

Life beyond the JSE for small cap companies

By [Rob Bergman](#)

22 Oct 2019

Apparently as many as 35 companies have terminated their listings on the Johannesburg Stock Exchange (JSE) from January 2018 to August this year, with 10% of small capitalised (small cap) companies placed under cautionary notice or in the process of discussing buyouts or share buybacks. With disappointing share price performances on the JSE that do not always reflect underlying performance, these companies now seek fresh opportunities that better reflect and enable underlying performance beyond the bourse. The question is, will they be able to successfully unlock more stakeholder value as unlisted entities?



Rob Bergman

Inhouse liquidity analysis of the JSE versus the London FTSE AIM (AIM) revealed that annual free float percentages traded on the AIM are 75% for small caps (96% for large caps) compared to only 53% for JSE small caps (86% for large caps) contributing to depressed small cap valuations in the South African market.

Based on recent JSE and AIM market data, JSE large caps trade at multiples c.44% lower than those on AIM, while discounts applied to small caps are more severe at c.57%. Furthermore, JSE small cap multiples trade at discounts of c.31% compared to JSE large caps, indicating significantly harsher discounts than those applied on the AIM equivalent (10%).

Choosing to delist

For many small cap companies, this could arguably have proved the tipping point in what has been a challenging few years in the face of a poorly performing economy, severely undervalued stocks and investor disinterest for small caps in favour of large entities. As investor appetite for risk has waned, small (and mid-) cap companies have experienced significant pressure on their share prices and difficulties in raising capital at valuation acceptable to current shareholders. This must be balanced against the considerable financial reporting, administrative, compliance and regulatory costs associated with operating as a listed entity, which for small caps could amount to between R3m and R5m per annum.

It is no wonder that small cap companies have begun exploring opportunities beyond the JSE. Those that have taken the plunge include industrial player Torre Industries; direct seller, Verimark; and more recently financial services company, Efficient Group.

For Torre Industries, there were a number of factors that led to the decision to delist the company. This included meeting a key strategic objective to improve Torre's BEE ownership levels from c.29% to 51%. According to the Sens announcement in July last year, the board were of the opinion that this would be significantly easier to achieve in an unlisted environment.

In addition to this, the proposed delisting was also driven by the benefits that would be gained from operating in an unlisted environment, which included the ability to eliminate listing costs and central costs; more flexibility in relation to the capital structure which would likely increase efficiency and improve overall returns for shareholders; and the opportunity to exit Torre shareholders from shares that were tightly held with relatively poor liquidity and analyst coverage.

By separating Torre Analytical Services and Torre Industrial, the businesses would be able to operate independently and receive focused management attention, strategy implementation and enhanced empowerment credentials. Following the successful delisting of Torre Industries in April this year, Torre Analytical Services was acquired by Ethos Mid-Market Fund and Torre Industrial by Apex Partners.

Verimark's delisting rationale pointed to a combination of factors, including a disappointing share price performance and a lack of liquidity over the previous five years to 2018, which averaged just 9% of issued shares traded per annum and over the last year only 4% (excluding share buy backs). Other reasons cited for delisting were Verimark's low market capitalisation (at approximately R101m prior to the cautionary announcement), lack of analyst coverage and limited institutional support, with the company falling below the radar of institutional investors.

At the time CEO and founder, Michael van Straaten, said that plans following the delisting would include a focus on the company's e-commerce offering, growing Verimark's international business and the development of a number of innovative products to be launched in the coming months.

Buy out

Financial services company Efficient Group's rationale to delist was somewhat different to both Torre and Verimark in that it became opportune following the cancellation and buyout of a profit-share agreement. The complex buyout process included raising senior debt and securing a convertible loan from an existing shareholder. The group's corporate advisor, independent investment banking company Bravura, assisted Efficient to raise equity capital from a UK-based private equity manager, Apis Partners LLP, to replace part of the convertible loan. Apis subsequently provided the Efficient Group's board with an offer to acquire all of the minority shareholding in the company and thereafter apply for the delisting of the group from the JSE.

For the Efficient Group, the delisting signals one of the most significant corporate actions in its existence which will enable the conclusion of a long-awaited restructuring of its business and capital structure, as well as enable the company to raise further funds to pursue more acquisitions in the financial services space.

There are some criticisms levied at the delisting of companies, for example, that the extra layer of compliance protection afforded to investors through JSE listing requirements now falls away. However, for those companies that have opted to

delist, the potential gains through delisting could be considerable. As public companies, many small caps are hamstrung by high costs, an inability to raise equity capital due to illiquid and undervalued shares and disappointing growth opportunities.

As delisted entities there are immediate gains in the form of cost savings. In the longer term, a new private shareholder that fully understands and appreciates the underlying value and risk profiles of these companies can bring in new blood, bring focus to core activities and raise capital at acceptable valuations more effectively than passive JSE investors are able to. Further, through this in-depth understanding and participation it could support the implementation of diversification and expansion strategies more effectively, which are critical for the company to remain relevant and sustainable in an evolving business landscape.

The key to this is that management and the board can focus on the underlying value creation for all stakeholders, rather than being distracted daily by the effects of an inefficient capital structure.

ABOUT THE AUTHOR

Rob Bergman is a corporate finance principal at Bravura.

For more, visit: <https://www.bizcommunity.com>