THE KEY TO AIM SUCCESS

Christopher Boxall explains how investors can avoid Aim pitfalls with close analysis of company admission documents

The admission documents of **Conviviality (CVR)** and **Acroll Group Holdings (ACRL)** should have been essential reading for investors. The disastrous performance from both these companies suggests many investors – both large and small – missed the warning signs that may have prevented a substantial loss of capital.

The share register of Conviviality, the distributor of alcoholic beverages, suggests plenty of well-known institutional investors were enamoured of this stock, which has now given notice of its intention to appoint administrators, having failed to secure a required £125m to stay in business.

We are aware that it was also a popular company for those investing in the Alternative Investment Market (Aim) for inheritance tax (IHT) planning purposes, being a seemingly reliable, dividend-paying business that many investors could easily understand; indeed, my own firm previously owned shares in Conviviality across our Aim IHT planning book. Having sold out in October 2016, we then proceeded to look foolish for the next 12 months as the share price continued its inexorable rise. Thankfully, for our reputation, that premature sale is now seen in a more positive light by our clients.

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The saga of Conviviality and fellow Aim constituent Accrol Group Holdings, a manufacturer of toilet and kitchen rolls, which only floated in 2016 and has also needed rescue funding from shareholders, provides an excellent lesson for all investors in Aim companies.

THE BASIC ANNUAL SALARIES OF CONVIVIALITY'S EXECUTIVE DIRECTORS IN APRIL 2017 – UP FROM £684,960 FOUR YEARS' EARLIER

Free information that is ignored by many

The Aim admission document is a requirement of every Aim company and can usually be found in the section headed 'Aim Rule 26' information, on the company's website. This free information should be essential reading for anyone contemplating investing in an Aim company.

The admission document is not light reading. It summarises the significant due diligence undertaken on every aspect of the business by lawyers, reporting accountants and the company's nominated adviser (Nomad). As well as being the key regulatory document, the admission document is the main marketing document for the initial public offering (IPO) and the directors of the company are legally responsible for its contents.

Also identified as part of the due diligence effort are the various risks associated with the company and its shares, which are all covered under a separate section titled 'risk factors'. This section is also typically separately broken down as 'risks specific to the company' and 'general risks', with the latter generally full of 'boilerplate' language which is less helpful.

This section in Accrol's admission document helpfully pointed to a potential risk which would subsequently contribute to the company's undoing, 'parent reel price volatility'. Due to an oversupply of parent reels and pulp at the time of the IPO, parent reel prices were comparatively low, but "if parent reel prices were to rise above the group's expectations and the group was unable to offset such increases through cost savings or price increases, that could have a material adverse effect on the group's business, financial condition and results of operations".

A trading update in October 2017, which brought about the temporary suspension of trading in Accrol shares pending clarification of its financial circumstances, reported how more challenging trading conditions were having a significant effect on the performance of the company. Increases in input costs, driven by parent reel price inflation, were stated as being a significant contributor to the group's problems. Those investors that had read the admission document and kept up to date with raw material prices could have predicted this eventuality. It's worth noting that back in July 2017, sector giant **Kimberly-Clark Corp (US:KMB)**, the owner of the Kleenex and Andrex brands, drew attention to the rising price of raw materials in its update. Results and presentations from larger listed peers can often provide useful information for investors in smaller quoted companies.

While many investors wish to dwell on the numbers in the admission document, we would urge you to read the risk factors as well. This section may look exceedingly boring (and often is), but it can contain snippets of information that can help you gain a better understanding of where things might, and often do, go wrong with an Aim company.

Change of strategy

IHT planning investors are invariably drawn to invest in seemingly safe mature businesses, operating in mature sectors, with modest ratings and above-average dividend yields. But this perceived low-risk approach can result in investment in low-quality companies, which can also ultimately turn out to be far riskier than envisaged. Businesses of this nature, which are struggling to grow organically, are also inclined to adopt an acquisition-led strategy to growth, and this increases the risk further – as demonstrated by Conviviality.

Having been admitted to Aim in July 2013 as Conviviality Retail, with a clear focus on growing franchising operations, the group had an unremarkable first year on the market. The 12 months ending April 2015 saw like-for-like sales fall 1.7 per cent and diluted earnings per share fall 3.4 per cent. Evidently this business was struggling to grow in a highly competitive market and management felt it was necessary to change course. There followed a meaningful change of strategy as Conviviality Retail acquired Matthew Clark, the UK's largest independent drinks wholesaler, in September 2015, subsequently dropping the 'retail' from its PLC name.

Having raised over £60m in 2013 from institutions based on a defined, franchise-focused retailing strategy, the abrupt change ultimately surprised us. The acquisition of Matthew Clark and subsequent large acquisition of Bibendum had nothing to do with franchising but was all about buying power, which was previously stated as an existing strength of Conviviality Retail in its original admission document – a group with more than 600 off-licences surely already possessed plenty of buying power.

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An acquisition-led approach to growth can have merit if it is correctly executed, and we admit to initially being impressed by Conviviality's lofty acquisition-led growth ambitions. But we concluded that the redefined strategy increasingly smacked of desperation, far removed from what was outlined at IPO and so compellingly communicated in the Aim admission document.

The hotchpotch of poorly performing retail and wholesale businesses that Conviviality has now accumulated, financed by elevated levels of debt looks totally unmanageable. Of greater significance, we struggled to see where the growth may come from.

Beware selling shareholders

The admission documents for both Accrol and Conviviality point to material share sales on Aim admission by the main shareholders in both these companies.

In the case of Accrol, existing shareholders received £20m on IPO and the business joined Aim ▶

with a high level of debt. What was unusual from our perspective was the lack of main board representation for the selling shareholders who still retained a material stake in the business.

Conviviality Retail saw private equity owner ECI Ventures exit entirely on Aim admission, receiving gross proceeds of £30.8m at 100p a share. We dislike private equity exits on Aim, particularly where the seller gets out entirely, as was the case here.

Management paid handsomely to travel, rather than arrive

The Aim admission document for Conviviality revealed that the basic annual salaries of the three executive directors would be £684,960 in aggregate and be subject to annual review by the remuneration committee. This was already a substantial sum for a small business that was unproven on public markets. The admission document went on to confirm that each executive director would be eligible to participate in a discretionary annual bonus scheme with an initial maximum bonus of 20 per cent of basic annual salary.

The admission document stated there was no pension provision in respect of the executive directors, although each would be covered by auto-enrolment in the group's stakeholder pension scheme.

Fast-forward four years and the annual report for the year ending April 2017 shows that basic annual salaries for the now four executive directors had leapt to £1.4m. The chief executive's total remuneration for the year had risen to £966,000, bringing her aggregate remuneration for the four years to April 2017 of £2.955m. Of this, the base salary stated in the admission document of £310,000 in 2013 had risen 45 per cent to £450,000 by 2017. Contrary to what was stated in the original admission document, the annual bonus entitlement for 2017 was bizarrely 95 per cent of the chief executive's basic salary having been 90 per cent of basic salary in 2016. Pension contributions equivalent to 15 per cent of salary, had also mysteriously appeared for all executive directors.

However, it's worth noting that by September 2015, a short paragraph on page 87 of the second admission document covering the acquisition of Matthew Clark, reveals revised terms covering remuneration of directors. This simply stated that the salary or remuneration of executive directors shall be determined by the board and may be either a fixed sum of money or may altogether or in part be governed by business done or profits made or otherwise determined by the board. This is a shockingly loose clause that would surely never have been accepted by shareholders on Aim admission.

We would argue that the wilful disregard of the original terms of admission was a sign of trouble ahead and illustrated the misalignment between the interests of management and shareholders. We are staggered why leading institutional holders approved such a loose and ridiculously generous remuneration structure.

The remuneration structure for Conviviality directors can be described as loose and ridiculously generous

'We are surprised that institutions don't demand management participation in equity fund-raisings, to ensure better alignment with outside share-holders'

Little real equity commitment from the senior management and architects of strategy

Diana Hunter, chief executive of Conviviality and chief architect of the company's strategy, did not participate in the equity placing at the time of the original IPO and her equity interest in the business was entirely option-based until a month or so ago. Having taken several years to acquire shares in the company her recent purchases also suggest she was totally out of touch with the operations of this business and the trouble it was in.

Our review of the subsequent admission document for Conviviality, issued in September 2015 following the acquisition of Matthew Clark, revealed that Ms Hunter surprisingly hadn't participated in the accompanying placing, which raised £130m to support this deal. She also chose to sit out the £40m placing in May 2016 to support the acquisition of Bibendum PLC and the December 2017 placing of £30m in support of the acquisition of Central Convenience.

We are surprised that institutions don't demand management participation in equity fundraisings, to ensure better alignment with outside shareholders. We would argue that with real 'skin in the game' management would be less inclined to spend recklessly and remain better focused.

The admission documents for both Conviviality and Accrol offered clues to the looming problems ahead for both these businesses. In the case of Conviviality, it was the meaningful change of strategy that originally set off alarm bells for us and ultimately the overcomplicated, debt-laden enlarged group and outrageous level of executive remuneration that caused us to sell. The risk factors highlighted in Accrol's business on IPO, and indeed numerous other matters included in its admission document, made us wonder how this company ever made it on to the public markets in the first place.

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