

Momentum broking – the importance of not getting lost between deals

Beyond fundraising, a proactive small cap broker plays an invaluable role in broadening the investor audience, and driving liquidity, writes **Derren Nathan**.

It's not easy getting noticed when you're small. Being somewhat vertically challenged, I speak from experience, particularly when trying to get served at a crowded bar. The same applies to listed companies. In our experience of acting for smaller companies, getting noticed is one of the biggest challenges for management. This applies across a wide range of potential audience members, from potential customers, through to journalists in the financial press as well as retail and institutional investors.

A quick visit to the *Financial Times* UK small companies section reveals a total of just 18 articles for the whole of August 2018, just over one a day for every business day of the month. In our experience, it's equally challenging for smaller companies to get noticed by investors. For smaller companies the R in IR is paramount. For micro-caps in particular, there is very little in the way of

natural investor traffic such as index trackers, and with smaller companies often lacking in a profitable record of accomplishment, building trust in management's ability to execute is paramount.

The biggest fanfare of activity by brokers and other company advisers often surrounds the market debut, and binary success-based fees can be a clear motivating factor at such a time. However, just because a company manages to attract sufficient funding for the near future at an IPO, does not mean the broker's job is done.

Should the promise of a lucrative fundraising no longer be on the horizon there is a risk that advisers may focus their attention on the next deal. In our opinion a fundraising is only just the beginning. Liquidity issues in smaller companies mean that the shareholder register can quickly become stale. Without a continued drive to generate buying interest in the shares, even the smallest exit or trimming of a position can cause a disproportionate fall in a company's share price.

The three 'R's

At Hybridan, we believe there are three pillars to building positive momentum in a share price or the three 'R's – results, research and roadshows.

Results

Clearly this is the element most closely within the remit of the company itself. Over the long term, this always comes down to financial results. However, in sectors where the path to financial success is longer, this can also apply to the likes of resource definition (in the natural resources sector), clinical trial results (pharma and biotech), and non-financial KPIs such as rate and cost of customer acquisition which can be powerful forward indicators in tech-led subscription-based businesses. We would also stress the importance of delivering

MOMENTUM BROKING

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- There are three pillars to building positive momentum in a share price – results, research and roadshows.
- Over time smaller quoted companies can build up significant institutional holdings.

‘ Nothing brings a company's strategy or product to life more than a meeting with management ’

relevant and material news flow between the bi-annual statutory reporting dates that prevail in the UK.

Roadshows

Nothing brings a company's strategy or product to life more than a meeting with management. There is a larger universe of companies out there than most institutional investors will ever have the chance to meet in their careers. A company may have a disruptive technology that can completely revolutionise an industry. However, in the same way that customers may feel safer buying what they know, there is a perception amongst investors that familiarity equals security.

To gain a new holder, companies may need to meet a fund manager multiple



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times, over a period of months or if not years. The only way to establish trust, is for a company to deliver on its promises, and where there are bumps in the road, to show accountability and the willingness to take remedial action or withdraw from loss-making activities. We have shown that over time smaller quoted companies can build up significant institutional holdings.

Research

We are well aware that a management team's core focus needs to be on running and building the business and that roadshows need to be an efficient and limited use of time. In between it is very much the broker's job to keep investors aware of the company's progress and educate investors. The digestion of an in-depth research note is often an investor's first step in the due diligence process, but it is important that this is followed up by regular updates so that a view can be formed of the impact of company and industry specific news flow on a stock's valuation.

Falling commission rates and the arrival of MiFID II has not been helpful in terms of sell-side research. The Quoted Companies Alliance (QCA)/Peel Hunt Mid & Small Cap Investor Survey 2018 revealed that 70% of fund managers questioned think MIFID II will result in less research being produced on small

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and mid-cap companies in the future, and nearly half (48%) already see less research being produced in these companies.

Against this backdrop, we have seen a proliferation of so-called ‘independent’ research providers. However they also charge a retainer not dissimilar in quantum to a broking fee. In our world, our relationship with fund managers, and ability to transact for them is our biggest asset, and, as such, we believe research by a broker that has spent years nurturing the trust of institutions, is viewed with greater credibility. In conjunction with the other two Rs, such research has the

greatest chance of catching the attention of the relevant audience.

Providing comfort

We believe adherence to the three ‘R’s is the key to maximising the usefulness of a smaller company’s listing. Momentum creates momentum. Research sets a backdrop against which results can be delivered and measured. Converting that momentum into orders requires facetime on investor roadshows. The fulfilment of all three can help to build a long-term supportive investor base and a foundation for capital raisings from a position of strength. There is a certain herd-like mentality in the small-cap world. The addition of a respected institution to the register can provide a degree of comfort to others considering an investment.

Solid results and newsflow also resound with retail investors who can be very active in the space and can be core contributors to liquidity, with the flexibility to trade in smaller deal sizes. The evolution of instant communications and social media has led to an entire universe of bulletin boards and (unregulated) armchair analysts.

While it is not a broker's job to communicate directly with this universe, successful implementation of the three ‘R’s can only enhance the reputation of a company amongst all stakeholders, and we always see a positive trickledown effect. ■



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