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NewConnect as an Alternative Trading System

Key words: *alternative trading system, NewConnect, Warsaw Stock Exchange, Authorized Adviser*

Abstract: The present paper is focused on NewConnect that is a new market that was organized and has been operated by the Warsaw Stock Exchange next to the main regulated market. On 30 August 2009 this new trading platform celebrated the second anniversary of its functioning. Because of a short period of its operation, NewConnect still remains unknown and mysterious for both potential issuers and investors as well as for many individuals interested in stock exchanges and capital markets. This common unfamiliarity with the NC Market operations is an essential obstacle to its development whereas NewConnect has a chance to become a significant part of the Polish capital market. It is intended for young dynamic Polish and foreign entities as an alternative source of capital required for financing of small and very innovative companies and investments. It gives them a chance to raise capital at a lower cost. On the other hand, investors gain a great opportunity to become shareholders in a company with the prospects of success. The aim of this paper is to present basic information about the NC Market, its rules, participants as well as to provide some statistics of NewConnect functioning from its beginning in August 2007 until the end of August 2009.

INTRODUCTION

The NewConnect Market (NC) was opened on 30 August, 2007. It was organized and has been operated by the Warsaw Stock Exchange (WSE). NewConnect has the status of an organized market, but it is operated by the WSE outside the regulated market as an Alternative Trading System (AST). This platform is developed for young dynamic Polish and foreign entities as an alternative source of capital required for financing of small and very innovative companies and investments. It is intended for companies which cannot get capital from the main market of the WSE because they do not meet the WSE's requirements (such as: stage of development, size, age or type of business), or for which less rigorous

regulations are more appropriate. Because of such an issuer profile, NewConnect offers more liberal formal obligations and information requirements, which reduces the cost of capital.

According to the assumptions of the Warsaw Stock Exchange, NewConnect was also launched as the first step on the main exchange market for listed companies. It functions as a kind of ‘kindergarten’ for companies on their way to the main regular market.

ISSUERS ON NEWCONNECT

NewConnect is mainly intended for dynamic start-up companies that need some capital to take advantage of their innovative potential and so to grow and become a large, high-value entity. The Warsaw Stock Exchange decided to open NewConnect for companies that:

- were established no more than 3-4 years ago and are in the start-up phase, in the process of building their business track record;
- are seeking to raise between a few hundred thousand to a few million PLN or even higher levels of capital;
- come from innovative sectors based on intangible assets, such as, e.g., information technology, electronic media, biotechnologies, environment protection, alternative energy;
- have an expected capitalization of up to PLN 20 million;
- are characterized by high growth dynamics and a chance for a regulated market debut in the near future.

Because the NC Market is intended for special group of issuers, the Alternative System Organizer established only few requirements to be met by a company which is seeking a NewConnect debut. They are listed below (Issuer Manual, p. 5):

- The status of a joint stock company (or a joint-stock limited partnership company);
- Unlimited transferability of shares;
- The company has not been declared insolvent nor is in the process of undergoing liquidation proceedings;
- Cooperation with an Authorized Adviser or Market Animator/Market Maker (in certain cases this requirement is waived);
- Preparation of an information document.

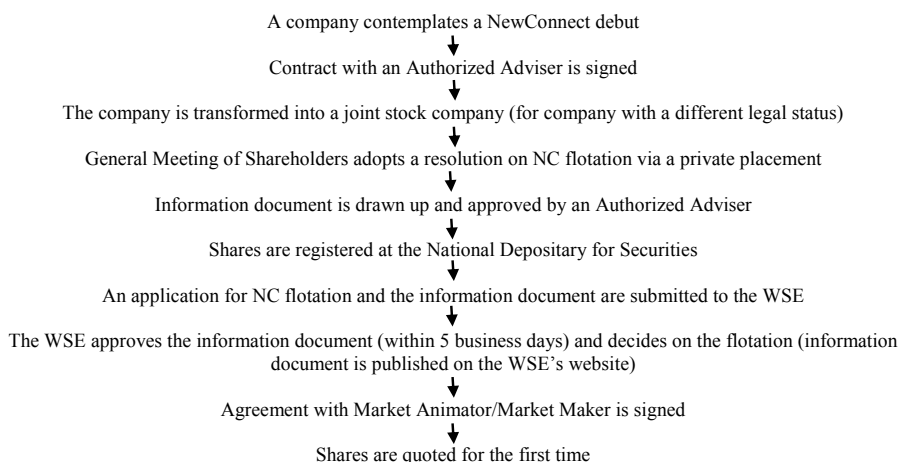
A unique advantage of NewConnect is that it offers all the benefits of being traded on a public market but within a regulatory environment designed specifically for smaller companies. There are many reasons why companies choose to be listed on NewConnect. Generally, most companies decide to join the NC Market to:

- access capital for growth, both at the time of debut and later through further issues;
- create a market for their shares, broadening their shareholder base and giving existing shareholders the chance to exit;
- obtain an objective market value for their business;
- raise their profile with a view to expanding their operations into new overseas markets;
- reward and encourage employees through the introduction of share incentive schemes.

There are two ways to a NewConnect debut (Issuer Manual, pp. 5–7):

1. Via a private placement – it is a private offering targeted at a maximum of 99 entities: institutional and individual investors. In this case, regardless of the size of the issue, the admission to trading is based on a short and simple information document prepared and approved by an Authorized Adviser. The preparatory phase from the decision to the start of trading may be as short as 2–3 months, much less than in the regulated main market.

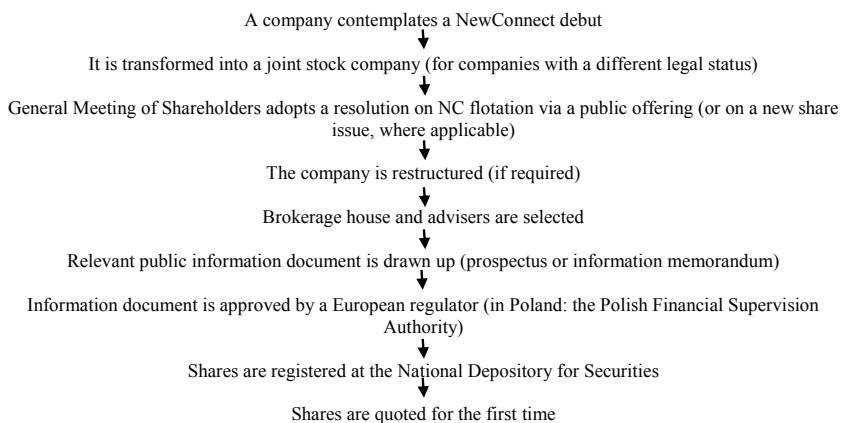
Scheme 1. Private placement procedure



Source: *The study based on Issuer Manual*, Warsaw Stock Exchange, www.newconnect.pl (01.09.2009).

2. Via a public placement – an issuer is subject to the same admission procedures as these applicable on the regulated market, including the requirement to prepare a prospectus that must be approved by the Polish Financial Supervision Authority (PFSA). For offerings of up to EUR 2.5 million an information memorandum may be considered as an admission document. The whole procedure from the decision to the IPO (Initial Public Offering) is the same as in the regulated market and lasts about 6–9 months.

Scheme 2. Public share issue procedure



Source: *The study based on Issuer Manual*, Warsaw Stock Exchange, www.newconnect.pl.

AUTHORIZED ADVISERS AND OTHER ALTERNATIVE TRADING SYSTEM'S PARTICIPANTS

When the Warsaw Stock Exchange launched the Alternative Trading System, it aimed to establish a flexible and practical method of regulation that would be appropriate for younger and smaller companies that the WSE wanted to attract. Realizing that many companies would not have a management team experienced in running public companies and not wishing to employ additional regulators itself, the WSE chose to outsource the responsibility for ongoing supervision of NC companies. It achieved this by creating a new type of financial adviser – the Authorized Adviser (AA) and charging him with three principal tasks.

Firstly, an Authorized Adviser is responsible for judging whether the company is appropriate for NewConnect Market. He should also explain the NC rules to the company's board, and ensure that the directors are aware of their responsibilities and obligations (point No. 13 Appendix to Resolution No. 469/2008). This is especially important because directors are ultimately responsible for their company's compliance with the NC's regulations, including the accuracy of the information in the admission document.

Once the Adviser has agreed that a company is suitable for admission to the NC Market, his task is to manage a flotation process – he will bring together a team of other necessary advisers, set a timetable, allocate responsibilities and ensure that all parties realize their roles that have been agreed.

After the company's admission to NewConnect, the Adviser will continue to give advice and guidance on the NC rules on an ongoing basis (Points No. 14–17

Appendix to Resolution No. 469/2008). He cooperates with the company for at least one year of quotation on NewConnect Market.

The role of the Authorized Adviser is so crucial that if a NC company ceases to have an advisor, trading in its securities will be suspended until a new adviser has been appointed (Par. 18 Alternative Trading System Rules).

Under the Alternative System Organizer's rules an Authorized Adviser is an investment firm or another entity providing services related to business transactions, including financial and legal advice or financial audits, and entered into a register maintained by the Alternative System Organizer. An Authorized Adviser may not be an issuer's parent entity or subsidiary (Par. 18 Alternative Trading System Rules).

Companies interested in acquiring the status of an Authorized Adviser should submit an application for an entry into the register of NewConnect Authorized Advisers*. The WSE evaluates the competences of the applicant considering, among others things, the experience of the company and its managers in operation on the stock market. An Authorized Adviser is also obliged to cooperate with the Alternative System Organizer in developing the NewConnect Market, so the WSE evaluates the applicant's concerning proceeded or planned actions aimed at attracting new issuers for the Alternative Trading System (points No. 6-7 in Application form for entry into register of Authorized Advisers).

The Alternative System Organizer provides regularly the review of the Authorized Advisers in order to confirm that the company can operate as an adviser on a continuous basis, reliably complies with the statutory tasks, provides ongoing advisory services to NewConnect issuers and assists them in complying with NewConnect reporting requirements. Every year, by 15 January, every Authorized Adviser is obliged to provide the Alternative System Organizer with a report for the previous calendar year. This report should present information about actions it performed as the AA in a reporting period (point 31 Appendix to Resolution No. 469/2008). The Warsaw Stock Exchange maintains a register on its website of entities nominated to act as Authorized Advisers for NewConnect Market.

Apart from the Authorized Advisers, there are Market Animators and Market Makers operating on the NewConnect. These are brokerage houses or banks which are members of the Warsaw Stock Exchange. Market Animators and Market Makers were not created especially for the NC market – they are well known on the Polish capital market because they operate on the WSE's Main Market. In the period of trading, at least for 2 years after the debut, they support the company by ensuring liquidity of trading in the issuer's shares (Par. 20 Alternative Trading System Rules). As in the case of Authorized Advisers, the Warsaw Stock

* An application form for entry into register of WSE Authorized Advisers for NewConnect is available on NewConnect website: www.newconnect.pl.

Exchange may waive the requirement for an issuer to cooperate with an investment company (Par. 8 Resolution No. 575/2007).

NEWCONNECT REGULATORY ENVIRONMENT

NewConnect is not a regulated market in the meaning of European Union law and Polish legislation, which means that it is not governed by numerous Polish and European regulations applicable to companies being listed on regulated markets. Trading is organized and regulated primarily by the Warsaw Stock Exchange, which aims to make sure that NewConnect is not overregulated but, rather, guarantees relatively high transparency of trading typical of public markets.

The main legislation binding on the NewConnect Market is the Alternative Trading System Rules and two Exhibits:

- Exhibit 1 on the rules of preparation and contents of the information document;

- Exhibit 2 on the specific rules of trading in listed financial instruments.

The provisions of the Alternative Trading System Rules are complemented and elaborated by the Resolutions passed by the WSE Management Board under powers delegated in the Rules (Par. 25–26 Alternative Trading System Rules). These include in particular:

- ‘Authorized Adviser in the Alternative Trading System’;
- ‘Current and Periodical Information in the Alternative Trading System’;
- ‘Rules of Transmitting Current and Periodical Information on the NewConnect Market’;
- ‘Fees in the Alternative Trading System’;
- ‘Specific Rules of Operation of a Market Animator on the NewConnect Market’;
- ‘Code of Best Practice of NewConnect Authorized Advisers’;
- ‘Code of Best Practice of NewConnect Listed Companies’;
- Resolution concerning the specific conditions for starting operation in the Alternative Trading System (NewConnect Market) by Market Members.

The NewConnect regulations are very important part of market operation. The Warsaw Stock Exchange, as the Market Organizer, regularly reviews the regulations from the perspective of the trading practice, improved operating standards, safety of trading, as well as suggestions of market participants, including investors. To the extent that the review indicates a need of amending, improving and expanding the regulations, the WSE gradually amends the binding regulations. The Alternative Trading System Rules and any amendments thereof are subject to approval by the Financial Supervision Authority.

NEWCONNECT ONE YEAR AFTER ITS DEBUT

When NewConnect was opened (on 30 August 2007), there were listed five companies: Digital Avenue S.A., S4E S.A., VIAGUARA S.A., Virtual Vision S.A. and Wrocławski Dom Maklerski S.A. By the end of 2007, after four months of quotations on NewConnect, 24 companies had decided to make their debut on the new WSE's market.

In the first 12 months of operations, 64 issuers were listed – on average there were five new listings each month. In this group prior to the listings:

- 51 companies completed private placements of newly issued shares;
- 3 companies completed public offerings of newly issued shares;
- 10 companies did not offer newly issued shares, however, in seven of them the owners decided to sell their shares (Road to Maturity Report, August 2008, pp. 15–16).

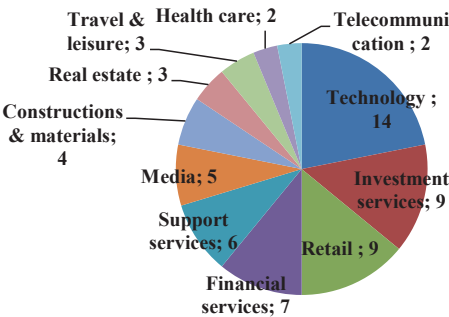
By 29 August 2008, the total value of shares issued on NewConnect was close to PLN 300 million, of which around PLN 280 million were raised by companies in private placements of newly issued shares and around PLN 15 million were obtained in public offerings. Apart from new issues, around PLN 19 million were collected by the owners who sold their shares shortly before listing on NewConnect, thus companies and shareholders raised the total of approximately PLN 314 million (Road to Maturity Report, August 2008, p. 16). The largest issues were those of LUG S.A. (PLN 20.7 million), M.W. TRADE S.A. (PLN 16.3 million) and MERA SCHODY S.A. (PLN 13.7 million) (Report NewConnect 2008, IPO.pl, pp. 7-8). The average value of an issue on NewConnect was around PLN 5 million.

The Alternative System Organizer has classified the listed companies into 11 sectors. The largest category of NewConnect official sectors are new economy companies. This includes technology (14 companies), media (5 companies) and telecommunication (2 companies). The second biggest category are investment service providers and retail companies (9 companies in each) followed by 7 financial companies. Other sectors are presented below (see Figure 1).

As was mentioned above, a company listed on the NC Market is obliged to choose an Authorized Adviser and cooperate with this entity during at least one year after a debut. The register of Authorized Advisers is provided by the Alternative System Organizer on the website (www.newconnect.pl).

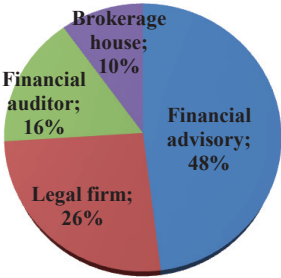
From the very beginning of the NC Market operation, the number of advisers accredited by the WSE has been considerably higher than the number of listed companies. Six months after the NC Market debut, about 110 entities were registered by the WSE as an Authorized Adviser and about 35 companies were listed. As of 30 August 2008, the WSE accredited 136 advisers and 64 companies were quoted. The structure of an adviser business profile is presented below.

Figure 1. NewConnect sector classification of companies (30 August 2008)



Source: own study on the basis of the list of companies presented on: www.newconnect.pl.

Figure 2. Authorized Adviser Business Profile at 30 August 2008



Source: own study on the basis of the Register of Authorized Advisors presented on: www.newconnect.pl.

The leading Authorized Adviser in the first year of the NC Market, both in terms of the number of companies listed and the share in the total value of offerings, was CEE Capital Sp. z o.o. (10 companies, 28.8% share). Invest Consulting S.A. (7 companies, 7.1% share) was in the second position. The third position in the Authorized Advisers ranking was occupied by: (by the number of listed companies) – Ruciński i Wspólnicy Kancelaria Audytorów i Doradców Sp. z o.o. (6 companies) and (by the share the value of offerings) by Capital One Advisers Sp. z o.o. (6.0% share) (Report NewConnect 2008, IPO.pl, p. 14). Detailed information is presented below in Table 1 and Table 2.

Table 1. The ranking of Authorized Advisers – the number of supported companies (30 August 2008)

Rank	Authorized Adviser	Number of companies
1	CEE Capital Sp. z o.o.	10
2	Invest Consulting S.A.	7
3	Ruciński i Wspólnicy Kancelaria Audytorów i Doradców Sp. z o.o.	6
4	GoAdvisers Sp. z o.o.	5
5	Capital One Advisers Sp. z o.o.	4

Source: Report NewConnect 2008, IPO.pl, www.ipo.pl.

Table 2. The ranking of Authorized Advisers – the value of an offering (PLN million, 30 August 2008)

Rank	Authorized Adviser	The total value of offerings	Market share
1	CEE Capital Sp. z o.o.	82.9	28.0%
2	Invest Consulting S.A.	21.1	7.1%
3	Capital One Advisers Sp. z o.o.	17.9	6.0%
4	Investin Sp. z o.o.	16.4	5.5%
5	IPO Doradztwo Strategiczne Sp. z o.o.	12.8	4.3%

Source: Report NewConnect 2008, IPO.pl, www.ipo.pl.

The year 2008 brought crucial changes in the Authorized Advisers register. From 20 August, 2008 to 15 December, 2008 the WSE made a review of the AA work on NewConnect. The assessment covered advisers entered into the register by 15 July 2008 – about 132 entities (The WSE Communiqué of 15 July, 2008). The main criteria of this assessment included (Road to Maturity Report, August 2008, p 28–29, Hamernik N., IPO.pl):

- Quality of the portfolio of issuers – volatility of stock prices, number of issuers listed within the period, assessment of the innovative profile of the company's business;

- Quality of the issues in the portfolio – amount of equity raised in the issue, concentration of issued stock among primary market investors in a private placement, cost of issue, overall assessment of the private placement on the basis of the Private Placement Report;

- Quality of an AA compliance – quality of the information document, quality of current and periodical reports, assessment of an adviser compliance with Best Practice, assessment of an adviser by the issuer and the WSE;

– Other – promotion of information about the NewConnect, sector represented by the NewConnect issuer, profile of the company's market and geographic scope of business.

As the result of the WSE's review, 43 of 132 Authorized Advisers lost their authorization to provide advisory services on NewConnect Market. This event should be treated as the WSE's concern for the quality and effective operation of NewConnect. After the assessment made by the Alternative System Organizer, investors and companies can be sure that now there are the best and the most effective advisers operating on the NC Market. Finally, NewConnect finished the year 2008 with 101 entities in the AA register.

The first year of NewConnect operation indicates strong interest of the Polish entities in providing advisory services. A steadily growing number of Authorized Advisers improves competition among advisory companies, which has a positive impact on the quality and price of services offered on the NC Market. The AA register also includes one foreign advisory company – New Europe Advisers Limited from London. This could mean that the potential of NewConnect is noticed not only by local capital markets.

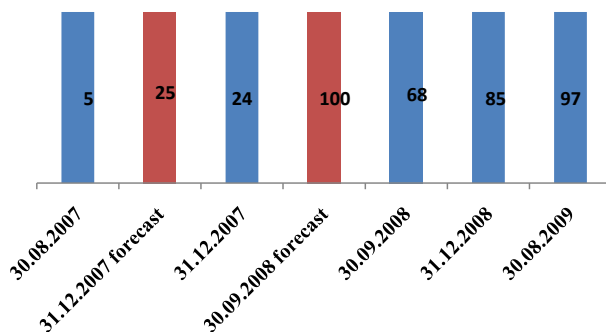
TWO YEARS OF NEWCONNECT OPERATION

On 30 August 2007, when the NC Market was opened with five debuts, the Alternative System Organizer was very hopeful and made quite optimistic assumptions about NewConnect development in the future (see below: Figure 3). In fact, the actual number of quoted companies was closed to the forecast only at the end of the year 2007. At the end of the year 2008, there were 85 companies listed and two years after NC debut there were 97 issuers listed – this was even less than the forecast number of companies on 30 September, 2008.

The NC Market growth rate is still rather beyond WSE's expectations. This situation is caused the world financial crisis. The volatility on world financial markets affected negatively the activity of foreign investors and prompted Polish individuals, investing either directly or through investment funds, to withdraw from capital markets. This investor behavior also had an adverse impact on the NewConnect – many companies decided to cancel or postpone a debut on the NC Market.

Under the Alternative System Organizer's rules, issuers based outside Poland may be quoted on NewConnect. They are subject to the same WSE's regulations as Polish companies. At the end of the year 2008, there was only one foreign company quoted on NewConnect. On 16 October 2008, Photon Energy a.s. from the Czech Republic started listing its ordinary bearer shares on the Polish Alternative Trading System (Resolution No. 757/2008)

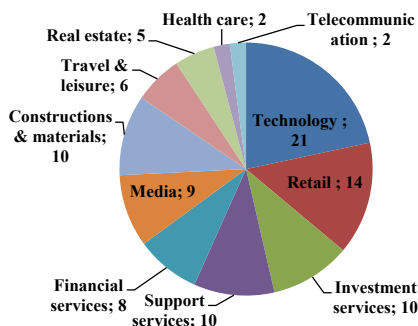
Figure 3. Number of companies listed on NewConnect – forecast and actual data



Source: own study on the basis of www.newconnect.pl.

Two years after NC debut, the sector classification of listed companies still included 11 sectors (Resolution No. 594 /2008). The new economy companies remained the largest category of NewConnect official sectors consisting of 32 issuers, but the second biggest category were retail companies (14 businesses). Next, there were investment service providers, support services providers and construction companies (consisting of 10 companies each) (see below: Figure 4).

Figure 4. NewConnect sector classification of companies (30 August 2009)



Source: own study on the basis of the list of companies presented on: www.newconnect.pl.

In 2009 the WSE made the second review of the work of Authorized Advisers. This assessment lasted from 1 June until 15 July 2009 and covered Authorized Advisers entered into the register by 30 September 2008 – about 92 entities. As the result of this review, 33 advisers lost their authorization (The WSE Communiqué of 15 July 2009). Finally, on 30 August 2009 the Authorized Advisers register consisted of 72 entities.

There were many crucial changes and events during the two years of NC operation, but the principal event on the NC Market was the transition of M.W Trade S.A. from NewConnect to the WSE's Main Market. M.W. Trade S.A. has

been the first company listed on the WSE's regular market after being quoted on NewConnect. The company made its NC debut on September 2007. Since 19 December, 2008 its shares are listed on the Main Market (www.mwtrade.pl, Resolution No. 948/2008). Another company – Centrum Klima S.A. – changed the Alternative Trading System for the WSE's Main Market on 6 January, 2009. It has been listed on NewConnect since 27 May 2008 (www.centrumklima.pl, Resolution No. 986/2008).

CONCLUSION

NewConnect Market was opened on 30 August 2007, at the end of a bull market period on global financial markets and at a time when economic problems in the USA started. Strong volatility on equity markets that followed resulted from high uncertainty about the condition of the global economy. The tensions, which still affect the market, were generated among others by the collapse of the United States mortgage market, huge financial losses of global banks causing volatility on the money markets, tighter bank policies of granting investment loans, and a sharp rise of prices of natural resources, in particular of crude oil (Road to Maturity Report, August 2008, p. 5).

NewConnect started its operation in a relatively difficult and deteriorating environment. In spite of this unfavorable background, the number of new listings grew very dynamically as issuers were finding financing through private placements and initial public offerings as well as through secondary offerings. NewConnect became undoubtedly a significant part of the Polish capital market. Aimed especially at small and start-up companies, it gives them a chance to raise capital at a lower cost.

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Resolution No. 594/2008 of the Warsaw Stock Exchange Management Board dated 31 July 2008 concerning sector classification of companies whose stocks are introduced to the alternative trading system on the NewConnect market.

Resolution No. 757/2008 of the Warsaw Stock Exchange Management Board dated 15 October 2008 concerning setting the first trading day for series B bearer ordinary shares of the company PHOTON ENERGY a.s. in the alternative trading system on the NewConnect market.

Resolution No. 948/2008 of the Warsaw Stock Exchange Management Board dated 17 December 2008 concerning delisting of series A, B, and C bearer ordinary shares of the company M.W. TRADE S.A. in the alternative trading system on the NewConnect market and cancellation of broker's orders for shares of the company on the NewConnect market.

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NEWCONNECT JAKO ALTERNATYWNY SYSTEM OBROTU

Słowa kluczowe: *alternatywny system obrotu, NewConnect, Warszawska Giełda Papierów Wartościowych, autoryzowany Doradca*

Abstrakt: Prezentowany artykuł ma na celu przedstawienie rynku NewConnect (NC), będącego Alternatywnym Systemem Obrotu (ASO), zorganizowanym i prowadzonym przez Warszawską Giełdę Papierów Wartościowych w Warszawie S.A. (GPW). W dniu 30 sierpnia 2009 roku rynek NewConnect obchodził drugą rocznicę funkcjonowania. Ze względu na krótki okres działania, NewConnect nadal pozostaje tajemnicą zarówno dla potencjalnych inwestorów i debiutantów, jak i dla wszystkich osób zainteresowanych tematyką rynków kapitałowych. Powszechna niezajomość zasad funkcjonowania ASO jest jedną z najważniejszych barier rozwoju NewConnect, tymczasem rynek ten ma wielkie szanse stać się znaczącą częścią polskiego rynku kapitałowego. Platforma NC powstała z myślą o małych, nowo-powstałych, dynamicznie rozwijających się spółkach polskich i zagranicznych, jako alternatywne źródło kapitału niezbędnego do finansowania innowacyjnych podmiotów. NewConnect umożliwia pozyskanie tańszego kapitału oferowanego przez rynek publiczny przedsiębiorstwom, które nie spełniają kryteriów wymaganych dla debiutu na głównym rynku GPW. Natomiast inwestorom stwarza możliwość zakupu akcji spółek publicznych, charakteryzujących się większym ryzykiem (w stosunku do spółek notowanych na rynku głównym), ale jednocześnie z ogromnymi szansami na sukces w przyszłości. W artykule przedstawione zostały najważniejsze zasady działania NewConnect, regulacje prawne oraz uczestnicy tego rynku. Zaprezentowano również podstawowe dane statystyczne obrazujące rozwój NC w okresie pierwszych dwóch lat jego funkcjonowania.

