Liquidity Enhancement

The liquidity of a share is one important parameter impacting its attractiveness, as it is part of an investor's investment decision. This document aims to provide a general overview of aspects that may affect liquidity, and potential measures that can be taken to improve liquidity of a company's share.

What is liquidity and how is it measured?

Liquidity is the degree to which a share can be quickly bought or sold in the market without significantly affecting the share price. Several indicators are used to measure the liquidity of a company's share. Three key measurements are turnover, spread and order depth.

Liquidity is characterized by the level of trading activity in a company's share, i.e. turnover. Turnover is the percent of shares, out of total shares outstanding, that have been traded in a period of time. High turnover is commonly the result of a combination of low transaction costs and a high interest in both buying and selling the share.

The quoted spread is the difference between the bid and ask price. The spread is significant to investors because it is an indirect transaction cost, i.e., the cost between buying and selling at any given time. The tighter the spread, the lower the transaction cost for the investor, as the buyer need to meet the ask price of the seller in order to be able to buy and vice versa.

The order depth is the total volume available at the bid and ask price, and is a measurement of trading intent. The order depth shows how many shares an investor can buy or sell at a given price at that time. A high order depth reduces the risk for a negative price movement when buying or selling shares.

A tight spread and high order depth consequently mean lower costs for investors. Not only that, it reduces risk and makes a company's shares more attractive for investors, all other things being equal.

Why is liquidity important?

When trading in a liquid share it is easier to find someone to trade with, independently if you are buying or selling. This reduces the risk of owning the share or more specifically of not being able to trade out of the position. A liquid share will also more quickly adapt to a new price level as interest in the share is larger and the price will often reflect the fundamental valuation of the company better. Overall, high liquidity in a share tends to increase the overall willingness to invest in it.

How can liquidity be improved?

There are several factors influencing the liquidity of a share and a number of activities may be undertaken to impact them. The liquidity increasing activity most suitable for a certain company depends on the company's situation.

<table>
<thead>
<tr>
<th>Liquidity Factor</th>
<th>Measure that may be taken</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost of trade</td>
<td>▪ Liquidity Provider Program</td>
</tr>
<tr>
<td>Investor awareness</td>
<td>▪ Investor Communication</td>
</tr>
<tr>
<td></td>
<td>▪ Analyst coverage</td>
</tr>
<tr>
<td></td>
<td>▪ Index inclusion</td>
</tr>
<tr>
<td>Share price level</td>
<td>Share split / Reverse share split</td>
</tr>
<tr>
<td>Shareholder value</td>
<td>▪ Dividend strategy</td>
</tr>
<tr>
<td></td>
<td>▪ Share buy-backs</td>
</tr>
<tr>
<td></td>
<td>▪ Spin-off</td>
</tr>
</tbody>
</table>

Note: This list is not exhaustive.
Liquidity Provider Program

In the absence of a large pool of investors creating natural liquidity, it is possible to generate liquidity with the help of a Liquidity Provider. In a Liquidity Provider Program a trading member ("Liquidity Provider") is contracted to take on the responsibility to ensure liquidity in the company's share by supplementing the existing pool of investors and stepping into the role of the missing desired investor. The Liquidity Provider will provide liquidity both as a buyer and seller, and also provide liquidity in absence of other trading interests. This activity will act as a bridge between buyers and sellers when the liquidity is not sufficient to find counterparts for every trade at every given time.

Benefits of a Liquidity Provider Program

Research by Nasdaq has shown that companies that engage a Liquidity Provider to enhance liquidity were able to improve both their liquidity and increase the likelihood of a trade on any given day. Based on Nasdaq analysis, turnover increased by 9 percent in the months following the introduction of a Liquidity Provider compared to the period just before. In addition, the number of days with trades increased by 4 percent.

Features of the Liquidity Provider service

The minimum requirements for a Liquidity Provider entering into a Liquidity Provider Program relate to commitments concerning presence, volume and spread. Prices must be quoted at least 85 percent of the time during continuous trading. The Liquidity Provider must quote prices corresponding to a defined minimum value, on both buy and sell sides, so that the buy and sell price do not deviate more than a certain percentage.


How to enter into a Liquidity Provider Program

To enter into a Liquidity Provider Program the issuer and a trading member sign a Liquidity Provider agreement that stipulates the agreed terms. These terms can be stricter than the minimum terms required by Nasdaq. The Liquidity Provider then informs Nasdaq about the agreement and the Issuer sends a market disclosure.


NASDAQ ANALYSIS SHOWS

9%

increase in turnover in the months following the introduction of a Liquidity Provider compared to the period just before.

Contact

If you are interested in more detailed information about the Liquidity Provider Program, please contact listings@nasdaq.com.
Other factors affecting liquidity

INVESTOR COMMUNICATION

News about a share will generally result in increased turnover in the share, as it generates renewed analysis and updated opinions about its fair value. Communication regarding new deals, new partners, new products, reached targets, new key employees, etc., indicate progress and may attract investors. Financial reports, regular press releases, posts in social media and newsletters to the market and investor community all contribute to increasing the liquidity of a share.

ANALYST COVERAGE

Analyst research reports, or equity research, are done by specialized equity research analysts and serve to provide investors with educated estimates on the future performance of companies. It also allows investors to obtain an in depth understanding of the company's business, as well as an outside opinion on the future opportunities of the company.

Equity research generally increases investor comfort around investing in a particular share. Liquidity often improves subsequent to analyst coverage.

SHARE SPLIT

Psychological factors may affect investments, one such factor being the price level. A share split (or reversed share split) can influence the share price, as a company's market capitalization is calculated using the share price multiplied by the number of issued shares. If the company issues more shares (or reduces the number of shares) and there is no other change affecting the company's fundamental value then changing the number of issued shares will by necessity adjust the price of the share. The new price may attract more investors to consider the share simply for psychological reasons. However, the fundamental development and prospect of a company is the overall basis for investor interest in any share, and is not affected by a share split.

SPIN-OFFS

A spin-off is when a company breaks off a part of its business into a separate entity. In a spinoff, shares of the new company are distributed to shareholders of the parent company. Historically, spinoffs have been good for investors. On average, both the parent company and the subsidiary outperform the market during the 24-month period following a spinoff.

INDEX INCLUSION

Indexes are often an important tool for asset managers to benchmark their performance, and for institutional investors index inclusion may be a factor impacting their ability to invest. In many cases the asset manager is limited to investing in shares included in the index the fund is benchmarked against and is encouraged to invest similarly as the index, only deviating by a small percentage.

Indexes are also frequently used as an underlying asset for derivatives or structured products, such as Exchange Traded Funds.

Share buy-back programs impact turnover both directly and long term. If the transactions to buy back shares are executed on exchange, these trades count towards the turnover, which increases as a direct result of the activity. The money used to purchase the share can be seen as a way of returning cash to investors and part of a dividend strategy. However, buy-backs result in decreased free float, which might have an adverse effect on liquidity in the long term.

Note: The above factors often impact liquidity positively, but there is no guarantee. For individual guidance on suitable option(s) it is recommended for companies to turn to their investor relations and/or financial adviser.

DIVIDEND STRATEGY & SHARE BUY-BACKS

Companies that return a healthy dividend to investors may often be perceived as a safer investment. Trading is often triggered just prior to and after a dividend payout, also nurturing the liquidity in the share.

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