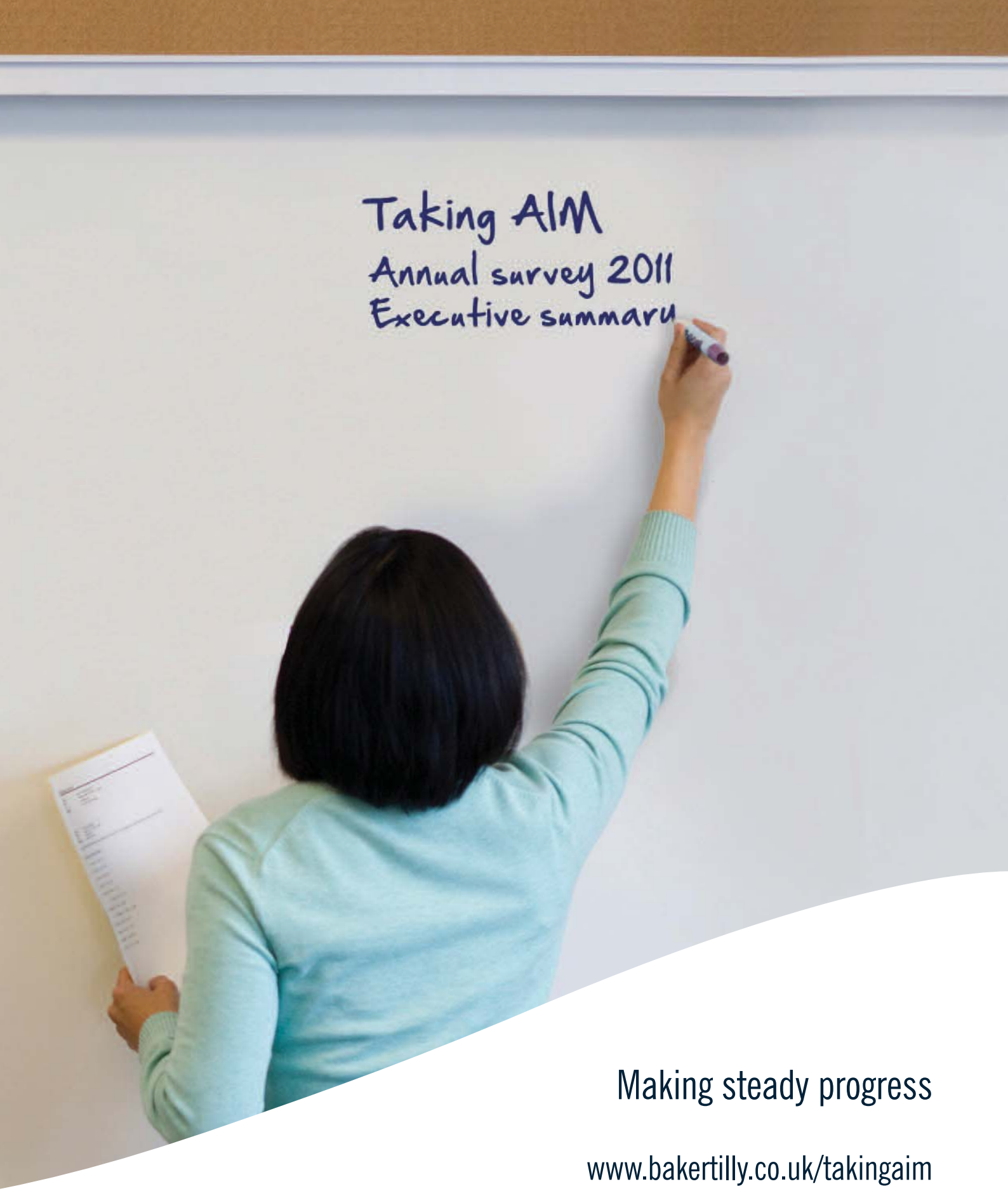


Making steady progress

www.bakertilly.co.uk/takingaim

FAEGRE & BENSON LLP

BAKER TILLY

This year's Taking AIM survey comes at an exciting period for the AIM community. We are winning the battle to put growth companies at the top of the policy agenda.

In Westminster and in Brussels, the potential of smaller companies to drive growth, exports and international competitiveness is increasingly understood.

The findings of this survey can only help. They highlight the resilience of the market as we emerge from challenging economic conditions. In 2010, AIM continued to demonstrate its ability to help growing businesses raise capital as total fundraisings were 24% higher compared to 2009 and new admissions nearly trebled. And, as valuations increased, the FTSE AIM indices showed strong growth, with the AIM All-share increasing by more than 40% from the start of 2010 and far outperforming the 8% increase in the FTSE 100.

There are strong grounds for optimism about the health, and future, of the UK small-cap sector. With the wider economic climate still uncertain, the access to equity finance that AIM provides is more important than ever. The new companies that joined in 2010 are the beginning of a growing, healthy, long-term pipeline of issuers, looking to join the market.

Since the last Taking AIM survey, the Exchange has continued to lead the debate around access to finance for smaller businesses. At the domestic level, we have made recommendations for effective fiscal incentives and regulatory policy. We are delighted by the Government's announcement in the Budget to increase the VCT qualifying company limits to 250 employees and £15 million gross assets. AIM VCTs are significant investors in the smaller UK companies and these changes will help them to operate more effectively and will allow a wider pool of SMEs to benefit from their funding and experience.

Similarly, at a European level, the review of key European directives provides an opportunity for positive changes to be made to the regulatory environment for SMEs. Amendments to the Prospectus Directive to increase the consideration and investor limits that trigger the requirement to produce a prospectus are an example of successful UK lobbying to the EU Commission and Parliament. These increased limits will allow AIM companies to conduct further issues more cost effectively and will help smaller companies attract a wider set of investors.

The current MiFID review also provides an opportunity for European policymakers to recognise the role that markets like AIM play in Europe. We are encouraged by the political appetite to help smaller businesses and recognition that policies need to consider the whole funding chain and not be implemented in isolation. I believe positive regulatory and fiscal measures as well as the Exchange's own product initiatives position the market well to serve ambitious businesses from the UK and across the world to achieve their growth potential.

With 'growth' being high on everyone's agenda, I have no doubt that one of the UK's greatest economic assets is the excellence of our high growth SMEs. Half of the new jobs generated in recent years in the UK have been created by the fastest growing six per cent of businesses. Today, there are over 950 UK incorporated AIM companies that employ around 240,000 people and have an aggregate market value of £49 billion.

We are committed to making sure that these companies have access to an unrivalled community of investors and intermediaries and access to efficient funding at every stage of their development. 2011 is an opportunity to lay the foundations for transformative change in the UK economy. Dynamic public markets like AIM, where companies can access equity finance on an ongoing basis, have a central role to play, continuing to drive and support entrepreneurial activity.

Marcus Stuttard
Head of AIM

"SMEs can only innovate, create new jobs and fuel economic growth if they have an encouraging and supportive environment. Equity funding is a vital part of this environment and will continue to become even more crucial as companies seek to diversify their sources of finance. The London Stock Exchange is passionate about the role it plays. By channelling equity funding from where it is to where it is needed, we believe there is a real opportunity to harness the power of SMEs, enabling them to achieve their full potential in leading economic growth".

Xavier Rolet, CEO, London Stock Exchange

AIM in 2010 yearly report summary:

Significant improvement over 2009, but still well off its peak

AIM bounced back in 2010 with its index increasing by 43%, whilst the FTSE 100 only increased by 8%. Secondary fundraisings held up well at £5,738 million (£4,861 million in 2009) demonstrating the maturity of AIM as a growth company market with considerable support by investors for existing listed companies.

Whilst IPOs increased significantly to 47 (13 in 2009), underpinned by 26% in the resources sector, this level is still a far cry from 2006 when there were 326 IPOs. Only the very best companies were able to complete an IPO as institutional investors, often with reduced funds available, preferred to support their existing portfolio companies or seize opportunities with other companies already listed.

Smaller, weaker companies continued to delist and the total number of companies on the market again fell, albeit at a lower rate to 1,195 (1,293 in 2009). The average market capitalisation increased, however from £44 million to £66 million, yet again demonstrating a more streamlined but arguably stronger AIM market.

Despite a year of continued economic hardship and investor caution we are pleased to see positive results in this year's Taking AIM survey from both companies and investors, in particular:

- the vast majority of current AIM-quoted companies (71%) support the market, saying that, if they had known about the recession, they would still have joined
- 80% of investors said AIM's performance during the year had a positive effect on their own fund's performance
- 80% of AIM companies say they have seen some benefit from the access to capital their listing provides, with 48% considering this to be a major benefit
- 56% of AIM companies said they had considered, or were considering, AIM for further fundraising in the next 12 months.

Has potential and can already see improvements for the second half of 2011

2011 has started in much the same vein as 2010, but with increased geopolitical risk across the world. Most advisers are seeing a greater number of companies seeking an IPO, which is not surprising; we are now in the fourth year of recession and with banks still not widely open for business, companies which seek to develop further are likely to look to the equity markets for new funding. Whether this increased demand will be matched by investor appetite is still uncertain.

Our survey shows that 60% of investors and 63% of AIM companies expect to see further improvement in AIM's performance over the next 12 months.

In the context of the future of AIM, we are delighted to see that, in the March 2011 Budget, the Government has clearly listened to SMEs, the London Stock Exchange and the adviser community, including ourselves, and announced plans to improve considerably the VCT and EIS legislation. These improvements will mostly only arise from 6 April 2012, but they will nevertheless provide a welcome benefit to qualifying AIM companies which seek to raise new funds.

Chilton Taylor
Head of Capital Markets, Baker Tilly

Melanie Wadsworth
Corporate Partner, Faegre & Benson

"AIM had a good year – more money raised than 2009 and some further housekeeping raised average market capitalisations up by 50% to a respectable £66 million."

Paul Watts, Baker Tilly, Corporate Finance Partner

Performance in 2010

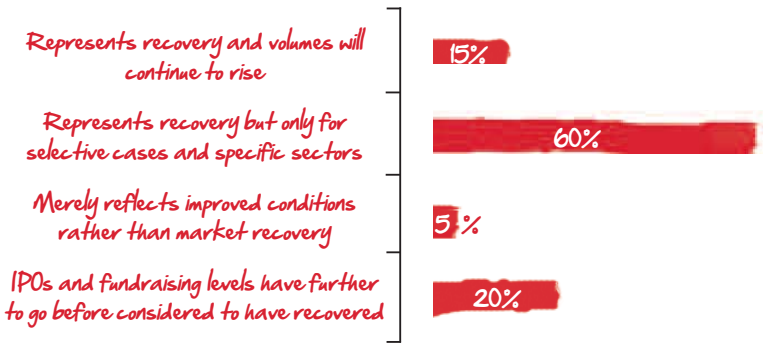
Last year's survey saw AIM ending 2009 'leaner and fitter' and both AIM companies and their investors faced the new year with cautious optimism. This year's survey shows that both caution and optimism were justified. It is clear that, as a market, AIM performed strongly in 2010, re-confirming its position as the leading market for growth companies. There were increases in both market activity and valuations. Although this was driven largely by a strong resources sector, many successful companies in other sectors also justified investors' faith and patience. But the economic recovery remained uncertain and some businesses continued to find it hard going.

- The year saw AIM outperform many other world markets and raise its profile and standing within the UK's business and financial communities. A majority of the investors and many of the AIM companies in our survey agreed that the market had performed solidly and shown resilience. Few now believe that AIM has been significantly damaged by the downturn, a view that was widely held two years ago.

"The institutional investor support that AIM has differentiates it from many other growth markets and has been a key contributor to its success and will aid its continued recovery."

Diane Gwilliam, Baker Tilly, Corporate Finance Partner

Given the increase in volume of IPOs in 2010, which best describes the extent to which you believe it represents a recovery in the IPO market? (Base: Institutional investors: 20)



"It has been particularly pleasing to see the return of the IPO market, albeit on a modest scale. There is an important message here for private UK growth companies – the AIM market will support quality IPOs – it is an excellent source of development capital and it will support growth strategies."

Gary Houghton, Baker Tilly Corporate Finance Partner

- With substantial activity in the growing resources sector and many other strongly performing businesses still undervalued, investor appetite improved. The 43% increase in the AIM Index over the year – compared to 8% in the FTSE 100 – signalled another good year for investors. Not surprisingly then, 80% of those in our survey said that AIM's performance during the year had a positive effect on their own fund's performance.
- Much of the investor interest was in secondary issues, with funds raised at their highest level since 2007, confirming investors' faith in the market and their continuing support for its companies. However, with growing confidence, there was renewed IPO activity, particularly in the last quarter of the year.
- Whilst the recession has seen a number of lower quality and smaller AIM companies delisting, the pace of departures from the market slowed in 2010. The companies that remain on AIM are, in the main, still happy with their position. Nearly three-quarters of those who listed before the downturn say that, even if they had known about it in advance, they would still have listed.

"To the extent any caution remains around AIM, it merely reflects the wider uncertainties of an unstable global environment. AIM has weathered the storm and emerged with its credibility restored."

Melanie Wadsworth, Corporate Partner, Faegre & Benson

- Although raising funds remains the main pressure on the successful operation of their business, this was mentioned less frequently this year by those in our survey (28% vs. 45% in 2010). However, it remains an issue for many of the smaller AIM companies (44% of those with market cap of up to £20 million, compared with only 20% of those with higher market cap).
- The upturn in the market has helped to reinforce many of the benefits that AIM companies have realised. Around 80% say that they have seen some benefit from the access to capital that their listing provides, with half (48%) considering this a major benefit (up from 36% in 2010 and only 22% in 2009).

Looking forward

With clear signs of recovery, increased interest and activity and an enhanced standing, both AIM companies and their investors face 2011 with growing confidence. Its prime position as an international market for growing companies, regulatory flexibility, relatively low costs, active investors and opportunities for growth position it well in a recovering world economy.

- A majority of both institutional investors (60%) and AIM companies (63%) anticipate an improvement in AIM's performance over the next 12 months. Asked about the threats that the AIM market might face going forward, however, one in five investors highlight the impact that any further downturn in world markets might have.
- The prospects for investment in AIM continue to look strong. A majority of investors in our survey agree that, going forward, there will be more value investing in AIM stocks than the Main Market. Institutions will be looking to invest in companies that can show good management and a sound financial position, and that have a good track record and are realistically valued.

"Investor criteria have not changed dramatically, but the continued weeding out of the weaker AIM companies has increased investor confidence and the market is back on the radar of many institutions who were shutting their doors to AIM a couple of years ago."

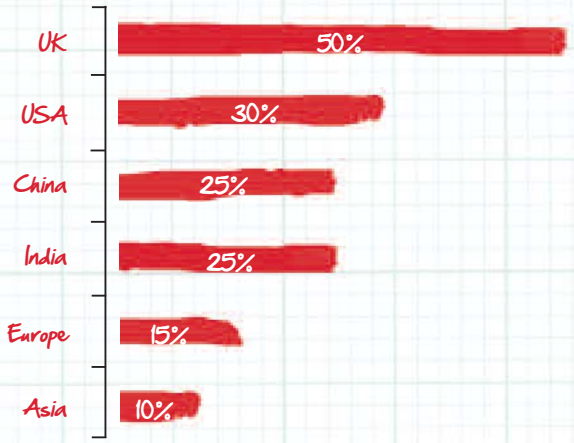
Melanie Wadsworth, Corporate Partner, Faegre & Benson

- Many AIM investors continue to believe that the UK market offers particularly attractive investment opportunities over the next year or two (50%). The US attracts more attention this year (30%), whilst there is still interest in the growing Asian economies, notably China (25%) and India (25%).
- The sectors most favoured by investors for their prospects over the next year or two are again technology and IT (50%, up from 33% last year) and mining, resources, oil and gas (40%).
- AIM remains an active and dynamic market and the recovery in interest and activity seen in 2010 is expected to be built upon in 2011. Secondary issues will continue to be an important element of market activity. More than half (56%) of the AIM companies in our survey said that they had considered or were considering AIM for further funding in the next 12 months.
- There is expected to be little or no growth in the number of companies listed on AIM over 2011. The IPO market is anticipated to gather a little more momentum, but, although the pace has slowed, there will continue to be departures from the market. To a large extent, this is likely to represent a further consolidation of the quality of companies listed.
- On the other hand, as AIM thrives, companies see fewer reasons for moving from the market. Only 5% – particularly among the smaller cap companies – expressed any likelihood that they would go private in the next 12-18 months, most (64%) seeing loss of company profile as the principal barrier faced.

"I've seen quite a lot of activity coming out of India and South America. Brazil is potentially going to be a strong area because of the large mining and mineral sector."

John Banks, Baker Tilly Corporate Finance Partner

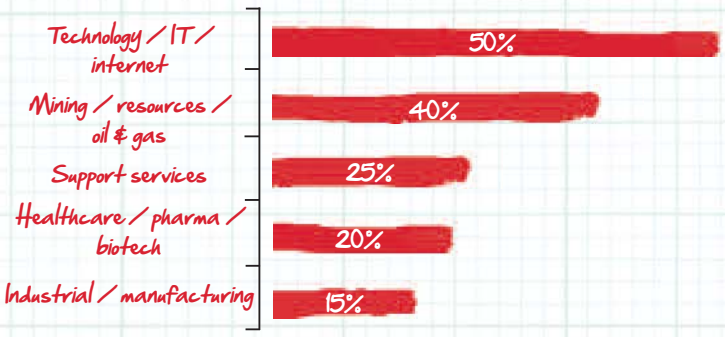
Which countries or regions do you think will be particularly attractive to investors over the next year or two? (Unprompted) (Base: Institutional investors: 20)



"Market and investor sentiment is such that for a company with a proven track record and promising growth story, funds are available."

Diane Gwilliam, Baker Tilly, Corporate Finance Partner

What AIM sectors do you think will be particularly attractive to investors like yourself over the next year or two? (Unprompted) (Base: Institutional investors: 20)



Regulation

The turbulent market environment of recent years has seen AIM trying to balance its light regulatory touch – a key feature in the market's success since its inception – with the occasionally knee-jerk demands for stricter regulation. It is generally judged to have achieved a good balance, although some investors believe that there may still be room for improvement.

"I think that it is a mistake for businesses to think that AIM is attractive just because they believe the regulation is 'lighter touch' than the main markets. There may be less red tape, but the market's success relies on its members being of a high quality and well controlled financially, administratively and operationally."

Paul Johnson, Baker Tilly, Corporate Finance Partner

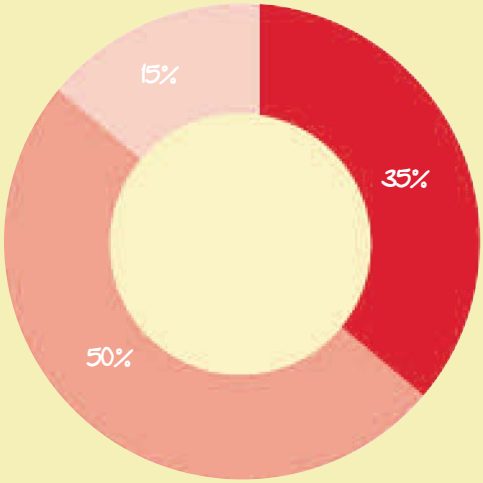
- There are signs that the steps that have been taken over the last few years are seen as appropriate by the investor community – and, asked about the threats that AIM might face going forward, a few identify danger of over-regulation. Yet, with the market stabilising and recovering, as many as 70% of the investors in our survey still believe that further increases in regulation are required, much in line with the views they expressed in 2009.
- Although there is no obligation for AIM companies to comply with the provisions of the UK Combined Code, it may be in the area of Board composition – and, specifically, the presence and role of non-executive directors – that some investors see grounds for tightening of corporate governance requirements.

"Non-executive directors are still rarely given proper training and adequate access to information and this inevitably is reflected in their performance. These directors have a key role to play in avoiding the high-profile corporate failures that can be so damaging to the market's reputation and they should be better supported."

Melanie Wadsworth, Corporate Partner, Faegre & Benson

- Half of the investors surveyed judge the non-executive directors in AIM companies to be 'not very effective'. In contrast, over 90% of those in AIM companies say that their own non-executive directors have been at least 'fairly effective' since listing, and a majority (55%) believe them to be 'very effective'.
- In spite of their reservations, however, the large majority of investors in our survey generally maintain that the standards of corporate governance in AIM companies are at least 'acceptable' or better (80%, up from 60% last year). Only 15% believe them 'not good enough' (down from 37%).

How effective would you say that non-executive directors are in AIM companies?
(Base: Institutional investors: 20)



Fairly effective

Not very effective

Don't know

"The current difficult environment has most definitely placed more focus on good corporate governance. Those businesses with strong systems and controls in place have been able to make swift decisions to ensure their survival and in doing so, demonstrate this as a strength to the market."

Angela Toner, Baker Tilly Corporate Finance Partner

Advisers and IR

While investor relations takes up valuable management time, the relationship with their investors is a key element in driving institutional support for growing companies, particularly during turbulent times.

- The AIM companies in our survey say that, typically, between one and five days per month of senior management time is spent on investor relations activity. Not surprisingly, the larger companies spend longer (average four and a half days for those with market cap over £50 million, two days for those with market cap up to £20 million).
- A majority believe that their efforts are reasonably well reflected in the City's understanding of their company (60%) and in the level of interest in their company and its shares (57%). Again, the larger companies – who are devoting more time to IR – are seeing a stronger understanding of and interest in their company through their efforts.
- Most investors (80%, up from 60% last year) regard AIM companies' IR activities generally as at least fairly effective. However, within the limitations of management time, they still see some room for improvement in the quality and openness of communication, and particularly in the level of personal and face-to-face communication with management.
- The UK Stewardship Code, published by the Financial Reporting Council in July 2010, aimed to set out good practice on engagement between institutional investors and investee companies. At the time of the survey, only six months after its introduction, few investors or AIM companies believed that it had yet had much impact on their relationships and practices.
- AIM companies are broadly satisfied with the quality of advice that they get on an ongoing basis from their corporate advisers. As previously, they are most satisfied with the quality of advice from their corporate lawyers – none express dissatisfaction and two-thirds (69%) consider it to be excellent or very good. Close to 90% are broadly satisfied with the ongoing advice from their nomads and auditors.

To view the full Taking AIM 2011 report which includes market statistics, graphs and methodology, please visit:
www.bakertilly.co.uk/takingaim

About Baker Tilly

Baker Tilly is a leading independent firm of accountants and business advisers that specialises in providing an integrated range of services.

We provide our growing and established business clients with audit, accountancy, personal and corporate taxation, VAT, management consultancy, corporate finance, IT advisory, restructuring and recovery and forensic services. The firm has national coverage through its network of offices and is represented internationally through its independent membership of Baker Tilly International.

For more information about Baker Tilly please visit our website at www.bakertilly.co.uk/takingaim

About Faegre & Benson LLP

Faegre & Benson LLP is an international law firm which offers an integrated team of around 500 lawyers in the UK, USA and China. The London corporate finance team advises on flotations and fund raisings, takeovers, mergers and acquisitions, corporate governance and regulatory work. Much of the firm's work has an international element and the firm provides a co-ordinated service for multinational transactions.

Faegre & Benson is well known as one of only a few law firms in London which has a dedicated practice addressing the needs of companies seeking admission to, or whose shares are already traded on, AIM. The firm has been actively involved in advising companies on their admission to AIM since the market was established nearly fifteen years ago. Members of the Faegre team are actively involved in the work of the Quoted Companies Alliance representing the interests of smaller quoted companies with governmental and regulatory authorities and are recognised as being at the leading edge of developments in the market.

For more information please visit www.faegre.co.uk

Contacts

Melanie Wadsworth
mwadsworth@faegre.com

Donald Stewart
dstewart@faegre.com

Faegre & Benson LLP, 7 Pilgrim Street, London EC4V 6LB
Tel: +44 (0)20 7450 4500 Fax: +44 (0)20 7450 4545

About David Burton Associates

DBA is an independent specialist marketing research consultancy. It brings an effective mix of personal service, a practical and pragmatic approach and a high level of professionalism to help its individual clients meet their marketing needs. Its specialist focus is in the areas of corporate and stakeholder communication, business-to-business, financial and professional services and advertising/PR, in both UK and international markets. The company was established in 2004 by David Burton, who has 25 years' board-level experience in UK agencies and has worked with Baker Tilly and Taking AIM surveys for a number of years.

David Burton
Masters House, Guildford Road, Westcott, Dorking, Surrey, RH4 3NG
Tel: +44 (0)1306 887515 Fax: +44 (0)1306 887847

www.davidburtonassociates.com

an independent member of
BAKER TILLY
INTERNATIONAL