

Ukrainian Agricompanies Seek Alternatives on Warsaw Stock Exchange



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The financial crisis and the high cost of loan capital at the country's commercial banks have forced Ukrainian companies to seek alternative sources of funds. National and foreign experts reasonably name foreign and international capital markets as such an alternative. We already have some examples of successful stocks placements by major Ukrainian agribusinesses on foreign platforms. MHP, Kernel and Astarta are just some of them. And, while before the recession placement on foreign stock exchanges was exclusively the prerogative of some top-ranking Ukrainian companies, today more and more small and medium-sized businesses are turning their eyes to foreign capital markets.

It is clear that the main platforms of the foreign stock exchanges are closed for such companies. Meanwhile, many stock exchanges arranged alternative trading platforms, which may be a location for mid-sized companies to place their financial instruments. The Warsaw Stock Exchange (WSE) is one of them and experts quite often consider it among the most accessible and attractive for Ukrainian companies. In recent years, the WSE has also reasonably been regarded as one of the European leaders from the perspective of capitalization and trade volume.

WSE alternative trading platforms

The WSE currently offers issuers the following two alternative trading platforms:

NewConnect, which has been functioning since 30 September 2007, and is meant for placement of private equity instruments (shares, depository receipts, and options); and

Catalyst¹, which was established on 30 October 2009 as a market for accommodation of debt instruments issues — mainly corporate and municipal bonds.

Both trading platforms are quite attractive for issuers. Firstly, the platforms regulations do not prescribe qualified requirements to them and their financial instruments. In particular, in order to be traded on the main platform there is a requirement that a company's capitalization cannot be less than EUR 10 million. At the same time, NewConnect Trading Regulations do not contain capitalization requirements, and the minimum value of placement on the Catalyst is EUR 400,000. Secondly, to get access to the main trading platform a company must present accounting reports for the last three years. The rules of NewConnect and Catalyst do not specify such a requirement for private placement, and, therefore, even start-uppers may pursue investments through these platforms.

Placement procedures of the alternative trading platforms are much easier, less expensive and time-consuming. This relates especially to private placements. While an IPO on the main tra-

ding platform takes usually more than 1 year, an IPO on an alternative trading platform takes 6-9 months, and 2-3 months are necessary to place private equity instruments via private placement. Furthermore, expenses for placement on WSE alternative platforms are even incomparable with those for placement on the AIM at the London Stock Exchange.

Quite often placement on an alternative trading platform is considered a pre-IPO stage. In March 2010 NewConnect introduced a specific rank for some companies of the market. The rank is named NewConnect Lead. Its aim is to promote those companies, which have the best chance of getting listed on the main platform of the WSE. Public companies that have been operating at least 1 year and with capitalization of at least EUR 5 million will fall within NewConnect Lead rank. In addition, such companies should strictly comply with information disclosure requirements.

A principal weak point of alternative platforms is the investors and the volume of funds that may be attracted. NewConnect turnover in 2009 was 1162 million zloty (USD 407 million) and the majority of investors (89%) are individuals. Nevertheless, pension funds, with 37% share of the turnover, are the most active investors. In 2009 the number of foreign investors did not exceed 1% but their share in annual turnover of the market increased to 35%. The Czech Republic, followed by Great Britain and Germany, is the leader among non-residents. Catalyst, set up in

¹ Catalyst involves 4 trade platforms. Two of them are operated by the WSE (regulated market and alternative trading system) and two BondSpot markets (regulated market and alternative trading system). This article deals with the alternative trading systems of the Catalyst platform.

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the fall of 2009, accommodated 9 issues of municipal bonds and 26 issues of corporate bond issues by the end of the year. Total annual turnover at Catalyst was 5.1 billion zloty (USD 1.76 billion).

Choice of financial instruments

When deciding on a financial instrument that will be placed on a stock exchange, Ukrainian issuers should carefully consider the restrictions imposed by current Ukrainian legislation. In particular, the *On Securities and Stock Market Act of Ukraine* requires that an issuer obtain a permit from the State Commission of Ukraine on Securities and Stock Market to place its securities abroad.

The procedure for obtaining such a permit is governed by the Temporary Regulations *On the Procedure of Granting Permits to Circulation of Shares and Bonds of Ukrainian Companies Abroad*, approved by the Commission Resolution No.36 of 17 October 1997. These Regulations are obsolete and contain requirements that are impossible to comply with. Thus, Ukrainian companies do not have an opportunity to directly place their shares/bonds on foreign capital markets and instead apply one of the following models:

— Establishment of a holding company in an EU country (Cyprus, Great Britain and Netherlands are among the most popular jurisdictions), assignment of Ukraine-based assets to a holding company, and subsequent placement of shares/bonds issued by the holding;

— Deposition of shares of Ukrainian companies in a foreign bank and placement of depositary receipts, issued by this bank.

Under the NewConnect rules, depositary receipts are officially permitted for trading. However, Polish investors are not inclined to rely upon such instruments, and since they form the major-

ity of investors on NewConnect, depositary receipts have not yet been traded on NewConnect or on the main WSE platform. Thus, a Ukrainian issuer willing to have its instruments traded on the NewConnect can actually do it only via a foreign SPV.

Introduction to trading on NewConnect

The basic document that regulates admission and turnover of financial instruments on NewConnect is the Alternative Trading System Rules adopted by the Resolution of the WSE S.A. Management Board No.147/2007 of 1 March 2007.

Financial instruments can be introduced for trade on the NewConnect under the following terms: 1) an issuer is a company limited by shares; 2) an information document has been prepared by the issuer in accordance with the requirements specified in Annex 1 to the Rules; 3) there are no restrictions in effect upon circulation of the issuer's instruments (restrictions imply the preemptive rights, any clearance of instruments purchase or sale); 4) the issuer is not under a bankruptcy or winding-up procedure; 5) the issuer agreed to cooperate with an authorized advisor (in case of private placement), and after introduction to trading with a market animator/maker.

The issuer himself chooses the authorized advisor which, as a rule, is an investment company, law or audit firm, or a financial advisor. The main task of the authorized advisor is to prepare the information document, provide the issuer with comprehensive support for placement of the instruments, and to assist during the post-placement period (ensuring the issuer meets the requirements of the NewConnect, including information disclosure requirements). The period of cooperation with the authorized advisor must be no less than one year starting from the introduction date.

The function of the market animator/market maker covers supporting the financial instrument liquidity. It should be noted that in addition to the authorized advisor and market maker/animator, the issuer needs to retain a number of other advisors, who may substantially influence the placement success (lawyers, auditors, investment advisors and PR agencies, etc.)

Placement on NewConnect

Placement of financial instruments on the NewConnect can be public or private. If the offer is directed to not more than 99 investors, then the placement shall be deemed private. Public placement is directed to an unlimited number of investors.

The private placement procedure covers the following stages:

- 1) Restructuring of the issuer (if needed);
- 2) Making to an agreement with the authorized advisor;
- 3) General Meeting of the issuer decides on the flotation and placement of financial instruments on NewConnect via private placement;
- 4) Performance of financial and legal due diligence;
- 5) Preparation of the Information Document by the authorized advisor;
- 6) Registration of the instrument with the National Depository;
- 7) Filing the application for introduction of the instruments to the WSE;
- 8) Approval of the Information Document by the WSE (within 5 business days) and making the decision on introduction;
- 9) Publication of the Information Document on the WSE's website;
- 10) Making an agreement with the market animator/maker;
- 11) Filing the application for determining the first trading date;

An IPO on an
ALTERNATIVE
trading
PLATFORM
takes
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and
2-3 MONTHS
are necessary
to PLACE
PRIVATE equity
INSTRUMENTS
via PRIVATE
PLACEMENT

When
DECIDING on
a FINANCIAL
INSTRUMENT
that will
be placed
on a STOCK
EXCHANGE,
Ukrainian
ISSUERS
should
carefully
CONSIDER the
RESTRICTIONS
imposed
by current
UKRAINIAN
LEGISLATION

12) The first trading date is set by the WSE.

The procedure of public placement is in general almost the same. The main difference is that the company has to prepare the prospectus, which has to be approved by a competent national regulating authority.

Introduction to Catalyst

Introduction to trading on Catalyst is regulated by the Catalyst Market Rules, approved by the Resolution of the WSE S.A. Management Board No.408/2009 of 3 September 2009. The procedure is almost similar to the NewConnect procedure.

Applicable laws

A company, planning to trade its instruments on foreign capital markets, should consider that all the relations involved shall be subject to the laws of at least 3 jurisdictions: 1) Ukraine; 2) the jurisdiction, where the holding company is incorporated; and 3) Poland.

Thus, when choosing a legal advisor and auditor, the issuer should give preference to international companies with offices in relevant jurisdictions or to the reputable national companies, having partnership relations with law or audit firms, working in the relevant jurisdictions (that is, the so-called "best friends" system).

Legal due diligence

Legal due diligence is not among the obligatory terms for introduction to the NewConnect. However, to ensure success of instruments placement issuers (especially non-residents) should follow the "best practice" standards, which require the report on legal due diligence to be in place.

While drafting due diligence report, a legal advisor should consider possible requirements/

recommendations of the authorized advisor as to the scope and structure of the report. This is especially important due to the fact that information from the report serves as background for the Information Document.

Due diligence is, as a rule, divided into two stages: 1) initial due diligence, aimed at revealing existing risks and problems of the business; and 2) subsequent due diligence, which is meant to check if the risks and problems revealed on the initial stage have been eliminated.

Structuring of holding and restrictions of Ukrainian laws

When structuring an SPV holding, business owners should pay special attention to all the organization formalities, especially to the restrictions, provided by Ukrainian legislation. In some cases it may be mandatory to obtain some permit documents (licenses of the National Bank of Ukraine for investment abroad, preliminary opinions and concentration permits of the Antimonopoly Committee of Ukraine, etc.) from the Ukrainian authorities.

To avoid obtaining NBU licenses at the stage of a holding company's establishment nominal shareholders are frequently involved. Subsequently, business owners may either continue using nominal shareholders or become shareholders themselves. The last option may cause the necessity to obtain a license as well. However, this depends on the mechanism (purchase-and-sale or deed of gift) applied to formalize assignment of shares from the nominees to the business owners.

As a rule, some of the transactions involved in the business structuring process presuppose obtaining the preliminary opinions of the AMCU and, if any, concentration permits. In practice this may take a lot of time.

Information disclosure

NewConnect rules

Under the NewConnect rules the issuer is obliged to disclose current information, which is information on any circumstances or events that may have a significant influence on business, property or the financial situation of the issuer, or could, in the issuer's opinion, significantly affect the price or value of the financial instruments, and periodical information (an annual report and quarterly reports).

Current information shall be disclosed within 24 hours after the circumstances that fall within the current information occurred.

Quarterly reports are to be filed not later than 45 days after the end of a reporting quarter and the annual report — not later than 6 months after the end of the year.

After filing, financial reports should immediately be placed on the website. The report should be printed, signed and kept by the issuer for 3 years.

Catalyst rules

Catalyst information disclosure rules are less detailed. Issuers are obliged to disclose current information. However, unlike the NewConnect rules, the Catalyst rules do not provide a list of information, which may affect the issuer's status and on every occasion the decision as to whether or not to refer the information to current is at the issuer's discretion.

First signs

AGROLIGA GROUP (Kharkov) is the first Ukrainian issuer that has officially announced its intention to enter the NewConnect platform, as well as being the first mid-sized company planning to attract investments on the WSE. In the past only such major Ukrainian agricultural companies as Astarta and Kernel traded their financial instruments on the main WSE platform.

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