



White Paper

Is AIM the natural home for
US small and mid-cap
companies?



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About Osborne Clarke

Osborne Clarke is a European law firm that provides business-focused legal solutions to a wide range of organisations. With a presence in the US and offices across Europe, we are one of the world's experts in AIM transactions. Over the past 10 years we have advised on more than 70 AIM flotations, many involving international companies.

In 2005, we published a paper entitled 'Is AIM the new NASDAQ?'. That paper highlighted the differences between NASDAQ and AIM and examined the benefits and challenges for US companies considering admission to AIM as compared to NASDAQ. Since the publication of that paper, the internationalisation of AIM's membership has strengthened, with more than 45 per cent of the 462 admissions in 2006 being non-UK companies. The year also saw the near doubling of US representation on the market to 57 companies. This paper examines the case for AIM, reflects on the trends of the past 12 months, and highlights key current issues for US companies considering AIM.

Introduction

Is AIM really the natural choice for US small and mid-caps?

Today, global capital markets are experiencing huge change. Now 35 years old, NASDAQ has grown from a junior market for fast-growth companies into a market senior in all but name. As the minimum realistic size for a NASDAQ IPO continues to rise, small and mid-cap companies are asking if the benefits of a NASDAQ quotation outweigh the costs.

Alternative markets have had to step up to the plate - in particular, the AIM market of the London Stock Exchange (LSE), which has been embraced by many as 'the new NASDAQ'. Others regard AIM as an option only for companies incapable of reaching NASDAQ, or as a market that is yet to prove it has a regulatory structure to inspire long-term investor confidence. In this paper, we ask if any of these perceptions are correct. Has AIM become today what NASDAQ was yesterday - a stable platform critical to public fundraising for younger, fast-growth companies?

In Europe, we believe the answer is 'yes'. Small and mid-cap investing is viewed as mainstream by the London financial community, and investors have developed a sophisticated understanding of the risk profile of AIM companies.

But is AIM also ideal for non-European companies - particularly US companies? Osborne Clarke has been involved in AIM admissions of companies from around the world, and our answer here is 'perhaps'. It's not the ideal environment for every company - but, in the right circumstances, AIM can be a more natural 'fit' for US companies, and a more attractive alternative than NASDAQ.

The subject of US interest in AIM has attracted recent press attention, particularly with regard to regulatory issues and the recent performance of US companies on AIM. This paper is intended to give the insight of one of AIM's key professional advisers to the attractions of the market for international companies and the practical impact that AIM is having on the choice of market for US companies. We hope this paper will help you decide whether AIM is appropriate for your company.

Andrew Gowans

Partner

Osborne Clarke
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AIM - the new international market of choice?

What makes a 'junior market'?

To understand why AIM has recently become successful, it is first important to understand the need for a global junior market - and the best way to do that is by looking at one of the most successful junior markets worldwide, NASDAQ. First established in 1971, it has transformed the way investors look at emerging industries.

NASDAQ, arguably, created the first market focused on sectors such as IT, biotech, and media and communications at a time when no other market catered adequately for companies in these sectors.

Now, 35 years later, NASDAQ is so successful it has outgrown its beginnings. Its dynamic has changed and it is dominated by some of the world's largest businesses, like Microsoft and Google. NASDAQ's average market capitalisation is well over US\$1 billion.

NASDAQ has effectively become a senior market and, in the view of transatlantic investment bank Canaccord Adams, "it is no longer a hospitable place for companies with less than US\$250m capitalisation". As an example, 48.7 per cent of NASDAQ companies of this size - exactly the small/mid-cap companies so welcome on AIM - have no assigned analyst. The lack of analyst attention translates directly to poor liquidity. Another key factor is compliance costs, with the US governance regime currently making little distinction between the governance obligations imposed on these companies and some of the world's largest multinationals. Contrast AIM, where every stock has at least one market-maker, and the vast majority have analyst coverage, the 'light touch' governance regime can be tailored to a level appropriate to the size and evolution of the company. Also, the integrity of AIM as a junior market has historically been maintained through

the 'graduation' of larger AIM companies (such as Tribal Group) to the LSE 'main list'.

That is partly why AIM became such a talking point in 2004 and 2005. A junior market with global reach first established in 1995, it now has more than 1,600 members.

Like NASDAQ, it has a range of smaller, mid-sized and even some large companies. The largest AIM quotation has a market capitalisation of more than £2 billion. Like NASDAQ, AIM embraces a range of high-growth potential sectors, with particular strength in all forms of technology. But AIM offers a level of engagement for mid-sized companies that is simply not available in more senior markets such as the NYSE, the LSE and, arguably, NASDAQ. In London, small/mid-cap investing is vibrant and in AIM the LSE has created a highly effective platform through which to channel strong investor appetite for growth companies.

The international junior market of choice

AIM added 462 companies in 2006, and that's on top of the 874 new members in 2004 and 2005. In each of the past three years of high growth, the ratio of non-UK companies admitted has continued to rise, with 2006 seeing international companies account for a record 45 per cent of admissions.

But is AIM a sensible option for small/mid-cap companies from all countries and industry sectors? We believe that AIM is in many respects already the junior market of choice for the UK, Canada and Australia. But is this true for the US?

The US remains home to an overwhelming number of the world's fast-growth companies, and the growth in US interest in AIM that we have predicted for some time has certainly materialised. The number of US companies quoted on AIM doubled in 2005, and nearly doubled again in 2006, with 24 joining the market.

AIM - the new international market of choice?

But have those companies made the right decision?

"On AIM, your liquidity is very closely related to how much demand you create. You need to bring yourself to the attention of institutional investors out actively looking for large blocks of shares. Going to AIM is making a commitment to a very different style of market - but there isn't another junior capital market with the same credibility anywhere else in the world."

John Voltz, Jane Capital Partners, LLC, US

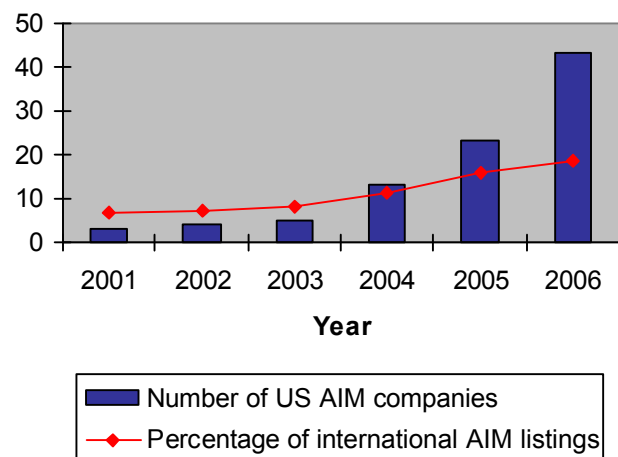
AIM - the new international market of choice?

"The listing mechanics and corporate governance requirements on AIM are good for a high quality growth company of our size. It accelerated our ability to raise funds to grow to the next level and continue to be competitive against large organizations. With required financial reporting only every six months, we have the structured discipline to report, but we are not overwhelmed by the cost and management time that quarterly reporting requires. The sophisticated investors of the AIM community give our company the flexibility to structure our growth in a dynamic market and to stay focused on our fast moving business, which in turn gives us a run at success."

Rafferty Atha, General Counsel, Ubiquity Software Corporation

Percentage of International AIM Listings & Number of US AIM Companies 2001-2005¹

Percentage of International AIM Listings & Number of US AIM Companies 2001-2005



¹ Source: London Stock Exchange

The 10 key benefits of AIM

To understand AIM's success, look at the unique structure, market dynamics and regulatory environment. Here are 10 important factors that have attracted fast-growth companies from around the world.

1. Earlier access to capital for growth companies

In the early stages of development, it is helpful for a company to be a big fish in a medium-sized pond - exactly the kind of opportunity offered by AIM. More than 40 per cent of the companies quoted on AIM have a market capitalisation of between £25 million and £500 million. Fewer than 5 per cent have a market capitalisation over US\$500 million, which is the level commonly felt to be the minimum realistic projected IPO for new entrants to NASDAQ.

2. Focus on the needs of small/mid-cap companies

AIM was specifically set up as to cater for the needs of growth companies. The investors, nominated advisers and other professionals active in the market typically focus mainly on AIM, rather than treating it as 'poor cousin' to the senior markets. A significant example of this focus is that every AIM company is covered by a nominated 'broker' and many AIM companies frequently find themselves being covered by multiple analysts. Contrast NASDAQ, where nearly half the sub-US\$250 million stocks have no assigned analyst.

Whereas NASDAQ has become dominated by some of the largest corporations in the world, a factor in preserving the integrity of AIM as a junior market is that some larger AIM companies 'graduate' to the LSE 'main list'.

Average market capitalisation per company

AIM: US\$66.5 million
NASDAQ: US\$1.13 billion

Source: Canaccord Adams 2006

3. Professional and reputable investor base

AIM is predominantly an institutional market, with professional investors specialising in small/mid-cap stocks. This means that AIM investors understand the risk profile of growth companies better than retail investors, and tend to invest with a longer-term view. As a result, AIM companies tend to experience less price volatility than small/mid-cap companies quoted on other markets.

The quality of those investors is of the highest level. The top 10 AIM investors in recent years have included Fidelity, Merrill Lynch Goldman Sachs and UBS.

4. Few 'qualifying conditions'

Unlike NASDAQ, which specifies a minimum trading record, capitalisation, offering price and level of shares in public hands, AIM is extremely flexible.

- No minimum market capitalisation
- No minimum offer price
- No trading record requirement
- No minimum number/value of shares to be in public hands

For US companies, there are important extra areas of flexibility.

- No requirement for UK corporate structure
- Shares can be denominated and quoted in US\$
- Financial reporting in US GAAP

5. Streamlined admission process

A company that meets AIM criteria can be admitted within as little as two or three months from first appointing a Nominated Advisor (or 'Nomad') and other professional advisers. In part, this is because the typical AIM 'IPO' process bears many of the characteristics of a private institutional placing, rather than a retail offer. The regulatory structure of AIM means that it is the Nomad's responsibility to ensure that the admission document complies with the AIM

The 10 key benefits of AIM

rules. There is no Securities and Exchange Commission (SEC)-type review of the AIM admission document by the UK regulatory authorities.

6. Lower costs

AIM charges an admission fee of £4,340 (approx \$8,000) and the same amount each year for its annual fee. The same fee applies regardless of the company's size. This is significantly lower than most other markets - NASDAQ, as an example, requires admission fees of up to US\$150,000 and annual fees of between US\$17,500 and US\$75,000. Data from Canaccord Adams suggests that the total cost (including all professional fees and underwriting commissions) of an AIM IPO for a US\$50 million company is 25 per cent less than the cost of listing on NASDAQ. The table below shows the ongoing annual costs of maintaining a quotation.

Estimated costs of being a \$200M public company today¹

(\$ US)	NASDAQ National Market	AIM
Directors & Officers Insurance	~\$500,000	~\$100,000
Directors Fees & Expenses	~\$150,000	~\$150,000
Annual Audit Accounting Fees	~\$300,000	~\$150,000
404 compliance	~\$500,000	N/A
Legal Fees	~\$300,000	~\$300,000
Internal Costs for SEC & Exchange Compliance	~\$300,000	N/A
SEC Filing Expenses & Listing Fees	\$35,000	~\$7,000
Nomad Expenses	N/A	~\$90,000
Other (Investor Relations, Mailing, Printing, Travel, etc)	~\$250,000	~\$125,000
Total Approximate Cost	~\$2,335,000	~\$1,324,000

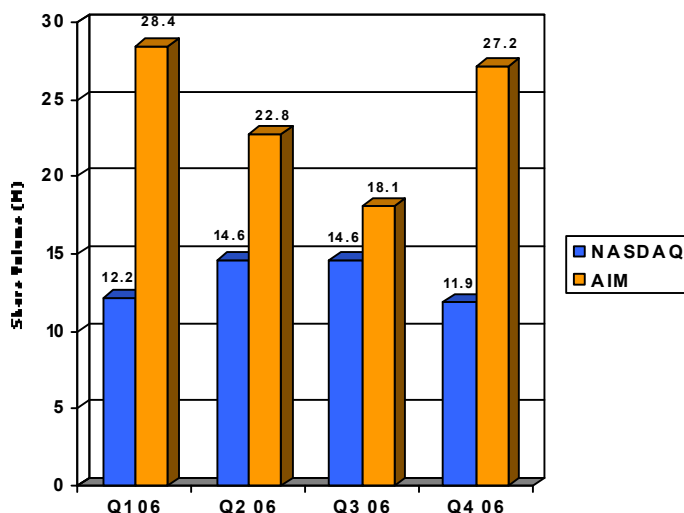
¹ Costs are drawn from Canaccord Adams estimates based on recent similarly sized companies.

7. Attractive liquidity for small/mid-cap companies

It is certainly true that NASDAQ has significantly higher average volumes and value of trading than AIM. However, for small/mid-cap companies - many of which are thinly traded on NASDAQ - AIM provides a liquidity advantage, as shown by the table below.

Average Share Volume / Company for companies with Mkt. Cap. of \$100M-\$400M²

Average Share Volume / Company for companies with Mkt. Cap. of \$100 M - \$400 M



² Sources: FactSet. Data is for the Nasdaq Composite and AIM All Share indices as of Jan. 25, 2007. Conversion rate for AIM data is the average exchange rate per quarter. Dollar volume calculated per security as average share price per quarter times total shares traded per quarter.

The 10 key benefits of AIM

The introduction of the AIM 50 and AIM 100 indexes has encouraged some funds to develop AIM tracker products, which has improved liquidity across the market. In addition, AIM has also recently introduced the order (as opposed to quote) driven SETSmm trading platform designed to reduce price spreads and, again, improve liquidity.

8. 'Light touch' governance regime

AIM's regulatory structure attempts to balance the need for investor confidence with avoiding excessive burden on growth companies. The LSE has delegated much of the compliance responsibility to the Nomads. In practice, AIM companies follow governance best-practice guidelines based on the same 'Combined Code' that applies to companies quoted on the LSE main market. However, in keeping with the flexibility inherent in other aspects of the AIM structure, Nomads can sanction governance that falls short of 'Combined Code' standards, provided there are appropriate internal controls for a company of the size/type in question, and full disclosure is made in the admission document. This system has come under intense scrutiny in recent months, with some concern being voiced about the varying practices between Nomads. As a result, the LSE has responded by codifying Nomads' responsibilities generally.

9. Simplified shareholder reporting/consent mechanisms

AIM does not have a quarterly reporting structure. Companies are required to file annual accounts and to make a short form half-yearly interim statement. Non-UK companies are not necessarily obliged to adopt UK accounting standards; US companies can report in US GAAP. In addition, only the most significant corporate events (such as reverse takeovers) require a shareholder vote; most M&A activity, director changes and other events can be dealt with through a simple regulatory announcement.

10. Ability to raise further funds through secondary market

Because the shareholder profile of a typical AIM company is largely institutional, it is often a relatively simple matter for the Nomad to gauge the level of market appetite for secondary fundraising, and to then execute the offering quickly. Many AIM companies have repeatedly 'returned to the market' for further funding, and data shows that more than half of the money raised by AIM companies in 2006 was through secondary fundraising mechanisms.

Issues specific to US companies

Many US companies are actively exploring AIM, but not all of them will find AIM a sensible place to be publicly traded. There are a number of important issues to consider.

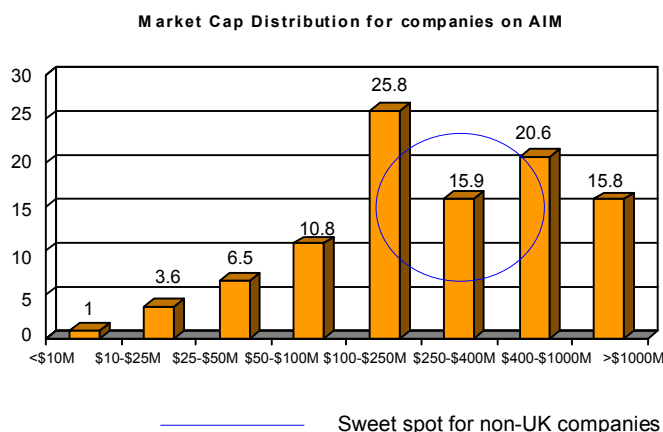
UK presence/business

There is certainly no formal requirement for a company seeking an AIM admission to have a UK presence, or even to be doing business in the UK - and many AIM companies have no connection with Europe whatsoever. However, some AIM investors will look less favourably on such companies, which can have a negative effect on valuation and liquidity. Some US companies with no existing European element to their business have been able to raise funds in London on the basis that those funds will be used to develop European revenues.

Average size of non-UK deals

While the average size of AIM companies is a market capitalisation of US\$100 million, it is important to understand that for non-UK companies the average is considerably higher. This is perhaps because the additional risk (perceived or imagined) in investing in and monitoring overseas companies means that Nomads generally feel that only the larger deals are worth pursuing.

Market Cap Distribution for companies on AIM¹



Exit strategies for venture-backed companies

Venture-backed companies - which account for a significant proportion of growth companies - must clearly consider the interests of their investors. AIM presents some downsides for venture investors compared to NASDAQ, the most obvious being that a typical lock-in for major investors would be at least a year (twice as long as NASDAQ). However, for most companies, the possibility of an IPO will arise much earlier through AIM than NASDAQ, and for some, liquidity may be better on AIM. Also, unlike NASDAQ, it is sometimes possible for venture investors to exit (in whole or in part) at IPO. To date, AIM has allowed US venture capitalists to 'exit' more than US\$500 million at IPO.

¹ Source: FactSet and LSE AIM Statistics, Data as of Oct. 31, 2006 Conversion rate for AIM is \$1.96/£

Issues specific to US companies

Impact of US securities regulation

For US companies, any form of offering of securities is regulated by US securities law. Generally, US companies will seek exemption from the need to register the offering with the Securities and Exchange Commission (SEC) because of the burdens and restrictions inherent in registration. In order to fall outside SEC control, an offering made on AIM cannot generally be 'directed' into the US, and must also comply with the requirements of Regulation S of the Securities Act. The requirement to avoid any form of 'directed selling efforts' into the US catches not just overt marketing (such as investor road-shows or advertising) but can also present challenges with communications to US-based staff. The more significant issue is the restriction inherent in Regulation S, which requires that the stock issued in the offering is treated as "restricted stock". If not carefully handled, this can cause significant issues both for the AIM company and the investors (see below for detail).

Impact of US governance legislation

There has been much press comparison between AIM's 'light touch' governance/compliance approach and the impact of the Sarbanes-Oxley (SOX) legislation on US quoted companies. Many US companies cite the burden of SOX as a key reason for considering AIM. However, it is important to realise that SOX can potentially apply to any US company, and that the 'trigger' for SOX compliance is primarily the number of shareholders the US company has (regardless of where those shareholders reside). As a result, an AIM-quoted US company with a wide investor base could find itself subject to UK governance requirements as well as SOX.

Recent AIM market trends and regulatory developments

Frequently asked questions:

As one of the key AIM advisers, with a presence in both London and the US, we hear much market comment, on both sides of the Atlantic. We have set out below some of the most frequently asked questions in relation to the most recent trends and developments.

Do companies tend to get better valuation on NASDAQ than AIM?

There will always be individual cases where a better valuation could be found on one market compared to another, but there is no general trend to suggest that NASDAQ consistently provides better valuations than AIM.

Is 'light touch' governance viable for growth companies?

Recent corporate scandals have led to press attention on the issue of whether AIM's regulatory structure has enough substance. However, it would be a mistake to think that AIM's regulatory structure allows companies to ignore or bypass governance issues. While the AIM approach is more flexible and measured than NASDAQ, the UK system of 'best practice' in corporate governance has evolved over 15 years and the Nomads go to considerable lengths to investigate internal controls and recommend appropriate changes to maintain investor confidence. However, in recent months the LSE has recognised the need to codify much of the unwritten practice on AIM governance into a more identifiable set of guidelines for Nomads. Nevertheless, as with any market, there will always be some potential for corporate misfeasance. AIM is no exception but, statistically speaking, there have been relatively few instances in AIM's 12-year history.

AIM is rapidly expanding, and there are a finite number of Nomads. What does my company need to do to get their attention?

Over the past 12 months, as both domestic and international interest in AIM has strengthened, Nomads have been presented with many more opportunities than they can possibly take forward. Also, 2006 saw periods of market instability, the net result being an over-supply of candidates against investor demand. Therefore, most Nomads have begun to introduce (formally or informally) minimum thresholds for companies they are prepared to promote. Although the levels vary, and there are always exceptions, at the time of publication of this paper, it would be very difficult for a pre-profit company to attract Nomad attention, and the minimum realistic level of projected market capitalisation is £20 million (higher for non-UK companies).

What is the effect of Regulation S on US company AIM stocks and hasn't the LSE introduced recent changes to help?

The restrictions on resale to US persons imposed by Regulation S create a number of challenges for AIM-quoted US companies. The most important is the requirement that the physical stock certificate bears a legend setting out the relevant restrictions. Settlement of non-US AIM stocks is electronic, through the 'CREST' system. The Regulation S requirement for legended stock certificates means that Regulation S stock cannot be settled through CREST for the period of the Regulation S restrictions. Because electronic settlement is not possible, physical settlement is required. This has led to US companies trading two 'lines' of stock, one with the Regulation S restriction and the other without. The settlement delays and resale restrictions inherent in the Regulation S stock has often led to that stock trading at a discount to the unrestricted stock. However, much of the restricted stock is often held by major investors and/or directors or officers of the company, for whom sale of the

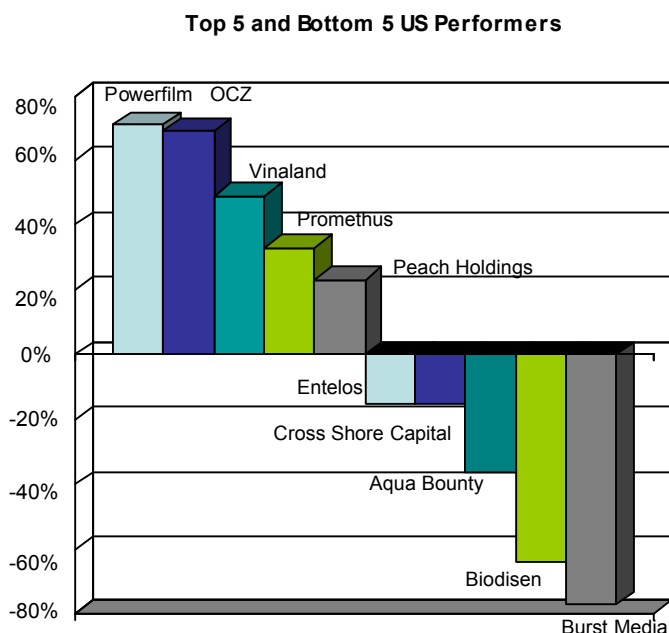
Recent AIM market trends and regulatory developments

restricted stock would not be possible during the period of their lock-in. The LSE has recently promoted alternative settlement systems intended to address some of these issues, although it remains to be seen whether these systems will be effective.

What's behind the recent press comment on the under-performance of US companies on AIM?

Just like any other market, there have been some notable successes and some disappointing under-performers. This is not peculiar to AIM, or to US companies on AIM. The chart below shows the top five and bottom five US performers on AIM. In overall terms, on a weighted basis, US companies on AIM outperformed the AIM All-Share index by 37.6 per cent in 2006.

Top 5 and Bottom 5 US Performers¹



¹ Source: First Columbus

Is AIM a viable 'stepping stone' to a NASDAQ IPO?

There is evidence that some of the US companies that have joined AIM have taken the opportunity AIM presents to become a quoted company earlier than NASDAQ would allow, with the possibility of eventually achieving a US listing. However, there is also some evidence that US companies that have taken the leap to AIM like what they have found in London, and the costs and challenges involved in a dual listing or delisting/relisting process potentially outweigh the perceived upsides of moving their listing to NASDAQ. Although the 'stepping stone' approach is viable, we believe that few companies will actually adopt it.

Can AIM sustain the growth of recent years in 2007?

Most market commentators are predicting that 2007 will see a decrease in the number of new companies admitted to AIM. However, even the most pessimistic forecasts still indicate that 2007 will see hundreds of companies join the market, and all predictions put 2007 growth in AIM at significantly higher levels than NASDAQ.

"AIM is a uniquely global market for smaller growing companies, offering ambitious companies from across the globe access to levels of investment capital and profile that they are unable to gain elsewhere. However, in order to make the most of their AIM quotation, overseas companies must be aware of the additional steps they must take and the competition for investment funds and public profile they will face."

Martin Graham, Head of AIM

Is AIM the natural home for small/mid-cap companies?

Growth companies worldwide are answering that question. The extraordinary number of admissions to AIM in each of the last three years speaks for itself, and is far in excess of growth achieved by any other capital market worldwide. AIM is now a truly global market, and demand to become part of its success is also global. Companies from a wide range of jurisdictions are eyeing the opportunity. Although the number of US companies quoted on AIM has recently doubled, the US is still under-represented considering the huge proportion of growth companies that the US has historically produced. We believe that US representation on AIM will continue to increase for as long as the fundamental strengths of AIM continue to offer significant benefits over NASDAQ in terms of:

- Long-term, high-quality knowledgeable institutional investors
- Focus on small/mid-cap companies
- Attractive valuation and liquidity for those companies
- Simplified, low-cost regulatory environment

But US companies considering joining AIM must be careful that they do so for the right reasons. The AIM investor community is relatively small and highly experienced in analysing growth companies; it is fast to pick up on good opportunities but possibly even faster to reject proposals that lack credibility. So US companies must carefully position their offering and seek the right advisers.

AIM is already bringing significant benefits to many international companies as a true global junior market. Joining AIM is not a trivial process. But it can bring enormous benefits to your business.

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Is AIM becoming the new global junior market of choice?

Is AIM becoming the new global junior market of choice? Osborne Clarke's AIM expertise has guided our clients through over 20 IPOs and many secondary fundraisings in the last 12 months, raising well over £350 million. We are a large UK law firm (recently awarded UK Law Firm of the Year by Legal Week magazine), with a level of business insight that will surprise you. We also have offices in the US and across Europe.