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New US exchange attracts interest from Asia

By **Anette Jönsson** | 7 July 2008

Market sponsor Merriman Curhan Ford says the OTCQX could easily become as large as London's AIM and expects the first Hong Kong company to join its ranks by early September.

Australian companies have already discovered the OTCQX and Hong Kong and Singapore companies could be next, according to a representative of one of the sponsors of this new US exchange. The bourse, which opened for trading in March 2007, offers non-US companies a chance to achieve a secondary listing in the US via depositary receipts (DRs) without having to go through the time consuming process of registering with the Securities and Exchange Commission and without having to deal with costly disclosure requirements imposed by the Sarbanes Oxley regulations.

This has attracted 29 international companies to the OTCQX in just 15 months, including high-profile market leaders such as Roche, BASF, Adidas, Akzo Nobel and Air France-KLM. Seven companies have switched their allegiance here after delisting from either the New York Stock Exchange or Nasdaq. As of mid-June, the combined market capitalisation amounted to about $415 billion and year-to-date trading volumes had already exceeded $6 billion.

Part of the attraction for issuers is that the exchange provides access to some of the deepest pools of institutional and retail liquidity in the world. And investors like it because it effectively differentiates solid, high-quality companies from the thousands of securities that trade over-the-counter. The latter is achieved by admitting only companies that already trade on a “qualified” exchange and thus comply with regulations in their home market. Each listing candidate also has to have a US sponsor that provides a second layer of due diligence and effectively puts its brand reputation at risk to guarantee that the company is solid.

By pooling together such companies on a real time OTC platform, the exchange is playing into the demand in the US for non-US equities, which is at a 20-year high and has only increased this year as domestic economic growth has slowed, credit has tightened and US stockmarkets continue to slump. For many onshore US fund managers, the only way to access foreign equities is through DRs, which explains the significant growth in this market segment. As of last month, the American DR market totalled some $4.9 trillion, after increasing about 29% year-on-year. ADR trading volumes grew 72% between 2006 and 2007 and in the first half of this year, volumes were expected to be up 100% from the same period last year.

The first Hong Kong company may be joining the new exchange in a matter of months, says Stephen Nash, who heads up Merriman Curhan Ford's OTCQX group. Merriman was the first investment bank to be selected to sponsor companies to list on this exchange and also the first to actually bring a company to the market in March last year.

Having recently made his third visit here in search of potential listing candidates, Nash says a yet-to-be-named Hong Kong-listed mid-cap company, which is active in the entertainment industry, is planning to launch DRs on the OTCQX in late August or early September – although the most recent downturn in global equity markets could potentially move back the timing somewhat. Another five to 10 companies are “very seriously considering this”, says Nash. “They like the fact that it is a much lower price point for entry into the US and capturing the benefits of US trading without the regulatory expense.”

A couple of Singaporean companies are also close to making a decision and once the first Asia-listed firm takes the plunge, others can be expected to follow close behind, he adds. At least that is what happened in Australia where the first company decided in favour of OTCQX in May last year. There are now six Aussie companies on the US exchange (of which four have been brought there by Merriman) and at least another 30 that, according to Nash, are looking at it seriously at the board level.

“It’s all about finding the first mover,” he says. “This exchange can easily become the size of (London’s Alternative Investment Market), if not significantly larger. AIM started with 10 companies 12 years ago, it is over 1,600 now and I think the OTCQX will, in a similar amount of time, reach that magnitude.” He projects the number of listed companies will increase to 50 or more by the end of this year as there are more successful case studies for others to be attracted by.

“The DR market is a leading indicator that this will flourish,” Nash says.

There are currently 33 companies listed on OTCQX, including four domestic US companies. The overwhelming majority of the new listings are expected to come from overseas, however, because the real value lies in being able to access US investors in the first place. Aside from Australia, Singapore and Hong Kong, the other qualified exchanges in Asia that could feed companies into the OTCQX are Japan, India, South Korea, New Zealand, the Philippines and Thailand. Globally, there are 42 qualified exchanges.

Nash sees the listing of Swiss healthcare and pharmaceutical giant Roche Holding on the OTCQX in November last year as an inflection point in terms of attracting new stocks on to the platform as it proved that this is not a secondary market for small- or mid-sized companies that for various reasons don’t qualify for the major exchanges. This makes the OTCQX different from a market like AIM and is, together with the requirement for companies to comply with regulations in their home market, believed to be a key reason for the investor interest in the new exchange. With a market cap of $160 billion Roche infused a lot of liquidity into the market and in return has seen its own trading volumes in the US increase by 30%, likely helped by the fact that the OTCQX is a market maker-driven trading platform. Roche has traded OTC in the US since 1992.

The largest Australian success story, according to Nash, has been Linc Energy, a supplier of environmentally friendly power, diesel and jet fuel through the use of among other things a technology referred to as underground coal gasification, which listed on the OTCQX in December last year. Since then, the Merriman-sponsored company has seen its market cap jump from $254 million to $1.4 billion. Obviously, the company is in a sector that has been quite hot this year, but the access to new investors has helped boost buying interest in the stock and is also prompting other Australian companies to consider a potential OTCQX listing of their own.

So far, the decline in US share prices hasn’t affected Merriman’s OTCQX sponsoring business at all and the current poor market environment could in fact be helpful in attracting non-US companies to the new exchange.

“Right now is not, and I don’t think anyone will disagree, the time to raise capital or do an IPO anywhere in the world. Now is the time for companies to think about alternative mechanisms that are non-dilutive to the current shareholder base, that can help them identify a new set of investors and find more demand without adjusting the supply – and that is exactly what this market captures,” Nash says. “These are the sort of things that support stocks when they are down and enable investors to get in at a lower price point and benefit from the upside when the economy recovers.”

“By focusing on this strategy now, companies can position themselves for significant momentum from new investor buying in the future when the economy comes back.”

Companies looking to list their DR programs on the OTCQX can chose between three types of sponsors: a lawyer sponsor, a DR bank sponsor or an investment bank sponsor. There currently 18 eligible sponsors to chose from. Merriman has so far brought six companies to the market. The US investment bank primarily targets candidates that fit the firm’s overall focus on cleantech (next generation energy), consumer and retail, healthcare/biotechnology/medical devises, and the technology, media and telecom sectors so that it can leverage its full resources, including research. However, Nash says it will also sponsor a company that fits certain macro trends and that is viewed as “best in class”.