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London Stock Exchange Announces New "High Growth Segment" To Boost Tech Companies In The UK

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Introduction

The London Stock Exchange ("LSE") has announced proposals to introduce a new section to its main market, catering specifically for high growth companies looking for a transitional route to the Official List. The announcement follows a similar regime introduced in the U.S. for emerging growth companies under the recently enacted Jumpstart Our Business Startups Act (the "JOBS Act").

The LSE's new "High Growth Segment" is set to open mid-March 2013 and will be an EU regulated market, open to both institutional and retail investors and operating under its own distinct rulebook. The key features of the new segment are:

- issuers will be required to produce an approved prospectus;
- issuers will not be required to be "listed" on the Financial Services Authority's ("FSA") Official List and as such would be subject to a new rule book rather than the UK Listing Authority's ("UKLA") Listing Rules;
- issuers will be required to have a key adviser at admission (similar to the sponsor role for the premium segment of the Official List); and
- issuers will be required to "clearly set out their intention" eventually to join the main market of the LSE if and when they become eligible.

Eligibility Requirements

The most pertinent of the proposals is that the eligibility requirements for an issuer will be more relaxed than for a main market listing. The proposed requirements are:

- incorporation in the European Economic Area;
- only equity securities issued by commercial companies will be capable of listing;
- a minimum free float of 10% and a value of at least £30m, the majority of which must be raised at admission either by the issue of new securities or sale of existing securities; and
- an historic revenue compound annual growth rate of 20% or more over a three-year period.

The minimum free float requirement of 10% is particularly significant, when compared to a standard requirement of 25% for a main market listing. This reduction in the minimum free float is intended to make the new regime appeal to entrepreneurs who may be reluctant to give away a large percentage of the company at an early stage.

The requirement to show a three-year track record is also significant. The UK used to have a specialised route to market for innovative high growth companies prior to the last wholesale review of the listing regime in 2003-5, which implemented the EU Prospectus Directive. This enabled innovative high growth companies without a three-year trading record to raise finance by listing their equity securities. Concerns at the time, and the reason that the same regime was not continued into the current framework, were exacerbated by the fallout of the dotcom bust. The three year track record requirement is therefore an important distinguishing factor from the prior regime.

Impact

As the world's leading stock exchanges have increasingly fought harder to attract issuers in a thinning market, for example following the introduction of the JOBS Act in the US and the review of the listing regime in Hong Kong, the LSE's proposals reflect the competition inherent in today's global capital markets.

The changes are undoubtedly aimed at the technology sector and are designed to attract issuers with a market capitalisation in the range of £300 – 600 million. In the five-month pre-proposal discussion both the government and a panel of investors expressed concerns that too many UK technology businesses were choosing Nasdaq or opting to sell via trade sale instead of undertaking a UK listed initial public offer. There have been no initial public offers by European technology companies on the LSE's main market since 2010, while the U.S. has seen a number of high profile tech-IPOs for Zynga, Groupon, LinkedIn, and Facebook. Edwards, a UK technology company that failed in its London listed initial public offering in 2011 succeeded in a Nasdaq listing the following year. Now other UK technology companies, including Wonga, the short-term lender, and King.com, the mobile games producer, are both said to be contemplating U.S. listings for their initial public offerings. The introduction of a new high growth segment is intended to present such companies with a genuine option for a London listing where either a main board listing or an admission to AIM are not considered appropriate or are unavailable.

That said, the impact of the proposals is uncertain. Whilst the changes mark a clear attempt by the LSE to attract companies who may previously have taken advantage of Nasdaq's flexible float requirements, it remains to be seen whether or not there will be sufficient investor appetite, given the liquidity concerns that can arise with such small free floats, which has commonly been raised as a concern with AIM, where there is no formal free float requirement.

The other critical condition to listing on the High Growth Segment is the 20% compound annual growth rate for turnover over the previous three years. This is a demanding condition that many companies may find hard to meet. The High Growth Segment will clearly only be suitable for the very best performing technology start-ups that can raise the necessary £30 million through newly traded stock. It will be interesting to see just how many companies can demonstrate the combination of significant growth and comparatively high initial valuation.

Retaining UK technology companies and dissuading them from seeking a listing on other exchanges is not as simplistic as revising the listing criteria. For London to truly rival New York as an attractive place to list technology shares it will require a much wider maturation of the market and a more sophisticated understanding of the sub-sectors that constitute it. For now, a Nasdaq listing is likely to continue to be the primary choice for many UK and European technology companies due to the unparalleled sophistication and coverage of technology analysts in the U.S., and the pricing tension that a deeper and more developed technology buy side can provide. However, the proposals mark an encouraging development in the LSE's attempts to make the London market more competitive for the development of a technology IPO market, as well as to plug the gap that exists between AIM and the LSE's main market for companies that wish to pursue a UK listing.

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