Taking AIM

Annual survey 2010

Restoring confidence in AIM

FAEGRE & BENSON LLP

BAKER TILLY

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Foreword

As AIM approaches its fifteenth birthday, there can be no doubt that it remains the world's leading growth market, having helped over 3,100 companies, from all over the globe, raise a total of over £65 billion to fund their expansion and development.

> We firmly believe that equity finance is going to be increasingly important for SMEs as we emerge from the debt induced crisis of recent years. As the availability of bank debt to many small and innovative firms has become a concern, dynamic public markets like AIM, where companies can access equity finance on an ongoing basis, will continue to support economic growth, job creation and entrepreneurial activity. AIM has firmly established its position as a leading growth market and is integral to the London Stock Exchange's portfolio of markets.
>
> **Xavier Rolet, CEO, London Stock Exchange**

This latest Taking AIM Survey underlines how AIM remains the only growth market in the world with the critical mass to provide companies from a wide range of countries and sectors with access to capital throughout their life on the market. While global IPO markets remain quiet, AIM is very much open for business, allowing companies to continue to raise significant sums of money through further issues.

Once quoted, AIM companies can return to the market to access further funds, to help them continue to develop and grow their business. The fact that in total AIM companies succeeded in raising over £4.7 billion through further issues last year demonstrates how interest in small and mid cap companies among London's unrivalled suite of investors remains strong.

AIM has become a byword for enterprise, attracting dynamic companies from around the world, and today plays a vital role in the SME funding ladder. An investment in AIM is one in the real economy, with over 1000 UK-incorporated AIM companies today alone employing around 260,000 people. AIM serves as a mechanism for companies seeking to access capital to realise their growth and innovation potential, thus contributing to the economy.

The Exchange is not standing still in helping companies make the most of their AIM quotation. Since the last Taking AIM survey we've undertaken a programme of regional road shows for investors and issuers, run a range of sector specific capital markets days, as well as continuing to urge the Government to make AIM shares eligible for ISAs and give Venture Capital Trusts greater freedom in the investments they make in small cap companies. At a European level, we are engaging with other market operators and policy makers to discuss and identify solutions to alleviate the challenges SMEs face in accessing finance, and are optimistic that the ongoing Prospectus Directive Review will include amendments to the benefit of smaller companies.

Continuing to work closely with market participants to develop greater liquidity in AIM and Main Market securities remains another key priority, and we remain committed to providing the companies on our markets with the tools they need to communicate with investors, having recently published our Practical Guide to Investor Relations. The Guide, which offers advice to companies about investor relations, collates a wealth of expertise from a series of corporate advisers, quoted companies and investors. In a difficult economic climate it is more essential than ever that companies establish an effective dialogue with their shareholders. As this is central to enhancing liquidity, we will also be arranging a series of roundtable meetings for companies around the UK to discuss the most effective ways to implement an effective investor relations strategy.

Looking forward, AIM, as a market for entrepreneurial companies, has an integral role to play in the UK's economic recovery, and London's continuing role as the world's leading international financial centre. I believe that AIM's market structure specially designed to meet the needs of small and medium-sized companies, will continue to create a compelling offering for companies seeking to raise funds on a public market and that over the coming years investors in AIM can look forward to yet more innovative firms coming to market.

Marcus Stuttard
Head of AIM

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Executive summary

AIM in 2009 – culling the weak, keeping the strong, coming of age

Although 2009 was a year of continued economic hardship and investor caution, a significant delisting of many of its smallest companies saw AIM end the year a stronger, but significantly streamlined, entity. Indeed, with the benefit of hindsight, we may ultimately come to regard 2009 as the year that AIM came of age, showing its ability less for the volume of its IPOs, and more for its continued support of existing quoted companies.

The contrast between the size of AIM's membership and its strength may be summarised in two statistics. Whilst the AIM population at 31 December 2009 was below 1,300 for the first time since August 2005, the average market value of an AIM company at that date stood at £44 million, compared with only £24 million at the end of 2008.

The attrition rate was not, in fact, significantly higher than in the previous year (293 delistings in 2009, compared with 259 in 2008), but, with investors naturally keener on more proven secondary stocks, rather than untested start-ups, only 13 companies joined the market by IPO.

The good news is that AIM has revealed itself to be a market of maturity and strength, not to mention durability, and one with a role to play for companies advancing beyond their infancy and seeking to develop further. The most substantive proof of this is that secondary fund raisings increased from £3.2 billion in 2008 to £4.8 billion in 2009.

AIM also has the popular vote: our survey shows that the vast majority of current AIM-quoted companies (71%) support the market, saying that, if they had known about the recession in advance, they would still have joined.

Now that the dust has settled on 2009, one can see that AIM's aggregate membership is undoubtedly of a higher quality than before. This can only be good news for the market as it has responded to concerns about the merit of the companies in its previously long tail.

Cautious optimism for the second half of 2010

With the average AIM-quoted company in a reasonably strong position, and secondary funding seemingly available, our attention turns to IPOs and the likelihood of their return in significant numbers.

A substantial appetite for AIM IPOs will require an amount of economic certainty. Early 2010 sees a general election and the likelihood of two budgets, which is not the best recipe for a return of investor confidence. Of course, IPOs will still happen, but probably only for the highest quality companies – another way in which the recession will, ironically, strengthen the market's overall quality.

In the context of the future of AIM, we are delighted to see that, in the March 2010 Budget Report, the Government has, at last, announced plans to consult on allowing AIM shares to be eligible for inclusion in ISAs and on the possible relaxation of the VCT rules to make it easier for VCTs to invest in small cap companies. If implemented, these proposals will provide a real boost for the market and should provide its companies with access to valuable additional sources of capital.

As worldwide economic stability returns, and the UK economy benefits in the post-election period, there is cautious optimism for AIM's primary market expansion in the second half of 2010.

Resilience, re-establishment, readiness

The resilience of AIM's performance in 2009 should not be underestimated. Its weathering of that year's particular economic storm has re-established the market's credibility and world position after the severe difficulties of 2008. With a slimmer and stronger membership, AIM is ready both to welcome high quality entrants and to play its unique role in nurturing the further development of its existing companies.

Chilton Taylor
Head of Capital Markets, Baker Tilly

Melanie Wadsworth
Corporate Partner, Faegre & Benson

Key findings

Performance in 2009

Whilst the speed and severity of the economic downturn – and its impact on AIM – may have taken many by surprise in 2008, so AIM's resilience and its bounce back, principally in terms of market valuations, came as welcome relief in 2009. In the view of our experts, AIM silenced its critics, re-established its credibility, reasserted its position in world markets and ended the year leaner and fitter.

- With many investors retrenching to safer positions in 2008, the beginning of 2009 saw bargains to be had on AIM as soundly based companies continued to perform well. Investment stabilised and the 66% increase in the Index over the year – more than making up the losses of the previous year – flagged up a good year for investors. Nearly two-thirds of those in our survey said that AIM's performance during the year had a positive effect on their own funds.

- With few IPOs, investors' continued support for secondary issues confirmed their faith in the market and support for its companies. This support was welcomed by the companies, for whom, with bank debt and private equity capital scarce, raising finance was a major concern.

- With some outflow of – particularly smaller – companies, those that remain on AIM are, in the main, happy with their position. Nearly three-quarters of those who listed before the current downturn say that, even if they had known about it in advance, they would still have listed. Most of these companies have stayed with AIM because of the access to capital and to institutional investors that listing brings.

- The weeding out of some of the weaker companies and the general uplift of the market over the year has reinforced many of the benefits that AIM companies have realised. Around three-quarters have seen some benefit from the access to capital, and more than one in three say this has been a major benefit (36%, up from 22% last year). 90% say that they have realised benefits in profile and credibility, two-thirds in facilitating exit for investors and in liquidity, and more than half in facilitating strategic acquisitions, and these benefits have generally strengthened since the last survey.

Looking forward

With a strong performance in 2009, both companies and investors faced 2010 with greater confidence, expecting further recovery from AIM as world markets pick up. Its premier position as a market for growing companies will encourage its recovery and growth, providing growth opportunities for investors and access to capital and investor support for AIM companies. Both companies and investors believe that the market will be buoyed by the general upturn in world markets and renewed investor interest, with investors looking for some strong growth stories and successful IPOs to underline the market's recovery.

- A majority of both institutional investors (63%) and AIM companies (53%) anticipate an improvement in AIM's performance over the next 12 months, with many expecting a full recovery in market valuation and levels of activity. Investors are perhaps a little more cautious than companies, anticipating that full recovery may not be seen until 2011 or later.

- In particular, investors and our experts believe that there will only be a slow recovery in IPO activity, as investors continue to favour known companies with an established track record until confidence fully returns. However, secondary issues are likely to continue to be well supported, and two-thirds of

> *Both companies and investors believe that the market will be buoyed by the general upturn in world markets and renewed investor interest, with investors looking for some strong growth stories and successful IPOs to underline the market's recovery.*

the UK AIM companies surveyed say that they have considered or would consider AIM for further funding in the next 12 months.

- With few IPOs anticipated, it is expected that there may still be some contraction in AIM over 2010. Some smaller AIM companies may reconsider the cost and viability of remaining on AIM while they find it more difficult to attract investor attention. 60% of investors still believe that some smaller companies should consider de-listing, although the proportion of AIM companies seeing any likelihood of going private in the next 12-18 months has fallen from 22% in last year's survey to only 8%. Most investors also support further consolidation, particularly at the smaller end of the market. More than 40% of UK AIM companies see some likelihood of making acquisitions in the next 12-18 months, although the proportion seeing any likelihood of being acquired has fallen from 34% to 19%.

- Investors cite a strong balance sheet, a good track record, good management and realistic valuation as the most important criteria. However, our experts underline that AIM is even more a stock-pickers' market.

- There may be some return to a higher level of risk in investments, with investors looking for the best growth opportunities. In last year's survey, they were staying close to home, seeing the best, safest opportunity in UK companies. However, with the UK expected to lag other markets in recovery, they see opportunities in UK companies with good overseas earnings and in overseas companies from strong growth markets. Investors believe that

interest will be particularly high in China (37%) and India (23%). Sectors most favoured are mining, resources, oil and gas (37%), which has a high overseas focus, and technology and IT (33%).

Regulation

AIM's relatively light regulatory touch has always been a key feature in its success. However, the formalisation and tightening up of the rule book over the past two or three years is seen as a contributory factor in the market's resilience during the downturn and to retaining its international reputation. This has largely silenced its critics and reduced the call for further regulation.

- AIM companies and experts continue to believe that AIM's self-regulation is working well (86% of companies say that 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.

- It may be that companies already feel constrained by regulation – around one in three say that the most time- and resource-consuming aspects of being an AIM listed company are regulatory compliance (37%) and reporting requirements (33%).

- Whilst there is still some support among investors for further regulation, the strong market performance of the past year has perhaps eased their demands in this respect. A majority of investors now say that self-regulation is at least fairly effective (60%, up from 47% last year), and only half support the view that further increases in regulation are still required (50%, down from 67% last year).

- Similarly, some pressure may also have eased on corporate governance. Nearly three-quarters of investors say that good corporate governance is more important in the current difficult environment (73%, down from 91%), and most believe the standards of corporate governance in AIM companies to be at least acceptable. Little more than one in three now believe that they are not good enough (37%, down from 58%).

Advisers and IR

The stronger performance of the past 12 months may also have relieved a little of the pressure on investor relations (IR). Nevertheless, nearly three-quarters of investors (70%, down from 76% last year) and a majority of companies (59%, down from 76%) still say that IR is more important in the current difficult environment.

- There is some suggestion that companies may be putting a little less senior management time into investor relations now than they were a year ago. However, in an improved market, they believe that they are getting a better return on this investment. A majority believe that their efforts are reasonably well reflected in the City's understanding of their company (58%) and in the level of interest in their company and its shares (59%, up from 46% last year).

- Most investors (60%) see companies' IR activities as at least fairly effective (no change from last year). They look for full, clear, honest and timely communication from companies, and some call for more personal communication and better web-accessible information.

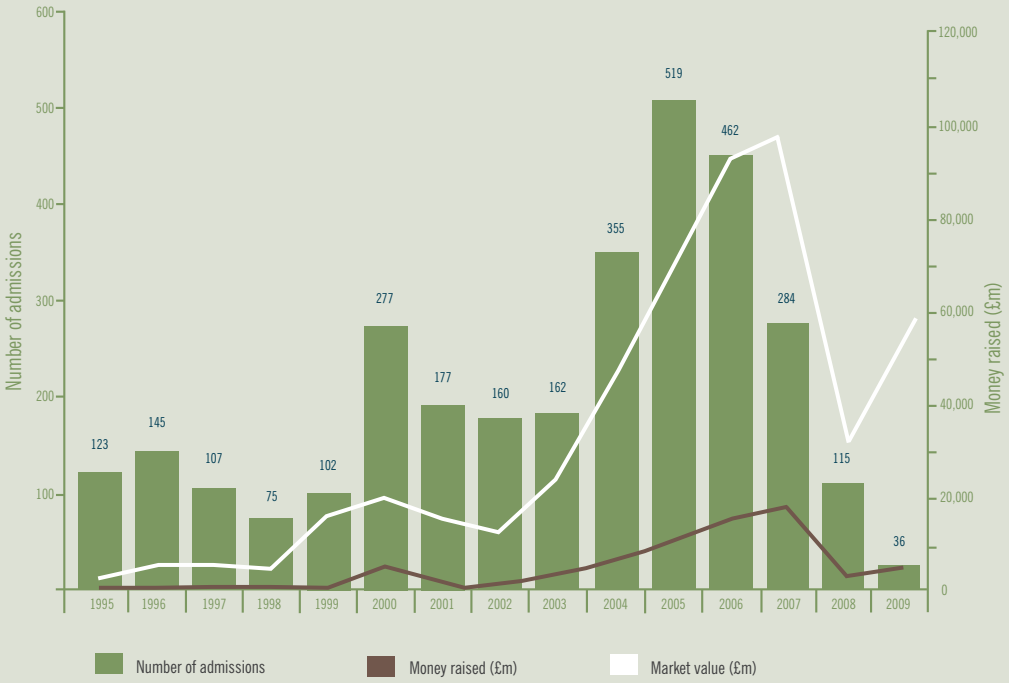
- Companies remain most satisfied with the quality of advice that they get from their corporate lawyers, although that from their nomads and auditors is a little more highly rated this year than last year. 92% of companies are generally pleased with the advice from their nomads (up from 86% last year), 88% with their auditors (up from 81%) and 94% with their corporate lawyers (up from 92%).

Market statistics

	AIM			MAIN LIST		
	2007	2008	2009	2007	2008	2009
Total number of companies	1694	1550	1,293	1580	1500	1,452
Total market cap	£97,561m	£37,710m	£56,632m	£4,226bn	£2,897bn	£3,527bn
Average market cap	£58m	£24m	£44m	£2,675m	£1,931m	£2.429m
Market cap of companies with a capitalisation below £250m	£63,737m	£32,833m	£37,733m	£60bn	£54bn	£51bn
Average market cap of companies with capitalisations below £250m	£39m	£21m	£30m	£62m	£52m	£55m
Market cap of companies with a capitalisation above £250m	£33,824m	£4,877m	£18,709m	£4,166bn	£2,843bn	£3,476bn
Average market cap of companies with capitalisations above £250m	£457m	£406m	£407m	£6.67bn	£6.25bn	£6.53bn
Total number of admissions	284	115	36	120	66	34
Number of new issues - introductions	35	24	2	20	12	13
Number of new issues - IPOs	182	38	13	82	32	7
Number of new issues - readmissions/ transfers (net)	67	53	21	18	22	14
Total new funds raised on admission	£6,581m	£1,108m	£740m	£18,923m	£6,050m	£693m
of which raised by IPOs	£6,262m	£917m	£610m	£18,903m	£6,050m	£590m
Average funds raised by IPOs	£34m	£24m	£47m	£231m	£189m	£84m
Number of further issues *	919	595	762	271	291	296
Total funds raised by further issues *	£9,602m	£3,204m	£4,861m	£9,524m	£60,438m	£73,805m
Average money raised by further issues *	£10m	£5m	£6m	£35m	£208m	£249m
Total funds raised	£16,183m	£4,312m	£5,601m	£28,447m	£66,487m	£74,498m

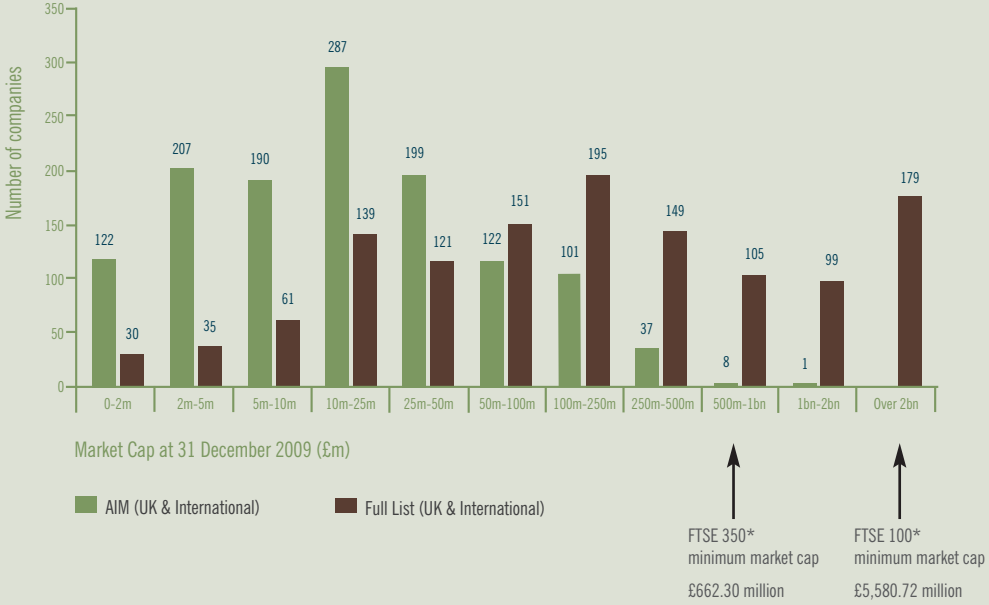
* Excludes non-money raising issues

AIM admissions, funds raised and market value since inception



Source (underlying data): London Stock Exchange

Companies by market capitalisation at December 2009



Values do not include suspended securities

* FTSE 100 and 350 are used to describe the top 100 and 350 UK Listed companies by market capitalisation as at 31 December 2009, they may not accurately reflect the components of the real FTSE 100 and 350 at that time.

Performance of AIM

MEETING THE CHALLENGES OF 2009

AIM bounces back

Following two years of underperformance, AIM clearly bounced back in 2009, to an extent that perhaps took many by surprise, just as the speed and depth of the downturn had done a year before. In last year's Taking AIM report, the majority view of survey participants, looking ahead, was that, "2009 will continue to be a difficult year for AIM and AIM companies," whilst we noted that, "relatively few anticipate much recovery before 2010." Undoubtedly, it was still a difficult year, but all the signs were that, by the latter part, AIM was getting firmly back on course.

Although the first half of the year remained relatively quiet, levels of activity and performance showed recovery in the second half. By the end of the year, the AIM All-share Index was up by 66%, recovering the losses of 2008 and outperforming most other markets. Although there was little IPO activity, secondary fundraising remained strong. As several of our experts point out, small cap markets typically tend to be worse hit in bad times, but also have the ability to recover quickly, and this was certainly true of AIM in 2009.

"2009 was undoubtedly a difficult year for all equity markets including AIM. Against that backdrop, the amount of further funds raised on the market was higher than 2008 at £4.9 billion, demonstrating that there is still institutional appetite to support good performing companies on the market."
(Diane Gwilliam, Baker Tilly)

"The stats would suggest it was probably the strongest performing market in the UK, possibly one of the strongest performing markets in the world. And I think it's a classic example of what falls the furthest, bounces the furthest. However you look at it, 2009 was an extremely exceptional year."
(Andy Crossley, Invesco Perpetual)

After two years of poor performance, high profile failures and some much-publicised criticism, our experts suggest that 2009 saw AIM strongly re-establish its credibility and reassert its position in world markets. In continuing adverse world market conditions, it has shown that it can operate and thrive. Although world economies, markets and companies are still suffering, its relatively good performance at such a time has silenced its critics, whilst attention has been drawn elsewhere, notably to the problems of the banking sector. For some, it has re-asserted its role as a premier market for growth companies.

"I think it was resilient, that's why I think it justifies its presence in the capital markets of the world. That's why I think if it didn't exist you would actually invent it! It showed that it could act effectively as a capital-raising forum, even in, by all sorts of measures and common consent, what was a particularly difficult year for investors. But I think it actually did its job extremely well."
(Andrew Buchanan, Octopus Investments)

"As a market for raising funds, it was the fourth best ever year, albeit heavily underpinning by secondary raising by existing companies."
(Kevin Denham, Baker Tilly)

This improvement in perception is reflected in the results of the surveys amongst both AIM companies and institutional investors. Asked about the impact of the past year's performance on the future of AIM, overall and compared with other markets, the main response in the 2009 survey was that, "AIM has been damaged more significantly by the downturn and will take longer to recover than other markets" (85% of investors and 62% of UK AIM companies). This year, the general impression is more relaxed, with most believing that, "AIM has suffered much in line with other world markets and will recover as markets pick up" (see chart 1). AIM investors are perhaps a little more cautious than companies, with just over one in three anticipating a slower recovery.

A leaner and stronger market

The rapidly falling market in 2008 saw interest in smaller stocks wane as institutions became more defensive and risk averse in their investment decisions. Life became more difficult for smaller companies and there was a steady stream of them leaving AIM, particularly at the lower end of the market, whether through failure, sale or going private. With relatively few new listings too, some of our experts believe that a slightly smaller AIM is stronger, focusing more attention on the better companies with a good track record.

"In some sense, there's been a cleansing of the market with some of the lower quality companies either going under or having been taken private. AIM is well positioned to recover and be a more robust market going forward with some of the weaker stocks having fallen by the wayside."
(Stephen Keys, Cenkos Securities)

"AIM took the opportunity for some housekeeping and nearly 300 companies left the market, although the majority of these were below £5 million market capitalisation. AIM faces 2010 in a stronger position with the average market capitalisation of £44 million (up from £24 million in 2008)."
(Paul Watts, Baker Tilly)

"As the markets began to slow in 2008, tough questions were asked, quite rightly, about the quality of AIM's smaller constituents. The disappearance of many of these has enhanced the credibility of the wider market which was increasingly, if unfairly, being tarred with the same brush as its weakest performers. Let's hope we can now draw a line under the debate on the justification of AIM: it is here to stay and has earned its place at the table."
(Melanie Wadsworth, Faegre & Benson)

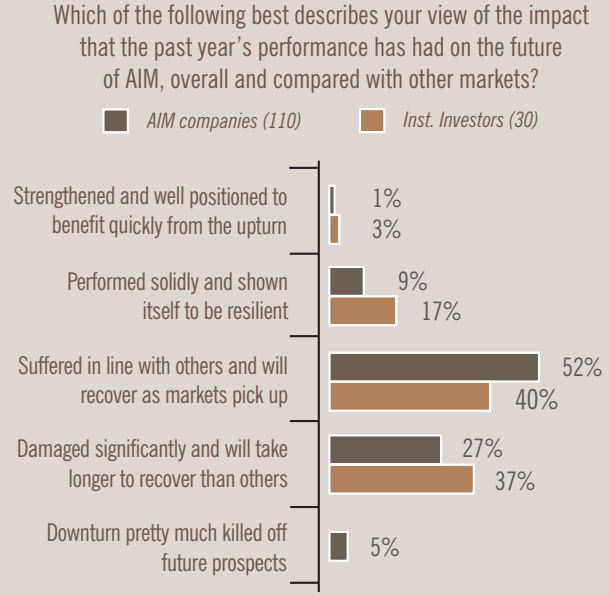
Few IPOs

2009 saw very few IPOs, a mere 13, but this was largely to be expected at a time when the markets were so uncertain and investors were playing it safe. Even with funds available, there was little appetite for riskier, unproven IPOs, and companies were unlikely to achieve the valuations they might have been looking for.

To a large extent, our experts see this as a sensible response to a weak market and a realistic withdrawal from the perceived excesses of previous years, when new companies were brought to the market in large numbers perhaps before they were ready. However, one or two did see the drying up of IPO activity as limiting the natural flow of new companies coming to the market and for investors to seek out exciting new opportunities.

"We went through a few years where there were probably too many new listings and the consequence was that they may not have been the best quality. And I think that quality expectations are higher and volume expectations are lower now with the result that we will see fewer better quality IPO's."
(Tim Worlledge, Evolution Securities)

Chart 1. AIM companies and investors see recovery in line with world markets



"Those few companies that were admitted in 2009 were very focused, in popular market sectors or backed by strong management teams, criteria that any potential new entrants should seek to emulate, whatever the market conditions."
(Paul Watts, Baker Tilly)

Strong support for secondary funding

One of the big successes of the year was the continuing support that the institutions are seen to have given to the safer, well-managed, often under-valued companies on AIM, even while the markets were having a difficult time. Investors showed little appetite for IPOs or riskier stocks, but, with

debt and private equity funding harder to come by, they exhibited strong support for well-run companies with a proven track record. Our experts emphasise that AIM has increasingly become a stock-pickers' market, perhaps to the benefit of the larger, stronger companies, whilst some of the smaller ones, or those with high exposure to debt, continue to struggle for survival.

"One positive aspect of the last 18 months was the support shown by institutional shareholders for their investee companies. We saw many secondary issues last year from companies with balance sheets which required to be strengthened and it demonstrated that small and mid cap investors are prepared to be supportive and take a longer term view."
(Stephen Keys, Cenkos Securities)

"Investors were clearly much happier putting more money into things they already owned than trying to back the next big thing. If you were an AIM company that had been around for a few years and done what you said you were going to do, but just wanted a bit more money to get to the next stage, you could probably do that."
(Jonathan Wright, Seymour Pierce)

"For proven companies with proven management and sensible shareholders, there was the ability, even in a recession, to raise new money, to carry on if you convinced people of the merits of your case. Certainly the survivors, pound for pound, are much stronger companies than they were before, because they've been through the process and they've proven they can actually deal with a recession."
(Clive Carver, finnCap)

For one or two of our experts, this is taken as a sign of AIM's maturity. They feel that there may have been too much emphasis in the past on AIM as a new listings market, whereas it can now be seen more as a mature market that helps soundly-based and proven smaller companies to grow.

"That a significant number of existing companies raised additional capital for, presumably, very good reasons, was a sign of both the maturity of the market, the maturity of the companies and the maturity of the investors. It is obviously a marketplace where the young companies of UK plc raise capital and grow up. I'm not sure that it's a good thing to acquire the perception, as AIM had done in the previous few years, that it's all about new companies floating. It isn't all about that. It must also be about the new companies of a few years ago making progress subsequently."
(Andrew Buchanan, Octopus Investments)

"The flood of new entrants in 2006 and 2007 not only raised quality issues, but also gave the impression that AIM was an IPO market, not necessarily able to support its companies' longer term aspirations. Whilst the subsequent fall in IPO numbers was expected and no bad thing, it was essential that AIM provided secondary funding opportunities to its best performers in 2009 and it did. The market has grown up."
(Melanie Wadsworth, Faegre & Benson)

Confidence returns, performance improves

Following the sharp downturn in 2008, the early part of 2009 saw solidly performing companies on low valuations, and, for investors, the recovery

perhaps started with the relative bargains to be had at that time. As business confidence returned and many AIM companies showed themselves to have successfully weathered the storm, investor confidence also started to return and the market ended the year strongly.

This clearly benefited the institutions invested in AIM companies. Not surprisingly, nearly two-thirds (63%) of investors said that AIM's performance in 2009 had a positive effect, more than one in four (27%) a very positive effect, on their own funds' performance. This was a marked improvement on the 4% who said this in last year's survey. Conversely, only 10% said that it had a negative effect, down from just over 80% last year.

"If you have a diminution in risk aversion in general, and you have in specific terms good companies reporting trading performances as expected or better than expected, then you're going to see share prices rising, which is what we did see. We saw values of funds rising, we saw inflows into funds, and, on the whole, it was certainly easier to report to clients at the end of 2009 than it was at the end of 2008."
(Andrew Buchanan, Octopus Investments)

Although the investment environment was still difficult, this perhaps had a calming effect on patterns of investment. Most fund managers (63%) said that they invested about the same proportion of funds by value in AIM companies in 2009 as they had in 2008, albeit that the proportion had largely dropped in 2008. A few (23%) did further reduce their exposure to AIM stocks in 2009, primarily because of poor liquidity, although a small number (10%) increased the proportion of investment, after seeing AIM companies performing well and seeing some bargains.

"The liquidity problems of 2008 were still relevant."
"The liquidity risk. We don't want to be stuck with unsellable stocks."
"There has been a lot of scepticism about AIM and it has been overlooked. If investors are looking for a strong balance sheet on FTSE, it would be at a high price. AIM is cheaper."
"Small companies performing well and coming from lower base."
(AIM investors)

The 66% rise in the AIM All-share Index across 2009 (as compared with the FTSE 100 at 22%) provided a welcome return for investors and reflected a combination of market influences. In the wider economic environment, it was clearly stimulated in part by the recovery in commodity prices, which benefited the resources, oil and gas sectors that are heavily represented on AIM and in the Index. Investors also believe that it may have reflected the more risk averse stance that they had taken to investment during the falling market of 2008 and some return to greater risk taking as a degree of confidence returned, together with the availability of bargains as strongly performing AIM companies came into 2009 on low valuations.

"Better quality of companies as the dross was filtered out and the market panicked and stocks went too low. As fear reduces, the Index will continue to rise."
"It mirrored recovering small companies and resource stocks."
"Because there was just a bubble of people looking for risk, not just in AIM but in small caps around the world."
"General economic growth and increase in risk taking."
(AIM investors)

Access to equity capital remains a prime consideration for AIM companies

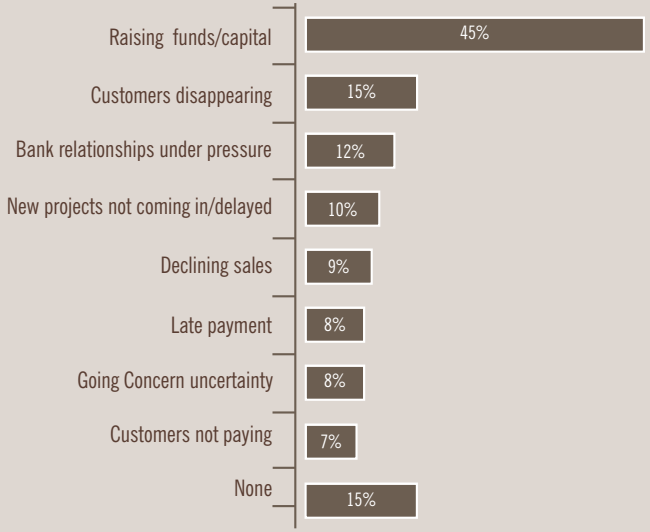
Clearly, the trading environment has remained difficult for UK AIM companies, with many citing sales, payment and customer issues, and pressure on banking relationships and credit terms among the main challenges that the current market conditions have put in the way of the successful operation of their business (see chart 2). However, these issues are mentioned less frequently than in last year's survey, whilst even greater emphasis is placed on the problems of raising finance, mentioned by nearly half of them (45%, up from 36% last year), and particularly by the smaller AIM companies.

Against a difficult trading background and with access to bank funding and private equity capital strictly limited, the availability of equity capital continues to be a vital ingredient in helping many companies to survive and thrive. Certainly that was the case for most who were surviving the downturn and had stayed with AIM through the falling valuations and into a period of recovery (the survey does not cover those companies that had left AIM during this period).

Chart 2. Raising funds a major concern for AIM companies

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

(Base: AIM companies: 110)



Following the relative freefall of 2008, many AIM companies were clearly prepared for another difficult year in 2009. Most (55%) said that AIM had performed much as they expected over the past 12 months, and some (12%) that it had done better. Only a minority expressed some disappointment, one in four (25%) feeling that it had done worse than expected (one in three in London).

Many (42%) said that their own company's share price had performed much in line with the AIM market generally, clearly benefiting from the market's strong recovery. Just over one in four (28%) said that they had outperformed the market, especially those in the resources and mining sector (38%), citing in particular good business practices, good company performance and sector strengths.

"Company performance. We have managed to remain very profitable."
"We have delivered on our commitment to our shareholders."
"We had to put out a profits warning last year but brought trading back into acceptable lines and have more orders, outperforming expectations."
"It has been better due to a vast improvement in the company's finance department, in-house performance and improved efficiency."
(AIM companies)

Balancing this out, a similar proportion (26%) had underperformed, attributing this to the global economy, sector difficulties, poor liquidity and lack of investor support.

"The impact of the recession on our sector. We have had a massive exodus of institutional investors who have no interest now in construction."
"Lack of liquidity for early stage companies."
"Performance of the market was worse than expected."
(AIM companies)

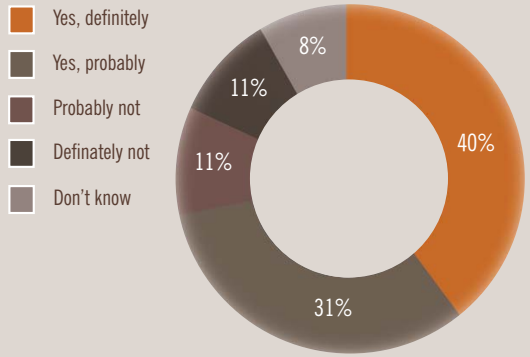
Companies remain happy with being on AIM

In spite of the turbulence in the economy and in AIM over the last two years, the majority of the UK companies in the survey that had been listed prior to this (and that had stayed on the market) do not regret their decision. Over 70% of them say that they would still have listed even if they had known about the market conditions over this period (see chart 3).

Chart 3. Most companies remain satisfied with their decision to list on AIM

If you had known about the market conditions over the last two years, would you still have listed?

(Base: AIM companies listing 2007 or earlier: 104)



Nevertheless, just over one in four may still have some doubts, particularly amongst those with lower market capitalisation (31% of those with market cap less than £10 million). This could suggest that the general trend of the last two years for some of the smaller cap companies to be 'weeded out' might still have a little way to go, depending on market movements over the coming year.

Indeed, nearly one in three of the AIM companies surveyed admitted that, in the past 12 months, they had considered de-listing (30%) or going private (32%). For a few of these, this was simply a case

of routine consideration of the company's status and expectations, a feeling that it needed to be kept under review during difficult market conditions, or, in one or two cases, specific to particular deals being considered. However, many, particularly lower cap companies, were questioning the costs associated with listing at a time when finances and markets were under pressure, reviewing the value and benefits to them of being on AIM when valuations and liquidity were low, and, for a few, reassessing their faith in AIM.

"It's very expensive to be a listed company, and de-listing would be an easy way to save money."
"We had to look at whether the costs of being AIM listed are worth it."
"We are a very small company and feel that we are not properly looked after by AIM."
"We are not currently seeking to raise capital. Therefore, the benefit of access to capital from the market is not warranted."
"We couldn't see the value that being listed was adding to the organisation."
(AIM companies)

However, these companies have stayed with AIM, whilst the majority have not considered any alternative course of action. Asked about their main reasons for staying with AIM, considering all the companies that did delist in 2009, first and foremost was the access to capital and to institutional investment that an AIM listing provides, a factor mentioned directly by more than one in three.

"The markets will come back to life in the next year and it will be easier to raise money. Future prospects look good and will entice a large number of new investors."
"Access to capital. AIM still gives us the most realistic way of raising funds."
"Ultimately it's about shareholder liquidity and ability to raise finance and this something we get from being with AIM."
"At some stage in the future, I may want to raise more funds. I don't want to swap AIM investors for venture capitalists."
"Debt is difficult to come by. The business is expanding and will require new equity."
(AIM companies)

Other main reasons included:

- The costs that would be involved in leaving AIM, particularly if the company wanted to relist again at a later stage
- An expectation that the company's position, and the markets it operates in, will improve in the near future
- AIM is a known and recognised market, and it and its conditions suit the company
- Can see no valid reasons to delist (or move to another market)
- Shareholder relationships and expectations
- Profile and credibility that AIM listing gives (and adverse publicity that delisting might bring)
- It fits in with the company's strategy, plans and expectations

"To ensure a liquid and visible market for our shares. We're very pleased to be associated with AIM and have our shares traded on the market. It also gives us staff incentivisation."

"The markets will come back to life in the next year and it will be easier to raise money. Future prospects look good and will entice a large number of new investors."

"We strongly disagree with delisting and indeed encourage other companies to stay. It is an awkward point for AIM that there is a corporate case for delisting. When shareholders buy listed stock they expect it to remain listed. We have a moral obligation to our shareholders to keep our stock listed."
"Visibility, trustworthiness of being listed. We are listed for our original reasons which haven't changed."
"Shareholders are looking for long term investments. Future prospects for the company and the markets generally are looking good."
"We feel the alternatives are not viable at the moment. The purpose of AIM is to provide liquidity for the company and shareholders."
"It is less regulated, which makes corporate transactions easier. The benefits of being public listed and gaining access to capital are too high to delist."
"We have a very strong institutional following. AIM adds credibility to our company, and our clients prefer listed companies to private companies. Overall, AIM has more advantages than disadvantages for us."
(AIM companies)

Benefits of AIM listing strengthened

So the advantages of listing on AIM remain and have been strengthened by the market's recovery. Most companies say that they have derived real benefits from their listing. Among the most prominent of these is the access to capital that listing provides (see chart 4). As last year, around 60% cite this as a significant ('major' or 'some') benefit, but, with bank and private equity funding more scarce, the proportion seeing this as a 'major' benefit has increased from 22% last year to 36% this year.

Most also see strong benefit in the profile and credibility that a listing provides. Three-quarters see this as a significant benefit, up from 60% last year, whilst the proportion considering it a major benefit has jumped from 9% to 33%. This may partly be accounted for again by AIM's recovery, but it is also possible that some of the companies that have left AIM in the past year are those who saw it as less appropriate to their profile.

The rising market and improvement in valuations have also seen more AIM companies this year identify significant benefits in facilitating exit for investors (47%, up from 31%) and enabling strategic acquisitions (41%, up from 35%). It has perhaps done less for liquidity, although two-thirds now recognise this as at least a little benefit, up from 55% last year.

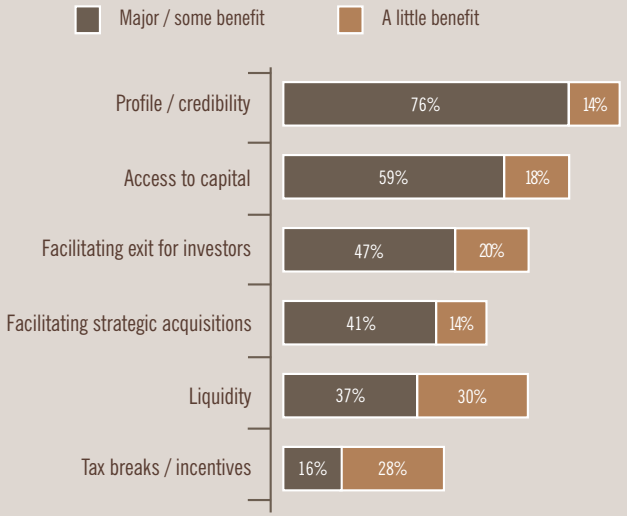
AIM companies responding to and learning from the downturn

With the economic climate remaining difficult, most UK AIM companies have taken steps to change their strategy and cut costs. More than three-quarters (78%) say that they have already done so, up from 67% last year, when UK companies appeared slower to respond than their overseas counterparts. Principal initiatives include reducing or refocusing staff costs, cutting operating and additional costs, focusing on different products or markets, and general streamlining of operations.

Chart 4. AIM is meeting most 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: 110)



Half of companies also say that they have (28%) or are considering (22%) a plan for further steps to take if economic conditions do not improve soon. This is down from 60% last year, suggesting that confidence in recovery may be growing.

Most companies believe that they and their peers generally have learnt some strong lessons from the economic downturn of 2008-09. Many of these relate to the sound financial management of the company, including having stricter financial and operational controls, focusing on cost reduction and control, maintaining a strong balance sheet, limiting reliance on debt and ensuring suitable financing options.

"A prudent approach to financing structure should be followed. Too many companies have been attracted to the ease of debt, which obviously caught up with them and caused major liquidity issues."
"They should have learnt to react quickly to reduce cost base in the future. They should maintain a tight control over costs and flexibility if required."
"Cash is king. Watch your costs, pay your bills."
"Liquidity - companies with strong funding behind them were able to function better in the downturn."
(AIM companies)

Some feel that companies have learnt the importance of strong communication with shareholders, keeping them in touch and on-side during difficult times, and others the importance of having good nomads, brokers and other advisors in providing help and support. For some, it is important to be realistic and honest in promises and in managing expectations, to ensure that there is substance behind communications.

"I think the most important thing we've learned is the value of keeping strong communication with shareholders. Delivering what management sets out to do, which will gain support in difficult times. We've seen our shareholders support us through the downturn."
"Companies with real assets will do well and be able to recover, rather than some companies with AIM that are filled with 'hot air'."
"Proactive early communication with the market - if things are going awry in your business, get that communication out there."
(AIM companies)

A few also underline the importance of not being complacent, being prepared to respond to changing circumstances quickly and have contingency plans.

"To act quickly - as soon as you see a downturn, take action and don't wait for a period of poor sales."
"Always have a plan B, because you can't rely on markets."
(AIM companies)

Investors underlined much the same messages - the need for sound financial management, to be realistic in expectations, not to be over-reliant on market valuation and to communicate openly and regularly with investors.

"With AIM, as with all markets, companies must manage their own finances better."
"Valuation is in the eye of the beholder, not the management."
"Maintaining active management and excellent investor relations, even when share prices are doing well."
"The businesses that thrived were high quality and with business models that could continue in a downturn. Companies should work on the assumption that the economy will not return to its previous level. They shouldn't rely on overall economic recovery but be able to thrive under current market conditions."
(AIM investors)

"Their shareholders are here to help if they have an understanding of the business and that's actually the payback for investor relations. When you need those shareholders for whatever reason, be it to raise a few million to acquire a competitor, to fund the working capital for some amazing order, even to keep you out of the bank's claws."
(Andrew Buchanan, Octopus Investments)

Looking forward

AIM IN 2010

At least with respect to market valuations, AIM showed an impressive bounce-back in 2009, although clearly it was still a difficult market environment for companies and investors alike. However, as we have seen, some of our experts praised its resilience and felt that it had recovered much of its reputation since the freefall of 2008. And both investors and companies were less pessimistic than they had been a year earlier about the prospects for an early recovery, anticipating that AIM would continue to recover as the markets generally pick up (see chart 1 earlier).

"AIM will have a better year in 2010, its 15th birthday year, than 2009. The AIM Index should continue to recover, existing companies will raise more money through secondary issues, and IPOs will return – but slowly and cautiously, as we have already seen. The UK general election may slow down the sort of recovery people expected, but 2010 will be better than 2009."
(Paul Watts, Baker Tilly)

Growth opportunities, institutional support and flexibility position AIM well for recovery

The characteristics that have positioned AIM well in the past, and seen it develop into the world's leading growth company market, are the same characteristics that will encourage its revival and growth as world markets recover. Its role as a market for growing companies will stand AIM in good stead as the economic environment improves, and its low costs and regulatory flexibility make it an attractive home for those companies.

Importantly, too, as we have seen in the preceding section, continuing institutional support for growing companies that offer good investment opportunities, at a time when other sources of finance are more scarce, makes AIM attractive to investors and companies alike. As some our experts emphasise, in spite of the turbulence of the last two or three years and the healthy increase in valuations in 2009, it remains a market where investors can still find strong growth opportunities.

What are the main characteristics of AIM that you think will encourage its recovery and growth?

(Unprompted question: main responses shown)

Institutional investors (Base: 30)	
Market for growing companies	37%
Higher risk / growth opportunity	30%
Low costs	23%
Regulatory flexibility	13%
Easy access to funds / liquidity	10%
Quality of companies	7%

AIM companies (Base: 110)	
Market for growing companies	36%
Investor interest in small caps	21%
Regulatory flexibility	19%
Easy access to funds	15%
Worldwide reputation	12%
Maturity as a market	5%
Institutional support	5%

"The main things that will encourage growth will be the support that is shown by institutional shareholders. The ability for companies to raise money and have flexibility to do it in a less regulated environment will be key to the market's success."
(Stephen Keys, Cenkos Securities)

"It's a stock-picker's market. There are still good companies within it. Some of those companies continue to progress and, the longer you are a public company, the more experience you get at it, the more developed the business is underneath. And the demonstration of that in terms of results and management expertise comes through."
(Peter Ashworth, Charles Stanley Securities)

"You have to pick stocks and you have to back management teams. If you continue to do that as an investor, you will do well, because there will always be success stories amongst 1200-odd companies. And if people believe that by doing a bit of research there are good quality companies that are currently undervalued, that will drive the recovery."
(Jonathan Wright, Seymour Pierce)

"AIM is a world leader, it is THE market for growth companies and has built a strong network of institutional investors and advisers. Investors looking for the potential returns that are available from such companies will come back to market as confidence levels improve. AIM is here for the long term."
(Paul Watts, Baker Tilly)

Economic upturn and growing investor confidence will encourage further recovery

Even though valuations may have picked up in 2009, this was largely a bounce-back after the panic of 2008, and other indicators remain fragile. Both AIM companies and investors believe that further recovery needs to be stimulated by a general upturn in world markets and in the economic environment and by a revival of investor confidence and interest in AIM. Investors in particular are looking for good success stories, in terms of company growth and successful IPOs, in order to build on the progress of the past year and stimulate further interest.

Where do you think the main thrust to kick start IPOs on AIM and generate increased investment will come from?

(Unprompted question: main responses shown)

Institutional investors (Base: 30)	
Renewed investor interest	40%
General upturn in world markets	30%
Good growth companies / floats	27%
Recovery of economy	17%
Stronger company / share performance	13%
Tax incentives	10%
Commodity prices	10%

AIM companies (Base: 110)	
Renewed investor interest	30%
General upturn in world markets	30%
Opportunities in particular sectors	11%
Commodity prices / energy / mining	8%
Stronger company / share performance	5%
Tax incentives	5%
Opportunities in high growth regions	5%

Our experts, however, suggest that there is little that will be necessary to 'kick-start' recovery. There are signs of recovery already and it will be a steady and gradual process for confidence to return to the market. They are looking for a steady pick up in share prices, a gradual return of IPOs, steady growth of solid AIM companies, and a measured growth in investor confidence, interest and funds, without some of the excesses associated with the middle of the 'noughties'.

There may be particular factors that will influence this. Some believe that the market will remain quiet until after a general election and hope that any new government will not do anything foolish. They are also looking for one or two high profile and successful IPOs to give increased confidence to investors, nomads and potential AIM companies and hope that there will be no major 'bad news' stories.

"It would be much better for everybody if there is just a general appreciation of the companies and a general improvement in market sentiment. And if it out-performs the larger cap markets for periods of time, then investors generally will start to believe there's value in the market."
(Jonathan Wright, Seymour Pierce)

"Good quality, but capital intensive, companies who are being forced to look at equity as a source of finance as it remains difficult to obtain loan finance. In particular this many come from overseas companies that have traditionally used debt finance, finding conditions difficult and a barrier to expansion."
(Kevin Denham, Baker Tilly)

"The kick start to AIM will be outside AIM's control and will come from institutions looking for growth opportunities on the one hand and their need to achieve better real returns than can be had from sitting on cash when inflation levels rise."
(Paul Watts, Baker Tilly)

Steady recovery expected over next 18 months

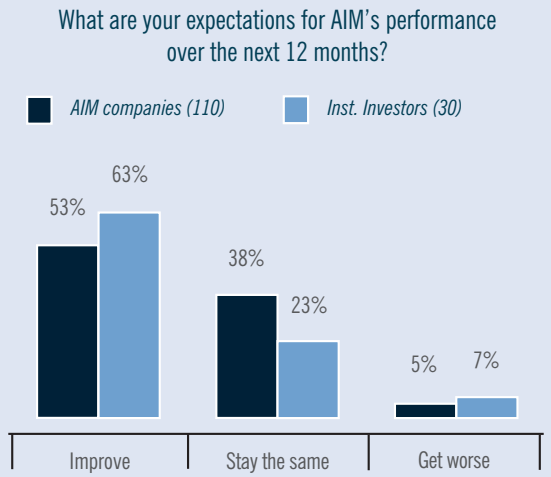
Some of our experts emphasise that recovery in 2010 will continue to be fragile in a difficult environment for AIM and AIM companies. The economy has not fully settled into recovery - there may be a double dip - the recovery in valuations was a response to the falls in 2008 and the appetite for small cap stocks may continue to be limited.

"Next year will be more difficult than last year. Your returns are likely to be lower in 2010 than 2009. The economic backdrop is very difficult. We could double dip in the UK and the imbalances that drove the crisis that we had, the issues behind that, have not really been addressed."
(Andy Crossley, Invesco Perpetual)

"I guess the buy side are cautiously optimistic. If you look at the overall market, investor appetite and investor confidence is still relatively fragile. Markets generally are much more global, capital is much more global, therefore things that happen in other parts of the world are likely to affect the local markets. And the UK economy continues to be fragile."
(Jonathan Wright, Seymour Pierce)

"Some of AIM's problems over the past few years were, frankly, of its own making. Those issues (too many IPOs, perceived lack of quality control) have now successfully been addressed and the market is very well-placed to benefit from an upturn in the wider economy. But investor confidence is still fragile and we may not be out of the woods just yet."
(Melanie Wadsworth, Faegre & Benson)

Chart 5. Both companies and investors more optimistic for 2010 performance



However, they and the AIM companies and investors are cautiously optimistic that the encouraging signs of 2009 will be carried forward into steady recovery in 2010. A majority of both companies and investors believe that AIM's performance will improve over the next 12 months (see chart 5), a substantial increase in optimism after last year's survey. Investors continue to be the more optimistic, nearly two-thirds predicting an improvement (63%, up from 40% last year). Just over half of UK AIM companies suggest the same (53%, up from 27% last year). Encouragingly, very few expect any deterioration in performance.

Both the investors and companies predicting improvement pointed to the recovery in economic and market conditions. Alongside this, companies

highlighted the greater availability of equity capital. Investors suggested that share prices are still relatively low, whilst the quality of companies has been enhanced through de-listings, encouraging a growth of investor interest as confidence builds. As our experts emphasise, AIM is very much a stock-pickers' market.

"It will be a more optimistic market. There is a better economic backdrop. Some companies are going to come to the market. If you've survived, you've progressed and now you might make progress in the current year."
(Peter Ashworth, Charles Stanley Securities)

"2010 will probably see a recovery over 2009, but whether it reaches 2008, never mind the peaks of 2005-07, would be probably too much to ask."
(Kevin Denham, Baker Tilly)

"There will be general economic recovery and people will realise the good value of investing in AIM."
"The number of stocks has reduced and some of the worse companies have delisted. This delisting has been positive as AIM has a reputation of having too many very small companies with little liquidity."
"There will be increased economic stability generally, and there will be a return of risk investors, which will drive valuation up."
(AIM investors)

"When we're out of the recession, AIM companies will grow rapidly. The performance will therefore increase."
"I am optimistic that AIM will improve as the economy does. Private capital will be more forthcoming."
(AIM companies)

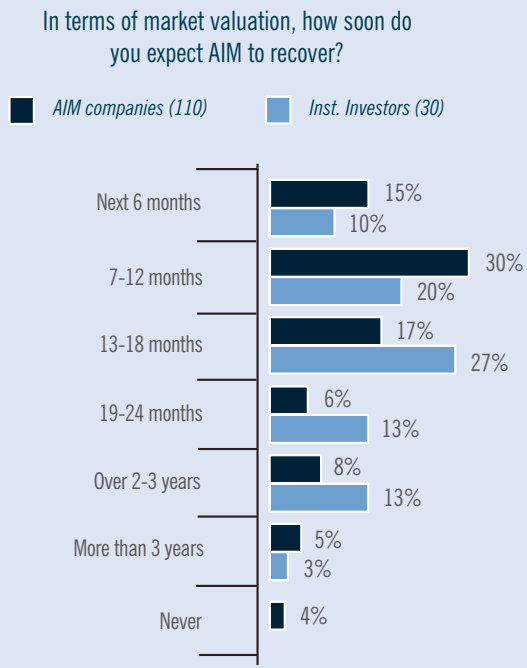
However, all audiences echo the view of our experts, that recovery will be steady and cautious. Relatively few anticipate recovery of market valuation and levels of activity in the first half of 2010 - as some of our experts point out, activity is likely to be low until after the general election. Nevertheless, nearly half of companies - and more than half of those expressing a view - anticipate recovery within twelve months of the survey (late January/early February). On the other hand, fewer than one in three (30%) of the investors sees it within a 12-month time frame, with more (40%) believing that it will be in the following 12 months (see chart 6).

Investors look for soundly based companies with a good track record

With few IPOs and a steady flow of companies de-listing, many of our experts and the investors surveyed believe that the general quality of AIM companies in a slimmed down market has been enhanced. Nearly half (47%) of investors said that it had increased the quality of AIM, whereas few (17%) thought the reverse.

Nevertheless, with recovery still fragile and many investors having suffered in the falling market of 2008, there is likely to be a degree of caution in investment in AIM companies. As our experts underline, there are still strong companies with a good track record that may have been overlooked and offer good growth opportunities. It is, even more than before, a stock pickers' market, with investors needing to do more research to identify the better investment opportunities.

Chart 6. AIM companies more positive about recovery in 2010



"The market will be more willing to pay for companies that are what I call quality growth stocks because growth will be that much rarer."
(Andy Crossley, Invesco Perpetual)

Investment will not be driven by the Index or, necessarily, by geography or sector. Investors will be looking for businesses with sound finances, strong management and strategy, a good track record and at a realistic valuation (see chart 7). If anything, the way that a company is financed and the strength of its balance sheet are considered even more important than they were in last year's survey, with investors more wary of companies with high levels of debt.

Whilst there is still a feeling that cautious investors feel more comfortable with UK companies, in looking for companies with good recovery and growth potential, one of the considerations suggested by several of our experts is overseas earnings. It is thought likely that the UK economy will be slower to recover than many others, so overseas companies and UK businesses with strong earnings from overseas may be at some advantage.

"For the market as a whole, a lot of the earnings are overseas. If the UK economy is going to be as weak as we expect it to be, then you would expect sterling to be weak as well, so the value of those overseas profits in pound terms goes up."
(Andy Crossley, Invesco Perpetual)

"AIM is a truly international market and was established for high growth companies. With the UK economy forecast to show minimal growth in the coming period, it may be that investors will seek quality, high growth companies from international markets, such as India."
(Stephen Keys, Cenkos Securities)

"Good companies in the right sectors from whatever jurisdictions will continue to attract investors at the right valuations. What is apparent is that the lack of debt finance may push companies towards capital markets who may not previously have thought of it as a source of finance."
(Kevin Denham, Baker Tilly)

"AIM has the established institutional investor base which sets it apart from its overseas counterparts so the trend of overseas growth companies considering AIM as their primary listing will likely continue."
(Diane Gwilliam, Baker Tilly)

That sentiment is echoed in the responses of the institutional investors in our survey. Last year, they were reluctant to nominate regions or countries, other than the UK, that they thought would be particularly attractive to investors. In contrast, the UK was mentioned less frequently this year (47%, down from 82%), probably for the reasons suggested above, whilst many thought that there would be particular interest in China, India and the Americas (see chart 8).

The strength of overseas markets and of commodity prices underlines the importance to AIM of the mining, resources, oil and gas sector. It is a major component of the AIM Index, and investors believe that this is the sector that will continue to generate most interest over the next year or two (see chart 9). The other main sector nominated is technology / IT. Although stressing that it is more about companies than sectors, our experts endorse this choice, whilst suggesting that sectors that rely particularly on UK consumer markets will continue to struggle, with a slow recovering economy and levels of consumer debt.

"The quality of overseas companies on AIM has historically been a mixed bag with certain countries or sectors being in favour at any time. The quality of overseas companies coming to AIM should improve as the number of listings falls, and hence investors and the market generally will be more selective, making the access to funding more competitive."
(Diane Gwilliam, Baker Tilly)

Chart 7. AIM investors look for soundly-financed businesses

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: 30)

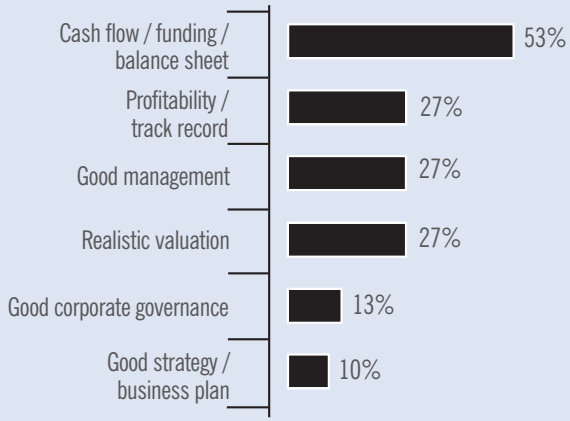
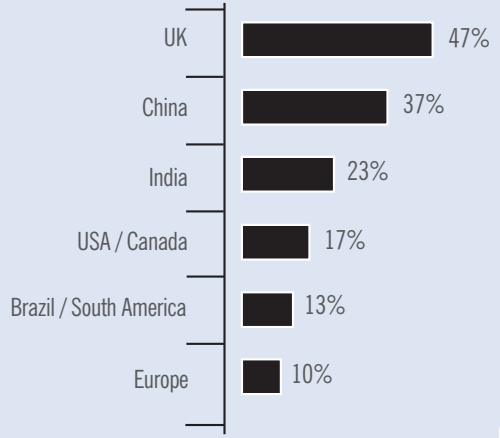


Chart 8. Emerging economies looking more attractive in 2010

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

(Base: Institutional investors: 30)



"We are already seeing interest in AIM again from the Far East, India and the USA. AIM is the world's growth market and gives investors access to companies operating in countries with double-digit growth, which is not available domestically. However, there will be a flight to quality as only the strongest, best managed and easily understood international companies will be good enough for AIM."
(Paul Watts, Baker Tilly)

"On top of a strong balance sheet, companies in emerging economies must demonstrate they have embraced fully the management structures and corporate governance standards demanded by UK investors. Nomads would do well to remember that when they sign up potential entrants – the bar is definitely set higher for overseas companies than it was before."
(Melanie Wadsworth, Faegre & Benson)

"There will be oil companies, the pot of gold at the end of the rainbow, or other exploration companies of one sort of another who do the same. There will be successes like that. There will be successes in the tech area, but I don't think you can assume that there are going to be individual sectors that bounce. The answer is that there are some interesting companies, I'm not sure there are necessarily sectors."
(Andrew Buchanan, Octopus Investments)

Slower recovery expected for IPOs

With few IPOs, and little investor appetite for them in 2009, our expert panel believes that it will take some time to generate renewed interest and activity.
The investors in our survey agree, not expecting to see recovery in the flow of IPOs until the second half of 2010 or first half of 2011 (next 7-12 months 30%, 13-18 months 27%). Indeed, they are more inclined to believe that there will still be a dearth of good quality UK companies looking to come to AIM when markets recover (40%) than that there will be a queue of them (30%). Asked what will attract them to return to investing in IPOs, they say that they are looking for:

Good investment opportunities	33%
General economic recovery	30%
Increase in confidence levels	17%
Strong companies coming to market	13%
General upturn in world markets	10%
Sensible valuation	10%

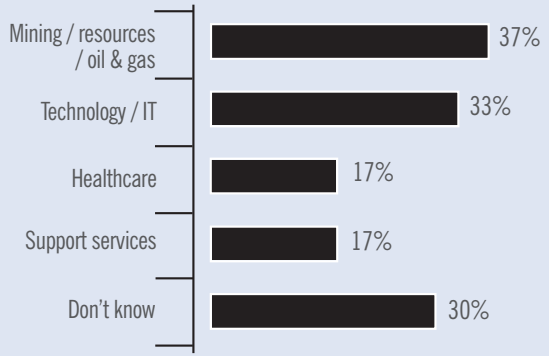
Whilst there needs to be some flow of IPOs to maintain interest and bring new blood into the market, our experts believe that the institutions will be highly selective. With the market still at a comparatively low level and early stage of recovery, they believe that there are a lot of good investment opportunities remaining with existing AIM companies that are performing solidly and are still under-valued. With funds for investment limited, investors are likely to favour established and proven companies with a known track record over riskier investments in unknown IPOs.

"I've got a universe of stocks that I can buy. UK small cap fund managers are managing less money each year because of being dis-invested from. So, every time I buy something, I've got to sell something, so it wouldn't bother me at all if there was never another IPO. I don't need an IPO to sustain interest. What's of interest to me is how my funds perform relative to my competition. I can do that through buying second hand shares."
(Andy Crossley, Invesco Perpetual)

Chart 9. Investors favour resources and technology stocks as attractive in 2010

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

(Base: Investors: 30)



"There are a lot of very cheap stocks. IPOs for the investors are inherently more risky than a company that is already listed and has been trading on the public markets for a while. And if you can buy companies with five and ten year track records on multiples of 4, 5, 6. It will have to be a very special company, and probably have a reasonable track record, to command a double digit multiple at IPO."
(Tim Worlledge, Evolution Securities)

So, our experts anticipate that there will be relatively few IPOs, but that those that do make it to the market should, in the main, be stronger companies with good management and strategy, and at a

realistic valuation that will provide some return for investors. And they think that one or two large, high profile and successful IPOs are needed before investors will truly develop a new appetite for them.

"If you've got a strong business with good growth prospects that is attractively priced, then there will be a market for that because, at the end of the day, if people want it enough they will sell existing shares to raise the money to buy the new shares."
(Andy Crossley, Invesco Perpetual)

"You just hope that people are sensible about the price they bring to market. In order to make it attractive, you've got to be leaving quite a bit on the table for the incoming investors. You've got to make it attractive. For your AIM investor, there are a lot of places he can put his money at the moment where he thinks he's getting a good deal. So, if you're trying to bring something new to the market, you've got to make it very appetising."
(Jonathan Wright, Seymour Pierce)

"It's going to be the quality of the companies coming and the valuations they're prepared to accept. Companies need to come that are sensible businesses, which have got some resilience to them. But also the owners of those businesses have got to accept sensible ratings when looking for new money."
(Clive Carver, finnCap)

They believe, and hope, that the level of IPO activity will not reach the level of perceived excess of the mid-noughties within the foreseeable future. In any case, there are fewer intermediaries and less investor appetite for them. They hope that companies will be more realistic, nomads more responsible and investors more selective. Whilst there is some expectation and hope that numbers will increase from the low 13 recorded in 2009, compared with a high of 335 in 2005, they generally feel that two to five a month will be a reasonable sign of recovery. That was largely echoed by the investors in our survey, who generally selected 50 (30%) or 100 (27%) a year as a sustainable level to demonstrate the market's recovery (down from the 150 most frequently suggested in last year's survey).

"If, at the end of the year, we had had an average of somewhere between two and three a month, I would have thought that actually would be sufficient to put the doubters and the sceptical commentators in their place. They'd have to admit that AIM has recovered in that sense. You would have to say that AIM is again continuing to do its job."
(Andrew Buchanan, Octopus Investments)

"The numbers that we saw in the heady days of the mid-2000s were unsustainable. It was just not possible for that number of companies to all be of sufficient quality for the market. There is certainly capacity and appetite for more than we saw last year and I would like to see that grow steadily throughout the year."
(Stephen Keys, Cenkos Securities)

Secondary funding will remain strong

Whilst IPOs may be slow to take off in 2010, investors still see value in existing AIM companies and, as preceding comments suggest, interest in secondary fund-raising for companies with a good track record is likely to be high.

This is likely to continue in 2010, with two-thirds (67%) of UK AIM companies surveyed saying that they have considered or would consider AIM for further funding in the next 12 months. This is especially the case for those companies with a higher market capitalisation (nearly all of those with a market cap of more than £50 million). This is at much the same level as in last year's survey and reflects the continuing importance of equity capital for funding at a time when other sources of finance may continue to prove less accessible.

AIM will continue to be a dynamic market

With a number of conflicting trends and pressures, there is no doubt that AIM will continue to be a dynamic and active market in 2010. However, there is not necessarily complete agreement between our experts over what the trends might be, but, with improved market conditions and a degree of 'clean-out' over the past two years, there may be a little more stability.

With a net loss of more than 250 companies in 2009, AIM ended the year just below 1,300 companies for the first time since August 2005. Nevertheless, as we have seen, many believe that this leaves the market leaner and stronger, retaining its status as a leading world growth company market. More than half of the de-listings during 2009 were of companies with a market capitalisation of less than £3 million, an inevitable weeding out of companies at the bottom end of the market, where many had questioned their viability as listed companies.

Some further de-listings expected

It is thought likely that there will be some continuation in the outflow of companies from AIM. Although economic conditions are thought to be improving, some of these may be through continuing company failures, although there is some variation in opinion, as to whether we are over the worst, or whether coming out of a recession might see a higher number of failures.

"Levels of debt have taken a lot of companies to the wall and will take more companies to the wall yet. There remains a lot of over-lending and that over-lending has to be got out of the system. Generally speaking, you get a higher rate of insolvencies as we come out of recession than when we're in it because companies tend to over-trade. So, I don't think the level of insolvencies is ready to drop quite yet."
(Tim Worlledge, Evolution Securities)

Our experts also tend to agree that some AIM companies, particularly at the smaller end of the market, will continue to question the cost and viability of their being on the market. As we saw earlier, nearly one in three of the AIM companies say that they have considered de-listing and/or going private. With investors focusing on some of the larger, known companies with good track records, it is likely that many of the smaller companies will continue to be 'under the radar', finding it more difficult to encourage institutional support and feeling the requirements of being on AIM relatively costly and burdensome.

"There will always be a de-listing process. It's either caused by companies going to the market and realising that it hasn't really helped them and there's no point in being there, or by private equity houses identifying cheap assets, and going and making bids which are going to be at a level which is bound to encourage investors to sell out and let the company go off the market."
(Tim Worlledge, Evolution Securities)

Although de-listing may create issues for investors, such a course of action may receive some institutional and market support.

- A majority of AIM investors (60%) suggest that more of the smaller AIM companies should consider de-listing. Some (23%) also think this of larger AIM companies, although this view is less widely held than it was in last year's survey (40%), and 70% disagree with such a course of action for these companies.
- Nearly half (44%) of AIM companies surveyed think that more AIM companies like themselves should consider de-listing, although, with more stable market conditions, the proportion supporting this has fallen from nearly two-thirds (63%) last year. A majority of those with a market capitalisation of below £10 million support this view.

On the other hand, as the markets improve, companies may see more benefit in staying on AIM. Only 8% of the AIM companies in this year's survey say that there is any likelihood (very or fairly likely) of their going private in the next 12-18 months, down from 22% at the time of last year's survey.

Companies perceive the main barriers to going private to be shareholder considerations (35%) and cost (25%). Other barriers include share price (12%), company profile (6%), management (5%) and supplier / customer perceptions (5%).

Continuing consolidation

The past two surveys have suggested that, with valuations down and private equity funding scarce, M&A activity could be a driver of market recovery. This year, with some recovery in economic conditions, there is perhaps less support for this view, although consolidation is likely to continue to be a feature of the market.

"I think you will see consolidation. It's a low growth environment and larger companies will look to bolster their growth through acquiring their smaller brethren."
(Andy Crossley, Invesco Perpetual)

"For the reason that there are quite a lot of cheap assets on the market, I think the M&A activity will probably be a bit more buoyant than it's been in the last couple of years."
(Tim Worlledge, Evolution Securities)

"I think you could see a certain amount of corporate activity, there must be a high probability that there will be a steady flow of M&A activity through the year. That will drive both valuations and perceptions of value and may interestingly encourage people to float their companies, not because they necessarily want to sell them, but because they see valuations rising."
(Andrew Buchanan, Octopus Investments)

However, with valuations still low, one or two of our experts question whether AIM companies have the value in them to make acquisitions, whilst there is some belief that private equity capital is coming back and the relatively low valuations may be attractive to the private equity houses.

"A lot of companies want to do it but, if your rating is five, the only way you can buy anything that is not dilutive is to buy it at two or three times earnings and there are not many companies out there prepared to sell on those terms. So, you might be cramming together a number of failed businesses, but making sensible acquisitions is very difficult when your own share price is so depressed."
(Clive Carver, finnCap)

Nevertheless, there is still strong support for consolidation at the bottom end of the market.

- 70% of AIM investors surveyed agree that more of the smaller AIM companies should consider consolidation, although this is down slightly from 80% last year.
- More than half (53%) of AIM companies surveyed think that more AIM companies like themselves should consider consolidation, although, again, this is down on last year (66%). Again, this view is slightly more likely to be held by those with a market capitalisation below £10 million (59%).

Clearly, many AIM companies have ambitions to expand by acquisition. Nearly half of those surveyed (44%) said that they are 'very' or 'fairly' likely to make an acquisition in the next 12-18 months, much in line with last year's response. On the other hand, with conditions improving and valuations recovering, the proportion seeing any likelihood of themselves being acquired in this time frame has fallen from 34% last year to 19% this year.

Nearly half (44%) of AIM companies were unable to identify any particular barriers to consolidation. The main perceived barriers are, again, shareholder considerations (28%) and cost (21%), although a few also mention share price (9%), company profile (6%) and management (4%).

Movement between markets

One or two of our experts also suggest that, as markets become more settled, there may be some increase in movement between markets, both within London and internationally. As AIM recovers, they have hopes that it will re-establish its position as a market that encourages growth that will later take companies up to the main market. However, they also expect to see some companies coming the other way, from the main market to AIM, as well as possible movements to overseas markets.

"I think we will be back to where we should be, which is, as companies grow, they will move to the full list."
(Andy Crossley, Invesco Perpetual)

"Probably there will be an increasing amount of movement between the various markets. You'll see companies on the full list moving down to AIM and you'll probably see AIM companies taking themselves off to other markets, whether that be Germany, USA, China or elsewhere."
(Tim Worlledge, Evolution Securities)

"For the reason that there are quite a lot of cheap assets on the market, I think the M&A activity will probably be a bit more buoyant than it's been in the last couple of years."

"AIM has always been a high growth market and it's a sign of AIM's success if companies move to the Full List once they have passed their high growth phase."
(Stephen Keys, Cenkos Securities)

One of the innovations of 2010 is the introduction of Standard listings on the London Stock Exchange. One in three (33%) of the investors in our survey say that they may (definitely or probably) invest in Standard listings over AIM IPOs. However, our experts believe that it is too early to predict the impact, but that the two are likely to be seen as separate routes, not necessarily as competing, and that Standard listings will have little impact on companies' or investors' interest in AIM. One goes so far as to suggest that it is a mistake to introduce Standard listings and that it could be to AIM's benefit.

"I don't think Standard listings will have a major impact. But I think there are a number of distinctly different features about the two markets which will cause some companies to be more suitable for AIM, and some more suitable for Standard listing, largely dependent on what they want out of it. The thing about AIM which a Standard listing doesn't offer is that, if you're going to be corporately active and be issuing paper on a regular basis, to make acquisitions or to grow by whatever means, it's still the case that it's more achievable more readily on AIM than it is on a full listing, albeit a Standard listing."
(Tim Worlledge, Evolution Securities)

"I think when it's understood what the Standard listing is – I'm not sure that very many people yet fully know that it exists, or, certainly, understand what it implies – they will be horrified that the UKLA has actually created such an entity. When that perception is widely understood, it can only do AIM's standing a whole host of good."
(Andrew Buchanan, Octopus Investments)

"I don't think that anyone will have a Standard listing. I would be staggered if any proper investors invested in a Standard listed company. Because you've got absolutely no investor protection. Why would you want to invest in one?"
(Andy Crossley, Invesco Perpetual)

"The Standard main listing route could attract some companies that would have previously considered AIM, but will the institutional investors follow? Given the choice between a UK AIM company that has undergone robust due diligence and suitability procedures as part of their listing, and a Standard listed UK company that may not have been through the same process, I suspect many investors would prefer the former."
(Diane Gwilliam, Baker Tilly)

"This will be interesting. Standard listing is not actually a change to the Listing Rules, except that UK companies are now able to avail themselves of Secondary (now Standard) listing. The regime is, perhaps surprisingly to some, even more flexible than AIM, being Prospectus Rules minimum, and this may attract overseas companies in particular, who may see an advantage in raising money in London and only having to do what would be required in any other EU regulated market."
(Kevin Denham, Baker Tilly)

AIM remains a key market for international growth companies

Although AIM has been through a difficult two or three years, this is much in line with other world markets. International companies may have held off for a little time – or even withdrawn from the UK markets – and it may be more difficult for UK institutions to follow, but our experts remain convinced that AIM has held its position as the leading market for international growth companies. It has perhaps been more resilient in difficult times than some of its international counterparts. So, as markets pick up, they believe that AIM has maintained, even strengthened, its position in world markets, attracting overseas investors as well as overseas companies to the market.

"The London market, whether it be full list or AIM, is still in many ways the most sophisticated stock market in the world and it probably has the most sophisticated investors. Therefore, good companies that want access to the capital markets are still going to be attracted by what London has to offer. AIM is part of the reason that that's happening. AIM is part of the reason that London is a quality financial centre."
(Tim Worlledge, Evolution Securities)

"Relative to other (international markets), it's as good as it's ever been, if not better. Because my impression is that AIM has stayed open in terms of raising money for companies, and I'm not sure that many of the others have. I'm not aware that any other markets got anywhere close to doing that for the type of companies that AIM caters for."
(Clive Carver, finnCap)

"AIM has marketed itself well internationally. It's maintained and probably enhanced its position as the leading growth company market internationally. All markets suffered significantly and smaller company markets were hit even harder. With AIM being the leading market for smaller companies internationally, it attracted some negative comment. I believe, however, that AIM's reputation has been enhanced by what's happened over the last six months in particular and that it's well set for the future."
(Stephen Keys, Cenkos Securities)

The longer term view

Taking the longer term view, our expert panel generally agrees that AIM is largely back on course and does not expect any fundamental change in its nature or structure over the next three to five years. AIM is part of the London market's landscape, has established its position as a market for growing companies and is always likely to be subject to cyclicality and market trends. Having shown its resilience during a difficult period, it has come out stronger to compete in world markets.

Most of our experts believe that there will be some controlled increase in the number of companies on AIM, but at least one expects a little further contraction. However, they generally agree that the companies on AIM will be perhaps larger, better quality companies with genuine growth strategy and potential. Smaller companies with no such aspirations and lower quality companies may find that it is no longer worth being listed or that AIM is not the market for them, so there may continue to be some flow of smaller companies leaving AIM. Those that just want a pro forma listing may migrate to Standard listing on the main market.

"I have no doubt the number of companies will increase again. You just want to hope they all, by and large, are better quality companies, that they are genuine growth companies. AIM should be for growth companies and there's got to be a plan for how they grow. You have to hope that those that decide to de-list are those that either shouldn't be there in the first place, or are pretty much the low-hanging fruit. And that those that do come to market are better quality companies that do have a rationale and a reason for being listed."
(Jonathan Wright, Seymour Pierce)

"There will continue to be a general maturing of the market, with higher quality companies flourishing and less high quality companies questioning whether they should be on the market at all. As a result, the market in three years' time may have broadly the same number of constituent companies as today, but the general quality of those companies will be higher."
(Stephen Keys, Cenkos Securities)

"In the medium term, there should be a strong demand from UK Corporates for equity funding – arising from the shortage of debt and the desire to build businesses from a sound capital base. In this context, I am still optimistic about AIM's longer term outlook."
(Gary Houghton, Baker Tilly)

"Tax incentives for investing in UK companies would go a long way to filling what is an increasing funding gap given the continuing difficulties in obtaining debt finance. Whichever party is elected in 2010, they need to negotiate robustly with Brussels to restore the VCT and EIS reliefs enforced prior to April 2006."
(Kevin Denham, Baker Tilly)

With generally larger, more substantive companies, they believe that there will be greater liquidity and investor interest. This will further raise the Index and company valuations. The market will also be more attractive to companies with genuine growth aspirations and perhaps to more international companies who do not have similar opportunities in their own domestic market.

One or two believe that, with the market maturing and growing, there may be thresholds and perhaps more classification of companies by size or sector – but, hopefully, no stricter regulation or control by the London Stock Exchange.

"One thing that may happen is there's a lower threshold put in place or there's more classification within the market. Because at the minute you've got companies that are tiny and companies that are in the billions all under the same rules."
(Clive Carver, finnCap)

Regulation

In previous Taking AIM reports, we have talked about AIM's light regulatory touch as being one of its key distinguishing features and regarded by most as a cornerstone of its success. Whilst this is still true to a large extent, the last two or three years have seen some tightening up of the rule book – seen by some as simply a formalisation of what was already common practice – in response both to events and to a certain amount of criticism and bad press.

Indeed, one or two of our expert panel feel that continuing to talk of 'self-regulation' of AIM is something of a misnomer.

"Self-regulation is the first line but there is so much oversight these days from the external regulators, not on a deal-by-deal basis, but there's far more intervention now and there has been by the AIM regulation team that the concept of self-regulation is slightly wrongly named."
(Clive Carver, finnCap)

Level of self-regulation working well

Although some saw the tightening up of the rule book as 'lip service' and others as over-regulation, looking back on two or three years of turbulence, many of our expert panel now believe that the work that was done in this respect contributed to AIM's resilience and to its maintaining its reputation during this difficult period, standing it in good stead to face the 2010s.

However, they are generally of the opinion now that enough has been done, and they would be reluctant to see the market hampered by further regulation. Indeed, one or two feel that AIM's performance during the past two difficult years has largely silenced its critics.

"In the current environment, it's as effective as it's ever been. The Stock Exchange has taken a pragmatic approach which is, if you over-regulate it you scare people away, and obviously if you under-regulate it you scare people away for a different reason. I think the balance is right. If you impose too much more then you're effectively going head-to-head with the main market."
(Jonathan Wright, Seymour Pierce)

"If you go much further you may as well just scrap AIM and be on the full list. So, in terms of the frontline regulation, it's gone as far as it needs to. It's wrong to think that regulation will get rid of the risk. The whole purpose of AIM is you're going to have some winners and some losers and trying to regulate out the risk isn't going to work."
(Clive Carver, finnCap)

This view is perhaps shared by many of those involved in the AIM market. Asked about the effectiveness of self-regulation for AIM, the AIM companies themselves remain very positive. Nearly 90% of companies consider it to be 'very' or 'fairly' effective, as they have over the past several surveys (see chart 10). Viewing the tightening up of the rule book in the context of a more buoyant market, AIM investors, whilst less positive than the companies, are less critical of self-regulation than they were in last year's survey, following the free-falling market of 2008. A majority (60%) now consider it to be at least 'fairly effective', compared with less than half (47%) giving this response last year (although still a little below the levels seen in the preceding two surveys).

"There are clear signs that the AIM team are taking transgressors to task over recent years, and that this is becoming effective."
(Kevin Denham, Baker Tilly)

There was some suggestion in the past that some investors equate light regulation with poor performance. Certainly, following the free-fall of 2008, one in three investors in last year's survey agreed with that viewpoint. However, in this year's better performing market, that percentage has halved, to one in six (see chart 11).

"AIM has had relatively few financial scandals or problems in its 14 year history. The Nomad system is respected and copied world wide."
(Paul Watts, Baker Tilly)

Although our expert panel are in general agreement that a reasonable equilibrium has been reached and no further regulation is required, the investors in our survey have generally shown some support for further increases in regulation. However, here, too, they are a little more relaxed in the current environment – just half of them agree that further increases are required, down from two-thirds last year (see chart 12), and close to half disagree, compared with only one in five last year.

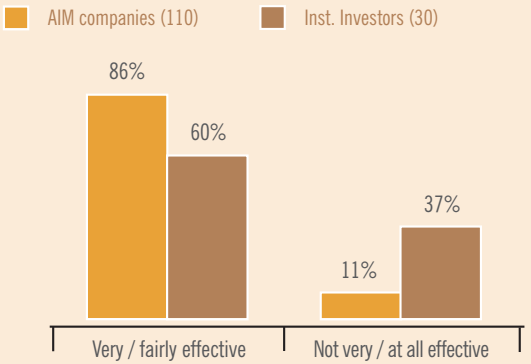
Regulatory compliance takes most company time and resource

Asked the same question about further increases in regulation, not surprisingly, fewer than one in five (18%) of the AIM companies surveyed supported further increases in regulation. Nearly two-thirds (65%) – and particularly the largest companies – disagree with the suggestion.

It is quite likely that they already feel over-burdened by regulation. Asked what aspects of being an AIM listed PLC they find most time- and resource-consuming, one in three or more cited regulatory compliance (37%) and reporting requirements (33%). Both of these were mentioned with greater frequency than last year (up from 21% and 23% respectively) and with greater frequency by those in the Financial Services sector (around half, albeit from a small base of 23).

Chart 10. AIM companies are generally satisfied with the effectiveness of self-regulation, and investors less critical this year

How effective do you think self-regulation is for the AIM market?



Conversely, fewer this year mentioned IFRS (24%, down from 38%) or investor relations (17%, down from 23%): it is possible that they have now become more familiar with the requirements of IFRS, whilst the improved investment climate may have eased some of the pressures on IR. A few also cited corporate governance (6%), the cost of finding good nomads (5%) and managing the share price (4%).

Among the specific reporting requirements, around one in five companies (19%) said that the current environment had made them focus more on the Going Concern reporting rules, much in line with last year's response. Particular comments were expressed about the relationships with auditors and bankers and the uncertainty over raising equity.

"Going Concern remains a key area of focus for all companies in the current climate where banks restrict access to debt."
(Paul Watts, Baker Tilly)

Chart 11. Investors less suspicious 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, 2010: 30)

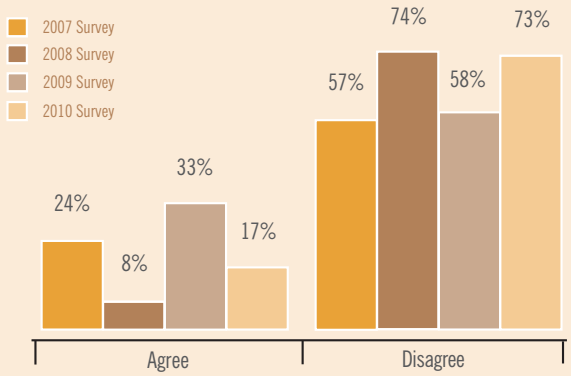
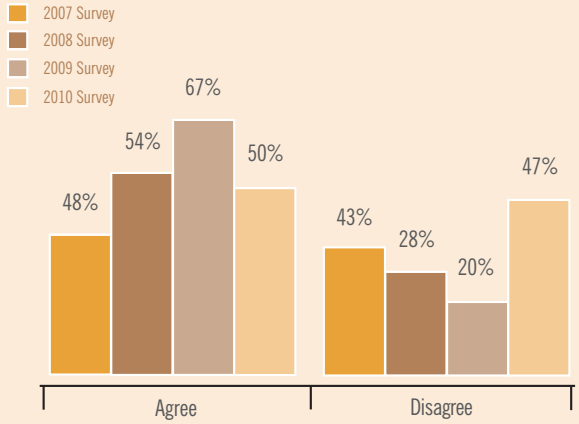


Chart 12. Investors show reduced support for increased regulation of AIM

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, 2010: 30)



Corporate governance

Better, but still room for improvement

Most of the AIM investors in our main survey (73%) agree that good corporate governance is increasingly important in the present difficult environment. However, this is felt less strongly now than it was a year ago – over 90% of investors held this view in last year's survey. It may be that the improved performance of AIM has eased some of the pressure on companies or on investors' scrutiny of their business. However, one of our expert panel suggests that the companies that have survived on AIM are the ones with better corporate governance.

"Investors have put more emphasis on good corporate governance. Companies which have performed well over the last 18 months have tended to be companies with strong corporate governance and good communication with their shareholders."
(Stephen Keys, Cenkos Securities)

Certainly there is some sense that companies have been paying more attention to corporate governance, although our experts suggest that there may be variations in standards. However, whilst last year a majority of investors surveyed (58%) thought that general standards were not good enough, this year little more than one in three express this view, with a majority considering them to be acceptable or even very good (see chart 13).

Several of our experts do believe that companies are now paying more attention to the requirements of good corporate governance, particularly with respect to the appointment and role of non-executive directors. However, they perhaps have a little concern over the need for companies to find non-executives of a suitable calibre and the cost of employing them.

"Good corporate governance really means good non-executives and one of the times you really need good non-executives is when companies get into difficulties. Companies that have good non-executives probably spot problems earlier and maybe come up with more in the way of creative solutions, or face facts earlier. It all comes down to the quality of people you've got as non-executives. That is very much a function of how much you're going to pay them. There is still an attitude that you just need to pay a pittance and people with lots of good commercial experience will flock to the job. You're only going to get better people doing it when you start paying for them."
(Clive Carver, finnCap)

"When you have a difficult economy, it causes more companies to go to the wall or go closer to the wall, and that in turn causes more people to examine themselves and whether they're doing things correctly and whether they could do things better. Companies are thinking a bit harder, and advisors are thinking a bit harder, about the identity of non-executive directors, and they're looking for people who can really make a difference and have the requisite knowledge."
(Tim Worlledge, Evolution Securities)

"Good corporate governance is incredibly important - never more so than when times are tough. But it is vital that we do not go down the road of over-prescription. The more boxes there are to tick, the more time directors must spend ticking them, rather than making a specific assessment of the particular risks and challenges faced by their own company."
(Melanie Wadsworth, Faegre & Benson)

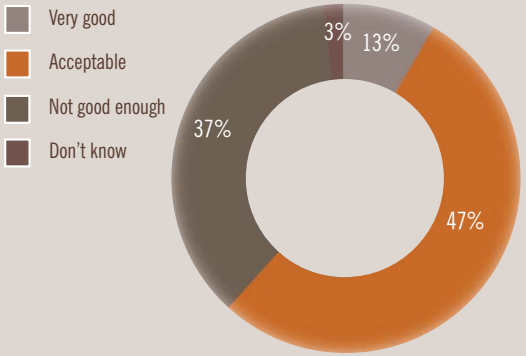
"There is clear evidence that investors are taking much more notice of this and in particular the suitability and independence of non-executive directors is coming to the fore."
(Kevin Denham, Baker Tilly)

"The Quoted Companies Alliance (QCA) Guidelines on Corporate Governance are best practice for AIM companies and could perhaps be codified into the AIM rules to give more focus in this area."
(Paul Watts, Baker Tilly)

Chart 13. Investors are less critical of standards of corporate governance

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

(Base:AIM investors: 30)



“The current economic environment has increased the focus on robust corporate governance and public interest in listed companies on all markets, including AIM, which can be positive. Listed companies with strong controls and corporate governance are likely to be seen in a more favourable light by the market and investors.”
(Diane Gwilliam, Baker Tilly)

Advisers and investor relations

As previous years' Taking AIM reports have emphasised, effective investor relations (IR) is a key ingredient in the successful communications strategy of any listed company. However, it is even more important within a difficult economic environment, at a time when many companies may have limited good news to impart to the investment community. The present upturn in performance may have taken a little of the pressure off IR, but, as preceding discussion has emphasised, the environment is likely to remain fragile for a little time to come.

Indeed, most of those surveyed believe that good IR is more important in a difficult environment, such as the one that companies have been experiencing – and continue to experience. 70% of investors (down slightly from 76% last year) and 59% of AIM companies (down from 76%) say that it is even more important at such a time to communicate well with investors.

Our experts agree that, when times are difficult, it is even more important to keep investors informed and 'on-side'. It is perhaps more difficult for smaller companies to do so, as investors' attention may be drawn elsewhere.

"In these difficult times, you are much more dependent on your shareholders and what they might or might not do if you go to raise money. So, I think there probably has been more attention on making sure that investors are in the loop, and are properly informed about their investee companies, including trading conditions and strategic options."
(Tim Worlledge, Evolution Securities)

"It's particularly important that, where you've got institutional investors and you know you're going to be relying on them in the future, you've got to keep them up-to-date. I think companies who say nothing and then turn up hoping for some cash struggle."
(Clive Carver, finnCap)

"The market does not digest shocks well, particularly in times of uncertainty generally. Keeping shareholders abreast of developments and managing expectations is crucial and investor relations play a key role in this."
(Stephen Keys, Cenkos Securities)

Companies may be spending a little less time on IR

Our experts feel that some companies are becoming more thorough in their approach to IR, and AIM companies suggest that they are taking their IR responsibilities more seriously. Around three-quarters (74%) of AIM companies believe that they have got better at IR since listing, much in line with last year's finding.

On the other hand, having said that they have got better at IR, companies are perhaps spending a little less senior management time on it than they suggested last year. Maybe pressures have eased, but, with market sentiment still fragile, it remains important to keep investors 'on-side'. IR typically takes up to five days of senior management time a month, but the most frequent response is 1-2 days (see chart 14), compared with 3-5 days last time, and only 8% take more than five days, compared with 14% last time.

"The smart companies recognise the value in spending time on IR and others wonder why no one notices what they are doing."
(Paul Watts, Baker Tilly)

In spite of suggesting that they spend less senior management time now on investor relations, with a more favourable investment environment, AIM companies believe that they are getting a better return on this investment:

- 58% of AIM companies say that the input of time and resource to the IR activity is reflected ('significantly' or at least 'a little') in the City's

understanding of their company. This is much in line with last year, although the proportion saying 'significantly' has increased from 3% last year to 24% this year.

- 59% say that it is reflected in the level of interest in their company and its shares, up from 46% last year, whilst the proportion saying 'significantly' has increased from 5% to 17%. Apart from the companies' own efforts, of course, this may also reflect the upturn in the market and increased investor interest generally.

Investors recognise companies' efforts

Although companies may believe that they are getting a better return on their investment in IR, this may be partly a reflection of the upturn in the market. Our experts believe that the companies' efforts are still very variable. And the investors in our main survey, whilst still generally positive, have not registered any apparent improvement in their evaluation of AIM companies' efforts. 60% consider them 'fairly effective', but one in three 'not very' or 'not at all' effective – an almost identical response to last year's (see chart 15).

"I think it's patchy. You need a good PR company but you also need the actual underlying company and the senior management to commit sufficient time to doing it. Those that do normally see it reflected in the share price. It's not just employing an agent to do it and assume they'll do it for you."
(Clive Carver, finnCap)

"Some companies haven't necessarily wanted to raise their profile that much, other companies continue to see it as part of the offer. And if they've got a reasonable story to recount, they've continued to do it. Clearly, when the focus of investors and everything else is in larger companies, you have to work slightly harder to get a focus on yourselves."
(Peter Ashworth, Charles Stanley Securities)

"By and large, the general level of activity has been broadly the same. It's been easier to hide things because there have been bigger stories. Conversely, it's been more difficult to get coverage of good stories because there have been bigger stories at play. So, whilst the activity hasn't diminished, the returns from it may have shrunk a bit."
(Jonathan Wright, Seymour Pierce)

Asked what they consider demonstrates particularly good investor relations practice, investors suggest (unprompted) that they need a good quality of communication, communicating both good and bad news, regularly and in a timely fashion and in an honest and open way. However, it is not always one way – they want the companies to be proactive and to listen more to their investors and their needs and recommendations. The main messages are:

Good communication	67%
Keep investors informed (good and bad news)	53%
Timely / regular communication	40%
Honesty / transparency / openness	20%
Proactive communication	20%
Listen to investors more	20%
Accessibility	7%
Meaningful releases	7%

Chart 14. Investor relations taking less senior management time for AIM companies

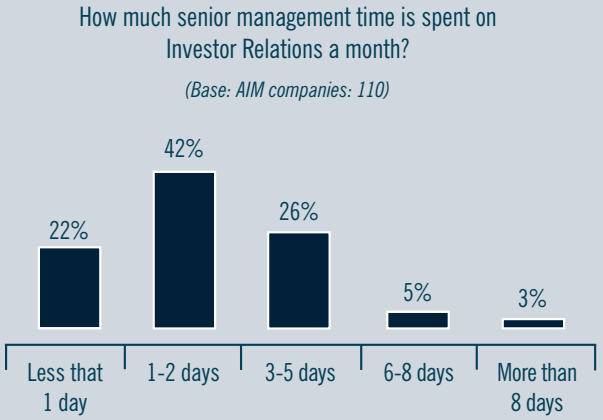
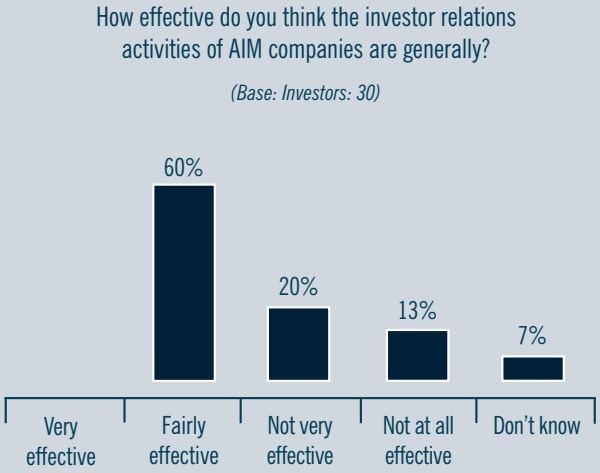


Chart 15. Most investors consider AIM companies' IR activities to be fairly effective



"(Good IR if) they treat shareholders like owners. It's a mentality that I am the stewardship of the shareholders' funds and that's what you want. You can legislate as much as you like, but if you've got people whose view is, this company is here to give me as much money as it can and make my life as long and easy as possible, then you've got a problem."
(Andy Crossley, Invesco Perpetual)

"Communication with investors is pretty important. Investors tend to be much more involved with small companies, you tend to have a smaller, tighter list of investors and therefore it's that much more important to make sure they know what they're doing."
(Tim Worlledge, Evolution Securities)

"Consistent message is the key, linkage between what you said before, just highlighting the underlying business. If they don't do it, they're missing out on the opportunity, if they think they've got a good business, to attach themselves to new stakeholders and existing shareholders so that people know what the company does and is. And that will be reflected in the rating in the end."
(Peter Ashworth, Charles Stanley Securities)

"You probably have regular investor road shows, your website will be up-to-date and you'll have all your presentations on it. Whilst clearly you can't go and see individual shareholders, you're making sure that the information that is made available to institutions is effectively simultaneously made available to everybody by looking on the website. The good companies are those that are not afraid of doing that. There are always going to be those that don't meet those standards, but they won't get investors and their share price won't go anywhere."
(Jonathan Wright, Seymour Pierce)

The same themes were reflected when investors were asked how they thought AIM companies could improve the effectiveness of their IR activity. However, in addition to messages of timeliness, honesty and clarity, some also express a need for more personal communication and better use of web-accessible information. Main suggestions are:

Quality of communication / information	50%
Honesty / transparency / openness	37%
Clear communication	33%
Personal / face-to-face communication	27%
More / better web-accessible information	20%
Listen to investors more	17%
Better research	7%
Better IR / PR resource	7%

"It's all to do with news flow and making sure that whenever there's something worth saying that it is said, in detail. It's not just talking to the markets at the time of the full year and half year results, but actually making an effort to let people know how things are going in between as well."
(Clive Carver, finnCap)

"It's just individual willingness to talk to their shareholders, and a willingness to make time to talk to potential shareholders. There are always two groups of people, one that is invested in the company and the others, and of course you do need to keep working hard at the latter and it just takes time."
(Andrew Buchanan, Octopus Investments)

Ongoing support

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

Just under half of all UK 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 a small number are more critical. This does represent a marginal improvement from last year – the percentage rating advice from their nominated adviser as 'excellent'/'very good' has increased from 42% to 48%, and from their auditor 37% to 44%, and, in both cases, the small proportion rating them as 'not very good'/'poor' has halved.

However, advice from corporate lawyers continues to be more highly valued. Nearly two-thirds rate it as 'excellent' or 'very good', although this shows no movement from the response received last year.

A shrinking pool of nomads aware of responsibilities
With the dramatic decline of IPOs over the past two years, the AIM nomad community has also faced difficulties and become smaller and more concentrated. The tightening of the nomads' rule book early in 2007 also focused attention more on their role in guiding AIM companies, albeit that most suggested that it was just a formalisation of their existing practice.

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, and perhaps introduced a greater degree of consistency and higher quality of service. One or two also suggest that nomads have had to be more proactive in steering their clients through a difficult period over the past two years.

"There is no doubt that nomads are much more aware of their responsibilities than perhaps they were a number of years ago. The quality of advisers, and therefore the quality of the companies that are coming to the market, has improved."
(Stephen Keys, Cenkos Securities)

However, only a minority of UK AIM companies say they have noticed any change in their nomad's proactivity during the past year (60% 'no difference'). Nevertheless, around one in four (22%) do feel that their nomad has been more proactive. In the main, this relates to their more regular involvement with the company and their greater knowledge of AIM and its requirements.

"Nomads have had a tough year, with few IPOs, pressure on fees and continuing consolidation in the sector."
(Paul Watts, Baker Tilly)

"We changed nomad through the year and the new one was more proactive and in regular contact regarding any activity."
"Regular updates, meeting with staff on day-to-day basis."
"They've got much more involved with the institutional side of things. Being much more aggressive corporate finance-wise to put us in front of new shareholders."
"More focused on corporate activity, share prices and level of activity in general."
(AIM companies)

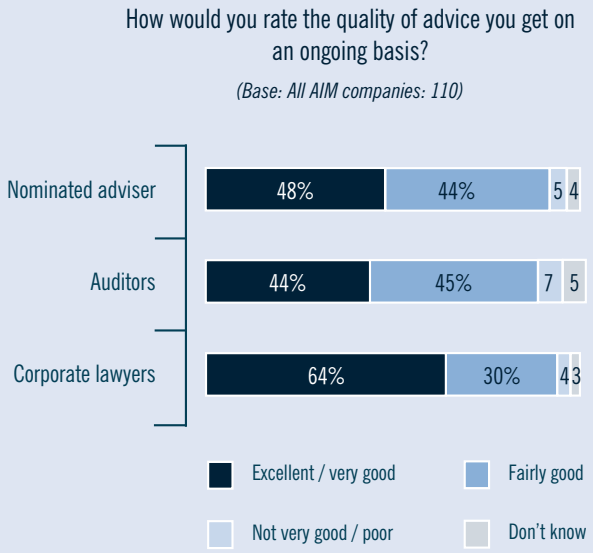
On the other hand, one in six feel that their nomad has been less proactive, citing infrequency of information, lack of involvement and a feeling that they are over-stretched.

"They don't understand the importance of liquidity and managing investments."
"We were not told AIM rules changed halfway through this year."
"They have taken much less interest in our organisation in general."
"They have lost a lot of staff so have an increased workload themselves."
(AIM companies)

"There has been a trend over recent years, particularly at the lower end of the market, for new entrants quickly to become disillusioned with their nomads, sensing that they lost interest as soon as the next IPO came along. Of course, the best nomads always did take their ongoing responsibilities seriously, but a tightening up of the rules (or, at least, greater visibility in their enforcement) does appear to have led to increased engagement by many nomads. This can only be good news for AIM companies and for the reputation of the market."

(Melanie Wadsworth, Faegre & Benson)

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



Methodology

This is the fourteenth 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

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

- Most respondents are at CFO / FD (47%) or CEO / MD level (15%), the remainder comprising Chairmen, other executive directors and non-executive directors.
- The companies represent a spread of region: 42 in the London region, 26 South, 19 Central and 23 North.
- Companies represent a spread of sector, in particular financial services (21%), telecoms / IT / technology / media (19%), manufacturing and engineering (15%), resources and mining (15%) and business services (13%).
- Companies represent a spread of market capitalisation: up to £10m (46%), £10m-£50m (41%) and £51m+ (13%).

Institutional investors

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

All telephone interviews were conducted between 22nd January and 15th February 2010.

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 2009, current trends, the outlook for 2010 and a longer-term view. Interviews were conducted between 3rd and 16th February 2010. Questionnaires were also completed by seven 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

Clive Carver
Head of Corporate Finance
finnCap

Stephen Keys
Cenkos Securities

Tim Worlledge
Corporate Finance Director
Evolution Securities

Jonathan Wright
Managing Director
Seymour Pierce

Analyst

Peter Ashworth
Head of Small Company Research
Charles Stanley Securities

Fund Managers

Andrew Buchanan
Fund Manager
Octopus Investments

Andrew Crossley
Fund Manager
Invesco Perpetual

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Chilton Taylor
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Kevin Denham
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About Faegre & Benson LLP

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

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

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

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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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