

# The Attraction of London's AIM Market

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AIM, the London Stock Exchange's junior market, is fast establishing itself as the market of choice for international emerging companies looking to go public, and it is being heavily touted from coast to coast in the United States as a viable source of capital for smaller businesses seeking to fuel their growth.

Of the 1,400 companies listed on AIM, 220 are now international, of which 160 joined since the beginning of 2004. The LSE reports that 19 U.S.-based companies completed IPOs on AIM in 2005, raising in excess of \$2.1 billion and bringing the total of U.S. issuers on AIM to 31. The first quarter of 2006 saw another 6 U.S. companies join the market, and it is believed that a healthy number of U.S. would-be-public companies are currently preparing to join the ranks.

## Advantages of AIM for U.S. Companies

The attraction of AIM is easy to understand. Smaller, growth businesses in need of additional funding, as well as VCs looking for liquidity events, are finding it increasingly hard to tap into the U.S. public markets. In the past five

years, the average market capitalization of new entrants to the markets has increased dramatically; analyst-coverage of smaller companies has all but evaporated; and regulatory costs have mushroomed.

AIM, on the other hand, boasts a system that has no minimum market capitalization or trading volume requirements, and a trading history is not mandatory. The IPO process is essentially self-regulated. The issuer appoints an LSE-approved investment bank as its "nominated adviser" (known as a "nomad"), whose responsibility it is to assess the suitability of the issuer for AIM, oversee the listing process and ensure the issuer fulfils its regulatory obligations going forward.

This streamlined approach allows companies to complete their IPOs on AIM within 12 to 16 weeks as opposed to the norm of 4 to 6 months for Nasdaq, and at a much lower cost. Provided the offering is carefully controlled and the number of stockholders "of record" does not exceed 500, it is possible to avoid registration and periodic filing requirements under the federal securities laws. The company and, importantly, its officers will also be beyond the reach of Sarbanes-Oxley. Experienced nomad, Canaccord Adams, has estimated the cost of an AIM flotation to be approximately 25% less than that of an SEC-registered

offering and the on-going compliance costs for AIM-listed companies to be approximately 60% less than those paid by similarly situated SEC-reporting companies.

Perhaps the most important feature bringing companies to AIM is the number of leading, UK-based financial institutions willing to invest, on a long-term basis, in businesses from a broad range of industry sectors, spread throughout the world. These investors have shown interest in companies with a bright future somewhat earlier in their growth cycle, as compared with their U.S.-based counterparts.

The AIM market is not without its problems for U.S. companies, however.

## The Physical Settlement Problem

For example, while average trading volumes have increased dramatically in recent years, AIM is largely an institutional market, and trades still tend to be relatively infrequent for all but the largest AIM companies. Adding to the illiquidity of U.S. stocks is a "physical settlement" requirement typically imposed by lawyers in order to assure compliance with five SEC rules, known collectively as "Regulation S."

Adopted in 1990 to clarify when securities could be issued outside the United States without SEC registration, and toughened in 1998 in order to curb what the SEC viewed as abuses, Reg. S was designed to prevent

unregistered stock from “flowing back” into the U.S. market and into the hands of U.S. investors for a period of one year.

In order to assure Reg. S compliance in one of the first AIM listings of a U.S. issuer in 1999, lawyers required that trades in the secondary market be settled with paper certificates as a way for each purchaser to certify that it was not a U.S. person. This requirement remains typical in the AIM market today.

Physical settlement creates serious headaches, however. Back offices have to push paper instead of buttons; traders have to agree on settlement periods longer than T+3; and, unless the seller is willing to wait for his money, his broker has to finance the trade.

As a result, brokers have a disincentive to recommend the stock, and some investors may be reluctant to purchase in the initial offering, knowing that the secondary market will be adversely impacted. Some U.S. companies have considered corporate restructuring in order to avoid the problem, and valuable time is spent during roadshows explaining the restrictions rather than describing the business. According to Neil Johnson, Head of Corporate Finance in the London office of Canaccord Adams, “the initial offering prices of Reg. S securities may be reduced by as much as 10% because of the physical settlement requirement.”

Happily, this unproductive economic friction may soon be a thing of the past.

### **Electronic Settlement on the Horizon**

As this article is being written, an effort is being made to permit electronic settlement of trades in shares subject to Reg. S. In essence, a settlement alternative would be introduced that would permit certifications of the purchaser’s non-U.S. status to be transmitted electronically rather than on paper. When accompanied by such an electronic certification, the trade would clear and settle; without it, the trade would fail.

A number of benefits would ensue. Because settlement in Reg. S shares could proceed in accordance with market practices, back offices would no longer face paper-based hassles; investment decisions would be less influenced by fears of a sluggish after-market; discounts from the normally expected offering price would shrink; smaller trades would make economic sense; and brokers would give more thought to whether Reg. S stocks might be suitable for their retail customers. Additional benefits would include likely reductions in the number of shareholders “of record.”

### **The Outlook for AIM and U.S. Companies**

The AIM market is succeeding because it fills a need. Tailored to the circumstances of its target audience, it has a regulatory structure that is more relaxed in some respects, but more rigorous in other respects, as compared to those of its senior brethren. One wishes it continued success for precisely that reason.

Once the physical settlement problem is resolved, AIM should become even more attractive for those U.S. companies that fit its profile. ■

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