



The Hard Facts of AIM

Access to capital and M&A made easy are just some of the attractions of AIM, the London Stock Exchange's junior market for growth companies. While there are undeniable benefits, seasoned NED and Plc veteran David Hickey explains the risks executives need to be aware of before going public

Of course the AIM market works. It identifies and then channels investment funds into (usually) faster growing and smaller companies than, broadly speaking, the so-called Official List shares on the London Stock Exchange.

It's an attractive market for investment institutions because it is transparent and regulated, and also for private client investors as it carries significant fiscal advantages over fully listed shares (eg the inheritance tax exemption). For companies entering the market it raises their profile, boosts their credibility,

constitutes a fresh source of capital, and provides them with an additional currency for corporate transactions.

Who wouldn't seize the opportunity?

Well, there are a few caveats...

INDUSTRY

Be wary of the industry your company operates in and the market perception of growth potential. In general, the valuation rating which your company will attract will be affected by many

factors, including earnings or asset growth record, perceived industry and company prospects, and the quality of the management team. A deficiency in any of these could produce a modest rating, meaning that acquisitions could readily become dilutive and hence unaffordable.

Consider the AIM-quoted wealth manager Lighthouse Group, where I used to be Chairman. Over an eight-year period turnover grew six-fold, trading losses turned to consistent year-on-year profits, the payment of dividends commenced and a net-debt position turned to substantial

surplus cash balances with no debt. A perfect turnaround story: except that the shares dropped by 75 per cent. Why? Probably because five of its six quoted competitors became insolvent during the same period, leaving investors with the view that the industry was to be avoided.

Buying competitors is not now possible for this group as unquoted competitors in the industry are valued more highly, and hence any transaction would dilute earnings per share, and existing investors would be worse off. So before you even get to consider the merits of your own record and the capabilities of your team, cast a cold eye on the external perception of your industry's prospects.

SELLING SHARES

If company management looks to sell shares for their own benefit it is always greeted with suspicion and great hesitation. Investors like to see the growth story walked as well as talked, and management bailing out early sends out a strong 'sell' signal.

Even after having been quoted for many years, it can still be extremely difficult to find buyers for management shares. Should you really be in a sale mode then sell the company, don't float it. It can be the case that AIM will provide a higher base than the usual industry valuation matrix, and therefore an AIM float might appeal as an interim step on the way to a sale. However, expecting a buyer to pay a further premium for control of your business is pushing the 'bigger fool' theory quite some way. It can and does happen when equity markets are hot, but in the main, cashed-up corporate buyers in those circumstances usually opt to buy the unquoted competitors for less.

LIQUIDITY

Many institutional investors have a minimum investment size criteria, and even more don't like to have to disclose their ownership proportion holding (which is required at 3 per cent and above). Simple maths means that for an institution with a normal investment appetite of £1 million and an aversion to disclosure, the AIM valuation (or market capitalisation) needs to be £33 million. Since investors will want room for slippage, £50 million is nearer the mark. Below that and your investor constituency is becoming specialised, not main stream. That makes it harder to raise capital.

It gets worse. There are over 400 companies on AIM valued at £10 million or less. The normal market size in which AIM's market makers (the actual day-to-day stock traders) will commit to trading the shares in companies of this size can be as low as £500. No, not £50,000 or even £5,000: £500 trades will regularly change an AIM share price, up as well as down. So a market maker suddenly needing to offload his or her holding in your small company will likely, in the absence of buyers, drop the asking price to tease out some interest.

The company may be fine, but the message implied by a volatile share price is never positive.

TO AIM OR NOT?

I wouldn't hesitate to recommend that growing companies should consider an AIM flotation. It does confer an aura of maturity over and above similarly sized unquoted rivals: the resulting employee morale boost and trade counterparty

'feel good' factors are usually real, and expansionary funds can be procured on reasonable terms and a decent rating will facilitate using the newly quoted shares as consideration for transactions.

Do make sure, however, that your industry is seen as being in the 'sunrise' rather than the 'sunset'. Likewise, don't expect to be able to offload your personal holding in any size; make sure you are big enough to avoid the 'living dead' liquidity trap; and get a broker with market making capability to assist in mopping up small lots.

If you can do all of this then you and your management team and owners deserve to enjoy the benefits emanating from the junior market.

AIM high and carefully... ■

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