

The Alternative Investment Market (AIM). I don't get it! Do you?

by Malcolm Howard

According to academic theory the price of a share is the discounted value of its future earnings. Of course, reality is that the price of a share is determined by supply and demand. Over the long term academic theory and reality should be very close to each other. This is the assumption I use when valuing shares.

First I assess a company's accounts to ensure the company passes my prime test. If they do I calculate 'Estimated earnings per share' (EEPS) which is cash inflow from operating activities before movement in working capital divided by the number of shares. I then discount EEPS if the company has debt at the rate of 25% of net debt per share. So, for example, if a company's EEPS was 30p and the company had net debt of 20p per share, I would use 25p as the EEPS. The reason for this is that the only thing that forces companies out of business is they run out of cash, the banks will not support them and they cannot pay their debts. Using the same process I calculate EEPS for four years to find out what compound growth was achieved in this time. Finally I calculate the growth built into the share price on the day of assessment to make a buy, hold or sell decision.

When I started assessing this way over twenty years ago, I had some spectacular gains, but also some horrendous losses. Then I realised that almost all my losses were in companies that were quoted on AIM, so I stopped buying such companies and my overall returns improved dramatically. So, as far as AIM is concerned I don't get it!

In the July 2016 edition of Private Investor I argued that investors relied on tips, rather than doing their own research, and in doing so were over reliant on brokers' recommendations. To demonstrate this I quoted Victoria plc, which I regarded as a 'bubble' stock. This company are carpet manufacturers operating primarily in the UK and Australia who recently have been on the acquisition trail. This brought a high level of growth in profitability, but at a price; debt soared. My view was that such growth had been bought and could not be repeated so with the market price assuming a high level of compound growth, the share was over-valued. I said a fair price was 750p per share, while the NOMAD was touting 1,750p. I asked: who do you believe? Since then Victoria plc issued 5 new shares for one old share, so the comparative prices are 150p and 350p. On 31 December 2016 the share was priced at 355p, so nobody should have believed me!

In the January 2016 edition of Private Investor I suggested that the then share price for Newmark Securities of 2.82p "could not represent a significant over-valuation." This company always makes a profit, maintains its dividend and relative to its size it holds a significant amount of cash. Prior to the 2016 result the company warned that profits would be down because it had taken longer for the market to accept its new products, but that it was confident of the long term future. As forecast, EEPS dropped 28.6% to 0.5p per share, but given its cash position even if it suffers a similar in 2017, the share should be worth 2.5p. If 2017 profits turn out to be between its 2015 and 2016 level the shares should be 6p. On 31 December 2016 the shares were priced at 1.3p

	EEPS	EEPS	Net cash/	Share price	
	latest	prior	debt	31/12/16	M
Dart Group *	123.7	66.0	217.1	496.0	1,440.0
Newmark Security	0.5	0.7	0.9	1.4	2.5
Cohort	27.0	21.0	48.3	410.0	697.0

SQS Qual. Systems (€p)	86.3	75.1	(18.0)	622.5	990.0
Sprue Aegis	15.2	20.7	48.6	180.0	256.0
Finsbury Food Grp*	16.8	10.1	(15.1)	120.0	142.0
Brainjuicer Grp	29.9	26.3	48.1	550.0	570.0
Asos	90.2	66.3	150.0	4,964.0	4,670.0
IQE*	3.2	2.1	(2.3)	38.0	35.0
Playtech (€p)	72.1	69.3	91.2	826.0	755.0
Blue Prism Grp	7.5	5.5	13.8	445.0	404.0
Advanced Medical Sol.	9.2	8.0	16.4	221.8	195.0
Victoria*	28.8	17.8	(70.0)	355.0	307.0
Impellam Grp	94.0	71.7	(234.9)	712.5	470.0
Brooks Macdonald Grp	112.7	119.8	149.4	1,891.0	984.0
Abcam	24.9	23.7	29.7	767.0	306.0
Goals Soccer Centres	18.2	16.5	(62.7)	101.0	30.0
Majestic Wine	26.2	29.9	(34.8)	315.0	92.0
Park Grp	1.5	4.2	18.1	73.0	17.4
Mulberry	18.9	20.4	23.4	1,095.0	102.0
Hotel Chocolat	7.0	29.3	(0.5)	288.5	26.5
Access Intelligence	(0.5)	0.3	(0.8)	4.6	0.0
Castelton Technology	1.7	(2.9)	(12.7)	60.0	0.0
Hargreaves Services	3.2	123.9	(99.0)	272.0	0.0
Tissue Regenix	(1.2)	(1.2)	2.6	20.5	0.0

*In calculating 'value' compound growth is assumed to be less than that shown.
(€p) Figures shown are in €, but share prices are in pence.

As an experiment I chose 25 AIM shares at random and calculated EEPS for the current and prior year and priced each share purely on growth (positive or negative) after adjusting for net debt (as illustrated above). The results are as below (all in pence per share). M = my valuation.

It must be stressed that the above figures were just taken from each company's full year accounts and no attempt has been made to carry out further research to assess the reasons behind the numbers. For example, the numbers for Hotel Chocolat seem dire, having suffered a 76.1% decline in EEPS between 2015 and 2016. But what actually happened was that the company floated on AIM in February 2016 at an Initial Public Offering (IPO) price of 148p. On the first day of trading, 10 May 2016, the price surged 26% to 186p and finished the year at 288.5p. Actual growth between 2015 and 2016 was 13% and EEPS obviously declined because the number of shares ('000) had increased from 24,379 to 112,838. At the year end price the market is assuming compound growth of 26% which is double what seems likely. On this basis my target price would be 143p, not the 26.5p shown in the above table. Another company I looked at was Hargreaves Services; I couldn't understand why a company I regarded as worthless was priced at 272p. The problem the company had was that it was involved too heavily in coal, which is no longer being produced in the UK. So the company's directors have spent two years restructuring and re-positioning. The Chairman suggests a strategy of unlocking the company's property and energy portfolio will generate cash, but with property valued at only 205p per share and net debt of 99p per share, I cannot see how you can possibly get to 272p per share. In short, when it comes to AIM, I don't get it. The question is: do you?

Members' Competition

Well now you chance to prove it. To help UKSA get back into the black we are running a £20 sweepstake. Simply look at the above list of shares and select FIVE shares you think will do the best in 2017 in PERCENTAGE terms. Select your nap, the one company out of your five who you think perform the best. The prices taken will be the closing 2017 prices as shown on the London Stock Exchange website and will be compared to the closing 2016 prices as shown in the above table. Dividends and transaction costs will NOT be taken into account. Points will be awarded as follows:

Company making the greatest percentage gain	- 5 points
Company making the second best percentage gain	- 4 points
3 rd best	- 3 points
4 th best	- 2 points
5 th best	- 1 point

You score DOUBLE points for you nap selection. This means that the maximum points that can be scored is 20. As an example, if your nap selection finished 2nd and one of your other selections finished 5th you would score 9 points.

Dead heat rules apply. If no contestant scores a single point, the winner will be the one who has selected the highest ranking share.

The more entries (£20 per entry) we have will mean higher prize money, but fewer entries will make it easier to win. The 'pot' will be distributed as follow:

The winner will receive 50%, 2nd 20% and 3rd 10%. The remaining 20% will go into UKSA's funds. **This sweepstake is ONLY open to members of the United Kingdom Shareholders**

Association. Members of UKSA's Board, the Company Secretary and the Administrator, the writer of this piece and their families are ineligible and may **not** enter.

The closing date for entries is Tuesday 28 February 2016. Entries and payment should be sent to the office, copied to me as I will keep all the records. Either online, email to the office at officeatuksa@gmail.com , copy to me at malcolmhoward.mh@gmail.com , payment to UKSA Account No. 31342606, Bank Code 40-46-21, ref COMP & surname: or mail to the office with cheque.

Finally, please note that none of the above shares constitute investment advice. They were chosen purely for the sake of having a bit of fun with a sweepstake.

Malcolm Howard