalisation or on the amount of shares in public hands. It is a condition of listing on the Official List that the expected market value of the shares for which listing is sought be at least £700,000 and that at least 25% of the shares be in public hands by the time of admission to listing.

Employee commitment: A public market in the shares means employee share ownership schemes have a visible value and market for trading. This encourages employees' participation in the ownership of the company, and increases their long-term commitment to the business. This in turn helps the company to recruit and retain good staff.

Ability to take advantage of acquisition opportunities: Greater access to capital and the capability to issue paper with a market value as an acquisition currency, can increase the potential to make acquisitions of private or quoted companies.

Higher public profile: The listing on a public market inevitably means that the business and its activities will receive more extensive coverage in the press, thus widening the awareness of the company and its products. This heightened profile in turn can help to sustain demand for and liquidity in the shares.

Reassurance for customers and suppliers: Companies coming to market tend to find that the perception of their financial strength within their own industry is transformed. This is especially true of a smaller company dealing with much larger customers, who are reassured

© CHARLTONS

that the company has received regulatory approval and has undergone a rigorous due diligence process.

The Cons: Reasons for Staying Private

It is crucial that a business considering a flotation appreciates the drawbacks, obligations and costs, both in terms of money and management time, which are likely to be involved. Some of these are one-off effects before and during the flotation process, while others – such as the higher degree of disclosure – continue beyond the listing. Overall, a flotation brings significant responsibilities as well as benefits, since it involves the stewardship of outside investors' money.

Susceptibility to market conditions: However strong and well-run a business is, it may find that the price and liquidity of its shares are affected by market conditions beyond its control. A smaller listed company may find that its shares suffer from illiquidity, or a company of any size may find that its share price is adversely (or even positively) affected by market rumour, economic developments or events elsewhere in the same industry.

Potential loss of control: The sale of equity in the company inevitably involves ceding a degree of management control to the outside shareholders, whose views must be taken into account. And the need to satisfy shareholders' requirement for a return on their investment, on a continuing basis, can lead to the company feeling pressure to achieve short-term performance rather than long-term strategic goals.

Disclosure requirements and ongoing reporting: The process of floating, and the subsequent listing, both involve the company in a much higher degree of disclosure and reporting than is required of a private company. This will require additional investment in management information systems, and a more rigorous application of compliance controls.

Loss of privacy: The greater accountability to outside shareholders inevitably means that the directors lose much of the privacy and autonomy they may have enjoyed when running a private company.

Costs and fees: Especially if the company is relatively small, the overall costs involved in flotation, raising additional capital and the ongoing costs of maintaining a listing may be considerable.

Management time: Both the flotation process itself and the continuing obligations may, unless the process is properly managed by the advisers, use up significant amounts of management time.

IS YOUR COMPANY RIGHT FOR A LISTING?

The prime requirement must be that the investment community views your company as an attractive business with good commercial prospects. Assuming that it does, you must satisfy a specific set of criteria.

An additional consideration is the investment community's view of your company as an attractive business with good commercial prospects.

Regulatory Requirements

© Charltons

Though these rules generally apply, there are also some exceptions. For example, a technology company at the “pre profit” research and development stage would not necessarily be prevented from listing – and many such companies have done so.

AIM companies are subject to the requirements of the AIM Rules (a copy of which can be obtained from www.londonstockexchange.com) and the Public Office of Securities Regulations 1995.

Admission Document: Under the AIM Rules all companies must produce an admission document making certain disclosures about such matters as the directors’ backgrounds, the shareholders, business activities and its financial position. There is a fast track route to AIM for companies who have had their securities traded upon an AIM designated market (UKLA Official List, NASDAQ, Deutsche Borse, Australian Stock Exchange, Johannesburg Stock Exchange, NYSE, Stockholmsborsen, Swiss Exchange, Toronto Stock Exchange) for at least 18 months prior to the date of admission to AIM. They can apply without having to publish a full admission document.

Accounts: The company must normally have published or filed audited accounts for a period ending no more than six months before the planned flotation. However, there is no requirement for a minimum trading record.

Track record: The company should have an independent trading and revenue-earning record covering the same period. Also, if the company has made a number of significant acquisitions prior to the flotation, then it must show that these have a suitable track record as well.

Directors: The company’s directors and senior management must show they have appropriate collective experience and expertise to run all areas of the business, and must be free of conflicts of interests which might hamper their ability to do this.

Working capital: The company must be able to show it has enough working capital for its current needs and for at least the next 12 months.

Market Requirements

To be suitable and ready to float and attractive to investors, your business should possess the following attributes, many of which are inter-related. In individual cases, other factors may be relevant – but this list will provide you with a good general starting point:

Track record as a sound, well managed business: Investors are generally comforted by the perception that a business has a reliable and relatively broad base of products and customers, and a relatively consistent record of revenues and profits. This is not an absolute requirement, since some companies in sectors such as IT and biotechnology now come to market at the pre-profit stage to enable them to fund the necessary R&D.

Viable and realistic business plan: No one will invest in a business which does set out where it thinks its revenues will come from in the future. The business plan, which forms one of the building blocks for the prospectus, and must be backed up by sound and justifiable projections of sales and costs, with enough working capital to meet the projected requirements.

Management quality and continuity: As potential investors look over your company, the

© CHARLTONS

range and depth of its management experience will be a key focus of their attention. They will want to check that the board and senior management include people who have had relatively long experience – preferably several years – in the business. The company should look to identify and plug any gaps in the full breadth of expertise needed to fulfil its business plan. This is where non-executive directors can be very useful. Investors will also look for a management team which shows it is united behind the company's plans, personally committed to its future, and fully agreed on its objectives.

Corporate governance: Although compliance with the corporate governance requirements as set out in the Combined Code is voluntary, investors will expect to see the development of appropriate corporate and management structures. These will help to reduce the company's reliance on individuals, thus giving greater security to investors. While some changes might be inappropriate for a very small business, potentially relevant steps may include splitting the roles of chairman and chief executive, the appointment of non-executive directors to the board, and appointing a qualified finance director. Investors may also look for signs of long-term commitment to the business from key staff at and below board level, through contractual arrangements or share option schemes. A further point to remember is that it may be worth considering going beyond the minimum requirements in areas such as accounting controls and corporate governance, and instead to aim for "best practice" as standard. Again, this policy can be instituted well before the flotation takes place, and may help convince advisers and investors of the value and solidity of your business. Beachcroft Wansbroughs place importance on advising directors of their obligations and responsibilities both in the run up to admission and post admission and together with the nominated adviser will take a view as to the appropriate corporate and management structures which require to be in place.

PREPARING THE WAY FOR YOUR FLOTATION

If careful consideration of all the pros and cons shows you that a listing will benefit your company, that it is suited to joining AIM and that the timing in terms of the business cycle appear to be favourable, the it will time to push ahead with preparing the ground. All the necessary steps will be covered in greater depth later in this guide, but these are the main issues you will need to think about

Appointment of Advisers

The first step, once you have decided on a flotation, should be to identify and appoint the nominated adviser ("nomad") for your listing. They will co-ordinate your company's entry to the market. In addition to solicitors you will also need a corporate broker, which may or may not be the same firm as the nomad. Further advisers needed for the flotation include reporting accountants and you will also probably decide to use public/investor relations advisers who will ensure that the investment community and potential investors become aware of your compoany.

Beginning the Valuation Process

The market value of your business is clearly central to the flotation. If funds are to be raised, it will affect the proportion of the company's capital which needs to be sold. Also, the value of the business might be affected by any corporate restructuring and board appointments made in the run up to the float. The final valuation achieved on flotation will depend on market conditions at the time.

© CHARLTONS

DIFFERENT METHODS OF FLOTATION

Depending on the nature of your business and its capital requirements, you may choose one of three different ways in which to come to market.

Public offer: In a public offer, your sponsor will offer your company's shares to private and/or institutional investors. The sponsor will also usually arrange for the offer to be "underwritten" meaning that any share not bought will be purchased by institutions who have agreed to do so for a fee. A public offer is generally the most expensive route to the market, and is often used by larger companies. However, it also brings in private investors who are important in increasing the liquidity of a company's shares. It is also the method of choice for a business looking to raise substantial amounts of capital.

Placing: A placing usually involves offering the shares to a selected base of institutional investors. This allows the company to raise capital but with lower costs and greater freedom in terms of how it is done. It also potentially gives a company more discretion to choose its investors. However, the downside is that it can result in a narrower shareholder base than a public offer which can give rise to less liquidity in the shares.

Introduction: An introduction is where a company joins the market without raising capital and is therefore often the least expensive and most straight-forward way of joining the market. Generally, a company can use this method if there is already a fair spread of shareholders. It keeps costs to a minimum. However, the downside of an introduction is that the opportunities for boosting the company's profile and visibility are more limited than with other methods of flotation.

Reverse: This is where the business is acquired by a company which is already listed on AIM but the value of which is substantially less than the value of your business. In fact, it might only be a "shell" possibly with cash already in it. The shares issued by the shell to the owners of the business will result in the latter becoming the controlling shareholders of the shell. This route has the advantage of simplifying, to a degree, the route to AIM and may also, if the shell has cash in it, provide a full or partial alternative to a public offer or a placing as a means of raising capital.

CHOOSING YOUR ADVISERS – AND WHAT THEY DO

Choosing good quality corporate advisers is one of the first and most important things that you must do in preparation for a flotation – and is also one of the most difficult.

During the flotation process, you will inevitably rely heavily on your advisers for guidance as to what is happening at each stage.

Lawyers

Most flotations involve two separate sets of lawyers – one to advise the company and its existing shareholders, and the other to advise the nomad. The responsibilities of the company's lawyers with whom you will of course have the most contact, include legal due diligence and advising on the suitability of your company for listing on AIM, overseeing the changes to the company's articles of association to ensure that they comply with the requirements imposed on a publicly quoted company and directors' contracts, and possibly re-registering the company as a plc. They also prepare the painstaking "verification" questions

© CHARLTONS

and replies, which are used to confirm that every single statement in the prospectus can be justified as fact. The rigours of this process mean you will get to know your lawyers very well. The verification process is an integral part of protecting directors from any fraudulent or negligent mis-statements made in the admission document. Lawyers also provide guidance for directors as to the nature of the responsibilities and obligations as directors of AIM listed companies.

Your lawyers will also work alongside the sponsor's lawyers on the necessary agreements between your company, the sponsor and the existing shareholders, covering aspects like underwriting and tax. You might also want them to draw up share option schemes for staff, to be introduced with the flotation.

The Nomad

The role of the nomad is essential to the listing of a company on AIM. The Stock Exchange delegated to the appointed nomads the responsibility for ensuring that applicants to the market met the requirements set out in the AIM Rules and that the process was completed in a satisfactory manner. The nomad will usually be responsible for maintaining the admission document or prospectus and will arrange with the AIM Panel for the scheduling of the date of admission of the company to the market.

The Corporate Broker

The corporate broker acts as your main interface with the stock market and potential investors. The firm you appoint will assess the stock market and provide vital feedback on investors likely response to the issue. If your sponsor is an integrated firm offering both investment banking and stockbroking services, then you may decide you also want them to take on the role of corporate broker.

As well as advising you and your sponsor on market conditions and the likely level of demand, the corporate broker also actively markets the shares to potential investors, and can advise on the best method, size, timing and price. It can put in place market-related arrangements such as underwriting and placing agreements. It will continue to work with your company after the flotation to maintain your shares' liquidity and profile in the after-market.

The Reporting Accountant

The role of reporting accounting in a flotation is separate from that of the company's existing auditors but can be (and often is) fulfilled by a separate team in the same firm if you so choose. The sponsor may want to appoint a different firm to ensure the highest possible level of detachment and independence in this key role. Essentially, the reporting accountant is responsible for reviewing the company's financial record and internal systems for potential investors, and thus has an influence on their decision as to whether to buy the shares.

As you go through the flotation process, you will hear a lot about "long form" and "short form" reports. The difference is quite simple. The "long form" report as the name suggest, is a detailed financial and management history of the business. It is not published but does provide the management and sponsors with the information needed to draft the prospectus. It also serves as the basis for the reporting accountants' "short form" report, which is published as part of the prospectus itself. The reporting accountants will also usually prepare a report for the nomad on the company's projected working capital position over the 12 to 18 months

© CHARLTONS

following flotation. They may also advise on the tax implications.

Other Advisers

Depending on the method of your flotation and the specific circumstances of your company, you might also decide to use a number of other advisers in particular areas. The most likely is a firm of financial public relations consultants, to maximise the degree of positive awareness of your company, and its products or services, amongst the general public and the professional investment community in the run up to the flotation. Companies coming to market often underestimate the importance of public profile and press contacts. Your financial PR consultants should also help ensure that any public statements and press releases are permissible under the relevant disclosure regulations. You will also find that by helping to generate press interest and publicity, your financial PR consultants can play a key role in sustaining awareness and liquidity after the flotation. You may consider media training for those key directors who will be under the spotlight.

You may also require a number of other advisers. These include: registrars to manage your company's share register; chartered surveyors or valuers to assess property values; security printers for safe, accurate and speedy production of documentation; actuaries to assess the position of company pension schemes; receiving bankers to handle share applications (only in a public offer); and insurance brokers to check that all risks are adequately covered.

COUNTDOWN TO FLOTATION

It is difficult to be precise on the length of time which a company will take to come to market, since the length of the process is influenced by so many variables – including the size, sector and structure of the company, the method of flotation being used, and the degree and complexity of "due diligence" which has to be conducted by professional advisers. A company undergoing an introduction will have to follow through the full due diligence and disclosure process, including the preparation of listing particulars.

In contrast, a flotation involving an offer for subscription to the public is a much bigger project. The company will have to follow through the full due diligence and disclosure process including the preparation of a prospectus. In addition, it will probably require participation in various marketing activities, including roadshows, alongside the regulatory and disclosure duties. This sounds more expensive – but it is interesting to note that, as a general rule, the total costs of coming to market as a percentage of the funds raised tend to fall as the actual size of the offer increases.

Documents

Whatever method of listing your company is going for, you and your advisers will have to prepare a prospectus or listing particulars, as appropriate. This document is central to your flotation, and has two main functions. Firstly, it sets out all the information which has to be made public to investors. And secondly, it plays a crucial role for the company itself, amounting to a coherent description of the business, its areas of activity and its prospects. The quality of the document can have a fundamental impact on the success of your flotation, and you and your advisers should pay close attention to both its style and content. The main requirements of a prospectus are to include information on the Company, its trading history and its directors. It must also incorporate a statement that it has sufficient working capital for the twelve months from the date of admission, a statement of the principal assumptions in

© CHARLTONS

relation to any profit forecast, estimate or projection, a standard risk assessment regarding AIM, and where new businesses are concerned, compulsory 12 month lock-in for directors and certain employees.

If your company is coming to market via a placing or public offer, then it may decide to issue a "pathfinder" prospectus, which contains almost everything a full prospectus would except the price. The pathfinder can be used to market the issue to selected potential investors, on a restricted basis. For bigger issues, a "book building" process may be conducted to identify potential institutional investors and the price at which they are prepared to buy. The full prospectus is then issued, complete with the price and a notice of any changes from the contents of the pathfinder.

The Flotation Timetable

The run up to the flotation is generally described in terms of a timetable counting down to "admission". Admission follows "impact day". Impact day is when the full prospectus will be issued and advertised to investors, and the flotation officially announced. The "listing process" is generally regarded as starting 12 weeks before admission, depending on the size, complexity and method of flotation. The period up to 24 weeks before impact day is regarded as "pre float preparation" – during which the company should prepare itself for life as a public company and discus the planned float with potential advisers. The timetable starts with the appointment of the advisers.

Costs

There are a number of factors which determine the costs of an admission to AIM: The route that is chosen (for example, an introduction as opposed to a placing) the amount of money that is raised, (commissions charged by the brokers will range from 3% to 5% of the money raised) The overall fees could range from £150,000 for an admission by way of an introduction without a cash raising to £350,000 for a particularly complex introduction with significant sums being raised.

CONCLUSION

In this note we have outlined the procedure for the admission to AIM and the parties who are necessary for the process. Apart from ensuring a satisfactory completion of the admission the advisers' role is also to minimise the amount of time that management have to spend on that process so that it does not distract them from the running of their business. Advisers who deal with AIM companies require a skill that goes beyond a knowledge of the AIM Rules; they have to be able to advise the directors and shareholders in a commercial and business-like manner and to be able to understand the nature of the business and the effect that an AIM admission will have on it. Beachcroft Wansbroughs' approach is that before preparing documents we need to understand the nature of the business that is to be floated, how it works and what it requires from a listing and the concerns of its directors and shareholders. The success of this approach is demonstrated by the number of companies who retain us as their lawyers following their admission to AIM.

We would be happy to discuss the process with you and to provide you with an estimate of the costs of admitting your business to AIM.

© CHARLTONS

January 2006

This note is provided for information purposes only and does not constitute legal advice. Specific advice should be sought in relation to any particular situation. This note has been prepared based on the laws and regulations in force at the date of this note which may be subsequently amended, modified, re-enacted, restated or replaced.

© Charltons