

Simple sums for the Chancellor

2 July 2020

AIM is one of the UK's rare success stories, in fact probably the best growth market for smaller companies in the world. Despite the occasional high-profile failure, it possesses a better record for avoiding scams and frauds than others.

It is therefore clear to us that the value to the UK economy of the mild encouragement provided by the IHT concession to those considering an IPO onto AIM is a very large multiple of the cost in tax foregone by HMRC.

A recent report by Grant Thornton on AIM's first 25 years shows that small companies listed on AIM perform 'better' - generating more added value, more employment and far greater tax receipts for HMRC - than comparable "private" companies. This is interesting: we have heard too much about companies run by private equity doing better by being out of the glare of publicity attached to quoted status. Grant Thornton found that:

- In their first year on AIM companies on average grew profits by 36%, and by 24% per annum for the next four years.
- Revenues grew 40% p.a. for three years, then 20% p.a. for the next two. Over the last five years AIM companies have outgrown, by a significant amount, the "private" companies in their sectors in nearly every case (see later).

Let us temporarily disregard the 36% first-year growth since, firstly, only (some of) the better companies will be accepted for an IPO and listing and, secondly, the cash raised for the company thereby will aid, usually significantly, short-term performance. So, we can't say how much of that is wholly due to being on AIM.

Instead we can focus on the 24% growth over 4 years, which shows how AIM companies *continue* to outperform even after the immediate boost from the IPO wears off. There are many factors including the incentive to retain and reinvest profits for growth as CGT on share price appreciation is lower than higher rate tax on dividends, the marketing benefits of AIM status, the ability to attract and retain high-quality staff through share incentives and lower borrowing costs as the IPO cash lowers the gearing ratio and thus perceived risk to bankers (among others).

It doesn't really matter exactly how these factors contribute to performance: **the reality remains that AIM listings boost the economy by many £billions.**

AIM companies contribute over £33bn Gross Value Added (GVA) directly - over 40% more per employee than the national average - and just as much indirectly to the UK economy since their direct GVA has increased by 35% in the last five years, more than twice as fast as the average. Not only are AIM companies more productive than average, their productivity is growing - at 11% pa, significantly faster than average.

AIM's superior growth has, in just the last five years, added £4.7bn pa to UK economy and more than £1bn pa to HMRC. But you may ask, at what cost?

The IHT concession is not a precise sum that can be easily calculated, but we reckon it 'costs' the Treasury c. £50m pa.

Business Property Relief

Inheritance Tax ("IHT") is levied on most of a deceased person's "estate" above a threshold according to complicated regulations.

Business Property Relief ("BPR") exempts from IHT family farms and shareholdings in unquoted trading companies, but not those companies that merely invest in, or buy and sell, securities and/or property.

In 1996 BPR was extended to include "long-term" investment in AIM-listed companies that are defined for some purposes as "unquoted". Only shares that had been held for at least two years at the date of death qualify for BPR.

John Borgars (Analyst)

0207 065 2690

info@equitydevelopment.co.uk

Andy Edmond

0207 065 2692

andy@equitydevelopment.co.uk

Investors in AIM stocks

AIM's aggregate market cap at time of writing is £104bn, with individual shareholders owning about 25% of the shares (according to the ONS). However, companies mainly investing in securities and property are excluded from claiming Business Property Relief (BPR), so that reduces the IHT-eligible assets to c. £80bn. Many variables pertaining to individuals age and wealth also come into play. Of course, HMRC would only collect anything like this amount **for one year** if they abolished BPR - since a different, less economically valuable, IHT avoidance mechanism would be adopted by the vast majority.

So, why should HMRC abolish BPR to gain roughly £50m at a probable future cost to themselves exceeding £1bn pa?

What would abolishing BPR mean

Firstly, it would sharply reduce the number of new companies making an IPO. Floating on AIM would only benefit the entrepreneur's children if it led to (their share of) the company growing to 67% bigger than it would have been if it stayed private. That's a big hurdle to jump and many would opt not to raise cash or for private equity instead.

Secondly, it would reduce profit retention and investment in many existing AIM companies. If Jim Smith owns 30% of Smith plc that has a 20% pa return on equity he is, after a mere 4 years, better off reinvesting £1m of profits than taking it in dividends/salary – abolish BPR and he's better off taking the cash, paying 45% tax and moving what's left into an IHT shelter.

Hence AIM's superior performance (see table below), that enriches both HMRC and all of us as individuals, would boost far fewer companies.

Outperformance of AIM listed companies

Compound annual growth rate in revenues 2015 – 2019, %

	AIM	"Private"
Technology	18.8	10.7
Healthcare	12.5	7.8
Financials	16.1	12.5
Consumer discretionary	13.8	11.0
Consumer Staples	11.8	5.6
Industrials	7.0	7.6

Source: Grant Thornton report. NB the table covers the six major sectors that comprise the bulk of revenue for AIM companies.

Vested Interests

We strongly suspect that much of the publicity given to suggestions that BPR *should* be abolished comes from promoters of more expensive, less useful IHT-avoidance schemes who are losing customers to simple AIM IHT ISAs.

Why? Certain claims in recent internet articles are so implausible as to verge on the ridiculous:

- "The manager of a large AIM IHT product who wishes to remain anonymous" is alleged to believe his portfolio would shrink between 20% and 30% if the stocks no longer qualified for IHT relief as investors would ditch the fund".

There are two – **just two** – ‘large’ AIM IHT ISAs managing over £300m – Octopus with £1.7bn and Investec with £0.48bn and they each more than justify themselves without the BPR. Both funds have outperformed both the FTSE AIM and the FTSE All-Share index over almost all recorded periods, massively so over longer periods.

It is inconceivable that 20% of Octopus or Investec clients would run for the door if the icing on the cake in the form of IHT relief was to be taken away. So that looks like “creative” use of the word ‘large’.

AIM IHT ISA management

£m	AUM
Octopus	1700
Investec	479
Fundamental	70
Stellar	70
Downing	67
Time	42
Blankstone Sington	38
Puma	37

Source Various websites

- “Around a third of all money invested in AIM is for tax planning purposes.” Since the ONS says that less than 30% of the money invested in AIM is owned by individual investors, even including large chunks of companies owned by founders, this looks simply impossible. A better estimate would be around 10%, as AIM IHT ISAs make up around £4bn and stockbrokers/wealth managers run bespoke portfolios for clients. Surely any tax planners would use ISAs, which give exemption from income tax and CGT, as far as possible? Most investment in AIM stocks is stock-specific rather than IHT-specific.
- “There are many common stocks held across many providers’ AIM IHT portfolios which could further exacerbate liquidity issues”. This sounded more plausible, but on closer examination there is far less overlap than I expected. Micap says there are 31 IHT funds and we have found disclosure on holdings from 16 of them. Those 16 funds held 71 different stocks. **No company was owned by 4 funds; only 6 shares were present in 3 funds; and just 21 others were held by 2 funds; more than 60% appeared solely on 1 list.** That is remarkably diverse.

4 of the 6 companies (**CareTech, EMIS, RWS** and **Strix Group**) named in 3 funds are large, liquid stocks that often trade more than £2m in a single day; the two of medium-size (**Bioventix** and **Gateley**) sometimes trade over £0.8m in a day.

No, there are *not* many common stocks, so little risk of a liquidity crunch and most funds could sell their lead holdings without moving the share price by more than the odd penny. Obviously if a fund wanted to sell £25m of a mid-cap AIM stock it would require care: but only Octopus and Investec are likely to have holdings that big. Yet Octopus only has one stock with a mkt cap **under £250m** and Investec’s average investee company’s mkt cap is **over £400m**.

Impact on AIM companies of BPR removal

We have looked at the possible impact of abolition of BPR and the consequent sale of some IHT ISAs on the share price of each of the 71 companies named. It is a summary review as there is not space here to include all data and conclusions.

Some investee companies have lofty PERs because they are viewed as high growth stocks and there is a preponderance of willing buyers at any price they consider "reasonable". The bigger funds are, prudently, invested in large, liquid stocks where the market should have no problem absorbing a sale of a large part of their holdings.

Most of the stocks held by the smaller funds also have ample liquidity to cope with a sale by one fund and an adequate amount for two sellers. However, there are a handful where day-to-day liquidity has shrunk recently, so selling could have an impact.

Fundamentals will remain the most important factor

Stock overhangs, real or perceived, would act as a drag on the related share price. But markets exist to allow buyers and sellers to find a price at which both can transact with each other. It may take time (think of Woodford fund holdings) but it will happen as long as there are buyers are interested in the underlying businesses.

Although we believe strongly that abolition of BPR would be a very damaging decision for the Treasury to make, and have illustrated why in the course of this note, it is only prudent to consider what investors might choose to do *if* such an event occurred. Our presumption is that share prices of businesses where IHT investors make up a significant part of the register would be swiftly and substantially 'marked down' by traders. Therefore, other investors may choose to look for attractive buying opportunities – if those companies possess sound investment credentials and a price fall offers entry levels at attractive ratios.

Looking at our list of 71 stocks again, and particularly at situations where at least 2 IHT funds have positions, some companies bear more scrutiny than others.

For instance, **H&T Group (HAT)** is a leading pawnbroker whose share price is 10% lower this year. Selling £1m would modestly impact share price, £5m would have noticeable short-term impact. On a PER of just c. 7x now, a further sharp fall could be tempting for patient investors. **Ramsdens (RFX)** also incorporates a pawnbroking unit, alongside foreign exchange, precious metals trading and jewellery retailing. Its Management are well regarded.

Renew Holdings (RNWH) specialise in engineering services with plenty of work on essential infrastructure. A sale of >1% of share capital would likely hit share price in short term, presenting an opportunity for supporters to join the register. **Strix Group (KETL)** holds over half of the global kettle safety controls market, which has itself been growing, and the shares carry an attractive dividend yield.

Finally, we would note that **Epwin Group** and **Joules Group** have sizeable IHT presence on their register, so stock digestion would be likely to have some impact in the short term.



Investor Access

Hannah Crowe

Direct: 0207 065 2692

Tel: 0207 065 2690

hannah@equitydevelopment.co.uk

Equity Development Limited is regulated by the Financial Conduct Authority

Equity Development Limited ('ED') is retained to act as financial adviser for various clients, some or all of whom may now or in the future have an interest in the contents of this document and/or in the Company. In the preparation of this report ED has taken professional efforts to ensure that the facts stated herein are clear, fair and not misleading, but make no guarantee as to the accuracy or completeness of the information or opinions contained herein.

This document has not been approved for the purposes of Section 21(2) of the Financial Services & Markets Act 2000 of the United Kingdom ('FSMA'). Any person who is not a relevant person under this section should not act or rely on this document or any of its contents. Research on its client companies produced and distributed by ED is normally commissioned and paid for by those companies themselves ('issuer financed research') and as such is not deemed to be independent, as defined by the FCA, but is 'objective' in that the authors are stating their own opinions. This document is prepared for clients under UK law. In the UK, companies quoted on AIM are subject to lighter due diligence than shares quoted on the main market and are therefore more likely to carry a higher degree of risk than main market companies.

This report is being provided to relevant persons by ED to provide background information about the AIM market and related IHT considerations. This document does not constitute, nor form part of, and should not be construed as, any offer for sale or purchase of (or solicitation of, or invitation to make any offer to buy or sell) any Securities (which may rise and fall in value). Nor shall it, or any part of it, form the basis of, or be relied on in connection with, any contract or commitment whatsoever. Self-certification by investors can be completed free of charge at www.fisma.org

ED may in the future provide, or may have in the past provided, investment banking services to the Company. ED, its Directors or persons connected may have in the future, or have had in the past, a material investment in the Company.

More information is available on our website

www.equitydevelopment.co.uk

Equity Development, 15 Eldon Street, London, EC2M 7LD. Contact: info@equitydevelopment.co.uk 0207 065 2690