LIGHTHOUSE
INSTITUTO ESPAÑOL
DE ANALISTAS

EFFAS SUMMER SCHOOL 2023. Lisbon.
6th & 7th of July.

The lack of SME research coverage. The "Spanish solution"

Lighthouse started up its operations in 2018 and has already become a leader in fundamental analysis of Small & Micro Cap stocks on the Spanish market. It has considerably improved its coverage ratios.

July 2023

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2018-2023: sharp drop in research coverage in the Spanish market

Especially in the Small & Micro Caps segment

The Mifid II draft guidelines were approved in December 2014 and the new regulations became effective in January 2018. What impact has Mifid II had on the level of research coverage of the Spanish market?

As expected, Mifid II has provided an incentive to discontinue coverage of Small & Micro Caps. Moreover, financial sector margins narrowed amid the prolonged period of low interest rates. This resulted in:

- A sharp reduction in the number of analysts covering Small Caps in the Spanish market. Analysts covering stocks with <EUR 300Mn in Mkt Cap have fallen by c. 37% -5y.
- And the decline in coverage of Small Caps was not only in Spain, but widespread across Europe.

Average number of analysts evolution per Mkt Cap tranches (Jun 2023)

	Market Cap (EUR Mn)	Average number of analysts						2018 vs 2023	CAGR 2018-2023
		Jun-18	Jun-19	Jun-20	Jun-21	Jun-22	Jun-23		
Spain	**<300**	1.2	0.9	0.7	0.7	0.8	0.7	-37.4%	-8.9%
	300 a 500	4.1	3.9	3.6	3.6	3.8	3.7	-10.0%	-2.1%
	500 a 1,000	10.6	9.1	8.2	8.1	8.1	7.8	-27.2%	-6.1%
	1,000 a 10,000	13.9	13.2	13.4	13.7	13.7	13.7	-1.6%	-0.3%
	>=10,000	28.2	25.1	26.5	25.9	25.4	25.5	-9.7%	-2.0%
	Total	**9.8**	**8.8**	**8.8**	**8.6**	**8.5**	**8.3**	**-15.3%**	**-3.3%**

What exactly is an "orphan" stock?

The real problem with SMEs is "zero" coverage

What is an orphan stock?

1. **No coverage.** This is a *sine qua non* condition, but not a sufficient condition. First, there must be no firm (including corporate research houses) that publishes research on the company. In other words, none that is in condition to publish research on the company as part of the firm's research universe.
2. **No in-depth analysis.** This means fundamental analysis backed by a financial model and projections. Research that effectively enables an institutional investor to form an opinion about whether a stock is expensive or cheap. Therefore, a mere description of the company's business is not enough.
3. **No current research**. Research must be up to date. Quality research does not mean the stock is under coverage if it is over a year old.
4. **Irregularity.** Opportunistic research is not coverage. A stock is under coverage when research is published regularly, informing the market of any event or circumstance affecting the share price (e.g. earnings, acquisitions or sales of businesses, changes in capital structure).
5. **No distribution**. A distribution system must be in place for the research to "reach" the main institutional investors in each market.
6. **In conclusion:** an orphan stock is one that, at least, lacks any real research coverage; i.e. quality, up-to-date, ongoing and widely distributed fundamental research coverage.

SMEs' real problem arises when there is zero coverage; i.e. a complete lack of knowledge of the company's fundamentals and real situation. This has an extremely adverse impact on financing and, therefore, the growth of this type of company; i.e. orphan stocks. there are more than one might suspect at first glance…

Lighthouse: the “Spanish solution” to the orphan stock problem

Lighthouse is a fundamental analysis project of Instituto Español de Analistas and BME (owner of the Spanish stock exchange; SIX Group): an atypical project whose aim is to provide high quality research coverage of orphan stocks on the Spanish market. And that they can benefit from. Lighthouse started up its operations in 2018.

1. **Just research.** Lighthouse produces fundamental analysis of companies listed on both Spain's Continuous Market and MAB.
2. **Instituto Español de Analistas + BME**. Lighthouse is a service of Instituto Español de Analistas backed and funded by BME (owner of the Spanish stock exchange).
3. **Only orphan stocks.** Lighthouse limits its activity to the coverage of those stocks listed on the Spanish Stock Exchange that are not covered by other analysts; i.e. stocks not covered by sell side equity research This means that, in general, it covers small and/or illiquid stocks.
4. **Service.** Instituto Español de Analistas is a non-profit organisation. Lighthouse is strictly considered a service to the market.
5. **No competition.** By definition, Lighthouse is a service that does not compete with anyone. It was created to analyse stocks not covered by any other firm. Accordingly, it is a complementary service to those already provided in the market.
6. **Quality.** Lighthouse seeks to provide top quality research coverage. Its coverage is neither conventional nor superficial, but rather high level fundamental analysis in terms of both its models and reports and its distribution to investors.
7. **Independence.** Lighthouse is an independent research service. This makes it optimal for appreciation by institutional investors.
8. **Low cost.** Instituto Español de Analistas does not charge companies anything for this service. BME passes on a small portion of the cost to the companies covered by Lighthouse so as to ensure that they are engaged with their coverage.

Lighthouse's product (1)

Notes and reports: type of coverage and research focus

1. **Fundamental analysis.** Lighthouse follows classic fundamental analysis. Its approach is based on in-depth knowledge of the businesses analysed and good modelling, with a focus on explaining each business' cash flow generation capacity. It does not provide quantitative or technical analysis.
2. **No recommendations or valuations.** Lighthouse believes that the value of research (especially for small caps) lies in financial projections and not in the valuation. Or the recommendation. Lighthouse does not issue recommendations (it doesn't say "buy or sell") and it does not value stocks or publish target prices.
3. **Regularity.** Lighthouse is a continuous research coverage solution. It does not provide opportunistic or ad-hoc research. Rather, it offers continuous coverage of each company, publishing notes and reports on interim and annual earnings and any events with an impact on the share price.
4. **Technical quality.** The objective of Lighthouse's product is to be useful to the market. To achieve this, Lighthouse focuses entirely on providing research with supreme technical quality.
5. **Designed for institutional investors.** Lighthouse wants to enhance the liquidity of the stocks it analyses and stop them from being penalised by the lack of knowledge about their fundamentals. For it to do this, institutional investors must become familiar with these stocks, using a product that is specifically tailored to them. Lighthouse's product targets institutional, not retail investors.

Lighthouse has designed its product based on its objectives. It does not need to issue recommendations. Being scrupulous in modelling companies is crucial.

Lighthouse's product (2)

Maximising distribution of the product

Lighthouse wants its research to reach the entire market. This will raise the liquidity of the stocks covered and reduce their discount (due to the lack of knowledge).

1. Universal. Lighthouse’s success depends on its research having the maximum distribution possible. Its goal is to achieve mass, not selective distribution. Universal: all investors in all markets.
2. In Spanish and English. Lighthouse publishes all its research in Spanish and English. This guarantees distribution in both the Spanish and international markets.
3. No cost for institutional investors. Lighthouse's objective is to maximise distribution of its product, so investors have free access to its research.
4. Website. The research is available (at no cost) on both the Instituto Español de Analistas and BME websites.
5. Distribution via platforms. In addition to distribution on the Instituto Español de Analistas website, Lighthouse’s research also reaches the market through financial information platforms: Capital IQ (S&P), Refinitiv (formerly Thomson Reuters), Factsect and Bloomberg.
6. Direct delivery to institutional investors. Lastly, Lighthouse distributes directly to an exclusive list of (domestic and international) institutional investors that are specifically interested in investing in this kind of stocks (Spanish Small & Micro Caps).

The main objective of Lighthouse’s research distribution is to maximise its market reach. Distribution is crucial for generating knowledge about the stocks and liquidity.

In conclusion: what does the "Lighthouse solution" provide?

The context is evident: the high number of orphan stocks on the Spanish market. These are almost always small, illiquid stocks not covered by sell side equity research because they are not profitable.

In this respect, Lighthouse is a key service of Instituto Español de Analistas and BME provided to the Spanish market. It is an "oddity" that provides something unique:

- **Quality fundamental analysis** tailored to institutional investors.
- **Independent research.** It is not a sponsored research service.
- **Universal research distribution:** guaranteeing that Lighthouse's reports and notes reach all investors in all markets.
- **Increased liquidity:** the interaction of these three factors (quality analysis + independence + distribution) directly impacts the liquidity of the stocks covered. In Spain, growth in the liquidity of stocks analysed by Lighthouse has outstripped that of the overall market and the rest of the Small Caps by c.15 p.p.

Lighthouse provides a comprehensive solution to the orphan stock problem: quality, independent and universal research distribution. And at a cost that any company can afford, not to mention a direct, positive impact on the liquidity of the stocks it covers.

Lighthouse now covers 31 stocks on the Spanish market

Companies covered by Lighthouse (June 2023): c.100%, Micro Caps (<EUR 300Mn Mkt Cap)

Nº	Company	Coverage Star	Market	Sector	Market Cap. (Mn EUR)
1	Adolfo Domínguez	03-Dec-2019	Mercado Continuo	Textiles, Apparel & Luxury Goods	48.70
2	Agile Content	22-May-2023	BME Growth	Software	90.13
3	Alquiber	09-Mar-2022	BME Growth	Transportation - Road & Rail	49.13
4	Amper	04-Apr-2019	Mercado Continuo	Communications Equipment	117.96
5	Audax Renovables	24-Sep-2019	Mercado Continuo	Electric Utilities	560.05
6	Borges - BAIN	11-Apr-2019	Mercado Continuo	Food Products	68.96
7	Cevasa	14-Nov-2022	Mercado Continuo	Real Estate	155.80
8	Cuatroochenta	22-Apr-2021	BME Growth	Software	24.04
9	Desa	23-Dec-2019	Mercado Continuo	Machinery	27.36
10	Ecolumber	10-Jun-2020	Corros	Food Products	32.41
11	Endurance Motive	26-Apr-2022	BME Growth	Electrical Equipment	17.24
12	Enerside	29-Jul-2022	BME Growth	Independent Power Producers (IPP)	186.63
13	Ercros	03-Jun-2019	Mercado Continuo	Chemicals	304.29
14	Facephi	20-Dec-2019	BME Growth	Software	44.16
15	GAM	08-Apr-2020	Mercado Continuo	Trading Companies & Distributors	141.91
16	IFFE Futura	09-Jul-2020	BME Growth	Food Products	40.82
17	Inmobiliaria del Sur	22-Dec-2022	Mercado Continuo	Real Estate	134.42
18	Innovative Solutions Ecosystem	15-Dec-2020	Mercado Continuo	IT Services	32.54
19	Kompuestos	28-Jul-2021	BME Growth	Chemicals	11.79
20	Libertas 7	07-Jul-2021	Mercado Continuo	Real Estate	21.26
21	Lingotes Especiales	22-Nov-2018	Mercado Continuo	Auto Components	79.00
22	Liwe	07-Nov-2019	Corros	Textiles, Apparel & Luxury Goods	22.00
23	LLYC	23-Dec-2021	BME Growth	Media	125.71
24	Mondo TV Studios	25-May-2022	BME Growth	Media	5.76
25	Naturhouse Health	23-Apr-2021	Mercado Continuo	Personal Products	100.20
26	Netex	07-Jul-2022	BME Growth	Software	22.87
27	Nicolás Correa	17-Jan-2019	Mercado Continuo	Machinery	70.82
28	Pangaea Oncology	16-Oct-2020	BME Growth	Biotechnology	64.03
29	Seresco	04-May-2023	BME Growth	Software	32.65
30	Squirrel Media	29-Jan-2021	Mercado Continuo	Media	204.77
31	Substrate Artificial Intelligence	22-Dec-2022	BME Growth	Software	10.02

Lighthouse is a reality: it provides a research coverage solution for 31 Spanish companies from all kinds of sectors and no size restrictions. It covers 40% of the Micro Caps on the Spanish market.

Level of coverage of the Spanish market (June 2023)

If not for Lighthouse…

Situation if Lighthouse didn't exist today:

- Continuous Market "ex outcry", c. 25% orphan. BME Growth, c. 80% orphan. Continuous Market "ex IBEX 35" 27% orphan.
- Overall, some 80 stocks are not covered (30 on the Continuous Market); i.e. 45% of the Spanish market with no (independent or paid) research coverage.
- There a several stocks at risk of becoming orphans: c. 25 companies are only followed by 1-3 analysts (13% of the market). Orphan stocks plus companies with limited coverage ("extended orphans") represent c.40% of the Continuous Market "ex outcry" c. 60% of the total market.

Level of research coverage of the Spanish market (Jun 2023), without Lighthouse

				Without Lighthouse	
(No. Companies)	**Total**	**1-3 Analysts**	**Orphans**	**% Orphans**	**% extended orphans**
Continuous Market	114	13	30	26.3%	37.7%
Open outcry	6	1	5	83.3%	100.0%
BME Growth	49	10	38	77.6%	98.0%
Total Market	**169**	**24**	**73**	**43.2%**	**57.4%**

(*) BME Growth: Excludes SOCIMIS (Spanish REITs)
(**) Extended orphans: Percentage of stocks with no coverage (orphans) and stocks with limited coverage (1-3 analysts)

How has Lighthouse affected the level of research coverage of the Spanish market?

Effect of coverage already initiated by Lighthouse:

- Lighthouse now covers 31 companies. The objective is to expand coverage to 40 stocks in 2024 (25% of companies listed on the Spanish Market).
- This would imply a decrease in the level of orphan stocks on the Spanish market of c.18 p.p., from 43.2% to 24.9%. Assuming that mature markets similar to Spain's have orphan rates of c. 35%, the Spanish market would go from being one with coverage well below the average to one with coverage considerably higher than its peers.
- Lighthouse has already brought the percentage of orphan stocks on the Continuous Market to below 15%.

Level of research coverage of the Spanish market (Jun 2023), with Lighthouse

				Without Lighthouse		With Lighthouse	
(No. Companies)	**Total**	**1-3 Analysts**	**Orphans**	**% Orphans**	**% extended orphans**	**Lighthouse coverage**	**% Orphans**
Continuous Market	114	13	30	26.3%	37.7%	15	13.2%
Open outcry	6	1	5	83.3%	100.0%	2	50.0%
BME Growth	49	10	38	77.6%	98.0%	14	49.0%
Total Market	**169**	**24**	**73**	**43.2%**	**57.4%**	**31**	**24.9%**

What lies ahead: What does Lighthouse want to become? What is its goal?

- Lighthouse was set up in June 2008 as a joint project between Instituto Español de Analistas and BME. Its purpose was to provide visibility to orphan stocks on the Spanish market, based on the premise that coverage is crucial for increasing the liquidity of this type of stocks. First, the stock must be considered a genuine investment target.
- This would give rise to a real opportunity for SMEs to tap the market for finance. In other words: it would afford them an alternative financing source to debt. And at a reasonable cost. This is essential for the feasibility, stability and growth of any business.
- Given the size of the Spanish market and level of orphans, Lighthouse aims to increase its coverage to 40 stocks in 2024, bringing the Continuous Market to near full coverage.

Level of research coverage of the Spanish market (Jun 2023), with Lighthouse

	Current situation		**Number of companies covered by Lighthouse**		
% Orphans	**Without Lighthouse**	**With Lighthouse**	**35**	**40**	**45**
Continuous Market	26.3%	13.2%	7.9%	5.3%	2.6%
Total Market	43.2%	24.9%	22.5%	19.5%	16.6%

An award-winning initiative

In 2020, Lighthouse was a winner at the European Small & Mid Cap awards

- The European Small & Mid-Cap Awards are granted by the European Commission, European Issuers and FESE (Federation of European Securities Exchanges).

- During that edition, Lighthouse earned a 'Special Mention', which recognises companies/projects that have helped the visibility and had supported small and mid-cap issuers accessing capital markets. At its core, this is Lighthouse's *raison d'être.* Helping small and mid-cap stocks become more well known, more highly valued and, ultimately, more liquid.

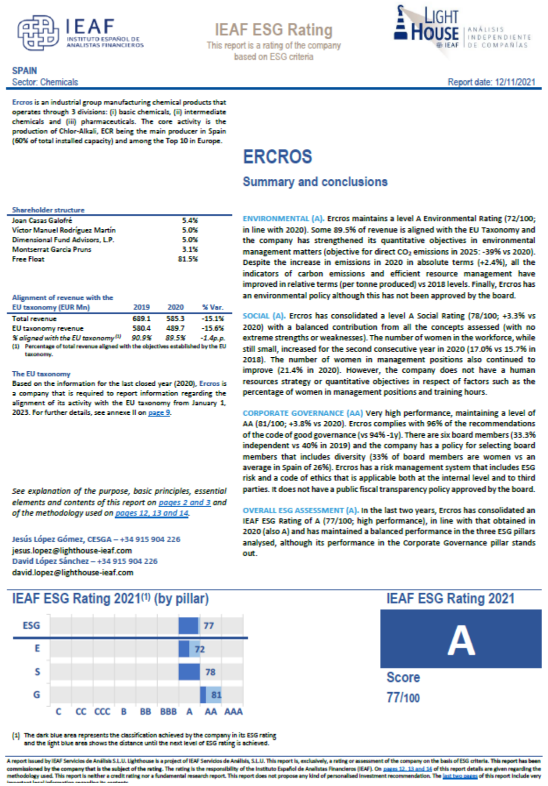
What about sustainability? What's Lighthouse’s ESG research proposal for Small Caps on the Spanish market?

The Instituto Español de Analistas and its research services company (Lighthouse) have implemented an ESG rating service that can easily be exported to other countries.

The ESG certification of the Instituto Español de Analistas is based on 6 pillars:

1. The lack of quality ESG certifications for Small&Mid Caps: independent, with the verification of data with the companies and sound methodology. In other words, there is a need in the market.
2. Design of a proprietary certification methodology for Small & Mid Caps. A methodology that is adapted to the ESG capabilities/needs of this kind of company. And based on verification of data with the companies and adjusted to market and regulatory standards.
3. The research work is carried out by Lighthouse, based on access to CESGA holders of the Instituto Español de Analistas. Lighthouse carries out:
   - Collects data from the companies
   - Applies the rating methodology
   - Prepares the certification report
   - Prepares the ESG recommendations report
4. The certification is carried out by the Instituto Español de Analistas, verifying that the research work and application of the methodology is correct. This means that the certification benefits from the prestige and independence (lack of conflicts of interest) of the Instituto Español de Analistas (NMS of EFFAS).
5. Lighthouse prepares the ESG recommendations report, proposing specific actions to the company to improve its sustainability and future rating.
6. Constant updating of Lighthouse's methodology to reflect changes in regulations and market standards in respect of ESG issues.

Lighthouse ESG Rating



ESG Recommendations report

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All Lighthouse research documents are available simultaneously on the Lighthouse website (http://institutodeanalistas.com/Lighthouse/) and via third-party aggregators such as Bloomberg, Factset, Capital IQ and Refinitiv.

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