

OFEX has come a long way in recent months. It now enjoys a measure of liquidity and offers benefits that companies listing on AIM do without. **Dan Matthews** takes a look at the perks and asks: is it right for you?



Choosing OFEX

Near-collapse and an inability to raise significant sums have blighted the more recent existence of OFEX.

In many cases, instead of offering a lower rung to AIM, OFEX was arguably offering a more complicated alternative to bank loans, asset finance and angel funding.

But the turnaround since last winter's takeover, which installed Simon Brickles, AIM's former head, as chief executive, is making many take it more seriously as a growth option.

Perceptions of the market being static and lacking liquidity have been countered, to the extent that it now boasts the backing of some notable institutional investors as well as a growing number of private money men.

While yet to achieve AIM's fluidity – which itself is not optimal, there are now more shares traded on the market than ever before. It achieved more transactions in the first half of this year than the whole of last.

It is best described as a stepping stone or training ground

for the more senior markets, where you can raise some money, strengthen your reputation, gain a currency for acquisition and get a taste of the prudence and maturity required for public life.

The official line from OFEX is that you can raise up to £5m through an IPO on the market, although this seems to be the absolute maximum and advisers are dubious whether anything above £2m to £3m is achievable in 90% of cases.

But as increasingly large companies turn to AIM and bag ever more valuable investments, OFEX is looking to dominate the sub-£5m funding gap.

Les Paul, managing director of Datum International, an HR and accounting software company that floated on OFEX in July, raised £750,000 but says about two-thirds of enquiries came from institutional investors – a sign that bigger fundraisings are possible.

On the other side of the coin is Graham Whitworth, chairman and chief executive of Sprue Aegis, which produces self-recharging smoke alarms and floated on OFEX in 2001, raising £1.2m.

The company last raised funds in spring 2004 and managed to attract one investment from an institution, but Whitworth says that at the time the number of institutions you could approach was limited.

"The downside is the lack of liquidity and the attending lack of institutional interest, certainly in the past. They are quite averse to putting money in," he says.

The problem is that institutions are obligated to turn liquid very quickly, explains Jamie Stewart at stock brokers Eden Financial. They want to know they can get out instantly if there is a run on a company's shares.

Most fund managers report quarterly, which increases the pressure to make gains in a short space of time. This is only possible if there is sufficient trading on the market to make quick transactions. Therefore, says Stewart, OFEX is better suited to organisations with fewer retail investors, such as corporate treasury portfolios, family offices and charities.

Views on the type of investor and the amounts you can actually achieve are mixed, not least among advisers. Maggie Baverstock, director of corporate finance at Mazars, argues that liquidity has not improved sufficiently to make the market a resounding success.

Meanwhile, Bill Sharp at market maker Hoodless Brennan asserts that the issue of liquidity has been resolved: "There are now at least two and normally three market makers in all OFEX stocks. The normal market size available to trade used to be 100 to 200 shares; it's now up around the 5,000 mark, which will interest institutions."

The median assessment of OFEX, then, is that you can raise around £2.5m. It offers irregular trades, but on the plus side gives companies an independent valuation of shares and a chance to make acquisitions using paper (shares instead of money). If your ambitions fit these criteria then this is the market for you.

FORM FILLING

The main selling point of OFEX is that it is a cost-effective way of raising funds, getting noticed and learning some fiscal discipline on a public market. Its light bureaucratic touch and the fact that OFEX-approved advisers determine what forms need to be filled in mean you can get a float away for a third of the costs of an AIM listing.

Interestingly though, some owners of companies that have stepped from OFEX to AIM believe quarterly reporting and general regulation of the market was more onerous than they are now experiencing with AIM.

This could explain why removing red tape and freeing up the market for new entrants was a key objective for former AIM boss Simon Brickles and his team when they took over OFEX from its founders last year.

"We have changed the rules for issuers," explains Cyril Theret, business development director at OFEX. "Our old rule book was similar to the listing process, but in April we changed it to a disclosure-based format. Companies joining the market must ask an approved corporate adviser what they have to disclose."

Floats valued at €2.5m (£1.7m) upwards, or involving 100 or more people, qualify for extra form filling under the Prospectus Directive, which came into force in July. The legislation, covering all markets, obligates businesses to disclose a detailed history of the business, its finances, directors and strategy.

This means extra cost because all the information must be verified independently, and there's no difference if you list on OFEX, AIM or the main market. So OFEX's lighter touch is confined to sub-€2.5m deals.

"We have taken a different approach," says Theret. "If you fall under the exemption of the Prospectus Directive, then you'll only have to produce an OFEX admissions document, which is similar to the old rules on public fundraising. It's preserving a City-recognised proven method."

As AIM grows, so do its regulatory standards, says Theret. Companies listing on the market must comply with IFRS

NAMES YOU SHOULD KNOW

MARKET MAKERS

They act as a wholesale trader by quoting buy and sell prices to brokers, thereby creating a marketplace. There are currently three that trade in OFEX stocks – the main market has many more. They provide liquidity in the market.

BROKERS

Brokers deal in stocks and shares on behalf of the investor. They must be regulated by the Financial Services Authority and be a member of OFEX.

REGISTRARS

Registrars hold the share register. They are informed when shares are traded and change the record on behalf of the company's secretary. They keep information on who holds what and for how much.

FINANCIAL PRS

There is a big difference between PR firms that increase companies' exposure in the media, and financial PR firms that communicate to shareholders and potential investors. FPRs look after institutional and financial messaging.

accounting standards too, but OFEX will not mandate on the legislation.

"It is right for AIM to do it," he adds, "but we are not mandating on it because of the smaller size of companies who are listing on our market, such as Esprow, Myhome and Betex, who are all sub-£5m market cap."

All that is asked of companies at this level is that they meet a standard of corporate governance dictated by their corporate adviser, have 12 months working capital and audited financial statements that are no more than nine months old.

Again, there are no hard-and-fast rules about corporate governance on OFEX and the number and nature of non-executive positions are down to advisers. Assume, however, that you will need at least one non-exec director.

Look for one with experience of listed businesses as well as an understanding of your industry. The £15,000 to £20,000 you pay them a year will return many times in the advice and leads they will be able to provide.

SELECTED TAX PERKS

Paul Fay, director of corporate taxation, Horwath Clark Whitehill

Tax planning can be used to increase value, incentivise management and reduce investors' tax costs.

It is important that reported tax figures in listing documents and the float vehicle's accounts give the right message. Potential investors will want to see that management is focused on tax matters and is taking advantage of tax planning opportunities and available reliefs without being unnecessarily aggressive.

They will expect to see a reasonable tax charge, in line with UK tax rates and industry norms. If tax rates are unusually high or low, it will be important that potential investors understand why this is the case and how the tax rate is expected to vary going forward.

Fluctuating tax rates can be a concern and investors will generally prefer to see a smooth reported rate.

Tax planning is also important to incentivise and tie-in key management and staff. Management will want to acquire their interests in the float vehicle tax efficiently, and share option plans are commonly used to align management with commercial objectives. There are a number of Revenue-approved share option arrangements, which add value by reducing tax costs.

There are also a number of tax breaks potentially available for investors, including tax relief on their investment and low tax rates on disposal. These reliefs can significantly enhance the investors' overall returns and they may be unwilling to invest if these reliefs are not available.

Tax issues should be considered as early as possible in the run-up to the listing, to give time for proper planning and efficient structuring. If tax matters have not been fully addressed investors may be wary and could be tempted to look at other offerings where the tax position is more attractive.

"OFEX is better suited to organisations with fewer retail investors"

OFEX claims that it is not a soft touch with regulation though. At the end of the day, you must convince veteran investors that your business is low-risk and high-growth; producing sketchy books and hiring the wrong people is a quick way of earning yourself a rebuff.

HOW TO FLOAT

It is important to keep in mind the reasons for planning an OFEX flotation. It's cheaper to gain admission to this market than to list on AIM, but it could cost even less to take another funding route altogether.

Getting an OFEX corporate adviser early is a must. They act in the same way as nominated advisers on AIM and will instruct you as to whether your business is prepared for flotation, if OFEX is the right destination for it and who you need to get on board to help you through the process.

It is good practice to meet a handful of advisers and find out with whom you feel most comfortable. Floating can take anything up to a year and you'll work with your adviser every step of the way. You should pick one that has good OFEX experience and has a track record of successful floats.

They will shed light on the process from then on. If you use local lawyers and accountants, then you may be required to upgrade to new firms that have experience of public markets.

Your accountant will provide tax experts to structure your finances and make the most of various government incentive schemes, which give investors more return on their money and make them more likely to pick you.

If raising funds is your motive for coming to market, the next step is to organise an investor 'road show', involving as many business angels, venture capital trusts (VCTs) and other potential backers as possible.

Your advisers will help you shape your business plan and presentation in a way that will convince investors to part with their cash. Once money starts trickling in, it's down to a registrar

– again sourced by your adviser – to document and keep track of the investments.

Paul's experience of this process was a positive one overall: "Our accountant helped us write our pitch in an attractive way. We started a book and it began to fill up, in fact by the end we were slightly over-subscribed."

Together with your adviser, you will prepare application documents and meet with OFEX officials to explain your objectives. Once approved you'll meet the market makers, who will hopefully agree to take some of your stock.

The final step is to agree on an IPO date, when your company will 'go live' on the market and people can start trading your shares. Paul had a good first week, with interest from investors and a 28% increase in market cap as a result, but don't assume this level of activity will happen in every case.

THE RISKS

If you prepare thoroughly and listen to your advisers then the risks attached to an OFEX float are relatively slight. Max Audley at corporate law firm Faegre & Benson says the

TWO ALTERNATIVES

ANGELBOURSE

Provides an online platform where investors can view and research companies, participate in direct equity investments or buy and sell shares in unquoted companies.

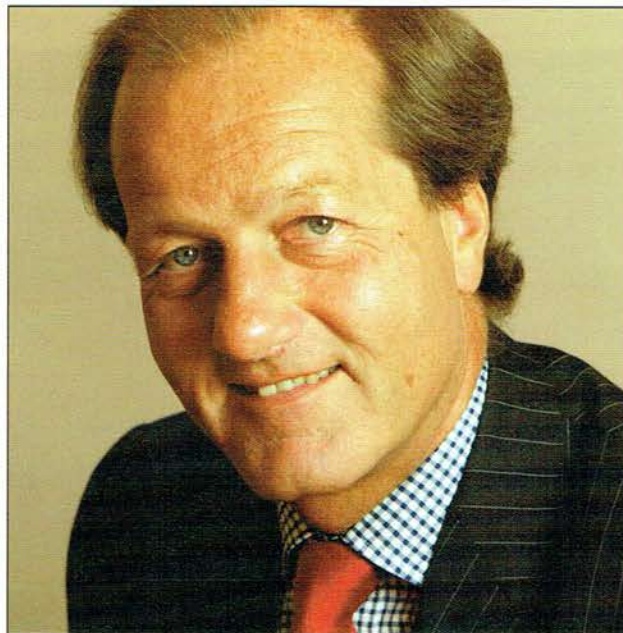
It is a regulated and low-cost trading facility, and claims to create a realistic exit strategy for directors and investors, allowing you to trade shares and value your business without the associated costs or full regulatory burden of bigger markets.

It provides a first step for companies thinking about future listings on OFEX or AIM and, according to AngelBourse, will let investors know you are serious about growth.

SHAREMARK

ShareMark is a share-trading and fundraising facility for small and medium-sized companies. It aims to be low-cost, simple, accessible and visible. According to the management team, it provides a valuation, trading and fundraising facility ideally suited to illiquid funds.

It operates through an electronic auction market, matching buyers and sellers at a single price, thus there is no bid/offer spread on ShareMark stocks.



Above: Max Audley; It's unusual for companies to fail at the last minute, but plenty decide it's not for them along the way

biggest threat before a float is failing to attract funds.

"It's unusual for companies to fail at the last minute, but plenty decide it's not for them along the way," he says. "Usually, this is because they find another funding route. However, it's quite rare for a business to fall short of its investment target."

For Audley, the risks increase once you are listed, and they are the same as on AIM or the main market. Stewart agrees: "Once you've listed on OFEX you've lifted your head above the ramparts; meaning exposure to media scrutiny, analysts and predators. It's easier to get a bad name and therefore higher risk."

Corporate governance also kicks in when you list, and even with OFEX's less onerous definition, you are obligated to make sure you are operating ethically.

One of the biggest changes, however, is that you are now responsible to shareholders. Your accountability to them beats most other considerations, and return on their investment could trump your long-term goals.

So is OFEX for you? You'll need to do some research before answering that question. But generally speaking it can provide you with valuable experience of a public market, how to handle the media, keep shareholders happy and maintain financial discipline.

Currently, the market occupies a relatively small space above junior markets such as AngelBourse, without quite meeting AIM at the £5m mark. It is widely accepted, however, that Simon Brickles' team has improved the market and many expect great things in future. What this means to your business is up to you.

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