



Taking AIM

Annual survey 2009
The big picture



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Foreword

There can be little doubt that 2008 produced the most difficult market conditions many of us can remember, affecting investor confidence and the number of new companies joining markets across the globe. The current financial crisis has forced unprecedented action by governments, central banks and regulators across the world. Now established as an integral part of the fabric of the City of London, AIM has not been immune to the turbulence in the global economy.

Despite the onset of the credit crunch, AIM has remained open. It is only relative to AIM's extraordinary success and strong track record that the market's lower IPO rate is attracting particular comment. Much has also been written about AIM's current contraction, overlooking the fact that many companies leave AIM for positive reasons, such as a reverse takeover or other corporate activity, signs of a dynamic rather than a static market.

Comparing overall company numbers and IPO rates year on year misses the point that unlike most growth markets AIM has never just been about providing 'one-off' financing for as many new companies as possible. Once on market, thanks to London's deep pool of investment capital, AIM companies can return to the market to access further funds to help them continue to develop and grow their business. Since the market's launch in 1995, around £28 billion has been raised through further issues on AIM. The fact that over £3 billion was raised through secondary issues last year is a reflection of long-term investor support for AIM companies, even in difficult market conditions. And the Exchange is not standing still in its efforts to help AIM companies make the most of their AIM quotation. In our Budget Submission we called-upon the Government to recognise that policies to facilitate

access to public equity finance provide an additional opportunity to support business and employment. In particular, urgent action is needed to stimulate investment in companies quoted on AIM. We believe the quickest and most effective way to do this is to reform existing tax legislation, the Venture Capital Trust regime, in this year's Finance Bill.

Since I last introduced the Taking AIM survey we have also announced the launch of AIM Italia, providing another route to capital for Italy's dynamic SME sector. Like its namesake here in the UK, AIM Italia has been specifically tailored to meet companies needs for growth capital, profile-building opportunities and, in time, a liquid secondary market. We are also looking to provide new opportunities for growing Japanese & Asian companies with a new venture with the Tokyo Stock Exchange – Tokyo AIM.

Our commitment to leverage the success of the AIM model in Italy and Japan is testament to our belief in AIM's structure and our long-term goal to build a global network of investors, issuers and advisers around AIM. AIM's success has helped position London as the world's leading capital market, where international companies seek to benefit from London's core strengths; our international focus; our principles-based approach to regulation; and the deep pools of capital for international investment. As with any risk based capital market, companies' valuations may suffer in a downturn, but in time conditions will change and some of the growth companies of today will become tomorrow's blue chips.

Martin Graham

Director of Equity Markets & Head of AIM
London Stock Exchange Group

Executive summary

Value and quality increasingly in view

The start of 2009 finds AIM down like almost every equity market globally - but far from out, as this thirteenth edition of Baker Tilly and Faegre & Benson's Taking AIM Survey underscores. While last year's unprecedented volatility and market turmoil sent the AIM all-share plunging by more than 60% and curbed IPO volume by an even greater percentage, other parameters show that AIM has much to offer in its unique role as the world's growth company market.

A year as challenging to financial markets as 2008 inevitably hurt headline performance on every exchange. But, although much reduced, AIM's IPO total outpaced comparable markets in Europe and elsewhere (as well as the main London market) and even the much larger Nasdaq.

Channelling capital

Moreover, secondary issues remain one of the market's key strengths. While many institutional investors chose to withdraw from IPOs last year, their willingness to support existing AIM companies was a notable contrast: as much as £3.2 billion of further equity funding was completed in 2008.

In a period when access to credit evaporated – particularly for younger, higher-risk companies – the significance of AIM's capacity to keep channelling capital to credible growth stories cannot be over-stated. The emphasis on adequate funding and balance sheet strength that echoes through this survey's interviews with AIM companies reinforces the point.

Global reach

The market's global reach was also undiminished in 2008. Three-quarters of the year's IPOs were for companies whose main areas of operation are outside the UK. This flies in the face of 2008's huge rise in risk aversion.

It also demonstrates AIM's credentials as the key platform for growth companies around the world to access risk capital: it continues to fill a gap that few local equity markets are able to address effectively.

Regulatory reflection

As in previous years, we structure this report around four key themes that emerged from interviews with experts on AIM. Besides 2008 performance, these comprise the outlook for 2009, regulation and advisers/investor relations. Note that the fourth theme has been slightly modified from last year.

Demands for increased regulation on AIM will probably grow this year. Some investors' survey responses point in this direction. But, as our other experts indicate, hasty moves risk being over-prescriptive and losing the light regulatory touch that has been a key element in AIM's past success. The imposition of a minimum market cap offers some superficial attractions, for example. But after the market's sharp fall in the last quarter of 2008 the £5 million threshold sometimes proposed would capture as much as 40% of all AIM companies – twice the number three months earlier.

Raising the bar for new entrants could be beneficial, though. A mechanism such as minimum capital to be raised might improve perceptions of AIM. In any case, the market is already addressing these issues. Investors' recent preference for secondary funding signals a shift away from the riskiest business models and towards proven management and track records.

Advisory responsibility

In the near-absence of IPO income, some Nomads are struggling. We recognise this and the gains that codifying best practice into the Nomad rulebook has



“ Nearly all AIM companies and investors expect AIM to recover from the current down turn ”



brought, but nonetheless hope to see increased efforts by these key market players to nurture and encourage the companies they have brought to market.

Companies surveyed this year agree that Nomads can do more in this regard.

Conversely, in an environment where investors are more key than ever and their preferences are for safety and strength, AIM companies will need to heed the survey's message that their investor relations can improve.

Consolidating for quality

Last year's reduction in the number of AIM companies has a positive dimension. Nearly 10% of the market's end-2007 corporate base departed over the year as a result of takeovers and mergers, delisting, switching market and administration (though AIM's overall failure rate remains strikingly low).

With recession biting, we expect more of the same in 2009. Lack of investor focus and the obligations of being a public company will no doubt lead some of the market's stronger names to trade in the benefits of their listing; some weaker ones may have less choice in the matter.

We see this as a necessary passage to a smaller, but higher-quality and more mature market. AIM's very rapid expansion and internationalisation of recent

years was a vital stage in its development. But the time has clearly come for a move from quantitative to qualitative growth.

A reduced tail should help increase focus on AIM's core of excellent companies. For too many, continued operational success (hitting growth targets, completing transformational acquisitions) is far from reflected in their much reduced share prices.

Exceptional value

The year ahead looks challenging for AIM. IPO volumes are likely to remain subdued. The broader economy is weak almost everywhere. Investors' confidence in companies and markets is limited.

Any pick-up in share prices will begin in large cap stocks and only move on to AIM once initial froth subsides and focus on value emerges.

Clearly, a strong rally is an unlikely prospect for 2009. But the quality of the market's core and the exceptional value available mean that stock-picking – always the key to successful AIM investing – should be increasingly rewarding.

Chilton Taylor

Head of Capital Markets, Baker Tilly

Melanie Wadsworth

Corporate Partner, Faegre & Benson



Key findings

Performance in 2008

Few will have predicted the speed and severity of the economic downturn that impacted on equity markets around the world in 2008. Against this background, AIM fell by over 60% across the year, though it did fare better than almost all other growth markets in terms of IPOs and transactions. However, it is accepted by experts that higher risk, smaller and growth company markets are likely to suffer at such times as investors retrench to the larger, safer and more liquid markets and stocks. AIM companies still support the market despite the downturn.

- In spite of difficult conditions, most AIM companies (74%) have no regrets at having listed, and few (6%) have any significant regrets. Three in four AIM companies have realised benefits of being on AIM in respect of access to capital, profile and credibility. Other benefits include liquidity (58%), facilitation of strategic acquisitions (47%), facilitating exit for investors (49%) and tax breaks and incentives (33%).
- Most AIM companies (72%) have taken steps to change their strategy or cut costs in view of the current economic climate. One in three have a plan in place for further steps to take if economic conditions do not improve.
- It was a difficult year for investors. Over 80% surveyed reported a negative impact on their own funds' performance, and more than half reduced the proportion of funds that they invested in AIM stocks.
- However, many investors (40%) suggest that the reduction in the number of IPOs has produced an increase in the quality of the market.
- AIM companies continued to raise secondary funding. Nearly two-thirds (65%) of investors put a higher proportion of funds into secondary issues in 2008 than in 2007 reflecting the continuing support for good AIM companies.

Looking forward

2008 may have represented something of a set-back in AIM's long-term trajectory, but by no means a death-blow. Both companies and investors underline the importance of AIM as a market for growing companies and its regulatory flexibility as principal factors that will encourage its recovery and growth as world markets begin to recover. Our experts generally agree that some shake-up of the market and a reduction in the number of very small cap companies will be beneficial for the future strength and quality of the market.

- Nearly all AIM companies and investors surveyed expect AIM to recover from the current downturn. However, they agree (59% and 85% respectively) that it has been damaged more significantly than other markets and will take longer to return. Most companies (69%) and investors (67%) expect the market to recover in 2010.
- It is expected that AIM will further reduce in size over the next year or two. IPOs will continue at a lower level and there is widely expected to be consolidation among the smaller AIM companies. 80% of investors and 68% of companies encourage consolidation. Nearly half of AIM companies (47%) have some expectation of making an acquisition and nearly a third (32%) of being acquired in the next 12-18 months. Some de-listing is also likely to reduce the number of smallest cap companies on the market.



- AIM investors are likely to look close to home for a sense of security in their investments. 82% say they consider UK companies to be most attractive investments over the next year or two over international regions.
- Most investors expect, and welcome, that we may never see a return to the heady days for IPOs of 2004-06. Over half (51%) anticipate 100-150 a year as a more likely level to maintain quality and investor interest.
- Secondary fundraising is expected to remain firm, with 61% of AIM companies considering further funding in the next 12 months.
- Investors cite a good track record, good business plan, good management, a strong balance sheet and realistic valuation as the most important investment criteria.
- Experts also call for the government to restore the level of VCT tax breaks that helped AIM in the past. It is foreseen that this would kick start the market by providing opportunities for growing UK companies who find themselves in an increasing equity gap, now arguably up to around £25 million.

Regulation

AIM's relatively light regulatory touch has always been one of its key distinguishing features and regarded by most as a cornerstone of its success, both in the UK and internationally. Some perceived tightening up and formalisation of the rule book over the past couple of

years has been widely welcomed and has helped to create added confidence in the system.

- AIM companies and experts generally believe that self-regulation is working well (87% of companies say it is effective), that the level of regulation is about right and that it would be a mistake to impose additional regulation on the market.
- In sharp contrast to views expressed in last year's survey, investors clearly blame light regulation and want further increases. Fewer than half (47%) consider self-regulation effective (compared with 72% last year), and 67% now look for further increases in regulation.
- AIM companies generally accept the ongoing obligations of being on AIM. Three-quarters say they have been as they expected over the past 12-18 months and fewer than a quarter find them more onerous.
- IFRS is one of the most 'time-and-resource-consuming' aspects of being an AIM listed company. In its second year, most feel (65%) that it has not had any effect on the way in which they are perceived.
- Nearly all of the AIM investors (91%) agree that, in the present difficult environment, good corporate governance is more important than ever. Fewer than 40% of them consider standards of corporate governance in AIM companies generally to be acceptable, suggesting significant scope for improvement.

Advisers and IR

AIM companies (71%) and institutional investors (76%) agree that the present difficult market environment has placed even greater emphasis on good investor relations.

- AIM companies believe that they are getting better at IR (74%), that management is spending more time on it (44%) and that they have sufficient ongoing support and instruction (69%). IR typically takes up 1-5 days a month of senior management time.
- However, companies question the value of this expenditure when investor interest is low. Whilst they still believe it generates understanding of the company in the City, only 40% feel that their efforts are fully reflected in the level of interest in the company and its shares.
- Most investors (62%) see companies' IR activities as at least 'fairly effective' (up from 48% last year). They look for regular, timely and honest communication from companies and some call for companies to listen more to their investors.
- Most AIM companies are pleased with the quality of advice from their nomads, auditors and corporate lawyers, with the lawyers faring particularly well. 85% of companies are generally pleased with the advice from their nomads, 80% with their auditors and 93% with their corporate lawyers.



Market statistics

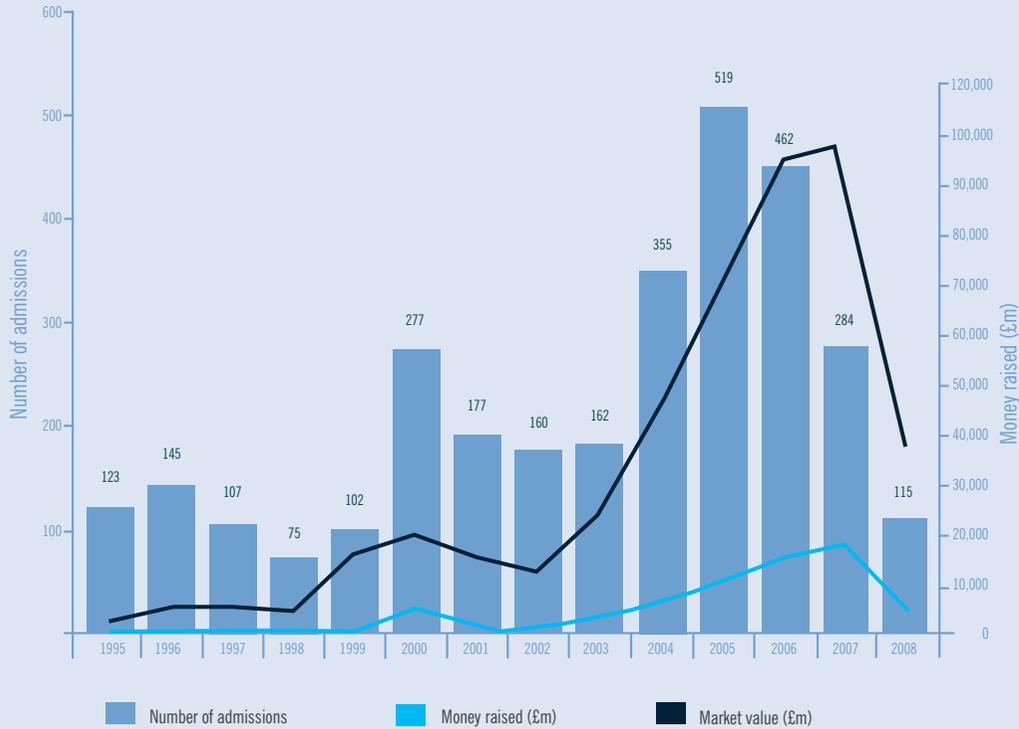
	AIM			FULL LIST		
	2006	2007	2008	2006	2007	2008
Total number of companies	1634	1694	1550	1606	1580	1500
Total market cap	£90,666m	£97,561m	£37,710m	£4,306bn	£4,226bn	£2,897bn
Average market cap	£55m	£58m	£24m	£2,681m	£2,675m	£1,931m
Market cap of companies with a capitalisation below £250m	£58,848m	£63,737m	£32,833m	£59bn	£60bn	£54bn
Average market cap of companies with capitalisations below £250m	£38m	£39m	£21m	£61m	£62m	£52m
Market cap of companies with a capitalisation above £250m	£31,818m	£33,824m	£4,877m	£4,247bn	£4,166bn	£2,843bn
Average market cap of companies with capitalisations above £250m	£522m	£457m	£406m	£6.61bn	£6.67bn	£6.25bn
Total number of admissions	462	284	115	112	120	66
Number of New Issues - Introductions	56	35	24	15	20	12
Number of New Issues - IPOs	278	182	38	85	82	32
Number of New Issues - Readmissions/ Transfers (net)	128	67	53	12	18	22
Total new funds raised	£9,944m	£6,581m	£1,108m	£19,539m	£18,923m	£6,050m
of which raised by IPOs	£9,315m	£6,262m	£917m	£19,517m	£18,903m	£6,050m
Average funds raised by IPOs	£34m	£34m	£24m	£230m	£231m	£189m
Number of further issues *	751	919	595	402	271	291
Total funds raised by further issues *	£5,734m	£9,602m	£3,204m	£16,161m	£9,524m	£60,438m
Average money raised by further issues *	£8m	£10m	£5m	£40m	£35m	£208m
Total funds raised	£15,678m	£16,183m	£4,312m	£35,700m	£28,447m	£66,487m

* Excludes non-money raising issues

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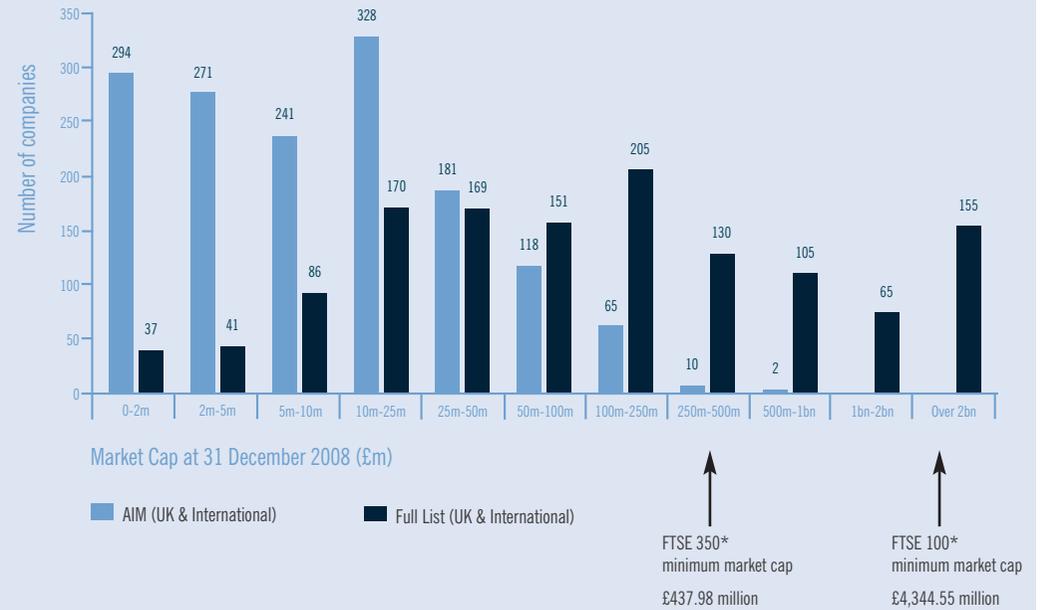


AIM admissions, funds raised and market value since inception



Source (underlying data): London Stock Exchange

Companies by Market Capitalisation at December 2008



Values do not include suspended securities

*FSTE 100 and 350 are used to describe the top 100 and 350 UK Listed companies by market capitalisation as at 31th December, they may not accurately reflect the components of the real FTSE 100 and 350 at that time.

Performance of AIM

MEETING THE CHALLENGES OF 2008

Surviving a decline in world markets

In last year's Taking AIM report, looking forward to 2008, the view of our panel of experts was that "AIM will face further challenges in 2008. But the second half of the year could see some improvement, unless there is a global recession". At the time, few could have predicted the speed and scale of the global economic downturn that affected, and continues to affect, markets worldwide.

The nervousness of the first half of 2008 was overtaken by the escalating panic of the second half, as bad news piled on top of bad news in global financial markets. Against this background, it was not altogether surprising that the value of AIM shares fell significantly across the year and that the flow of companies coming to the market all but dried up in the second half. This was exacerbated by high profile failures in the banking sector and the severe credit crunch that impacted on the financial well-being of many of the smaller businesses represented on AIM.

Whilst our experts may have been surprised by the speed and severity of the economic downturn, they were largely resigned to, and philosophical about the impact that this had on AIM's performance during the year. Those who had been through previous downturns saw this as symptomatic of investors' cautious aversity to risk and the lack of liquidity that combine to affect growth company and small cap markets at such times.

"AIM was perhaps a little more binary in terms of direction than the larger markets. But I think that's a factor of being a small cap market where liquidity dries up during a bear market rather than any fundamental flaw with AIM itself. There has been markedly less criticism of AIM in the last six to nine months, because I think people have come to realise that it is pretty much a market like any other."

(Richard Feigen, Seymour Pierce)

"No one expected the economy and the banks in particular to deteriorate in quite the way that they have done but, in those circumstances, small companies always suffer. They are deemed risky; they

are the least able to secure financing from banks that don't want to give it to them; and banks and investors regard them as suddenly a great deal riskier than they were weeks before. So, needless to say, share prices do go down in those circumstances."

(Andrew Buchanan, Octopus Investments)

A difficult year for investors

There is no getting away from the fact that the marked overall fall in the value of AIM shares across the year did have a negative impact on the livelihood of those investors for whom AIM is a major focus. Just over 80% of investors in our survey said that AIM's performance had a negative effect on their own fund's performance in 2008, compared with only 50% saying this in last year's survey, following disappointing share price performance in 2007. And only 4% reported a positive effect, down from 20% last year.

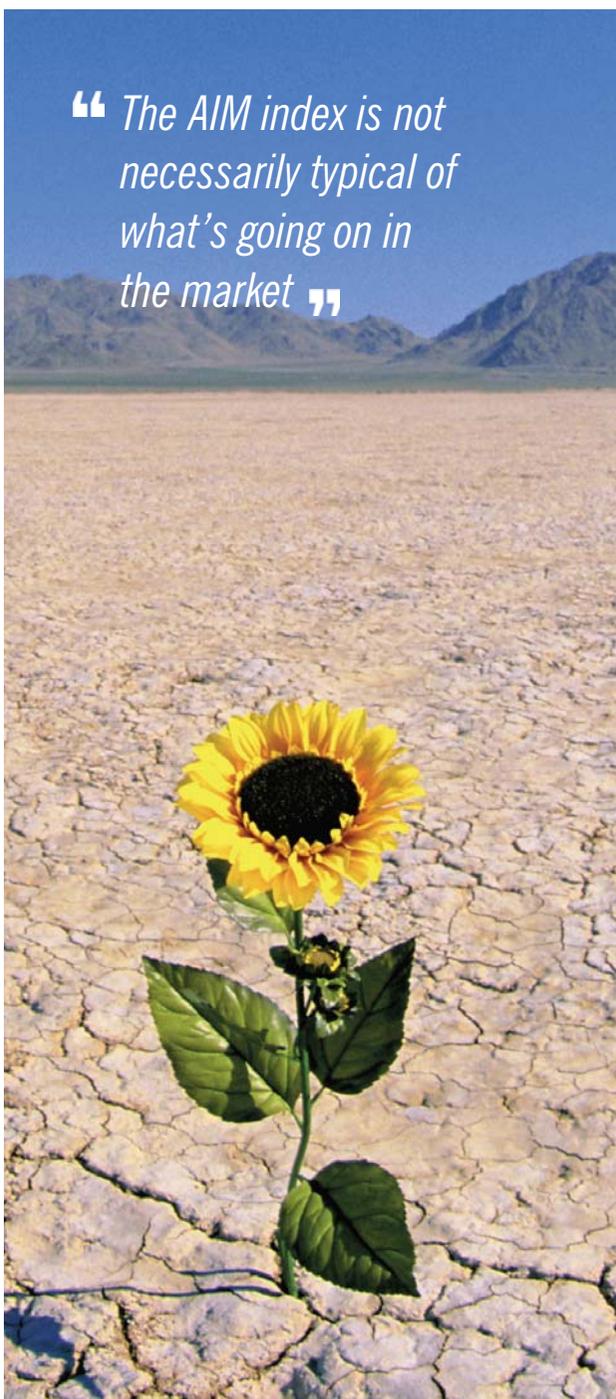
"Anyone who was involved in AIM has had a very tough time."

(Andrew Crossley, Invesco Perpetual)

In such market conditions, many investors did try to limit their exposure to AIM. In relative terms, half of the investors in our main survey (51%) invested a lower proportion in AIM stocks in 2008 than they had in 2007. This was influenced particularly by lack of liquidity, a lack of investment opportunities and the poor performance of the market and the companies on it. In contrast, only 9% said they invested a higher proportion in AIM stocks, mainly citing the opportunities offered by favourable valuation of shares in a depressed market.



“ The AIM index is not necessarily typical of what’s going on in the market ”



AIM’s successes overshadowed

A number of our experts did feel that the adverse publicity surrounding market conditions and the fall in share prices tended to overshadow some of the relative successes of AIM and AIM companies, during 2008.

“The disappointment is that there have been some headlines that haven’t necessarily been justified, whereas actually, in a difficult world, I don’t think AIM has necessarily under-performed by whatever yardstick, compared with other similar markets around the world. The British are good at denouncing their own successes and, in many respects, AIM has continued as it should have done, to raise money for deserving causes.”

(Andrew Buchanan, Octopus Investments)

Indeed, several suggest that the focus on indices – and, in this case, the performance of the AIM Index – may have been detrimental to perceptions of AIM’s performance. They believe that the AIM Index is not necessarily typical of what is going on in large parts of a broad and diverse market, and that the emphasis on the AIM Index over-focuses attention on a small number of larger companies in particular sectors. So, AIM is a market for stock-pickers, not index-followers.

“I think the AIM Index, unfortunately, is not a good bellweather for the market. The AIM market is made up of so many different pockets and different sectors, different companies, different shareholding structures, it’s almost statistically impossible for that to be relevant. I think the AIM Index is, unfortunately, uninvestable because it is just so

broad and wide and there’s no real link between a lot of the companies within it.”

(Adam Hart, Fairfax IS)

... some solid companies performing soundly

There are clearly still some strong, well-run companies on AIM that have continued to put in a solid performance, but these may well have been overlooked amid the general market hysteria, remaining under-recognised and under-valued. They offer good opportunities for diligent stock-pickers – or perhaps for private equity investors or for predators.

“I think a number of companies have adopted a more sanguine approach and just focused on running the company and I think that will pay dividends in the end. Some companies have continued to perform reasonably well and have traded in line with anticipated expectations. That gives me confidence that it’s not all dire. And I think those companies, if they continue to deliver as they set out their stall, will come to the fore.”

(Peter Ashworth, Charles Stanley Securities)

... and continuing to raise money

At the same time, AIM did still help many growing companies whether new admissions or in secondary funding, to raise money during 2008. So, for some of our experts, AIM continued to fulfil a prime purpose.

“AIM did keep going and still raised money and admitted new companies, despite the global downturn. True, the AIM Index suffered more than



most, but you have to remember that AIM is a market for growth companies, early-stage business models and specialist sectors that have all been hit particularly hard.”

(Paul Watts, Baker Tilly)

The relative lack of new market entrants largely reflected the broader market environment. With valuations falling and investors moving away from the riskier small cap stocks, it was not a good time to come to market.

On the other hand, a few companies did make the journey. Although most of them took place in the first half of the year; there were close to 40 IPOs in 2008, well below the peak of more than 300 in 2005.

Whilst market entrants may have found it hard to realise their true value, our experts feel that those that did make the grade are generally high quality companies, with good management, a clear strategy and a solid financial base. This contrasts with previous years, where there was a feeling – as we have reported in recent Taking AIM surveys – that some companies that came to market in the boom years for IPOs were too speculative and under-prepared. Hence, a reduction in the flow of new companies may have raised the quality of new entrants, enhanced the general quality of the market, and allowed a welcome period of calm re-assessment.

“The overall market uncertainty clearly impacted on the number of new listings in 2008 and raised the bar in terms of required criteria. This may actually

have the benefit of increasing the quality and size of companies going forward on the market, which in turn will further improve the reputation of the market. There is still appetite from investors to invest in AIM companies, but they are certainly being much more selective.”

(Diane Gwilliam, Baker Tilly)

The investors in our main survey expressed similar sentiments. Asked what contributed to the relative success of the few companies that did manage to get onto AIM during 2008, investors most frequently cited:

Good management	36%
Good quality companies	31%
Realistic pricing	24%
Well-prepared	22%
Good products	18%
Financial strength	11%
Good business model	9%
Good communication / investor relations	9%

A substantial minority of these investors (40%) suggest that the reduction in the number of companies on AIM and in the number of IPOs has produced an increase in the quality of the market, more than twice as many as suggested any deterioration (18%).

The relative lack of IPOs also meant that there was a shift in emphasis towards secondary funding – 65% of investors in our main survey invested a higher proportion in secondary funding in 2008 than in 2007 (up from 44% last year). This again

underlines one of the strengths of AIM, in providing ongoing money-raising opportunities for companies and reflects the faith that investors continue to have in solid AIM companies.

“One of the successes has been the amount of secondary fundraising that’s gone on. I think that’s a hallmark of real investors continuing to support the companies they’re invested in. It’s a sign of maturity that there can be new issues as well as secondary raisings by companies. This shows that they have worked hard to achieve a level of support amongst existing shareholders, which in turn means that they continue to put their hands in their pockets and support the companies they’re invested in. There have been a lot of headlines about flotations having dried up. Well, actually, AIM is continuing to raise money to support good, deserving companies. People seem to have forgotten that.”

(Andrew Buchanan, Octopus Investments)

Equity remains important for AIM companies

The market downturn and the credit crunch have put significant pressures on the successful operation of AIM companies, as it has on others, and on their financial well-being. First and foremost amongst these is raising funds, and many comment on the pressures on credit terms and (particularly in the UK) on banking relationships. This may be combined in times of economic uncertainty with delays or even default in receiving payment from customers.



In such times, particularly in light of bank failures, the credit crunch and the scarcity of private equity, the availability of equity capital becomes an even more important factor in helping the company to survive and thrive.

Like companies on many other markets, AIM companies saw their share price fall significantly during 2008. Whilst nearly half of the companies in our survey (46%) said that their own share price performed much in line with the AIM market generally, one in three (32%) was rather more adversely affected, outnumbering those who thought that they had outperformed the market (22%).

Some of our expert panel suggest that some management teams may have felt frustrated and hampered by the collapse of share prices across the year.

“The fact that there has been a drop in stock markets generally and the fact that there has been a move from small to larger cap stocks with greater liquidity has had an impact on AIM. As a result, the number of companies and management teams are becoming frustrated with the public markets and are considering taking their companies private.”
(Stephen Keys, Cenkos Securities)

AIM companies generally happy with their status and the benefits of AIM

Nevertheless, disappointing though their share price performance may have been, the companies themselves remain largely supportive of the market.

A large majority – 70% of UK and 77% of international companies – say that they have no regrets that they listed on AIM (see chart 2). Only one in four has any regrets at all and few (7%) express these strongly.

The advantages of listing on AIM remain, and a majority of companies say that they have realised real benefits, particularly in terms of access to capital (62% say this has been a major or some benefit – including 67% of overseas companies) and profile and credibility (59% - including 63% of overseas companies).

One in three or more points to benefits achieved in liquidity (37%), facilitating strategic acquisitions (37% - 43% of overseas companies) and facilitating exit for investors (33% - 37% of overseas companies). A few also comment on the benefit from tax breaks and financial incentives, primarily recognised by UK companies (just over one in five of whom sees this as of major or some benefit). Indeed, in hindsight, the majority of companies (55%) agreed that, had they known how the markets would be affected in 2008, there is nothing that they would – or could – have done differently. Most commonly, companies said that, had they anticipated the extent and impact of the market downturn, they would have raised funds earlier or restructured their capital to place them in a stronger position to withstand it.

Chart 1. AIM companies feel the economic pressures

What are the main pressures that current market conditions have put on the successful operation of your business?
 (Unprompted - main responses shown)

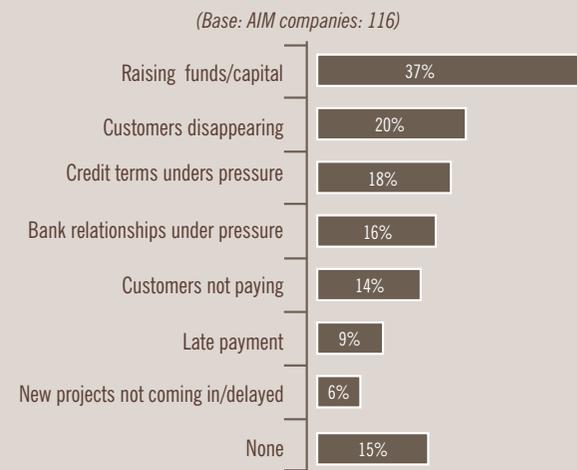
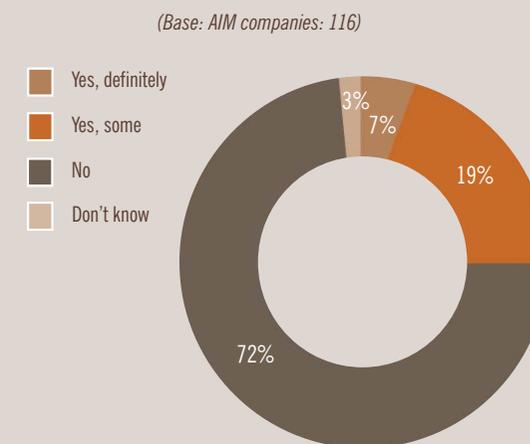


Chart 2. Companies remain satisfied with their decision to list on AIM

Given the current market environment, do you yourself have any regrets that your company listed on AIM?



AIM companies are responding to the economic downturn

The large majority of companies (72%) have now taken steps to change their strategy or cut costs in view of the current economic climate. However, overseas AIM companies appear to be more likely to have taken the necessary steps than their counterparts in the UK (83% vs. 67%). Particular initiatives include general cost-cutting, lay-offs, a freeze on new hirings and restructuring of the business. A few of those who have not yet taken such measures are planning to do so (7% of all companies).

Further, one in three companies (33%) has a plan in place for further steps to take if economic conditions do not improve – again, this applies more to overseas AIM companies than to those that are UK-based (40% vs. 30%). Many of those who have not yet progressed this far are considering taking this route (30% of all AIM companies).

... and learning lessons from the events of 2008

After a period of long-term growth, buoyancy and optimism, the deep and wide-ranging impact of the economic downturn may have taken some by surprise – in spite of the warning tones being sounded in previous Taking AIM reports. Asked about the lessons they have learnt from the downturn of 2008, the most frequent response from AIM companies is that ‘markets are cyclical’ and they should ‘be prepared for the risks’. Others

stress the importance of a strong balance sheet, and of liquidity – ‘cash is king’. Some believe that it has brought home the importance of keeping a cap on borrowing – even, in a few cases, it has taught them not to trust the banks.

“The lesson to be learned, for everyone not just for us, is to manage risk. The banks didn’t and it has affected everyone.”

“What goes up must go down, the market can be extremely fickle, one can’t manage a company purely on a share price.”

(AIM companies)

Investors focus particularly on the need for companies to ensure that they have adequate funds, that they do not borrow excessively and that they concentrate on a good, strong balance sheet. They also sound a note of warning to aspiring AIM companies - to learn from the events of 2008, not to list too early, to be realistic in expectations and promises, and to maintain good communications with investors.

“Don’t rely on share prices to raise capital - rely instead on good reliable earnings and investments.”

“Entrepreneurs are optimists by nature but we want to see more cool heads and realistic expectations based on sound business models.”

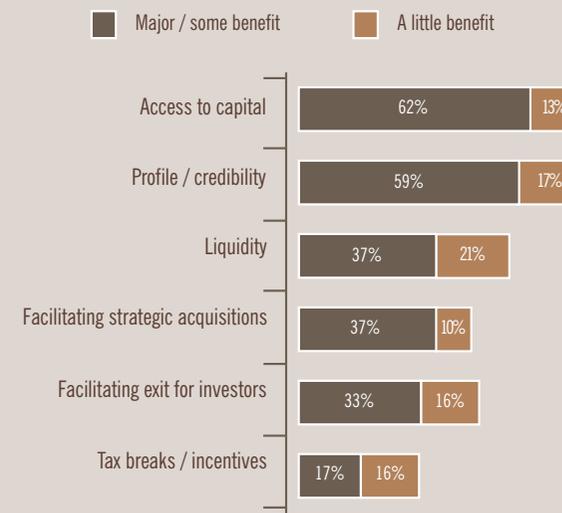
(AIM investors)

All good advice, these sentiments were echoed by our expert panel.

Chart 3. AIM is meeting many companies’ key objectives

Since you originally listed on AIM, would you say that each of the following aspects of listing have been... to your company

(Base: AIM companies: 116)



“I think the most significant lesson that many of them have learned is that you do need to be prepared for the rainy day, and that means not just in terms of your cash resource, but in terms of your overall corporate strategy. And you need to have a management team who is able to, with its advisors, with its non-execs, read the signs and take the actions ahead. And I think what we’ve had are a lot of companies with very inexperienced management teams who therefore react to what has happened, rather than working in an anticipatory manner.”
(Tim Worledge, Evolution Securities)



Looking forward

AIM in 2009

The downturn of 2008 may have dealt AIM something of a blow in its long-term trajectory, but all of our research audiences agree that it is far from being a death blow. It represents something of a set back to progress, but AIM is expected to bounce back as the markets recover. Indeed, one or two of our expert panel were at pains to criticise those who have written AIM off.

Growth company market and regulatory flexibility position AIM well for recovery

Asked what characteristics of AIM are most likely to encourage its recovery and growth, companies, investors and experts alike generally point to its well-established position as a leading growth company market and to its regulatory flexibility. Added to this, AIM's worldwide reputation and that of London as a financial centre, access to a pool of investors and its maturity and diversity all position the market well to be able to generate renewed interest with economic recovery.

What are the main characteristics of AIM that you think will encourage its recovery and growth? (Unprompted question; main responses shown)

Institutional investors (Base: 55)

Market for growing companies	40%
Regulatory flexibility	29%
London-based	11%
Low costs	9%
Maturity as a market	5%
Diversity	5%
Higher risk/growth opportunity	5%
Tax benefits	5%

AIM companies (Base: 116)

Market for growing companies	39%
Regulatory flexibility	34%
Investor interest in small caps	9%
Worldwide reputation	8%
Access to capital/liquidity	6%

Move with economic recovery	6%
Maturity as a market	5%
Institutional support	4%

"It is a growth market and, at the point where people start thinking about investing again, those are the sorts of companies they start looking for because they're going to offer them decent growth prospects."

(Richard Feigen, Seymour Pierce)

Global recovery and investor interest needed to kickstart AIM's recovery

Whilst AIM may have the necessary characteristics to encourage recovery, it is possible that it may need something of a 'kick start' to realise such a trend. Both AIM companies and investors believe that this is likely to come from a general upturn in world markets and a revival of investor confidence and interest in AIM. Renewed interest may be sparked by opportunities in particular high growth regions or sectors, whilst investors would especially welcome government intervention and tax incentives.

Where do you think the main thrust to kick start AIM and generate increased interest in investment will come from? (Unprompted question; main response shown)

Institutional investors (Base: 55)

Opportunities in growth regions	24%
Renewed investor interest	24%
Upturn in world markets	22%
Tax incentives	16%



Opportunities in industry sectors	15%
Commodity prices	13%
Government intervention	11%
Good growth companies/floats	7%
Recovery of economy	7%

AIM companies (Base: 116)

Upturn in world markets	47%
Renewed investor interest	31%
Opportunities in growth regions	21%
Opportunities in industry sectors	15%
Tax incentives	9%
Recovery in financial sector	6%
Strong company/share performance	6%
Government intervention	5%
Commodity prices	5%

Again, our panel of experts largely agrees with this view - that there may not necessarily be one specific action, but that recovery in AIM will come with an improving world economic environment, enhanced business performance and renewed investor confidence and a growing interest in smaller companies.

"You just need to believe that there is some stability in the external economy and in the wider economy and that underlying trading has stabilised and there is some progress. Once those features are evident, people will have more confidence in investing generally and, at some point, they will move to smaller companies, having seen a rally in larger companies."

(Peter Ashworth, Charles Stanley Securities)

However, at least one of our experts proposes that this may be a time for AIM itself to take action to kick start the recovery. The initiative suggested, to discourage the number of smaller companies on the market, is much in keeping with the sentiment of other experts and the AIM investors in the main survey, who see this as being another natural and desirable outcome of the current downturn.

"It has to come from the AIM team making some bold and visionary changes which will allow the market to mature and state clearly that the market is not suitable for all small companies. If AIM chooses to do something deliberate, it will face criticism in the short term. However, the market will emerge much stronger in the medium to long term. The time for action is now."

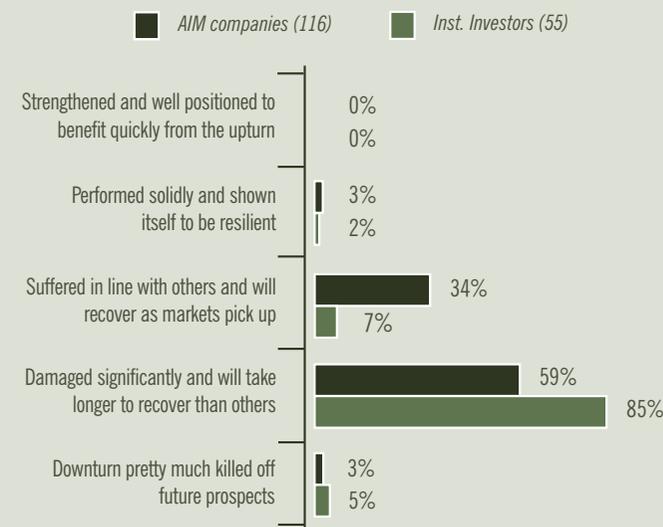
(Donald Stewart, Faegre & Benson)

A steady recovery in view

The general feeling of all audiences in this research is that AIM will bounce back, although its recovery is likely to be somewhat behind other markets. Companies – and particularly overseas companies (47%) – are perhaps more optimistic that AIM will recover alongside other markets as the general recovery takes place (see chart 4). Our expert panel follows the companies' view rather more than that of the investors, some feeling that it will recover in line with other world markets and some expecting a slower recovery. Typically, following a downturn, it is anticipated that funds will start flowing first into the larger companies, and then into smaller and growth companies as confidence returns.

Chart 4. AIM companies and investors think that AIM will recover slowly

Which of the following best describes your view of the impact that the past year's performance has had on the future of AIM, overall and compared with other markets?



"It'll take time for any recovery. I think the big companies, when they recover, will recover first. I think it's going to take time for investor confidence to return and to trickle down to small companies and AIM. Any recovery in underlying trading is going to take time. And until we have evidence of that, I think we're going to struggle."

(Peter Ashworth, Charles Stanley Securities)

"Whether small companies will pick up ahead of or behind large companies is an interesting debate. Generally speaking, small companies pick up after big companies. Investors have a sort of flight to

liquidity, so they'll go for the big companies first, then, when the big cap stocks begin to look overvalued, you'll see the smaller cap stocks looking up."

(Tim Worledge, Evolution Securities)

Uncertainty over recovery in 2009

Although almost all anticipate that AIM will get back on course as confidence returns, there are mixed expectations as to the speed of recovery. However, the majority agrees that 2009 will continue to be a difficult year for AIM and AIM companies.

In last year's Taking AIM Survey, institutional investors were more likely than the companies to anticipate poorer market performance during 2008, little expecting how true this would turn out to be. It may be encouraging this year, therefore, that investors are a little more optimistic for some improvement in 2009. Although views are still mixed, 40% anticipate that AIM will perform better in 2009, compared with one in three thinking that it will get worse.

The AIM companies are a little more cautious. Their general view is for no change, with the balance of opinion leaning slightly more towards poorer performance in 2009 than to an improvement (see chart 5).

Those companies and investors taking the more optimistic view tended to feel at the time of the survey (January 2009) that we were over the worst and markets would start to recover during 2009. Some investors consider that the bad news has

already been taken into account in the valuation of AIM companies. The relatively low valuation of some good quality companies will offer good investment opportunities for stock-pickers, generate increased investor interest and rebuild confidence in both the companies and the market. The shock of 2008 is likely to see greater realism creeping back into the market in 2009, and a predicted reduction in the number of companies on AIM will raise its general quality.

"It won't be as bad as last year. It is likely that we have seen the worst of the storm and improvement is likely as restructuring takes place."

"The prospects for good quality companies that create real wealth will obviously improve as their weaker competitors are eliminated."

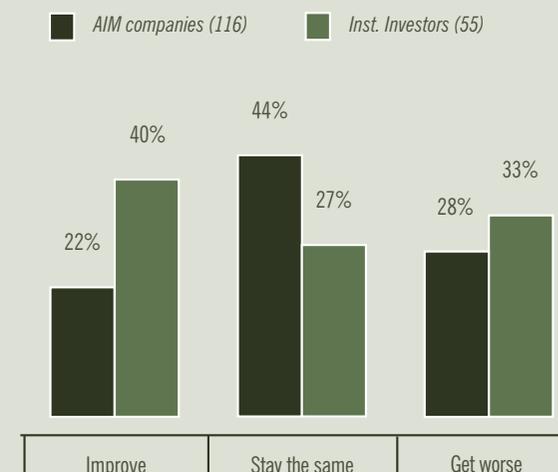
(AIM investors)

Against this, a number of both companies and investors predicted that there could be more bad news to come in 2009 for the global and UK economies and that any recovery would take rather longer. Many businesses and industry sectors would continue to struggle and there were likely to be more poor results, in the early part of the year at least. Investors would remain cautious about investing in smaller and growth companies and, as a consequence, it would take more than this year to rebuild confidence in AIM.

"With its lack of liquidity and record of underperforming, investors are now cautious about investing in AIM."

Chart 5. Mixed expectations for 2009 but investors more optimistic

What are your expectations for AIM's performance over the next 12 months?



"The projections we have seen have indicated that some of the worst conditions have yet to come for small companies, given the lack of available credit. On the other hand, some small businesses have sound balance sheets which can see them through and aid in recovery."

(AIM investors)

Relatively few of the AIM companies or investors in our main survey anticipate much recovery before 2010, with the first half of 2010 the most popular prediction. Only a quarter of investors and one in seven companies expects to see recovery in market valuation during 2009, whilst a few think that it may take several years (see chart 6).



Although several of our expert panel dismiss the AIM Index as an effective indicator of what is going on in the market, investors in our main survey are typically looking for it to recover to at least 500 (from 394 at the end of 2008) in order to demonstrate the market's recovery.

Our expert panel was similarly cautious about predicting the next 12 months during a period of such uncertainty. The consensus of views is that the first half of 2009 will remain difficult as companies continue to report poor 2008 figures. However, they are cautiously optimistic that there will start to be real signs of recovery in the second half of the year, although this will be evidenced first in the main market and AIM may take a little longer to see the benefits.

"It does feel as though things are perking up a little bit, as though people are beginning to consider making acquisitions, people are beginning to think about doing things. It is quite possible that by the end of the year, you will see a significant recovery in the equity market."

(Richard Feigen, Seymour Pierce)

Investors will remain cautious

There is reasonable confidence that AIM will start to see recovery and renewed interest in investment in the latter part of 2009 or early 2010. However, investors are likely to remain cautious about any major return to AIM investment and will be looking more diligently for well-managed companies with a proven track-record, good business plan, strong balance sheet and realistic valuation. In spite of current concerns about the UK economy, AIM

Chart 6. AIM companies and investors think recovery most likely in 2010

In terms of market valuation, how soon do you expect AIM to recover from the current downturn?



investors are likely to look close to home for a sense of security in their investments over the next year or two. Asked which countries or regions they consider will be particularly attractive to investors like themselves over this period, 82% nominated the UK. Whilst a number of our experts highlighted the attractions of the emerging BRIC economies, very few investors picked out other markets that they consider will be attractive – 9% China, 7% India, 7% North America / USA and 2% Brazil / South America. In terms of sectors, the AIM investors surveyed nominated healthcare as the one likely to be most attractive over the next year or two, with a number also choosing out resources and support services as promising (see chart 8).

Chart 7. AIM investors look for soundly-based investments

What are the two most important investment criteria you will be looking for when you consider future investment in AIM companies? (Unprompted question; main responses)

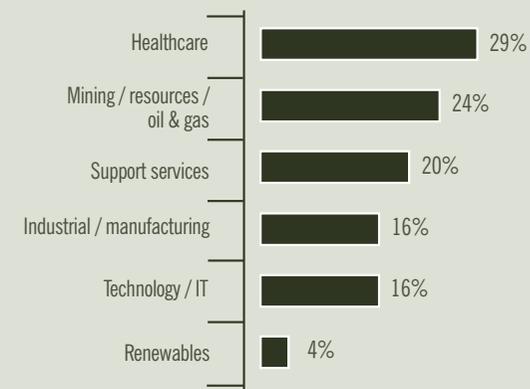
(Base: Institutional investors: 55)

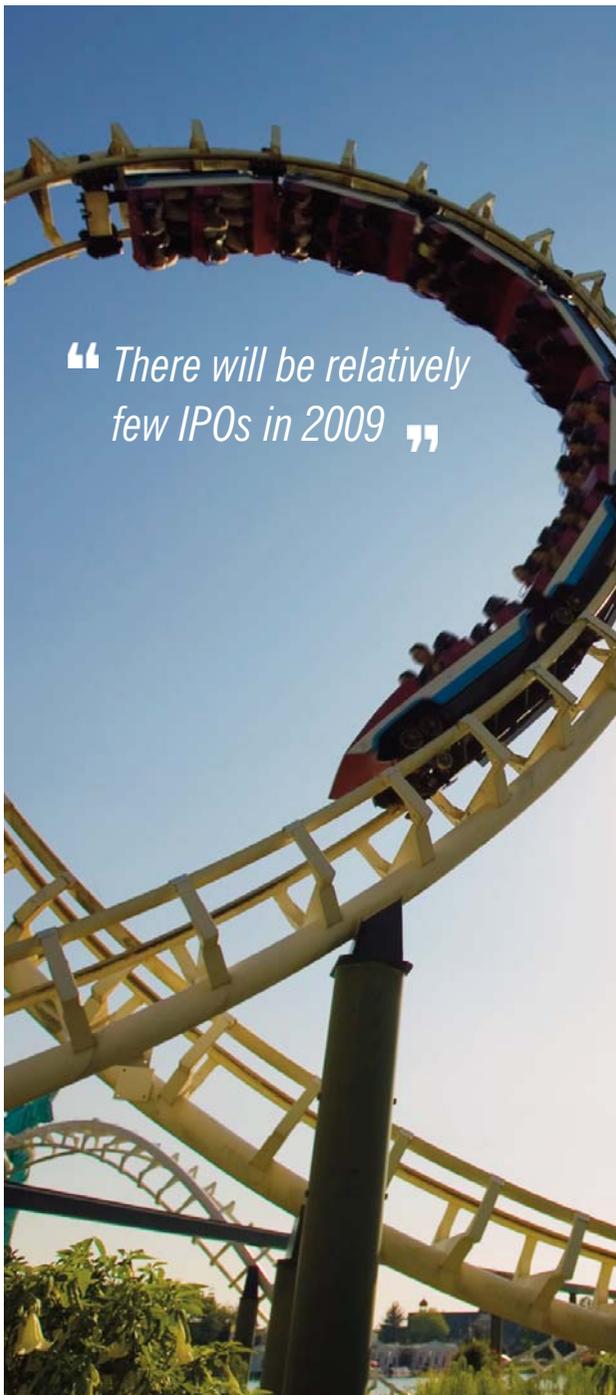


Chart 8. Investors favour healthcare stocks as attractive in 2009

What AIM sectors do you think will be particularly attractive to investors like yourself over the next year or two? (unprompted)

(Base: Institutional investors: 55)





“ There will be relatively few IPOs in 2009 ”

However, nearly a third of investors were unable to identify any particular sectors of interest or stressed that it would be very much down to picking individual companies rather than sectors. Whilst several of our expert panel also picked out individual sectors, they too emphasised the need for careful individual stock-picking, rather than necessarily following wider trends.

“I think people will go for safety first, so the early winners I think will be the companies that have visible, predictable income, the companies that are theoretically recession-proof.”

(Tim Worlledge, Evolution Securities)

IPOs will be slower to recover

With IPOs and investor appetite for them all but drying up in the second half of 2008, our expert panel believes that it will take a little longer before the market sees much recovery in the flow of IPOs to AIM. Investors will be looking carefully at investment opportunities and, as confidence starts to return to the market, for soundly based companies with a good track record. There will be fewer opportunities for the more speculative floats and those companies that do come to the market initially are likely to be safer, more established and better quality.

AIM investors surveyed generally anticipate that, even when markets do recover, there will continue to be a dearth of good quality UK companies looking to come to AIM (65%). Only one in six (16%) thinks that the relative pause in new admissions will provide a queue of such companies looking to float.

Those who foresee a scarcity of suitable companies point to the damage done to the market's credibility and reputation (25%) and its recent poor performance (14%), and feel that it will take time for confidence to be restored (14%). Some believe there to be a lack of such companies able and willing to come to the market (17%) and a lack of interest in this route (14%).

It is anticipated that there will be relatively few IPOs in 2009, with more signs of renewed interest in 2010. However, none of our experts expects the flow of IPOs ever to reach the heady levels of the recent past – 335 in the peak year of 2005. They believe that a level of 100, 150 or maybe up to 200 a year is perhaps more realistic in order to sustain the market, to continue to provide a listing for ambitious growth companies and to maintain interest in new investment. This largely accords with the view of institutional investors surveyed, around half of whom suggest that 100 (22%) or 150 (29%) would be a sustainable level to demonstrate the market's recovery, with a few suggesting lower (9%) or higher numbers (13%).

“I would suggest that the level of IPOs in 2005, 2006 and 2007 was probably too high and a better level is 200 a year. I'd rather see 200 quality companies than 200 quality and 200 less so. I would suspect there will be, if I have to make a guess, fewer than 50 (in 2009). I think companies that manage to come to the market will be stronger and better established because, in order to get financed, the companies will need to be better.”



But most of the really good companies will hold off until the markets are better when they can extract better value and less dilution.”

(Adam Hart, Fairfax IS)

... but companies still look for secondary funding

Whilst it may be difficult to generate interest in IPOs, investors' continued interest in safe, known quantities is likely to see a continuing demand for secondary funding.

61% of AIM companies surveyed have considered or would consider AIM for further funding in the next 12 months. This figure does confirm to some extent the continuing difficulty that AIM companies face in attracting investor interest – that level is a long way down from the 71% in the 2008 Taking AIM Survey – but also shows the importance of equity finance at a time when other sources are becoming increasingly difficult to access and demonstrates the confidence that these companies still have in AIM as a market. UK companies are more likely to consider a secondary issue than overseas companies (65% and 50% respectively).

Shrinkage and consolidation

After years of sometimes spectacular growth in the number of companies listed, 2008 saw this checked, with more companies leaving than joining the market. Nevertheless, with still more than 1,500 companies quoted, AIM retains its status as a significant player on the international stage.

However, it is widely felt – by our expert panel and many of the AIM investors in our main survey – that the high level of IPOs seen, over the ‘boom’ years of 2004-06 in particular, both damaged AIM’s reputation and contributed to its poor performance in 2008. In the rush of enthusiasm in better times, companies may have been brought to the market too early, too speculatively or too poorly prepared.

“It is no longer an ‘IPO market’ – which is a positive development. The fall in the number of new listings is providing the market with the opportunity to take stock and address some of the issues which have dogged it in the boom times – particularly in the sheer number of low quality small companies that have found their way onto the market and which should probably not have been there in the first place.”

(Donald Stewart, Faegre & Benson)

Combined with this, the recent downturn has left many companies struggling, whilst fast falling valuations have created a large tier of companies with low levels of capitalisation. It is widely agreed by our expert panel that some further reduction in the number of companies at the smaller end of the market is likely in 2009 and will be beneficial for the strength, quality and long-term health of the market.

“AIM will regroup and reinvent itself in 2009. A large number of smaller AIM companies will be considering their options (especially the 800-odd below £10 million market cap at the end of 2008 and will seek to delist or merge, but that will clear the way for the stronger companies to survive and





“ 47% of the AIM companies surveyed are ‘very’ or ‘fairly’ likely to make an acquisition in the next 12 to 18 months ”

become more visible. AIM should not be afraid to lose smaller companies in order to improve the future prospects for the market as a whole.”

(Paul Watts, Baker Tilly)

“AIM was designed for growth companies. If there is a significant basket of companies that are there effectively below people’s radar screens and not demonstrating any characteristics of growth, then really they’re not receiving any of the benefits of being on the market and may even damage the reputation of the market. I could see a number of those coming off the market in the coming months.”

(Stephen Keys, Cenkos Securities)

As we reported last year, with valuations down and private equity buyers limited by the global credit crunch, M&A activity could be a driver of market recovery. This is a course that appears to be welcomed by companies, investors and advisers alike.

- 80% of AIM investors surveyed agreed that more of the smaller AIM companies should consider consolidation.
- Two-thirds (68%) of AIM companies agreed that more AIM companies like themselves should consider it, a view slightly more prevalent among non-UK companies (73% vs. 66% of those UK based).

“Given the utter lack of appetite amongst investors for AIM stocks, any recovery is likely to be driven by M&A activity. The companies that will get bought

will be companies that have been consistently profitable, that have demonstrated reasonable returns, that have characteristics that trade buyers or private equity value, such as cash generation, consistency of returns, barriers to entry.”

(Andrew Crossley, Invesco Perpetual)

“For many companies, the way out of this is consolidation. It’s getting to critical mass in terms of operations so that they’re not so fragile, they’re not so dependent on one or two business streams. Bigger companies will be perceived as more attractive from investors’ points of view and I think you will see investors encouraging consolidation because, from their perspective, that creates something bigger and probably with more liquidity.”

(Tim Worledge, Evolution Securities)

Putting this into action, nearly half (47%) of AIM companies surveyed are ‘very’ or ‘fairly’ likely to make an acquisition in the next 12 to 18 months. This is slightly down on last year’s response (54%), perhaps reflecting financing issues. In a reversal of last year’s finding, however, non-UK companies are slightly more likely than those in the UK to be planning acquisitions (53% and 44% respectively).

Conversely, nearly a third of AIM companies (32%) are ‘very’ or ‘fairly’ likely to be acquired in the next 12 to 18 months, up from 20% last year. UK companies are a little more likely to be acquired than those from outside the UK (34% and 27% respectively).



Nearly 40% of AIM companies are unable to identify any particular barriers to consolidation. The main perceived barrier is cost (33%), but some also mention their shareholder base (15%), company profile (12%) and share price (11%).

Many also feel that an alternative course, for smaller AIM companies in particular, might be to go private.

- Two-thirds of AIM investors (65%) think smaller AIM companies should consider de-listing, and as many as 40% also think this of larger AIM companies (although here, more, 51%, disagree). Nearly two-thirds of AIM companies surveyed (63%) took a similar view – that more AIM companies like themselves should consider de-listing.

Although this is less likely to be carried through into action, still more than one in five companies (22%) is 'very' or 'fairly' likely to take this course in the next 12 to 18 months, double the level expressing this view last year (11%).

Most companies perceive some barriers to going private, foremost among these being cost (41%) and shareholder considerations (39%). Other barriers include share price (17%) and management (11%).

"There are something like 600 companies on AIM with a market cap of less than £5 million. Many of these are exploring their options for leaving the market. Regulation in the area of public to private transactions is out of proportion given the size of these companies, making the PTP process time-consuming and expensive. This needs to be looked

at – a quicker, simpler and more cost-effective process would be most welcome."

(Gary Houghton, Baker Tilly)

But AIM remains an international market of choice

As the markets recover, as we saw above, it is likely that investors will look first to invest in proven companies from the home market, although their horizons are likely to broaden as confidence returns. At the same time, some of our experts believe that overseas companies may be slow to return while investors remain cautious, also preferring to stay closer to their home markets.

"There will be a continued demand from overseas companies to come to AIM and raise money, but I think the willingness of investors is going to be low, certainly initially the interest in their offerings is going to rank behind those of domestic companies."

(Adam Hart, Fairfax IS)

Nevertheless, most agree that AIM has not lost any ground on the international stage, as other smaller company markets have been similarly affected by global uncertainty. Fledgling smaller company markets in one or two key centres will have struggled to become established and to generate the level of investor interest that there is in AIM. As business returns to normal, they believe that AIM will continue to be the market of choice for overseas companies seeking international listing.

"Although certain overseas jurisdictions have set up their own AIM lookalike markets, they have yet to prove themselves and the current economic



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climate will not help their development. AIM remains the global market of choice for growth companies, notwithstanding the fact that any further growth will be delayed until global market conditions improve.”

(Paul Watts, Baker Tilly)

One ongoing issue, however, is the extent to which overseas investors show sufficient interest. It has been said in previous Taking AIM reports that AIM has been very successful in attracting overseas companies to list, but less so in gaining overseas investors. Although this situation may have improved slowly, our experts fear that this continues to be the case.

AIM needs overseas investors to show interest in investing in companies from their own region, as this would demonstrate that it is truly an international market. Several of the panel feel that AIM itself and the brokers should be doing more in this direction.

“Although there are some brokers who have improved their access to overseas investors, there still need to be more. UK investors will look more favourably on a fundraising if the company can demonstrate domestic support.”

(Diane Gwilliam, Baker Tilly)

“It’s one of the things the Stock Exchange and the broking community have got to do. We’re putting resource into trying to increase the coverage we have amongst investors in places like continental Europe, the Middle East, the Far East and the US, but it isn’t happening enough.”

(Richard Feigen, Seymour Pierce)

THE LONGER TERM VIEW

Taking a longer term view, our expert panel generally agrees that AIM will recover from the present downturn and reassert its position as a leading market for growing companies. However, the speed of recovery will be largely dependent on the pace of world economic stabilisation.

They acknowledge the need for a strong second-tier market in order to encourage growth companies and enable them to raise money, and to provide opportunities for investors. AIM should continue to fulfil this role in the years to come and will continue to offer real opportunities to ambitious companies.

“AIM will weather this storm, as the factors that made AIM a success have not changed. The market will mature from here and represent a viable market for good quality growth companies.”

(Diane Gwilliam, Baker Tilly)

However, there are some mixed views on the size, shape and positioning that AIM is likely to see in future years. Some suggest more of the same, others think it will continue to evolve, whether by its own intention, the actions of companies or investors or increased competition.

Some agree that AIM will face increased competition over the next five years. This may be within the UK from PLUS Markets, and at least one expert believes that healthy competition will help both to thrive.

“I think it has to change. There are lots of competing alternatives. So, I think AIM has to be on its mettle and I think it has to find a way of



differentiating itself. I hope it's inevitable that there will be two tiers of market. I think competition is a good thing, so I'd like to see PLUS succeed and provide real competition to AIM. I think then you're giving both investors and companies choice and that in turn it forces each market to constantly strive to provide something which is a differentiator."

(Tim Worledge, Evolution Securities)

Alternatively, competition may come from international markets, as smaller company markets are encouraged in other centres, or competitors such as NASDAQ push their efforts in this area, or international companies that have suffered from the present downturn look closer to home for investor support – and AIM investors focus on UK stocks. Indeed, one or two see some retrenchment to become a more UK-focused market, at least in the short to medium term.

"Within five years it will hopefully be back in its place as the pre-eminent growth company market for global securities. I can see it retrenching back to being a UK market but I think if people put their shoulder to the wheel, we can keep it international and therefore helping Britain's balance of payments."

(Richard Feigen, Seymour Pierce)

There is some sense that the market will further reduce in size as the fall-out from the global downturn continues to bite. And there are some mixed views as to whether AIM should go back to nurturing the very small growth companies or focus instead of those of a reasonable weight – maybe £50 million plus cap.

"My view is that AIM is of strategic importance to the UK economy. In order to find its way forward in the global economy, the UK economy needs to produce new enterprises – we must encourage growth companies and provide the right environment for entrepreneurs. I am confident that AIM will continue to be the leading public market for UK growth companies. Given the turmoil in debt markets, AIM has a very important role to play in supporting these companies."

(Gary Houghton, Baker Tilly)

The message from some of our experts is not to panic – avoid the knee-jerk reaction to events, as hasty decisions can have detrimental effects, as the US markets have shown.

"People need to remain calm and not to panic. AIM is not over; there will be plenty of opportunities, but it will take time and it will also depend on when global macroeconomic indicators improve and confidence fully returns to the equity market."

(Paul Watts, Baker Tilly)

Several also call for some return to the level of tax breaks that helped AIM in the past.

"Government could help by bringing back some of the benefits that AIM has enjoyed in the past. Their effective killing off of VCTs has been very bad for smaller UK companies."

(Adam Hart, Fairfax IS)



Regulation

AIM's relatively light regulatory touch has always been one of its key distinguishing features and regarded by most as a cornerstone of its success, both in the UK and internationally. It has been admired and aspects copied in markets around the world.

"Self-regulation is very effective. AIM has had relatively few financial scandals or problems in its 13-year history. The nomad system is respected and copied worldwide and is also continually reviewed and updated by the London Stock Exchange."

(Paul Watts, Baker Tilly)

Self-regulation working well

Over the past two years, the Exchange has done a certain amount to tidy up and formalise some aspects of regulation, particularly in respect of the role of the nomad. Whilst this has been seen as little more than formalising good practices of most nomads that were already in place, it has been widely welcomed and helped to create added confidence in the system. The expert panel and the companies in our main survey agree that self-regulation is working well. They would be reluctant to see further regulation that might detract from the market's appeal and success at a time when it is seeking to consolidate and recover from the present global downturn.

The investors on our expert panel are also positive about self-regulation and the recent formalisation of the rule book they believe the current level of regulation to be sufficient. However, they do recognise that it is still subject to criticism by some of their peers, and one feels that the Stock Exchange could do more to police it.

"I'm broadly in favour of lighter touch regulation, I'm broadly in favour of that function being delegated to the nomads. I don't think there's any need to tighten regulation. The changes to the rule

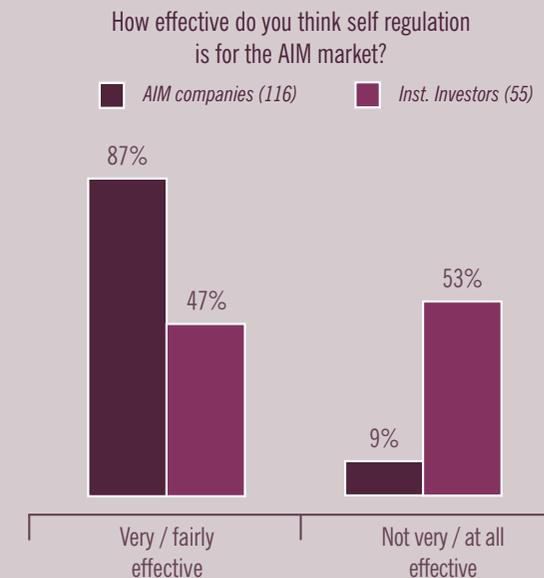
book were sensible. What you actually need is a greater willingness by the Exchange to name and shame individuals."

(Andrew Crossley, Invesco Perpetual)

... but investors are increasingly critical of level of regulation

Asked about the effectiveness of self-regulation for AIM, the AIM companies themselves remain very positive (see chart 9). Nearly 90% of companies consider it to be 'very' or 'fairly' effective, as they have in the previous two surveys. On the other hand, whilst more than two-thirds of AIM investors interviewed in the preceding two surveys had considered self-regulation effective (69% in 2007,

Chart 9. AIM companies are generally satisfied with the effectiveness of self-regulation, but investors differ



72% in 2008), fewer than half (47%) express the same view in the present survey. This is clearly quite a sharp reverse in perception, probably reflecting the damage inflicted on many investors by the fall in share prices during 2008.

Light regulation may be equated by some investors with poor performance – one in three expressed this view this year, compared with fewer than one in ten last year (see chart 10). Reflecting some of the comments of our expert panel, these investors may associate light regulation with some poorer quality entrants to the market.

Whilst our expert panel – including the investors – feel the level of regulation is now about right, the investors in our main survey, who have probably had their fingers burnt, show an increasing demand for further tightening of the regulations. Two-thirds of them now agree that further regulation is required (see chart 11), up from just over half last year. Only one in five disagrees.

Our expert panel did suggest three areas where they might consider some small changes in procedures – i.e. a tightening up of reporting periods, fuller rules on the ‘appropriateness’ of applicants and more requirements for independent research on all AIM companies.

Companies managing the obligations of being on AIM

Even against a background of market downturn, and the tightening of the rule-book and the introduction and development of IFRS, most companies have

accepted and are managing the continuing obligations of being an AIM listed PLC. Most say that those obligations have been ‘much in line with their expectations’ over the last 12-18 months (see chart 12).

However, nearly one in four companies does consider their obligations to have been more onerous than they expected. These are particularly likely to be the companies that came to the market some years ago and those with lower market capitalisation – the companies that our experts expect to be thinned out over the next year or two.

Chart 10. Investors starting to suspect that low regulation means low performance

Would you agree or disagree with the view that low regulation means low performance in growth markets?

(Base: Investors: 2007: 51, 2008: 50, 2009: 55)

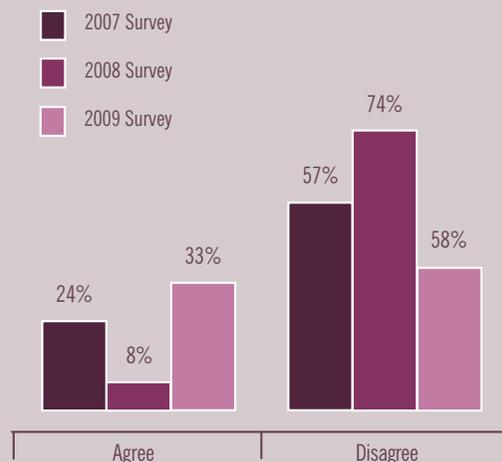


Chart 11. Most investors now show support for increased regulation of AIM

Would you agree or disagree with the view that further increases in regulation of AIM are still required?

(Base: Investors: 2007: 51, 2008: 50, 2009: 55)

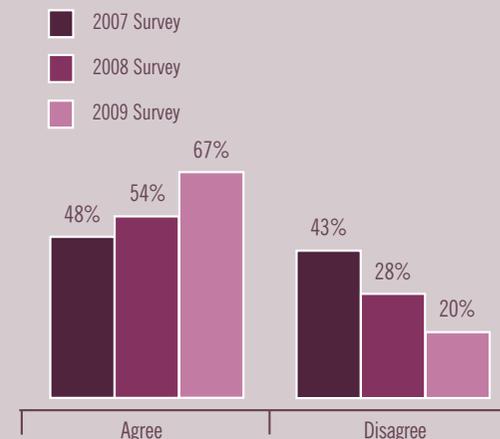
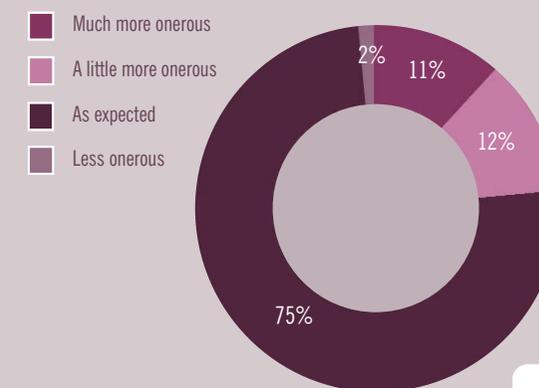


Chart 12. Companies are coping with the obligations of being listed on AIM

Over the last 12-18 months, have the continuing obligations of being an AIM listed PLC been...?

(Base: AIM companies: 116)



Asked what they consider to be the most time and resource consuming aspects of being an AIM listed PLC, companies were most likely to cite (unprompted):

IFRS	33%
Investor relations	28%
Reporting requirements	28%
Regulatory compliance	22%
Corporate governance	10%

Among the specific reporting requirements, just over one in five companies (21%) say the current environment has given them greater unease over the going concern reporting rules. Particular anxiety relates to increased 'heavy-handedness' by auditors, concern over banks and credit facilities and availability of financing.

"The uncertainty in this climate precipitates much greater importance about going concern issues. How confident can anyone be that a company's bank will continue to support them? I think it is inevitable that we will see an increase in going concern qualifications by auditors which may in itself start a series of motions that may exacerbate the issues."

(Diane Gwilliam, Baker Tilly)

IFRS

Although IFRS was introduced for AIM companies two years ago, there have been further changes in requirements in the second year. Companies typically found implementation in the second year much the same as in the preceding year, and 30%,

particularly among larger companies, considered it easier. On the other hand, one in six (16%) did find it more difficult in the second year – these were principally smaller and UK companies.

As we found last year, most companies believe that the implementation of IFRS has had no particular impact on perceptions of their company: 12% believe that it has had a positive effect and 16% a negative effect.

CORPORATE GOVERNANCE

More important than ever, but not good enough

Nearly all of the AIM investors in our main survey (91%) agree that, in the present difficult environment, good corporate governance is increasingly important. This is a view echoed by our expert panel.

"Good corporate governance has been on the agenda throughout 2008 and will continue to be through 2009. Institutions will support companies that can demonstrate best practice, or better practice than the others, so when there's a choice between two companies, the company with a good record of corporate governance will be a more likely recipient of cash."

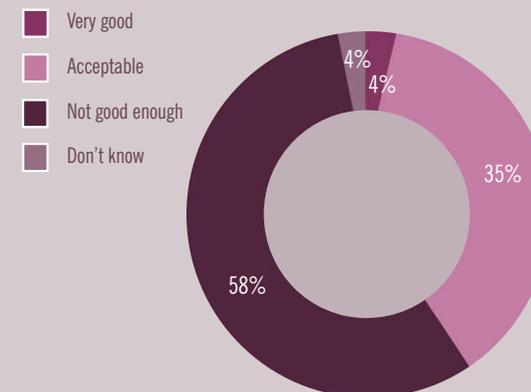
(Adam Hart, Fairfax IS)

However, although there has been some sense over the past couple of surveys that the standards of corporate governance in AIM companies have been improving, most institutional investors (58%) say they are not good enough (see chart 13). Fewer than 40% consider them even 'acceptable'.

Chart 13. Investors are critical of standards of corporate governance

Would you say that the standards of corporate governance in AIM companies are generally...?

(Base: AIM investors: 55)



"There is no particular evidence of improved corporate governance and, at the smaller end, especially with some overseas AIM companies, there has been little evidence of good corporate governance. Whilst there are no mandatory corporate governance AIM rules, the guidance issued by the Quoted Companies Alliance (QCA) is seen as best practice and perhaps could be given greater prominence and codified into the AIM rules to allow more active policing of compliance in this area."

(Paul Watts, Baker Tilly)

Two or three of our expert panel advocate the more active use of non-executive directors (NEDs) but bemoan the lack of a sufficient pool of good quality NEDs to meet the corporate governance needs of the many companies on AIM.

Advisers and investor relations

INVESTOR RELATIONS

For several years, the Taking AIM reports have emphasised the importance of effective investor relations (IR), but the present difficult environment has placed more emphasis on this aspect of an AIM company's operations. Around three-quarters of both AIM companies (71%) and institutional investors (76%) in our main survey say it is even more important at such a time to communicate well with investors.

"Undoubtedly there has been a need for companies to place more focus on investor relations in recent months and this will continue to be a key role for directors of AIM companies in the near future. Understanding the importance of investor relations and coaching directors in this skill, is an area that has proved a weakness for most AIM companies."
(John Banks, Baker Tilly)

Some of our experts acknowledge the difficulty of managing effective IR at a time when, firstly, management time and budgets are under pressure, secondly, there is not much good news to impart and, thirdly, investors have limited interest. However, they encourage AIM companies to continue making the effort, as it is at such times that they need their investors on-side.

"Unfortunately, people have worked very hard to improve their investor relations and have found that there's been no audience for it. I would hope that they would persist because I think that this is a hugely important part of any quoted company's agenda. They must tell their story as regularly and to as wide a group as possible."
(Adam Hart, Fairfax IS)

Companies say they are doing more, better IR

AIM companies feel that they are taking their IR responsibilities seriously.

- Three-quarters (74%) believe that they have got better at IR since listing, one in three (34%) claims 'much better'.

- Just over two-thirds (69%) – and particularly UK-based companies – feel that they have had sufficient ongoing support and instruction in IR.
- Approaching half (44%) say that management is spending more time now on investor relations than it was a year ago.

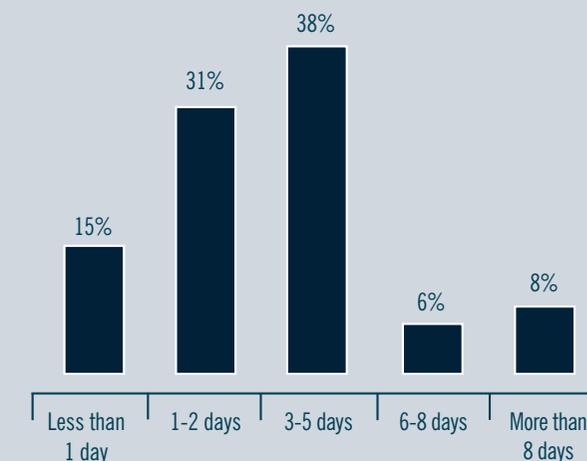
Up to a week of senior management time a month

Despite saying they are spending more management time on IR now, companies still estimate a similar amount of senior management time is spent in this

Chart 14. Investor relations requires significant input of senior management time for AIM companies

How much senior management time is spent on Investor Relations a month?

(Base: AIM companies: 116)



respect for what they reported in last year's survey. IR typically takes up 1 to 5 days a month of senior management time and more than this for one in seven (see chart 14).

... but many question whether this is time well spent

Most AIM companies still believe the time and resources they put into IR are fully reflected in the City's understanding of their company (54%). However, in a depressed market, only a minority now believe the time and resource spent is fully reflected in the level of interest in the company and its shares (40%) – this has dropped from 52% in 2008 and 64% in 2007. Clearly, the frustration suggested by some of our expert panel is felt by the companies themselves.

Overseas companies feel particularly frustrated in this respect – 60% believe that the time and resource expended is not recognised in the City's understanding of their company (compared with 35% of UK companies) and more than three-quarters (77%) in the level of interest in their company and its shares (compared with 45% of UK companies). As we saw earlier, investors are more inclined to focus on UK companies while the market is going through troubled times, and some feel that more should be done to attract overseas investors.

Investors appreciate companies' efforts

This year, a majority of institutions see AIM companies' IR activities as at least 'fairly effective' – 62% express this view, compared with only 48% in

last year's survey. Nevertheless, as last year, one in three investors (34%) still considers them ineffective (see chart 15).

Asked what they consider demonstrates particularly good IR, investors suggest (unprompted) that they should be kept regularly informed in an open and honest way – and also that companies must listen to their investors more. Main messages are:

Keep investors informed (good and bad news)	24%
Good communication	20%
Timely / regular communication	20%
Honesty / transparency / openness	20%
Listen to investors more	16%
Proactive communication	11%
Accessibility	11%
Personal / face-to-face communication	7%

"The good ones are prepared to be relatively open and forthcoming, they're prepared to talk to you and prepared to treat shareholders as an asset that's not quite on the balance sheet. And they're prepared to talk to them about a range of things rather than just, here are the results and what questions have you got. They're prepared to involve shareholders and try and make an effort."

(Andrew Buchanan, Octopus Investments)

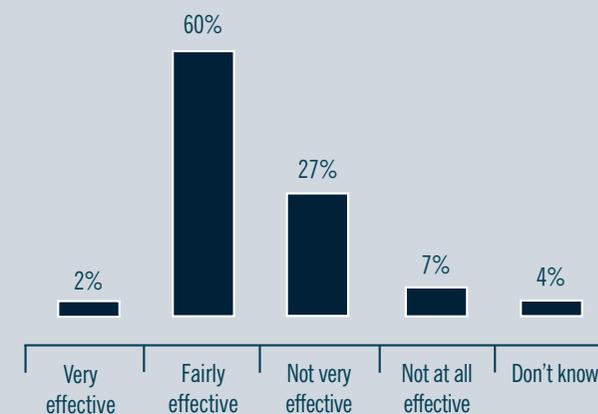
"They speak openly and honestly, they under-promise and over-deliver. They consult with shareholders on strategic issues and ultimately the very best ones have had a very clear idea of how shareholder value will be maximised, which is likely to mean a trade sale. They will articulate that quite clearly."

(Andrew Crossley, Invesco Perpetual)

Chart 15. Most investors consider AIM companies' IR activities to be fairly effective

How effective do you think the investor relations activities of AIM companies are generally?

(Base: Investors: 55)



The same themes were echoed when investors were asked how they thought AIM companies could improve the effectiveness of their communications activity. However, in addition to regularity and openness, they also express a need for better web-accessible information and better research on AIM companies. Main suggestions are:

Honesty / openness / transparency	16%
Quality of communication / information	13%
Personal / face-to-face communication	11%
Listen to investors more	9%
More / better web-accessible information	9%
Better research	7%
Clear communications	7%

ONGOING SUPPORT

Quality of advice well rated – but lawyers continue to come out the best

Just under half of all AIM companies regard the ongoing advice they receive from their nomads and auditors as ‘excellent’ or ‘very good’ (see chart 16). Most others rate their advice as ‘fairly good’, although more than one in ten is more critical.

As last year, international AIM companies are more satisfied in both cases than those from the UK (67% and 42% respectively rating nomads’ advice as ‘excellent’ or ‘very good’, 57% and 37% respectively auditors’).

However, advice from corporate lawyers continues to be more highly valued. Two-thirds rate it as ‘excellent’ or ‘very good’. International companies are again more satisfied in this respect than those from the UK (80% and 64% respectively rating it ‘excellent’ or ‘very good’).

Nomads aware of their responsibilities

The perceived tightening of the nomads’ ‘rule-book’ early in 2007, although seen as effectively a reaffirmation of what was already regarded as ‘best practice’, nevertheless focused attention more on the nomad’s role in guiding AIM companies. However, with a difficult year for AIM and AIM companies, the nomad community was inevitably affected – there were far fewer IPOs, some of their clients had problems and, inevitably, some of the nomads themselves encountered difficulties.

It is generally acknowledged by our expert panel that the increased focus on their role has ensured that nomads have remained highly aware of their responsibilities. The changing times have inevitably caused some readjustment in their relationships with their clients. Some perceive that nomads have had to be more proactive in steering their clients through a difficult period, although the general feeling is that some may have been more proactive than others.

“Some nomads have been more proactive last year. However the nomads have not escaped a good deal of their own turmoil. Nomads are certainly far more aware of their responsibilities since the AIM Rules for Nominated Advisers came into force.”
(Donald Stewart, Faegre & Benson)

Only a minority of companies have noticed any change in their nomad’s proactivity during this period (59% ‘no difference’). However, around one in four (24%) does feel that their nomad has been more proactive. Although in a few cases this relates to a change of nomad, a number say that their nomad has been better at communicating issues, has initiated more meetings, has visited the company more often and generally been more regularly in touch.

“A lot more helpful over strategy and tactics for the company and the market.”

“They seem to be coming to us with more ideas, which we are very happy about.”
(AIM companies)

On the other hand, one in six feels that their nomad has been less proactive, citing lack of interest and lack of contact.

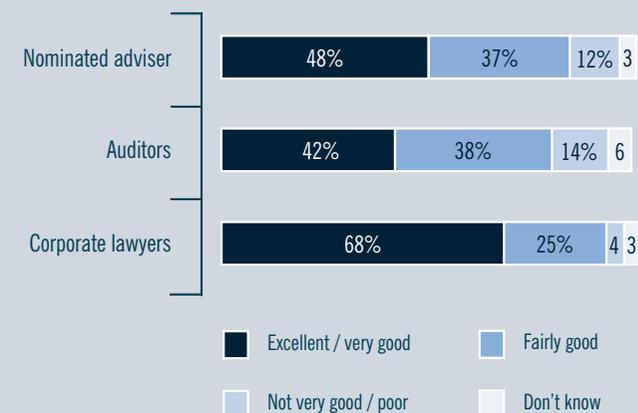
“Our nomad has taken decisions to please its own shareholders, which has affected our company. They have laid off their people, such as our own contacts. We no longer receive the attention we expected to receive.”

“Appeared less proactive in the last year. They have not appeared interested in us and there has been a decline in their level of willingness to assist.”
(AIM companies)

Chart 16. AIM companies are broadly satisfied with ongoing advice from nomads and auditors but lawyers are more highly regarded

How would you rate the quality of advice you get on an ongoing basis?

(Base: All AIM companies: 116)



Methodology

This is the thirteenth annual Taking AIM survey undertaken by Baker Tilly in partnership with Faegre & Benson.

The research was commissioned by Baker Tilly and carried out by an independent research consultancy, David Burton Associates.

Telephone surveys were conducted amongst AIM companies and institutional investors. These were supplemented by qualitative interviews with a number of market experts.

AIM companies

116 telephone interviews were conducted with senior decision-makers in companies currently listed on AIM.

- Most respondents are at CFO / FD (44%) or CEO / MD level (32%), the remainder comprising Chairmen, other executive directors and non-executive directors.
- 30 interviews were conducted with AIM companies based outside the UK. The UK companies represent a spread of region: 43 in the London region, 16 South, 15 Central and 12 North.
- Companies represent a spread of sectors, in particular resources and mining (28%), telecoms / IT / technology / media (21%), financial services (10%), business services (9%) and manufacturing and engineering (5%).

- Companies represent a spread of market capitalisation: up to £20million (47%), £21-£50 million (20%) and £51 million+ (34%).

Institutional investors

55 telephone interviews were conducted with fund managers investing in AIM companies in UK institutional investors.

All telephone interviews were conducted between 9 January and 3 February 2009.

Expert interviews

To gauge the views of the broader AIM community, qualitative interviews were carried out with seven recognised market experts: four brokers / nomads, two institutional investors and one analyst. Interviews typically lasted between 40 minutes and one hour and sought views on activity in 2008, current trends, the outlook for 2009 and a longer-term view. Interviews were conducted between 2 January and 12 February 2009. Questionnaires were also completed by five experts at Baker Tilly and Faegre & Benson. A list of participating experts can be found on the following page.

Note: due to rounding, not all charts will total to 100%.



Experts

Stockbrokers and Nomads

Richard Feigen
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Seymour Pierce

Adam Hart
Managing Director, Head of Corporate Finance
Fairfax I.S. PLC

Stephen Keys
Cenkos Securities

Tim Worlledge
Head of Corporate Finance
Evolution Securities

Analyst

Peter Ashworth
Head of Small Company Research
Charles Stanley Securities

Fund Managers

Andrew Buchanan
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Octopus Investments

Andrew Crossley
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About Faegre & Benson

Faegre & Benson LLP is an international law firm which offers an integrated team of over 500 lawyers in the UK, USA, Germany and China. The London corporate finance team advises on flotations and fund raisings, takeovers, mergers and acquisitions, reconstructions, private equity, 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 fourteen 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 recognized as being at the leading edge of developments in the market.

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

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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.

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About Baker Tilly

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