

# Small Company Checklist

The sudden return in investors' appetite for risk has led to a notable jump in the performance of small-cap shares compared to the FTSE 100 and even the Mid Cap 250 index. Graham Spooner, Investment Adviser, offers a checklist to investors.

Investors have shown an increased interest in small-cap shares since March. Perhaps they're taking the view that economic data won't get any worse and that after a poor 2008 there are now bargains to be had amongst the smaller companies.

Of course, investing in smaller companies carries increased risk and there is a huge variety to choose from, ranging from the established and mature to the new and esoteric. So we've prepared a checklist to help guide you through these dangerous waters.



## Management

Who's managing the company?

Management is important for small companies, and perhaps even more so than for large, often international operations with established business practices. Ideally, look for management with a track record and experience in the relevant industry. Many companies have struggled because they lacked industry knowledge. A good measure of confidence is whether the directors are backing the company by buying shares and increasing their holdings. It's not a good sign to see regular sales by directors, unless they're maturing share option schemes.



## Backers

Find out who the major shareholders are. See if they're respected fund managers or individual investors known to have a good record in spotting opportunities. Conversely, be wary of companies where a single investor has a significant holding; this could make the shares difficult to trade.



## Product/Service

Do you understand the product/service and its purpose? Investors around during the technology bubble will remember how share prices were chased higher when there was only limited understanding of the products they were offering. Try to assess the future demand for the product/service. Question the market place and competition. Is the company too reliant on a single product or over-dependent on a limited number of customers?



## Sector knowledge

Find out how the company's sector typically performs. For example, both the mining and pharmaceutical sectors are associated with boom or bust cycles with numerous pitfalls along the bumpy road to success. The mining sector can suffer from geological problems, political issues, natural events such as flooding, extraction costs and cash flow issues. The pharmaceutical sector can suffer from delays to regulatory approval and cash burn.



## Balance sheet

If it's a young company, look at the accounts to see if there are any profits or sales. Check also the level of debt and whether the company has enough cash to achieve its set goals. If the company is close to exhausting its cash reserves then there is an increased chance it will ask shareholders for more. Cash generation may indicate that the company is considering distributing a dividend.



## Share price/liquidity

Check the recent share price history: expectations can get ahead of reality. Liquidity – or lack of it – can also be a problem. Shares that are not actively traded on a daily basis can be subject to exaggerated share price movements in response to a sudden increase in buying or selling. The spread between the buying and selling price can also be wider than typical, meaning the share price has to rise by a greater percentage before you break even.

Share tips in the press or on the internet can also create a false market in the shares, resulting in some investors getting in or out at significantly different prices.

For example, let's consider Afren, an oil and gas exploration and development company focused on Western Africa, against the checklist. The chairman and chief executive have a long track record in the industry; Lansdowne Partners, a well known investment house has a 10% holding; oil will always be in demand; the shares are high risk as it's all about potential; the group is close to having a net cash position and has cash flow from current production; and the share price is volatile.

You'll find a lot of company information on our website at [www.share.com](http://www.share.com) and in the Annual Report and accounts on the company's website usually on an 'Investor Relations' page.

### Find out more

If you have any questions on smaller companies or the checklist call our Advice team on 01296 41 43 45.