Sarbanes-Oxley

London Calling

Erika Brown 05.08.06

Sidestepping the Sarbox pox, small companies around the globe snub U.S. stock markets to go public on easier markets overseas.

Peach Holdings did something shocking a few weeks ago. When the Boynton Beach, Fla. lending outfit wanted to mount an initial public offering, it shunned U.S. stock markets and investors to raise $231 million on AIM, the London Stock Exchange's Alternative Investment Market. Peach's reception across the pond has been peachy indeed: Its stock is up 6% from the offering price, and the company now carries a market valuation of $598 million.

Going public in the U.S. would have been brutal for Peach, with just $100 million in revenue. It would have had to pay a $100,000 fee to get on the Nasdaq plus something in excess of $2 million to comply with myriad rules and the onerous burden of Sarbanes-Oxley, the post-Enron antifraud act. To go public on AIM, the company spent all of $500,000, including a fee of $7,600 to the exchange.

"We chose London to be exempt from a litany of U.S. regulations," says James Terlizzi, Peach's chief executive. "The math is pretty straightforward." Had he gone public in the U.S., Terlizzi also would have had to shore up accounting practices and cajole executives at other companies to join his board, which by law must be dominated by independent outsiders. And he would have to report earnings each quarter rather than twice a year as is allowed in the U.K.

Small outfits around the world similarly are eschewing U.S. exchanges and the straitjacket of Sarbox in favor of the relaxed capital markets to be found abroad. London's AIM market is a prime beneficiary; it listed 335 initial offerings last year, nearly twice the total in the boom of 2000, while Nasdaq eked out just 126 last year, down 65% from 2000. Last month the beleaguered Nasdaq, spurned in an initial attempt to merge with the London Stock Exchange, managed to buy a 15% stake in it for $782 million.

Nasdaq officials say the Sarbox burden is heaviest on the smallest companies--and firms with less than $100 million in sales make up half of Nasdaq's 3,000 listings. The regulatory costs average 2% of revenue at firms with revenue under $100 million, while they are only 0.1% of revenue for the biggest companies.

"Nasdaq has become a hostile environment for small companies," says Oren Zeev, a venture capitalist with Apax Partners in Menlo Park, Calif., which has taken seven companies public on foreign markets in London, Milan, Frankfurt and Vienna in the last two years. Theodore Stebbins, chairman of investment banking at Canaccord Adams in the U.S., adds: "Clearly, the low end of the Nasdaq is broken. We can no longer in good conscience recommend to our small clients that they go public on Nasdaq." Since early 2005 his firm has listed 17 companies on AIM. Seven more deals are in the works. Canaccord has taken only four companies public in the U.S. in the same time.

Special Offer for Forbes.com members -- receive a Free Trial Issue of Forbes Magazine... no risk... no obligation! Click here for your Free Issue!

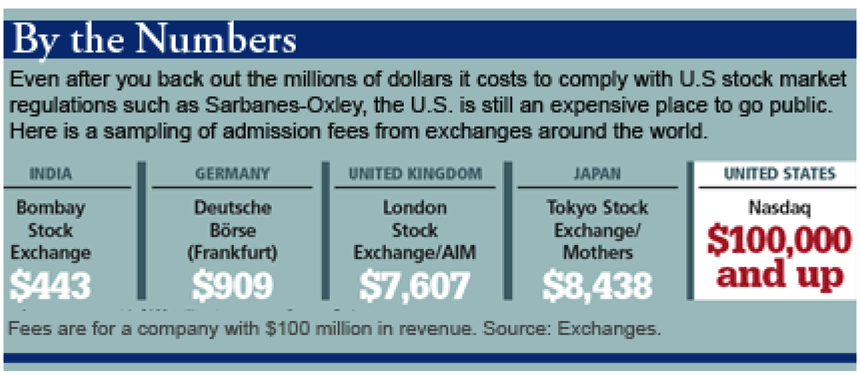
Other foreign markets have made gains, too, but London's AIM has been particularly persistent. In recent months AIM executives have hosted more than 30 pitchfests in the U.S., wooing investors in New York, Boston, Silicon Valley, Atlanta, Denver and Minneapolis. "It's not particularly subtle," says Graham Dallas, a senior international development manager at the London Stock Exchange. "We tell them there is an opportunity-rich landscape for them to exploit. The rules are quite simple and short. Otherwise, companies will spend all their time on compliance and not enough time building wealth."

"A year ago I never would have thought about foreign markets. Now my partners and I talk about it all the time," says Robert Pavey of Morgenthaler Ventures in Cleveland, who has been invited to a dozen or more AIM seminars.

India, too, is emerging as an alternate market. Tech giants such as Satyam Computer Services, Tata Consultancy Services and Wipro Technologies have brought legitimacy--and billions of dollars--to the Bombay Stock Exchange and National Stock Exchange of India. Promod Haque, a venture capitalist in Palo Alto, says he may list one of his firms in India: Persistent Systems, a software outsourcer based in Pune, India. "The Mumbai market was up 50% last year, and many U.S. mutual funds are investing there," says Haque. "Why would we waste our money on Sarbanes-Oxley?"

Charlotte Crosswell, head of Nasdaq's international business, is defensive. "The U.S. is the biggest capital market in the world. Our regulation is second to none, and investors are willing to pay a premium for that," she says. But her boss, Nasdaq President Robert Greifeld, has lamented the Sarbox fallout publicly. "Anguish over SOX in this country is not abating; if anything, sentiment has hardened and the perception gap abroad is now wider than ever," he opined in a column in the *Wall Street Journal* in early March.

Lovers of big government will tell you that, despite the Sarbox backlash, U.S. markets still hold the most sway and the biggest companies will continue to insist on trading here. Moreover, companies that bypass the U.S. to list overseas still can get hit by the regulatory pox. If 500 investors end up buying stock in an American company listed abroad, U.S. regulations kick in again and the company must bow to the law.



Special Offer: Get a Free Trial Issue of Forbes Magazine!