Hybridan Market Sentiment: May 2020

“Bad companies are destroyed by crises. Good companies survive them. Great companies are improved by them” Andy Grove (former CEO of Intel)

D:ream summarises the market sentiment well, coming out of Q1 2020, the worst quarter for the 100 largest listed companies since 1987… “Things can only get better”. That was until Royal Dutch Shell decided to cut its dividend for the first time since the Second Word War, delivering a stinging blow to income investors as they looked to the world’s largest dividend payer for stability during these unprecedented times.

Since the middle of March, over forty placings have occurred in the UK, raising more than £4bn. Some companies taking advantage of The Financial Reporting Council’s Pre-Emption Group relaxing the rule to increase share capital up to 20%.

AIM has always been a home to entrepreneurialism – this is no bad thing as it reflects the dynamism and agility of smaller companies and ultimately, it is the reason why we all love small caps. The market has long been a hotbed of companies that are quick to capitalise on various macro themes and the current situation is no different as companies seek to create opportunities from adversity. Before Covid-19, we had Cannabis (CBD), Blockchain/Crypto, mobile payments, cloud computing, the list goes on. Some will amount to viable businesses but capturing trends in this knee jerk way sadly means many will not and are perhaps to be treated with caution.

We have seen a welcome return of the biotech boom; some six years having passed since the last one. In that time, numerous high profile, late stage drug failures have weighed heavy on sentiment, and only the staunchest of supporters remained. As the sector clambers to support the COVID response for more testing kits, medical equipment, treatments and ultimately a vaccine, numerous companies in the space have raised money and share prices have experienced triple digit percentage growth. However, this has come at a cost, public market investors smelling “blood in the water” have created eye watering discounts on placing prices– 50, 60, 70% are not uncommon.

Some life science fund managers are quick to call for caution. Gilead with its mammoth R&D cash budget produced poor data from its antiviral drug, Remdesivir. GSK and Sanofi are the largest vaccine producers so we would hope for more success from these two heavyweights. But right now, there will potentially be delay to other lifescience companies’ clinical trials due to COVID, with hospitals being perhaps too stretched to host trials and social distancing/infection prevention protection, this may lead to stretched balance sheets and then potentially more fund raises.

With a plethora of companies in the life science sector to choose from, prioritise the ones that have “tweaked” their business model to help with the COVID effort rather than completely changed their focus. We all remember the various mining companies putting “Blockchain” in their name to try and jump on that band wagon!

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Expect more defensive fundraises from the bricks and mortar retail, property, and airline sectors to shore up their balance sheets to see them through the current uncertainty. Opportunistic fundraises from companies looking to capitalise on Covid-19 will start to dwindle as the market becomes exasperated. There is a danger of a harsh correction when the reality kicks in over the Bank of England's outlook of UK unemployment doubling and the economy shrinking by 14%. We are not anticipating any change to the dire IPO pipeline for the UK markets.

Our advice to small cap management teams is fourfold:

- Stay flexible when it comes to pricing new equity issuance, or if the discount needed to raise the required amount is too deep, consider other forms of financing including convertible loans.
- Don't give up in the quest to introduce your story to new investors, as it is a worthwhile exercise to ensure it is on the radars of new potential investors, and some may even buy in the market at the current lower levels. If cash is king, liquidity is queen – investors need liquidity more than ever and companies will only increase liquidity by being proactive with investors when they do not expressly require new funds.
- Ensure all possible pools of capital are approached, both professional and retail, in the latter case potentially utilising one of several platforms that specifically exist to service this audience.
- Make sure any available tax efficient structures such as Enterprise Investment Scheme and Venture Capital Trust eligibility is obtained and clarified respectively, given that this is one area of the market that is certainly still investing.

We welcome feedback and open dialogue on all the above.

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