

Maximising the benefit from your AIM advisors

In the third of our series focusing on AIM advisors, Barry Gamble reveals what your broker can offer you

The responsibility of the broker to an AIM company is to ensure there is, as far as possible, an orderly market in the shares of the company. The AIM rules require an AIM company to retain the services of a broker at all times.

Brokers are in business, and their business model requires the activity of broking shares to maintain income. Most of their revenue is derived from transactions such as an Initial Public Offering (IPO), where there will be substantial activity as the company's existing shares are made available by selling shareholders, or newly issued shares are bought by new shareholders. Maintaining the secondary market in the company's shares is tougher, since the volumes of shares regularly traded day by day can, in many instances, be small. Broking firms and the individual salesmen they employ will inevitably gravitate to where the trading volumes are available. It just cannot be ignored that the fees brokers earn from money raising are of a different order of magnitude than those from normal retainers and day to day broking.

Marketmakers – wholesale traders of company shares who buy, sell and hold shares and as a result can increase liquidity – may or may not be part of the trading equation. Again, they will apply a very practical consideration: are they able to make money through trading a particular share? Unlike the broker,

they have no responsibility towards the company whose shares they choose to trade. Both marketmakers and brokers each tend to operate on a matched bargain basis with the retail investors effectively pricing the stock.

Some brokers are better geared to private clients; many more are focused on institutions. For the smaller market capitalisation company, which make up the bulk of the numbers on AIM, choosing a smaller broker might well be the appropriate choice, particularly at the early stages of being on a public market. Where

investors which, if relationships are well maintained, can provide good liquidity. Some private investors operating through family offices can be significant investors – almost institutional in scale.

In an ongoing sense, maximising the benefits to be derived will involve insights from both company management and broker. Recognise that each has a job to do – in particular it is very important for companies to realise that to continue to work effectively, brokers have to have the trust of the investors. So recognise that the broker has to maintain a solid relationship

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the need develops to raise the proportion of institutional shareholders, then it becomes more appropriate to retain a larger firm. Inevitably, one has to judge whether one can command sufficient attention to ensure motivation for the larger firm to act effectively. This issue might be addressed through the nominated broker being focused on institutions and then looking to some of the excellent smaller, but still energetic, regional brokers to provide private client shareholders. Being close to their clients in the shires often gives these firms a real advantage with private

with investors for all the companies it represents now and in the future.

A common way for a more effective approach to broking is through the combination of nomad and broker in one firm. Brokers will seek to argue for the two advisors to be combined so that nomad and distribution capability are fully harmonised. This can work well but is not ideal for all situations, and real distance between nomad and broker can have advantages, especially where a company is under pressure from its shareholders (which, let's not forget, are also long-term clients of the broker).

At the time of the IPO and in a secondary fundraising, a critical consideration will always be price and dilution of existing shareholders. For most AIM companies these are difficult judgements and will involve some trade-offs. Releasing too many shares at too low a price may be unduly dilutive but contrarily, setting the share price too high may restrict investor appetite and set the barrier too high for the initial after market and later trading. So often, some of these key calls will have to be made over short time periods; therefore, as ever, a strong and trusting relationship between broker and company is necessary. Meeting and getting to know the key salesman also helps.

Solid small companies often suffer from a lack of following because there isn't really any money to be made by brokers in covering or selling the stock. Also, the number of IPO transactions has been at a much lower level than in previous years. The consequence is starting to be seen in more mergers and acquisitions of the smaller brokers, particularly where they have a strong corporate client list or sector reputation. This consolidation removes choice from the market and makes it important to foster an existing relationship between company and broker as far as possible, since opportunities for moving elsewhere will be more limited.

Companies should also seek to work closely with the broker research analyst. Encourage company visits, so that the analyst has a real sense of what the company does – its strategy, business model and key performance drivers. The broker-prepared research is the front line of solid communication with the AIM investors. Regular, insightful updates can achieve so much and set the tone for others to follow.

The availability of research which increases visibility in the investment community is widely available for FTSE350 companies simply because it informs the market and facilitates trading in the shares of these companies with volumes capable of generating solid commission income for brokers. However, producing research is an expensive business and relies on trading volumes to be viable. For many companies on AIM, the level of trading generated by research does not in itself justify the cost, and therefore the analyst coverage can be quite difficult to maintain. An alternative might be company-commissioned research. There are a few companies specialising in this service but without the necessary distribution to potential investors, its value may be limited.

In order to ensure existing and potential shareholders understand the company, the broker needs to take the lead in communication with the market, the company positioning and delivery of the message. A well briefed sales team will seek to ensure the message is reinforced in their contacts with institutions and other shareholders. Careful analysis of the share register – including tracing back through the increasingly common and somewhat opaque nominee holdings – should be done regularly so that there is complete and up to date knowledge of the make-up of the company shareholding. We are also now seeing stock lending and contracts for difference techniques being used, and the broker needs to be alert to monitor this activity. This is important at all times but particularly so in times of corporate activity such as an approach from a potential bidder.

Broking – top tips:

- 1 Recognise brokers need activity to make money
- 2 Forge strong relationships for key calls
- 3 Get to know salesmen and marketmakers
- 4 Work closely with research analysts
- 5 Monitor shareholder register
- 6 Brokers to introduce new shareholders

Building and diversifying the shareholder listing is not just about raising capital. It has to be about building a relationship so that the interests of the company, its management and shareholders are properly aligned. Some shareholders can be passive in their support; others can be more engaging and prepared to push for changes to company strategy. For the broker and the company the type and style of shareholders can have a huge impact on how much time is required to service their needs. Knowledgeable shareholders prepared to really engage can absorb significant time for the company and its advisors. Many expect such activist investors to become more apparent on AIM in future.

The broker needs to be forward-

looking and proactive in their approach to recognising how best buyers and sellers can be matched with the least disruption as possible. Avoiding overhangs of shares from holders seeking to sell a significant stake is where brokers really earn their fees. For many companies – not just small caps – such transactions may take place off market or, to use the latest jargon, where a 'liquidity event' occurs. The closeness of the brokers to the shareholders will be tested when the company has a need for secondary fundraising, perhaps to support an acquisition or major investment programme.

From time to time, company management should recalibrate with their broker what makes a successful relationship. Neil Kirton, head of corporate finance at Arbuthnot Securities (part of the Arbuthnot Banking Group) feels that, "an open and frank conversation from time to time on what's desirable and achievable on both sides is a healthy and desirable thing." Some simply measure the success of the broker through their ability to continue to keep bringing forward potential buyers of the company's shares. If this is not happening, remaining on AIM may be frustrating and debilitating. Often, management will complain that their paper cannot easily be used for acquisitions because the market does not understand the proposition. Although this problem might be addressable, it should not be assumed that this will be the case. As well as the direct costs of being on the market, the indirect costs and management time required to communicate with the market can be considerable. To contemplate leaving the market should not be seen as a sign of failure and could be the best way to release shareholder value. There are still a large number of companies which are not transitioning in a way to make use of the market and should consider whether a merger, trade sale or public to private transaction be pursued.

So the broker, in so many respects, makes it all happen, ensuring the market in the company shares is constantly maintained, that both buyers and sellers are accommodated and that the market remains orderly. The broker is a vital part of the array of advisors necessary to operate on AIM. ■**END**

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