



Aftermarket Support: How to Create a Liquid Public Stock

Executive Summary

Public companies can enjoy many benefits, particularly significantly higher valuations and superior access to capital, compared to privately owned businesses. These benefits are conditional on the existence of a “liquid” market for the company’s shares. Illiquidity can prevent the stock of a smaller public issuer from achieving the higher valuations enjoyed by its peers, thereby negating one of the primary benefits of being public. The goal of any publicly traded company, therefore, should be to have its stock become widely held, actively traded, fully valued, and covered by at least one research analyst. But what exactly do these things mean? This white paper creates a framework for objectively defining and quantifying these terms and outlines a path to the holy grail of liquidity.

Keating Capital, Inc. (“Keating Capital”) is a Maryland corporation that has elected to be regulated as a business development company under the Investment Company Act of 1940. Keating Investments, LLC (“Keating Investments”) is an SEC registered investment adviser, and acts as an investment adviser and receives base management and/or incentive fees from Keating Capital. Keating Investments and its affiliates, control persons, and related individuals or entities may invest in the businesses or securities of the companies for whom Keating Capital provides managerial assistance in connection with its investments. Investment advisory and business consulting services are provided by Keating Investments. Keating Investments and Keating Capital operate under the generic name of Keating. This white paper is a general communication of Keating and is not intended to be a solicitation to purchase or sell any security. The information contained in this white paper should not be considered to be part of Keating Capital’s Prospectus. The offering and sale of Keating Capital’s shares may only be made pursuant to Keating Capital’s Prospectus, which includes certain risk factors in the “Risk Factors” section of such Prospectus.

Introduction

Investors will always pay more for an asset in its most liquid form, and because of this, public companies often enjoy valuations 100%+ higher than comparable private companies.¹ In the parlance of capital markets, this is a “liquidity premium.”

When a publicly traded company has limited or no liquidity in its stock, not only will it fail to benefit from the liquidity premium but, even worse, its stock will enter the nether world of “orphan stocks.” Even value investors may shun its shares because of the “value trap”, where a cheap stock remains so in the absence of a catalyst that can unlock its latent value and cause the stock to trade in line with the publicly traded peer group.

Faced with this, the CFO of such a company may turn to a well-intentioned adviser, who then sagely recommends that an investor relations firm be engaged to create “aftermarket support” for the stock. But what exactly is aftermarket support? How is it defined? How is its performance measured? And, most importantly, how is it achieved? This white paper answers each of these questions.

Defining Aftermarket Support

The aftermarket is defined as secondary trading on an exchange once an issuer has completed its IPO, or otherwise listed its shares. Aftermarket *support*, is the proactive process of creating visibility, marketability and, most importantly, liquidity in a publicly traded stock. This requires active effort from management and/or its investor relations firm. Liquidity is only achieved when a stock is widely held, actively traded, fully valued and receives coverage from equity analysts.

Widely Held

Individual vs. Institutional Ownership

We need to begin by understanding the dramatic change that has occurred in the last 50 years in the ownership of common stocks by institutions and individuals. An *institutional investor* is an entity that pools large sums of money to invest on behalf of others, such as investment advisers, banks, insurance companies, pension funds, hedge funds and mutual funds. *Individual investors* act on their own behalf. A half century ago, individual investors owned more than 90% of all U.S. stocks, with institutions holding less than 10%. By 1975, institutional ownership had increased to 35%. In 1990, it was 53%. Today, institutional investors now own and control almost 70% of the shares of U.S. corporations.² The top three categories of institutional owners today are: mutual funds (28%), private pension plans (11%) and government pension plans (9%).³

Two important trends have contributed to this rapid decline in individual ownership of stocks: the rise of the independent broker-dealer together with the corresponding decline of the “wirehouse”⁴, and the conversion of most independents to a fee-based rather than transaction-based compensation

¹ Pratt's Stats® at BVMarketData.com, Public Stats™ at BVMarketData.com as of May 14, 2010, for transactions between January 1, 2005 and December 31, 2009. Used with permission from Business Valuation Resources, LLC.

² Bogle, John. “The Amazing Disappearance of the Individual Stockholder.” *The Wall Street Journal*. October 2005.

³ Ibid.

⁴ A wirehouse is typically a full-service broker, offering research, investment advice, and order execution, and is usually considered to be a “top-service” broker.

model.⁵ The stockbroker of yesterday has given way to today's asset gathering "financial adviser." The days of trying to pick stocks that outperform the market are gone, displaced by financial plans and asset allocation models. Ownership of common stocks has given way to ownership of mutual funds and ETFs as the securities of choice for today's modern financial adviser.

The implication for small business capital formation is profound, and not in a good way. Legions of salesmen who once peddled stocks to individuals for a living (i.e., stockbrokers) are rapidly thinning out. Without the support of individual investors, small IPO stocks are unable to climb the ladder toward institutional financing, and often times never reach their full potential. In the absence of stockbrokers, emerging growth companies find it extremely difficult to raise capital the old fashioned way — that is, through a small IPO. The same buyers who are no longer there to support IPOs are also not there to support fledgling stocks in the aftermarket.

Insidiously, the absence of individual stock owners also has the knock-on effect of keeping away institutional investors. Institutions will generally only take positions in stocks that have established liquidity, and that cannot exist without a solid base of individual stock owners. Institutional ownership is critical:

- Institutional ownership confers legitimacy that the company is "real," since institutional investors tend to be more judicious and careful in their investments than private individuals.
- Before initiating coverage, "sell-side" equity research analysts (i.e., those working for investment banks) check whether institutions will consider buying the relevant stock, because commissions received by their sales and trading colleagues from stock trades ultimately finance the research.
- Institutions can take large positions that absorb overhang (inclusive of dilutive securities or large blocks of stock available for sale), increase volume and, most importantly, drive up the price.

Optimally then, a company should have a "high" percentage of institutional ownership. This raises two questions: What does "high" mean? What is the typical or average amount of institutional ownership? To answer these questions we analyzed the performance of stocks trading on the Nasdaq, as a proxy for the entire U.S. stock market. We chose Nasdaq because stocks listed on the New York Stock Exchange are unrepresentatively large and stocks that trade over-the-counter generally don't attract institutional ownership. Furthermore, Nasdaq-listed stocks are dispersed across a very wide spectrum of market capitalization.

Table 1 divides the 2,524 stocks listed on all three tiers⁶ of the Nasdaq⁷ into five quintiles of roughly 505 stocks⁸, each based on market capitalization, and shows the breakdown of institutional ownership and individual ownership. (Throughout this paper, we refer to the "first" or "bottom" quintile as the one with the smallest values and the "fifth" or "top" quintile as the one with the largest values.) The pattern here is hardly surprising — the larger the company, the higher the percentage of institutional ownership. But the differences are striking. The median institutional ownership begins at 16% in the first quintile, increases by roughly 20% per quintile and hits a high

⁵ Weid, David and Edward Kim. "Why are IPOs in the ICU?" *Grant Thornton White Paper*.

⁶ The three tiers of Nasdaq are Nasdaq Capital Markets, Nasdaq Global Markets, and Nasdaq Global Select.

⁷ The 2,524 Nasdaq companies used for comparison were public operating companies (excluding ADRs) as of July 9, 2010. Stocks with incomplete and/or missing data were not used.

⁸ Each quintile contains 505 companies, except quintile 3, which contains 504. Source: Capital IQ.

of 86% in the fifth quintile. **Table 1** enables us to predict the level of institutional ownership for a company given its market cap. For example, a company with a market cap of \$178 million, which is the median market cap for companies trading on the Nasdaq, can roughly expect to have about 55% institutional ownership.

Table 1: Institutional vs. Individual Ownership of Nasdaq Stocks

| Quintile | Market Cap Range (MM) | Median Market Cap (MM) | Median Institutional Ownership | Median Individual Ownership |
|----------|-----------------------|------------------------|--------------------------------|-----------------------------|
| 1 | \$0 - 40 | \$21 | 16% | 84% |
| 2 | \$41 - 114 | \$67 | 33% | 67% |
| 3 | \$115 - 270 | \$178 | 55% | 45% |
| 4 | \$271 - 740 | \$442 | 76% | 24% |
| 5 | \$741+ | \$1,742 | 86% | 14% |

Actively Traded

Average Daily Trading Volume (“ADTV”)

In order to define an objective standard for trading volume, we look again at all Nasdaq-traded stocks as a proxy for the entire U.S. stock market. The clear metric by which we can measure activity is average daily trading volume (ADTV), defined here as the average number of shares traded daily during the last 12 months, divided by the average total number of shares outstanding during that time. As an example, a company that trades an average of 500,000 shares on a daily basis with a total of 100 million shares outstanding would have an ADTV of 0.50% [$500,000 / 100,000,000$]. It could be argued that measuring ADTV as a percentage of *shares outstanding* is flawed, since a small company would typically have a lower “float”⁹ and therefore a lower percentage of shares available to trade in the first place. However, even when ADTV is measured as a percentage of *float*, the pattern still holds.¹⁰

Table 2 again divides Nasdaq-listed stocks into five quintiles based on market capitalization. The highlighted column is the median ADTV for each quintile. For example, the median ADTV for the third market cap quintile is 0.43%. This means that if, for example, a company in the third quintile had 100 million shares outstanding, on average 430,000 shares would have been traded on a daily basis over the prior 365 days. The data show a very strong positive correlation between ADTV and market cap; the larger the company, the more liquid the stock. Liquidity improves markedly for largest companies found in the fifth quintile. **Table 2** enables us to identify the benchmark ADTV for a given company. For example, a company with a market cap of \$178 million can, all else being equal, expect to have an ADTV of roughly 0.43%.

We analyzed each quintile to identify stocks that were “under-traded”, which we defined as any stock with an ADTV below 50% of the median for its quintile. For example, in the third quintile we classified as under-traded any stock characterized by an ADTV below 0.22% (i.e., 50% of 0.43%).

⁹ Float is defined as the percentage of shares outstanding not held by insiders, affiliates, or 5% shareholders.

¹⁰ By Market Cap Quintiles, the median ADTV as percentages of *float* are: 0.26%, 0.34%, 0.57%, 0.79%, and 1.25%.

Table 2: Nasdaq ADTV by Market Cap Quintiles

| Quintile | Market Cap Range (MM) | Median Market Cap (MM) | Median ADTV | Under-Traded Stocks |
|----------|-----------------------|------------------------|-------------|---------------------|
| 1 | \$0 - 40 | \$21 | 0.18% | 24% |
| 2 | \$41 – 114 | \$67 | 0.25% | 25% |
| 3 | \$115 – 270 | \$178 | 0.43% | 17% |
| 4 | \$271 – 740 | \$442 | 0.63% | 18% |
| 5 | \$741+ | \$1,742 | 1.10% | 15% |

Float

In order to examine the concept of “float” as it relates to market cap, we divided all Nasdaq-listed stocks into quintiles by percentage of float (**Table 3**). The highlighted column shows the median ADTV for each quintile of float range. The data show that there is once again a very clear, positive correlation between float and ADTV. If we pick 0.42% ADTV as a liquidity benchmark, since it is the median ADTV of the third float range quintile, we can see that the average float range typically associated with that level of ADTV is 76 to 87%. This data provides useful guidance. For example, if a company were seeking to achieve an ADTV of 0.42%, but only has a 50% float, then its first step toward its liquidity goal would probably include a plan to increase the percentage of shares outstanding in the public float.

Table 3: Nasdaq ADTV Analysis by Float Quintiles

| Quintile | Float (%) Range | Median ADTV |
|----------|-----------------|-------------|
| 1 | 0 - 58% | 0.21% |
| 2 | 58 - 76% | 0.33% |
| 3 | 76 - 87% | 0.42% |
| 4 | 87 - 95% | 0.55% |
| 5 | 95 - 100% | 0.96% |

Share Price

In order to examine the relationship between share price and ADTV, we divided all Nasdaq-listed stocks into quintiles based on share price. The data in **Table 4** show a clear, positive correlation between share price and ADTV.¹¹ The highlighted column shows the median ADTV for each quintile of share price range, and enables correlations to be drawn between a given level of ADTV and a stock price range.

¹¹ The high ADTV of the first quintile can be explained by the high volume trading of the cheapest stocks. If the first quintile were to be further divided into two groups, one ranging from \$0.01 to \$1.00, and the other from \$1.01 to \$2.77, the median ADTV for each group is 0.56% and 0.32%, respectively.

Table 4: Nasdaq ADTV Analysis by Share Price Quintiles

| Quintile | Price Range | Median ADTV |
|----------|------------------|-------------|
| 1 | \$0.01 - 2.77 | 0.35% |
| 2 | \$2.78 - 5.91 | 0.33% |
| 3 | \$5.92 - 11.24 | 0.37% |
| 4 | \$11.25 - 20.80 | 0.53% |
| 5 | \$20.81 - 467.49 | 0.82% |

Fully Valued***Price-to-Sales Ratio (P/S) as the Proxy for Valuation***

This paper is no treatise on valuation. We pick only one valuation metric as a yardstick for identifying whether a stock is being “fully valued”, a perilous but simple exercise. We chose the Price-to-Sales (P/S) ratio as our sole valuation metric because it is widely acknowledged that sales is the financial item least prone to manipulation, and many of the stocks on the Nasdaq are “growth” stocks with little or no earnings. Relying, for instance, on the Price to Earnings (P/E) ratio would have resulted in the exclusion of 41% of Nasdaq-listed stocks from the analysis.

As depicted in **Table 5**, we divided Nasdaq-listed stocks into quintiles based on market cap. The third column of the Table illustrates the positive correlation between market cap and P/S. The greater the market cap, the higher the P/S ratio. The median P/S ratio for all Nasdaq-listed stocks when sorted by market cap is 1.56x; a company in the third quintile with \$100 million of sales would on average have a market capitalization of \$156 million. The difference between the P/S ratios of companies in the first (0.76x) and fifth (2.51x) quintiles is striking.

As previously, we define as “undervalued” stocks characterized by a P/S ratio 50% below the median in their quintile. This yardstick suggests that on average 28% of companies are undervalued across all quintiles.

Table 5: P/S Ratios of Nasdaq Companies by Market Cap Quintiles

| Quintile | Market Cap Range (MM) | Median P/S Multiples | Undervalued Stocks |
|----------|-----------------------|----------------------|--------------------|
| 1 | \$0 – 40 | 0.76x | 29% |
| 2 | \$41 – 114 | 1.19x | 28% |
| 3 | \$115 – 270 | 1.56x | 30% |
| 4 | \$271 – 740 | 1.69x | 27% |
| 5 | \$741+ | 2.51x | 25% |

Using **Table 5**, we can identify a benchmark P/S ratio for a given company. For example, a company with a market cap of \$178 million can, all else being equal, expect to have a P/S of about 1.56x.

Analyst Coverage

A widely-held, actively-traded, and fully-valued stock should help a company obtain the fourth and final attribute of a successful stock: analyst coverage.

Analyst coverage confers legitimacy and is an indication that a stock is of institutional quality. Analyst coverage is all the more coveted because *over 25% of Nasdaq-listed stocks have no coverage*. As **Table 6** shows, 71% of Nasdaq-listed companies with a market cap of \$40 million or less have no coverage, and companies with market caps between \$40 million and \$114 million (the second quintile) on average have only a single analyst. Large size, however, does not necessarily guarantee coverage, nor does small size always guarantee a lack of it. Abraxis BioScience Inc. (ticker: ABII, \$3.0 billion market cap) and American National Insurance Company (ticker: ANAT, \$2.2 billion market cap) have no analysts covering their stocks. Conversely, tiny micro-cap companies such as Poniard Pharmaceuticals, Inc. (ticker: PARD, \$26 million market cap) and Preferred Bank (ticker: PFBC, \$29 million market cap) have seven and four analysts, respectively.

Table 6: Analyst Coverage of Nasdaq Stocks by Market Cap Quintiles

| Quintile | Market Cap Range (MM) | Median Market Cap (MM) | Median # of Analysts | Max. # of Analysts | Stocks with No Analysts |
|----------|-----------------------|------------------------|----------------------|--------------------|-------------------------|
| 1 | \$0 – 40 | \$21 | 0 | 7 | 71% |
| 2 | \$41 – 114 | \$67 | 1 | 13 | 41% |
| 3 | \$115 – 270 | \$178 | 3 | 18 | 13% |
| 4 | \$271 – 740 | \$442 | 5 | 22 | 5% |
| 5 | \$741+ | \$1,742 | 12 | 51 | 1% |

Now comes some of the most shocking data of all. As shown in **Table 7**, we divided all Nasdaq-listed stocks by market cap and then measured the median net income for each quintile. The median net income for stocks in the bottom quintile is negative \$2.6 million. In the second quintile, the median net income is still only \$0.2 million. 41% of Nasdaq-listed companies generate net losses.

This raises interesting questions: Do the poor valuations of stocks in the bottom two quintiles result from their limited trading volume and analyst coverage or their poor financial performance? Should some, or all, of these companies be private? Since investors are motivated by the prospects for a company's future profitability, net losses seem reason enough for most individuals, institutions and analysts to look elsewhere for stock ideas.

Table 7: Net Income of Nasdaq Stocks by Market Cap Quintiles

| Quintile | Market Cap Range (MM) | Median Market Cap (MM) | Median Net Inc. (MM) | Companies w/ Negative Net Income |
|----------|-----------------------|------------------------|----------------------|----------------------------------|
| 1 | \$0 – 40 | \$21 | \$(2.6) | 68% |
| 2 | \$41 – 114 | \$67 | \$0.2 | 49% |
| 3 | \$115 – 270 | \$178 | \$2.9 | 43% |
| 4 | \$271 – 740 | \$442 | \$15.6 | 27% |
| 5 | \$741+ | \$1,742 | \$75.1 | 16% |

It is easy for pundits to blame Sarbanes-Oxley for every woe in the stock market, including the “deplorable” fact that 27% of all stocks traded on Nasdaq in 2009, had no coverage at all. But as the time series in **Table 8** below clearly illustrates, the average number of analysts covering a Nasdaq stock has actually steadily *increased* since 2002¹², the year that Sarbanes-Oxley was first implemented. In 2002, Nasdaq stocks had an average of 2.8 analysts, with 45% of stocks having no analyst coverage at all. In 2009, the average had increased to 4.6, and the percentage of stocks with no coverage had declined to 29%. Since the number of Nasdaq-listed stocks declined from 2002 to 2009, this suggests that many weak companies have left the exchange and as a result the overall quality of Nasdaq-listed companies has improved.

Table 8: Number of Analysts Covering Nasdaq-Listed Stocks, 2002-2009

| | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 |
|-------------------------|------|------|------|------|------|------|------|------|
| Mean | 2.8 | 3.3 | 3.7 | 4.1 | 4.3 | 4.5 | 4.0 | 4.6 |
| Stocks with no Coverage | 45% | 38% | 32% | 29% | 28% | 25% | 27% | 29% |

How to Create Liquidity in a Stock

We believe there are 10 critical steps that must be taken in order to achieve aftermarket support goals as defined above. Before we discuss them, however, we must discuss “penny stocks” and the Penny Stock Reform Act of 1990, and how the latter impacts any investor relations or aftermarket support program.

Penny Stocks

The SEC defines a penny stock as a share in a company which trades for less than \$5.00.¹³ Market practitioners also use the term penny stock to describe:

- A stock trading below \$1 per share; and/or
- Any stock that is traded over-the-counter (i.e., not a senior exchange)¹⁴.

¹² The data is for public, operating companies on Nasdaq Capital Markets, Global Markets, or Global Select.

¹³ Penny Stock Rules. <http://www.sec.gov/answers/penny.htm>. July, 2010.

In 1989, the National Association of Securities Administrator’s Report on Fraud and Abuse in the Penny Stock Industry declared, “Penny Stocks are now the No. 1 threat of fraud and abuse facing small investors in the U.S.”¹⁵ Congress created the Penny Stock Reform Act of 1990 in order to crack down on fraud and market abuses associated with the promotion of penny stocks to unsophisticated investors.

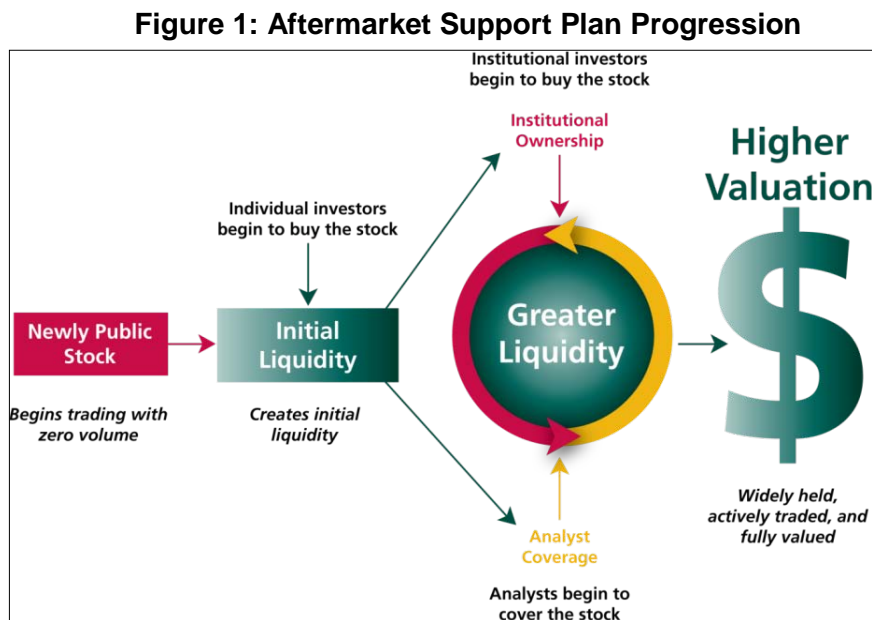
The Act created a set of rules that governed how and under what circumstances brokers could solicit orders in penny stocks. The result of this legislation is that today nearly all major brokerage firms either prohibit outright or make it exceedingly difficult for their brokers to trade in penny stocks, however defined.

The implication for any aftermarket support program is clear: If the stock in question is a penny stock (i.e., trades below \$5.00 per share and/or over-the-counter), then a “traditional” investor relations program built on soliciting support from retail brokers is doomed to failure because these brokers will almost never recommend such stocks to their clients.

In stark contrast, however, there is no such prohibition on self-directed or online trades; the rules regarding solicitation simply do not apply. Any thoughtful and well constructed aftermarket support program must therefore have a specific plan to attract this audience, which will no doubt involve a dedicated online campaign.

Aftermarket Support: The Approach

Figure 1 illustrates the flow of a successful aftermarket support program. It is critical to emphasize that for an aftermarket support program to be successful, the relevant company must do its part — that is, consistently deliver both top and bottom line growth, preferably in excess of Wall Street expectations. Aftermarket can’t work in a vacuum.



¹⁴ We define a “senior exchange” as: the New York Stock Exchange (NYSE), the Nasdaq (Global, Global Select, or Capital Market), or NYSE Amex Equities (formerly known as the American Stock Exchange).

¹⁵ Feldman, David. *Reverse Mergers*. p.22. Bloomberg Press: New York, NY. 2006.

A new, small public company needs to start an awareness campaign by targeting the online, self-directed traders in order to create a large shareholder base of small individual investors. This would include various forms of e-advertising, such as banner ads on financial portals, and key word searches. This type of investor is specifically attracted to low absolute stock prices, viewing the position as a type of call option with limited downside and upside potential to double or triple in value. A base of 1,000 or more stockholders is ideal; though the typical position size of these online buyers is often \$1,000 or less. This aggregation of an army of small buyers is typically how trading begins in a penny stock, or one that goes public through a direct listing. Then, through the normal course of buying and selling, trading activity will beget more trading activity. Broker-dealers will begin to place buy and sell orders through wholesale market-making firms, and the number of market-makers will begin to increase organically over time. Trading bid-ask spreads naturally narrow through the addition of additional market-makers and trading activity.

Once a stock reaches an ADTV equal to roughly half the Nasdaq average for its quintile, it would then be appropriate for the company to begin a concerted outreach to an institutional audience. Institutional investors will not generally buy a stock unless there is already both a reasonably consistent pattern of trading volume, for example an ADTV of 0.22% [Quintile 3 ADTV of 0.43% x 50%] (refer to **Table 2** for median trading volumes) and “depth.” Depth means that there is sufficient volume such that an institution looking to build a large position over time can do so without dramatically pushing up the stock price simply by virtue of its own purchasing. This is why a solid base of individual stockholders must first be created before a concerted institutional outreach begins. Trading volume begets institutional ownership, which begets analyst coverage, which leads to higher valuations.

A new, small issuer that tries to obtain institutional ownership in a stock with zero liquidity is very likely to fail. We believe such a company would be better served by following the 10-step guide set forth below in conjunction under the auspices of an investor relations firm that possesses expertise in micro- and small-cap stocks. For companies that complete traditional IPOs, steps 4 and 5 below can easily be omitted without adverse consequences. Notwithstanding, we still recommend them for all companies.

10-Step Guide to Create Liquidity in a Stock

1. **Content and platform.** Create a 2-page Fact Sheet, a 16 to 20-page PowerPoint, a 3-minute video and an investor relations module on your website. These are the minimum building blocks to begin to tell the story. Investors *need* to be able to access all of this information immediately and in easily digestible form. All content should be designed with an online audience in mind.
2. **Content distribution plan.** Create a plan with a storyboard with press releases, including those related to all relevant SEC filings, planned around known major corporate milestones for the next 12 months. Develop a calendar to disseminate content to your distribution list. Investors crave new *material* information, and it is important to have a thoughtful plan to disseminate this material information in somewhat regular, though never artificial, intervals over time. A company that issues few or no press releases on the one extreme, or one that is a serial issuer of non-material or frivolous releases at the other extreme, will negatively impact both its credibility and stock price in short order.

3. **Public relations plan.** Consider engaging a firm dedicated exclusively to public relations rather than investor relations. The PR firm is responsible for getting news articles written about the company and creating buzz within the industry and not necessarily with investors.
4. **Identify and target individual investors.** Identify individuals such as friends, family, vendors, strategic partners, affiliates, and employees and their networks, who would naturally have an interest in the stock and might be potential investors. The initial buying generally needs to start from within the inner circle. Even if these individuals do not become investors, word will spread, the viral marketing will have begun and the foundation will have been laid for attracting future investors. Whatever one's opinion of chat rooms, such as Raging Bull and Yahoo message boards, they nonetheless play an important role in viral marketing. The fact is that many individual investors turn to these as a source for stock tips and information.
5. **Online strategy/tactical plan.** Develop plans for search engine optimization, key word search, and online banner advertising on financial portals. A competent Web master should be able to help with the first two items, though for maximum effectiveness a specialist with knowledge of relevant financial portals would be required. Also consider joining appropriate groups on social networks such as LinkedIn and Facebook. These tools do more than enable networking; they are also mediums of communication and message delivery. When targeting individual investors, viral marketing can be a crucial step to get the ball rolling, although whether its use will be appropriate will depend on the type of business and industry.
6. **Quarterly stockholder calls.** Schedule and hold quarterly conferences calls without fail. Immature companies sometimes cancel conference calls when there is bad news. This can be fatal to a stock; keeping investors in the dark is a surefire way to lose them. Remember, there is no worse news than no news.
7. **Institutional investor and analyst outreach.** Create a targeted list of institutional investors with the aid of subscription software services such as Capital IQ, FactSet, and Ipreo, and begin systematic, highly structured campaigns to them. The campaigns should consist of a combination of direct mail, e-mail and telephone outreach. Replicate this process for both buy-side and sell-side equity analysts covering the company's sector/publicly traded peers. Conduct at least quarterly "non-deal" road shows to meet face-to-face with institutional investors and analysts.
8. **Work up the food chain.** All institutional investors are not the same. There are thousands of small funds, often run by ex-Wall Street analysts, looking for under-followed, undiscovered stocks. In other words, you don't have to go from John Q. Public to Fidelity in one fell swoop. Conferences, whether of the Wall Street sponsored or "pay-to-play" variety, are ideal way to meet face-to-face with analysts and institutions.
9. **Patience and effort.** Obtaining aftermarket support is a continuous and long-term process; expect costs of \$250,000 to \$500,000 a year (including the fees for investor and/or public relations firms) for the first few years to really gain any traction.
10. **Retaining investors.** Companies know that it is far more costly to obtain a new customer than to retain an existing one. It's no different for stockholders. Great care should be taken to nurture and cultivate current stockholders with a goal of converting them to long-term stockholders. There are few things more damaging to an emerging company's aftermarket

support program and reputation than volatility in the stock price resulting from questionable investor relations tactics associated with a campaign designed to pump up the stock price. Pumping invariably leads to dumping. Slow and steady wins the race. A company over time that consistently meets or beats its financial projections will be gradually rewarded with a rising stock price by thoughtful and long-term oriented investors. It's really that simple.

Measuring the Results

The success of an aftermarket support plan was precisely defined in the first section of this white paper and, together with the relevant company's consistently strong financial results, should enable a stock to trade favorably compared with companies of similar size. We suggest that a stock that achieves 80% of the median value in the quintile groups discussed above can be described as successful. Although arbitrary, this benchmark seems reasonable. On this basis a liquid stock is:

- Widely held – with an institutional ownership at least equal to 80% of its quintile-adjusted peer group;
- Actively traded – with an ADTV at least equal to 80% of its quintile-adjusted peer group; and
- Fully valued – with a Price-to-Sales ratio at least equal to 80% of its quintile-adjusted peer group.

In addition, a truly institutional quality stock should have at least one or two analysts covering the stock, depending on the size of the company.

Conclusion: Liquidity is a Virtuous Cycle

Trading volume, institutional ownership, valuation and analyst coverage are inextricably intertwined:

- Trading volume is a pre-condition to institutional ownership, which leads to analyst coverage, which leads to higher valuations.
- Analyst coverage leads to institutional ownership, which then leads to trading volume, which leads to higher valuation.
- Trading volume leads to analyst coverage, which then leads to institutional ownership, which leads to higher valuations.

Liquidity cannot make a company generate more sales or increase profits. However, increased liquidity tends to boost valuation. The goal of creating or increasing liquidity in a stock is to maximize enterprise value, surely the highest goal of all for any public company.

About Keating Investments:

Keating Investments, LLC is a Denver-based SEC registered investment adviser founded in 1997 and is the investment adviser to Keating Capital, Inc. (www.KeatingCapital.com). Keating Capital is a business development company that specializes in making pre-IPO investments in innovative, high growth private companies that are committed to becoming public. Keating Capital provides individual investors with the ability to participate in a unique fund that invests in a private company's late stage, pre-IPO financing round — an opportunity that has historically been reserved for institutional investors.

About the author:

Timothy J. Keating is the founder and President of Keating Investments. Previously, he held senior management positions in the equity and equity derivative departments of Bear Stearns, Nomura and Kidder, Peabody in both London and New York. He is a 1985 *cum laude* graduate of Harvard College with an A.B. in economics. He can be reached at (720) 889-0131 or at tk@keatinginvestments.com.