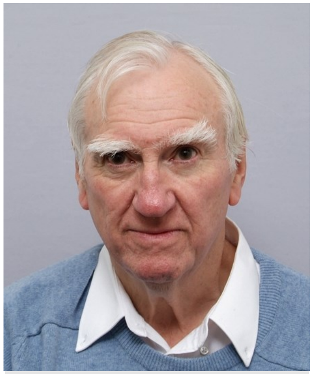
AIM companies – Bees, Superbees, Gonabees and Elts

by Malcolm Howard



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In previous issues of Private Investor I have explained that AIM replaced the failed 'Unlisted Securities Market' and was set up as an outlet for those investing in start-up companies through the Enterprise Investment Scheme and also to allow venture capitalists and business angels an opportunity to realize their investments.

All stocks on AIM fall into four categories - bees, superbees, gonabees and elts. Knowing which category each stock falls into is important as the valuation methods used by those dealing on AIM differ significantly as the four cases below illustrate.

A company that grows rapidly and generates cash will eventually graduate to the main market (the Small Cap index), which means they will have to meet more stringent reporting rules. On AIM, a Superbee is a profitable company that has generated consistent profits and growth, but there is a factor somewhere that prevents it moving on. Usually there is a risk somewhere that prevents the leap. An example of a Superbee is Youngs & Co Brewery plc.

The Ram Brewery in Wandsworth, London, dates back to 1581 and was bought by Allen Young and his partner Anthony Fothergill Bainbridge in 1831. It was the oldest British Brewery in continuous operation until it closed on 25th September 2006. The brewing operation was transferred to a new company, Wells and Youngs Brewery Company Ltd, with Young's holding 40% of the new company until it sold its stake in August 2011.

The site of the Ram Brewery is currently being redeveloped to deliver:

661 new homes to the borough; a 36 storey landmark residential tower designed by EPR architects; 9,500 sq. m of space dedicated to new shops, cafes, bars and restaurants; and approximately 200 car parking spaces.

The stable block will be retained, creating a new public space within a modern architectural setting and there will be a Micro Brewery in one of the listed buildings. There will also be a brewing museum which will incorporate the Beam Engine and the Coppers.

At the 2015 financial year end the company had 129 Young's pubs (including 22 hotels) and 37 Geronimo pubs. Some of the properties are freehold and accordingly fair value adjustments for changes in property valuations appear in the annual accounts.

The directors of the company are extremely generous as far as UKSA is concerned as they provide members with an excellent Christmas party. Any UKSA member attending one of these events would have got their subscription back in one go!

The financial analysis for Young's & Co Brewery plc is as below:

Year to March £'000	2013	2014	2015
Revenue	193,667	201,800	227,000
Earned Earnings	17,936	21,800	22,500
Property Adjustment	(958)	300	4,200
Effective Earnings	31,810	38,900	42,300
Assets excluding debt	456,229	500,100	548,000
Net Debt	121,684	120,400	141,000

Effective earnings are cash generated from operating activities before movement in working capital. This figure ignores unrealized profits and losses, such as movement in property valuations and share based payments and, in my view, is a fairer reflection of what a company has achieved. This company generates significant amount of cash, but net debt does not come down. What this means is that growth is being achieved through new outlets, the risk being overtrading if there were a downturn. Any valuation would be dependent upon each individual's risk profile.

The next category you find in AIM is the 'gonabees'. These are companies who never make a profit, but one day they just might! An example of a 'gonabee' is Venture Life Group. The company is an international consumer self-care company focused on developing, manufacturing and commercializing product for the ageing population. Their products fall into three categories

Food supplements for lowering LDL cholesterol and improving brain function and memory; Dermo-cosmetics and cosmetics for addressing the signs of ageing skin and hair loss; and Medical devices for improving conditions such as minor aches and pains, dry eyes and itchy skin.

A gonabee company - Venture Life Group

Year to June £'000	2012	2013	2014
Revenue	292	486	7,247
Earned Earnings	(788)	(1081)	(1,570)
Effective Earnings	(655)	(952)	(951)
Net Assets	127	557	15,647

Companies such as this usually start off through the Enterprise Investment Scheme or venture capital, including business angels. When these companies are set up and running they issue further share capital through AIM. The price charged for these shares assumes the company will be successful in the future and rich investors, believing such promises and calculating the tax relief they are going to get, are sucked in.

The price of this share when this company was analysed was 78p (October 2015), but the net asset value of the company (excluding intangibles) was a mere 6p. Of course, gonabees can become bees, so you never know.

The third category companies on AIM are the Elt's. Elt stands for 'expensive lottery tickets; because that is what they are. RedX Pharma is an example of an Elt. It is a drug discovery and development company. It was formed in 2010 to focus on improving the characteristics of existing drug classes to create best-in-class new drugs in the areas of cancer, infection and autoimmune diseases. It has a team of over 100 scientists looking into infectious diseases, oncology and immunology. The company claims that it has systems that ensure drugs can be developed quicker and thus be on the market earlier than would otherwise be the case.

The figures below show the latest position of Red X Pharma (an Elt)

Year to September £'000	2014	2014*	2015*
Revenue	6,157	3,327	2.0170
Earned Earnings	(3,353)	(1,598)	(3,233)
Effective Earnings	(3,397)	(1,358)	(3,179)
Net Assets	1,820	683	12,518

*6-month periods

Redx Pharma - 6-month share price graph

The only revenue to date has been from government and other grants; other than from this source revenue will only be generated when drugs successfully go through the development stages. At the moment the company is just burning cash and for the sake of future generations we have to hope this company is successful, but it is a gamble. The price of the share at the time of valuation was 73p (December 2015), but the net asset value per share, before more cash is burnt, was 24p. So, anyone investing at the current price is effectively buying a £2 lottery ticket for £6, but the lottery is sometimes won and with just one breakthrough drug curing some type of cancer, as an example, shareholders could find themselves making a fortune.

The gestation period for gonabees is always a lot longer than investors expect; many are stillborn and become neverbees. But some live births emerge and a bee is born. A 'bee' is a company that has got through the hard times and is both stable and profitable. An example of a bee is Newmark Security plc. This company is a leading provider of electronic and physical security systems where the emphasis is on the safety and security of a company's personnel and assets. It has three major products in its electronic security division, Custom time clocks, Sateon access control and Janus access control. The company's physical security division, its prime product is 'Safetell' which protects staff and assets from violence and aggression in the workplace. The company listed on AIM in 1997.

Newmark Security plc's results are as below:

Year to April £'000	2013	2014	2015
Revenue	18,316	19,171	22.854
Earned Earnings	140	857	2,143
Effective Earnings	3,427	2,766	3,360
Assets exc cash	10,259	10,467	9,606
Net cash	650	1,121	3,946
Earnings per share (p)	0.7	0.5	0.7

Now, what tends to happen is that investors buy into gonabees and Elts at the time they list on AIM. Investors believe the glossy brochures produced by the 'experts' which project the riches that might be there; the vast majority of these issues are therefore significantly over-priced. What happens next is that some investors, looking for quick profits, become disenchanted and sell. These sells reduce the price and subsequently some stop losses are triggered, causing prices to fall further. Some investors hold on, but year on year there is no sign of progress, so the consensus is that it is time to get out and many do. Investors have given up on the share and do not even look at the company, but slowly but surely it gestates and becomes a bee. But nobody has noticed!

Several years ago a company called Dialog Semiconductor set out to develop micro chips for mobile phones and car's engines and investors were excited and flocked to buy at $10 per share. The company listed on Nasdaq and on the Hamburg exchange. The years rolled by without success and investors lost heart. They certainly did not notice when the price on the Hamburg market was down to €0.79 that the company was profitable, was growing at 20% per annum and had no debt. The price at Christmas 2015 was €30.88.

So bees are worth looking at, because they might provide some real opportunities. So let us look at Newmark Securities. If the projection forward were 'no growth' then a reasonable price would be 5.5p per share, which is well above the 2.82p price at Christmas 2015 and still above the price of 3.4p when first reviewed in September 2015. However, the Chairman stated in the 2015 Annual Report that profits would be lower in 2016 because the latest products were not on stream, but that a large US contract scheduled to start in April 2016 was to get them back on track. So, whatever way you look at it 2.82p cannot represent a significant over-valuation.

What this demonstrates is that because of the way shares are priced on AIM, investing in this market can be something of a gamble. . At Christmas 2015 the gonabee's price was 76p per share, the Elt's price was 68p per share, while the price of a profitable company (a 'bee'), without any debt, was less than 3p.

It must be stressed that the companies shown are merely representatives of the companies trading on AIM. This article is not making investment recommendation for any of the four companies. The only point it is intended to make is that on the balance of probabilities, bees provide the best investment opportunities.

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