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INTRODUCTION TO DIRECTAIM Q1 2016

2015 was the year of the 20th anniversary of AIM and this landmark proved to be a mixed year for the index. On the one hand the total number of companies listed on AIM fell by 52 during 2015, with just 39 IPOs, whereas on the other the index grew faster than the main market over the past year.

As we now enter 2016 there are plenty of reasons to be positive about the prospects for companies within the index: we are still seeing a continuing rise in consumer confidence, and the fast growth, agile and reactive businesses of the AIM index are well placed to capitalise on this trend. Furthermore, with Banc De Binary recently revealing that the number of AIM-listed companies paying dividends has risen for the third year in a row, coupled with the underperformance of high profile large cap shares, AIM is looking increasingly attractive as a place for safe returns.

In this issue, our usual SectorWatch shows that Technology & Media and Leisure & Hospitality have been the star performers in the last quarter whereas the Natural Resources sector has continued to struggle. We look at corporate reputation: the possible cost to AIM companies and what they are doing to address the issues. We also review the pros and cons of a move from AIM to the main market, take a look at Petra Diamonds who made just this move and highlight a number of tax changes that could affect AIM companies.

I hope you find this edition of DirectAIM an interesting read but please do contact me if you would like more information on anything discussed.



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BDO AIM SECTORWATCH

The twentieth birthday of the AIM Index in the second quarter of 2015 attracted some pessimism from the journalist community, with many still dubbing it the "casino" index due to its less strict trading regulations. Marcus Stuttard, Head of AIM, was quick to defend the index, claiming it provides smaller firms with access to capital and the ability to grow without the costly and time consuming administrative demands faced by larger publicly listed peers.

Companies who currently rely on the index for growth, as well as those who are considering a listing in the near future, may have hoped that the index would enter its third decade of existence on a more positive footing. However, the new decade has not started well: the total number of companies listed on AIM fell by 52 during 2015 (compared to a net increase of four in 2014) and there were just 39 IPOs on the index during the year.

Whilst this drop in companies can hardly be a cause for celebration, it is also symptomatic of the index's success. The index has a long history of attracting mining and natural resources companies and many Chinese companies, riding on the wave of success of the Chinese economy, sought AIM-listings in order to provide access to capital in western markets. The

global collapse in commodity prices coupled with the well-profiled slowdown in the Chinese economy means the index has been affected more than any other by the macroeconomic environment.

Recent statistics released by the London Stock Exchange show that the number of AIM listed companies, whose primary operations are in China, fell from 55 at the start of 2015 to 37 by the end of the year, many due to the inability to find an advisor to work with. Furthermore, of the 37 that are left, 30 are now trading below their IPO price whilst the rest of the AIM index has risen by 3%.

Despite all of these issues, the index has quietly been growing faster than the main market over the past year. This can be attributed to rising consumer stocks – low inflation, rising wages and an ever

decreasing threat of an imminent interest rate rise – meaning sectors such as leisure, travel and food & drink have enjoyed a strong year. Some companies saw unprecedented growth on the back of this increased consumer confidence: Fever-Tree Drinks, which only joined the index in November 2014, saw its share price jump by 160% over the course of the year.

The AIM index may have stuttered over recent months, but there are certainly plenty of reasons to be positive about the prospects for companies within the index over the coming year: the continuing rise in consumer confidence looks set to continue, and the fast growth, agile and reactive businesses of the AIM index are well placed to capitalise on this trend.

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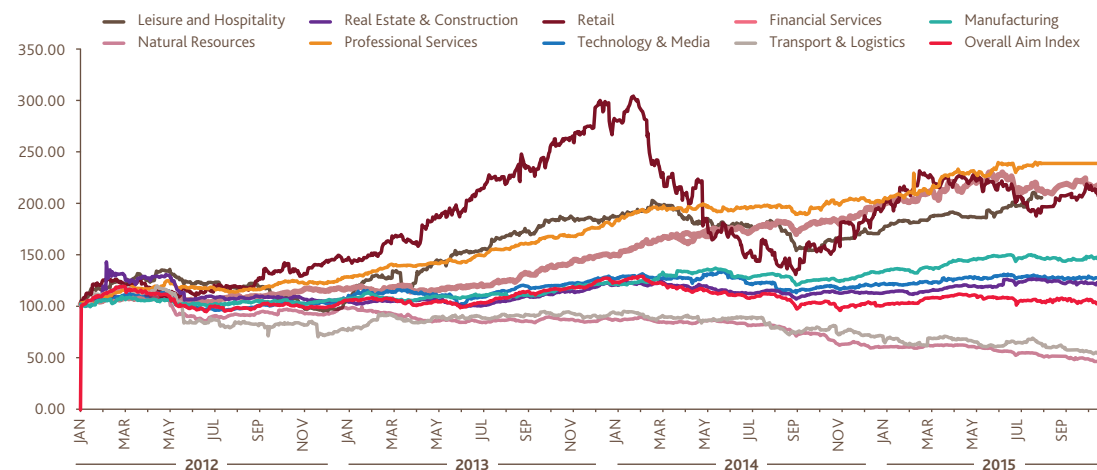
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SECTOR SHARE INDEX

AIM INDEX BY SECTOR: JANUARY 2012 TO 31 DECEMBER 2015 (REBASED TO 100)



SOURCE: Bloomberg; Values rebased to 100 on 2 January 2012

BEST PERFORMING SECTOR INDICES ON AIM THIS QUARTER

+7.73%

LEISURE &
HOSPITALITY

+6.27%

TECHNOLOGY
& MEDIA

+4.5%

MANUFACTURING



WORST PERFORMING SECTOR INDICES ON AIM THIS QUARTER

-18.15%

NATURAL
RESOURCES

-11.49%

TRANSPORT
& LOGISTICS

-2.9%

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TECHNOLOGY AND MEDIA SHINES

Technology companies within the AIM index have received a bad press over recent months, with Monitise taking most headlines after the stock plunged 90% over the course of the year and the company churning through three chief executives in the process. Telematics provider Quindell has also rebranded itself as The Watchstone Group following one of the biggest scandals in AIM's recent history.

However, behind these two high profile stories over recent months, there have been success stories amongst many AIM-listed technology players: APC Technology Group recently saw its share price leap as one of its subsidiaries won four major LED lighting contracts worth over £11.15m.

Other technology companies are using capital raised through their AIM-listings to invest in innovation for growth: Motive TV is on the verge of launching TabletTV Plus which effectively allows tablet TV devices to turn into a portable television and video recorder. DDD Group meanwhile saw its shares rise by 7% after announcing that it had strengthened patent

protection for its video and image processing technology. The growth of television technologies is also responsible for analysts upgrading IPTV software and hardware specialist, Amino Technologies, to a "BUY" rating following the welcome market reaction to its products and services which enable broadband operators to deliver entertainment and connected home services to consumers.

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WET WEATHER DOESN'T DAMPEN LEISURE & HOSPITALITY

The Leisure & Hospitality sector has seen increasingly positive results culminating in significant growth in the latter half of 2015. During the rainy summer months, consumers sought indoor entertainment leading to strong annual spending growth in pubs (11.9%), tourist attractions (11.8%) and cinemas (8.9%) according to the Barclaycard Consumer Spending report for the third quarter. This coincides with the data from Greene King's Leisure Spend Tracker for December 2015 (covering November 2015) which found that "ultimately leisure in Britain remains

robust even as consumers' thoughts turned to the festive season". AIM listed Young & Co Brewery has reaped the benefits with strong trading due in large part to the Rugby World Cup which started in September 2015. The boost also contributed to significant growth with the chain opening five pubs during the period and another two due to open in the second half.

On the other side of the leisure spectrum, retail adjacent sub-sectors such as gaming took a hit in the second half of the year. While some of the

larger main market players such as Game Digital plc (GAME UK) saw challenging conditions with total sales for the video games market down 13.5% year-on-year as the switch from older gaming formats impacted sales, the smaller AIM listed players in online gaming saw a boost. In its January 2016 trading update, 32Redplc delivered record annual net gaming revenues in 2015, up 51% to £48.6m, with early trading for the first nineteen days in January up 27% on the corresponding period in 2015.

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NATURAL RESOURCES THE UNSURPRISING UNDERPERFORMER

The global collapse in commodity prices has meant AIM-listed natural resources companies have had a difficult year with many seeing funding dry up in the past year and their share prices fall by 18.15% on average over the second half of the year. With exploration budgets slashed, banks less willing to lend and investors preferring to put their money into safer stocks, the environment is hardly one conducive to strong growth.

There have been many examples of companies on the index showing signs of weakness: Baron Oil recently saw its share price fall by 12% after revealing its planned exit from Columbia will set the company back \$1m, whilst Aureus Mining faces a potential catastrophic situation after it had to halt gold production in one of its major mines following equipment failure.

However, for gutsy investors and more risk averse lenders, the sector does continue to offer some sound investment opportunities: 88 Energy saw its stock performance jump after it announced it had begun drilling at the Icewine well in Alaska, whilst Falcon Oil and Gas saw its share price leap in October after it decided to fast-track to horizontal drilling in the coming weeks.

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SO WHAT HAPPENED TO RETAIL?

We discussed in previous issues of DirectAIM how retail was one of the stronger performers of the AIM index due to it acting as a bellwether for increased consumer confidence. And certain companies are doing well: Asos continues to be the darling of the AIM index, and has continued to gain throughout the year due to analyst upgrades.

However the retail sector endured a particularly difficult summer – one of the worst on record – which caused a catalogue of share price slumps across the sector as cool weather hampered retailers' abilities to shift summer lines. Even Asos hit a seven month low in September, with its share price slumping by 7.4%.

However, although recent news has been dominated by the somewhat poor results by retailer Next and the difficulties faced by M&S, AIM-listed retailers look set to benefit from strong post-Christmas sales which should, in turn, help to satisfy investors' appetites for strong returns.



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is it all it's cracked up to be?

Whilst AIM has offered growth companies, frequently with an international focus, the opportunity to secure access to capital markets underpinned by a lighter regulatory regime, larger AIM companies may be attracted by the opportunity to step up to the Main Market of the London Stock Exchange - often concerned they have grown 'too big' for AIM. BDO Partner, Ryan Ferguson, takes a look at the reasons why companies make the move and some of the potential pitfalls they may experience.

Companies are often seen to have 'grown up' when they move to the Main Market, typically citing an increased public profile and having matured as a business as motivation for the move. The increase in passive investment by tracker funds, together with the stronger reputation of the Main Market amongst US investors is also expected to improve liquidity in the shares. Similarly, the Main Market can provide access to a deeper pool of capital to fund further growth. Additionally, whilst the onerous and ever increasing governance and regulatory requirements of the Main Market, particularly the Premium List, can be challenging, a Main Market listing is often seen as a sign that management are committed to the level of governance and risk management that reassures investors.

Nine companies made the move to the Main Market in 2014 and 2015, a substantial increase on the one company in 2013 and three in 2012, although 2011 saw nine companies make the move. We analysed market data associated with those companies that moved to the Main Market in 2014 and 2015 to see what trends emerge.

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SHARE PRICES ON THE SLIDE

Larger AIM companies are sometimes told they can expect tangible growth in their share price in the Main Market, relative to remaining on AIM. The potential for increases of 20% plus sometimes cited by bankers are undoubtedly attractive.

In reality, the AIM 100 index saw growth of 13% in 2015, whilst the FTSE 250 delivered 9% and the FTSE All-Share index lost 1%. However, those companies that made the move in the last two years have had a tough induction, with all but two having seen falls (averaging 41%) in their share price and with the growth in the two best performers (BCA Marketplace and Urban&Civic) being 8% and 6% respectively. Whilst the sector mix plays a key role, 66% of the companies also underperformed against their FTSE All Share sector index. One possibility is the new investors that get involved once companies join the Main Market are less accustomed to the volatility these still relatively small businesses can bring. They may buy in but they can also be quick to sell.

NO GUARANTEE OF MORE LIQUIDITY

Based on average monthly traded volumes in the 12 months pre-step up versus the volumes since joining the Main Market, the promise of increased liquidity seems patchy to say the least. The majority of entrants saw reductions in liquidity, with reductions in volumes of 31% to 80%. Whilst a larger pool of potential investors and tracker funds should increase liquidity, it is possible the real benefit only consistently rests with those large enough to enter the FTSE 350.



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NEW MONEY

Historically, companies haven't raised new money as part of a Main Market step up, with only three companies doing so in the past five years. Whilst £1.2bn of new money was raised via placings in 2014 and 2015 as part of a step up, this was focused on BCA Marketplace and Urban&Civic, who used the placings to fund reverse acquisitions as part of their listings. £53m has been raised since listing by the new entrants as a whole in 2014 and 2015, mainly driven by Gulf Keystone's discounted £41m placing in 2015.

Standard listing still the norm – are the governance demands of a premium listing just too much?

A standard rather than premium listing continues to be the preferred route for those joining the Main Market, with 66% taking a standard listing

in 2014 and 2015. Frequently, businesses leaving AIM with substantial founding shareholders have been unable or reluctant to meet the tighter requirements associated with the premium listing. Other entrants publically state that the standard listing is a stepping stone to a future premium listing, but the full weight of regulatory and governance requirements that come with a premium listing also continue to make a standard listing attractive.

AIM GROWING UP

Whilst companies often see themselves as having become too big for AIM, the past decade has seen larger and larger businesses deciding to stay on AIM rather than make the move. The average market capitalisation of AIM 50 businesses has increased from £392m in 2004 to £643m in 2015, whilst the largest ten AIM companies have increased from an average of £870m to £1.4bn.

Equally, making the move to the Main Market is not the preserve of companies in the AIM 50 and with a market capitalisation over £300m. Bon Marche, Nanoco Group and Goldbridges all made the move with a market capitalisation of under £300m, and with Goldbridges having a market capitalisation on entry of about £60m.

However as long as the top end of AIM keeps growing, the market will continue to serve as an incubator to the Main Market. Undoubtedly Main Market status will continue to remain an attractive next step for some of AIM's success stories, however the full extent of the benefits often cited as a reason to make the move are likely to be focused on those businesses that are large enough to enter the FTSE 350.

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A GLITTERING SUCCESS

Petra Diamonds is a leading independent diamond mining group and an increasingly important supplier of rough diamonds to the international market. The company focuses on the highest margin section of the diamond pipeline, which involves the mining, processing, sorting and sale of rough diamonds. Petra's five mines in South Africa and Tanzania have produced some of the world's most famous diamonds, including the Great Star of Africa, which can be found in the British Crown Jewels.

The company has experienced rapid growth that saw it list on AIM in 1997, thereby giving it the impetus to move on up to the Main Market in 2011. Petra has grown significantly from a relatively small diamond explorer with a market capitalisation of less than £10m to a leading independent diamond mining group, quoted with a premium listing on the Main Market of the London Stock Exchange.



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WHY AIM?

In 1997 Petra became the first diamond mining company to list on AIM and, at that time, had a market capitalisation of less than £10m. The company selected London due to the access the city has to a broad and deep pool of investors and the fact that it is one of the most international capital markets. At the time, the London market also had a far stronger understanding of mining as well as historical ties with Africa, having financed many of the continent's largest mineral deposits over the years. Having a similar time zone to South Africa, where Petra's operations are based, also made the management of the company's listing easier.

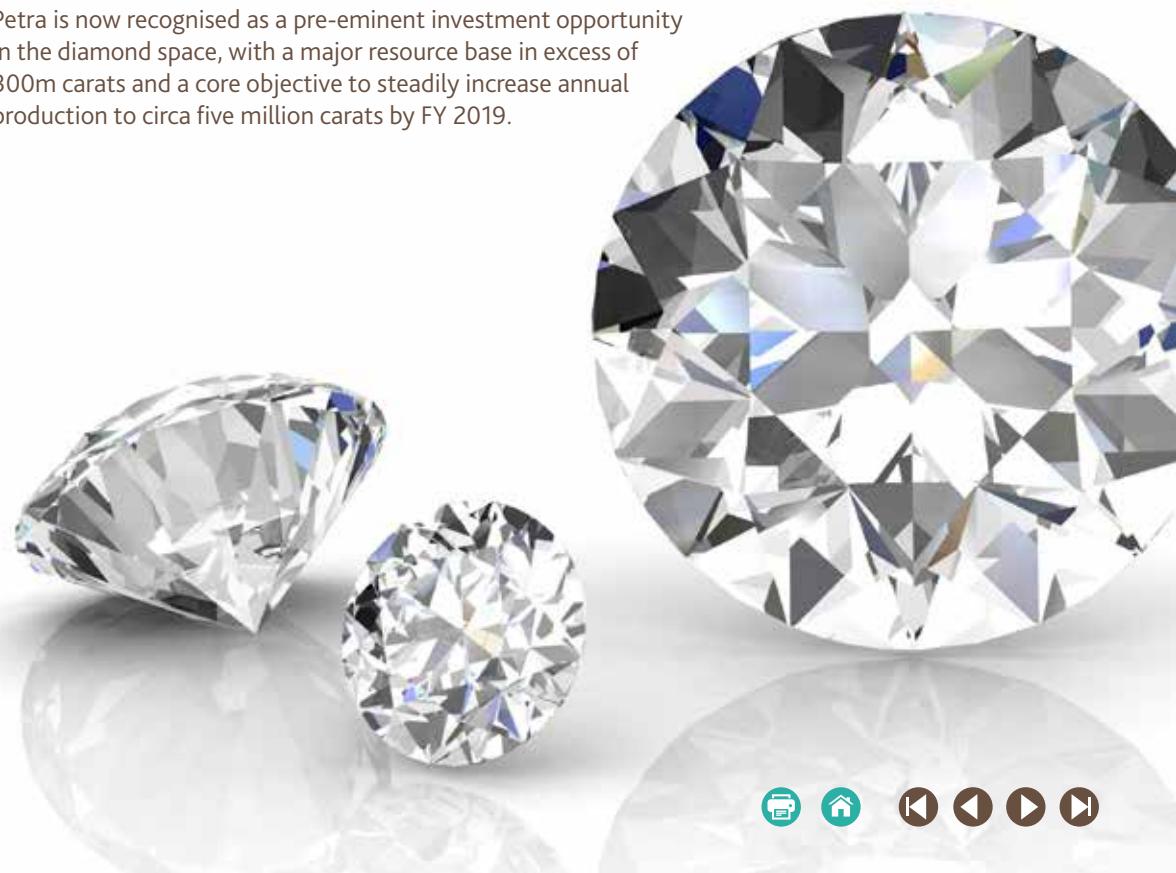
Petra's AIM listing, along with its entrepreneurial culture meant it was able to respond rapidly when De Beers announced that it was rationalising its portfolio and selling off mines, enabling the company to raise the finance to acquire five diamond mines between 2007 and 2011. By treating these assets as core to the business, empowering their management teams, focusing on cost control and using long-term thinking, Petra has been able to breathe new life into these mines. Importantly, Petra's AIM listing provided the company with access to capital in order to deliver its growth strategy, with two equity fundraisings (US\$120m in 2009 and US\$325m in 2011) which assisted with the purchase of its two flagship mines – Cullinan and Finsch.

MOVING ON UP

As the company grew into London's largest quoted diamond mining group, Petra took the decision to step up from AIM to the Main Market of the London Stock Exchange in 2011. The Main Market was identified as being able to provide the appropriate platform for Petra's continued growth, allowing the company to access a broader range of investors internationally and further enhancing its reputation and stature. The additional level of disclosure and governance required for Main Market companies also speaks to the quality and transparency of the business.

Through its London listing Petra has been introduced to a wide range of international investors and its profile has certainly been enhanced in the global arena.

Petra is now recognised as a pre-eminent investment opportunity in the diamond space, with a major resource base in excess of 300m carats and a core objective to steadily increase annual production to circa five million carats by FY 2019.



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REPORTING AND GOVERNANCE

Unlike many mining businesses, the group operates with a small corporate management team, so BDO is proud to have supported Petra through its development and helped the company identify and overcome the challenges of its rapid growth.

Operating in a fast-paced regulatory and reporting environment we have helped Petra to meet investor demand for more accessible financial and governance reporting and developed effective ways to improve the quality, transparency and accessibility of the company's reporting.

Petra's Finance Director, David Abery, commented



“ In an evolving market and with constant changes in legislation, Petra has had to adapt to maintain its growth and meet its ambitions as a business. BDO has provided excellent and valuable support through each stage of our development and we look forward to working with them in the future as we continue to grow the business. ”

THE FUTURE

Petra has been through a challenging period as production transitions from old to new mining areas and a weaker market has impacted on diamond pricing. However, the company is positive about the future of the diamond market due to constrained market supply versus a sustained growth in demand and it continues to make progress across its expansion projects.

In May 2015 the company raised US\$300m through an inaugural Notes Issue which is being used to construct a modern processing plant at one of Petra's mines, to further the group's expansion projects and to settle certain existing debt facilities, which remain available to the group (and have been increased).

Petra first set out its growth plan in FY 2009, then subsequently increasing the target in 2011, and is now well on track to achieve its goal of growing annual production from 3.2m carats in FY 2015 to circa 5m carats by FY 2019. They certainly look to have a glittering future.

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HOW MUCH COULD YOU AFFORD TO LOSE?

With the possibility of wiping £19m off the value of an average-sized AIM company, small and mid-cap quoted companies should be taking corporate reputation more seriously.

Corporate reputation is something that most agree is important. It is an asset that affects sales, drives share prices, builds employee morale and more. Corporate reputation can make or break a company. However, it is difficult to define, measure, build and control, which leads to companies struggling to manage reputation risks.

With today's lightning speeds of communication, understanding and managing corporate reputation risks is more important than ever. In the UK alone, there have been a number of high profile corporate reputation scandals in recent years – amongst both large and small companies – that have wiped millions off the value of companies, tarnished markets and affected investor confidence.

In partnership with the Quoted Companies Alliance, BDO recently researched what small and mid-cap quoted companies are doing to manage their corporate reputation and the risks it poses to them. The majority of small and mid-cap quoted companies (79%) believe that corporate reputation is very important to their company. However, advisers to the sector suggest that companies may not be as 'on the ball' as they say they are – with just over half (52%) believing that corporate reputation is very important to their small and mid-cap quoted company clients.

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OVER A QUARTER OF YOUR MARKET VALUE IS ACCOUNTED FOR BY YOUR REPUTATION

Small and mid-cap quoted companies estimate that, on average, 28% of their market value is accounted for by its reputation.

So with corporate reputation contributing a significant proportion of market value, there is a lot at stake for companies. With the average market capitalisation of an AIM company being £66m, AIM companies stand to lose up to £19m of their market value if they do not actively manage corporate reputation risks.

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PAYING MORE THAN LIP-SERVICE TO REPUTATION

With these amounts at stake, managing corporate reputation risks is crucial. However, despite an overwhelming majority of companies thinking that corporate reputation is important, a quarter do not know how much of their organisation's market value is accounted for by its reputation and a similar amount (26%) do little to manage their corporate reputation.

In addition, 52% of advisers believe that the majority of small and mid-cap quoted companies are only a little prepared to manage corporate reputation risks and 40% think that they are not well prepared.

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Nonetheless, companies say that they are prepared to manage their corporate reputation risks. 66% of small and mid-cap quoted companies say that they have formal plans in place to manage any issue that could potentially damage their corporate reputation, with nearly three quarters of those (74%) reviewing their plan at least annually.

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However, views of advisers to the sector suggest that companies may be overstating what they do, with many indicating that their small and mid-cap quoted company clients do not do much proactively to manage their reputation. Many mentioned that small and mid-cap quoted companies lack internal resources or do not have the skills on the board necessary to address corporate reputation issues effectively.

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OUR TIPS FOR MANAGING CORPORATE REPUTATION

1 CORPORATE GOVERNANCE AND CORPORATE REPUTATION GO HAND-IN-HAND

Good corporate governance inspires trust between a public company and its shareholders; it creates and protects value by reducing the risks that a company faces as it seeks to create growth in long-term shareholder value. Without trust, there will be no appetite from shareholders to invest further or remain shareholders.

2 IT IS NOT ENOUGH TO JUST HAVE GOOD GOVERNANCE – YOU HAVE TO REPORT ON IT TOO

Companies need to implement sound governance processes and procedures and then report on them regularly. Whilst institutional investors may get face time with companies and know them well, private investors do not and so need to be able to see what the company is doing to ensure that it is creating and protecting value and being run in the best interests of all shareholders.

3 TREAT CORPORATE REPUTATION AS YOU WOULD ANY RISK

Effective companies view corporate reputation as a strategic risk that should be discussed regularly as part of an overall risk management system.

4 FIGURE OUT WHO IS RESPONSIBLE FOR MANAGING CORPORATE REPUTATION

Companies need to be clear about who is responsible for corporate reputation within their businesses. The tone should be set from the top – and so a board member or CEO usually takes responsibility for this area. However, organisations also need to identify all the internal stakeholders that help to manage corporate reputation.

5 CORPORATE REPUTATION PRESENTS RISKS, BUT ALSO OPPORTUNITIES

Understanding corporate reputation and how you can influence it can help to grow your customer base, as well as attract new investors. Good corporate reputation is a great asset that can help contribute to long-term growth.

Corporate reputation is critically important, however it is hard to earn and easy to destroy so planning for, and managing, issues should be on every company's agenda.

[Read our November Pulse Small and Mid-cap Sentiment Index report, where the full version this article appears.](#)

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A quick round up of tax changes that may impact AIM listed companies.

Country-by-country reporting from 1 January 2016

WHAT'S NEW?

In June 2015, the OECD released its country-by-country reporting (CbCR) implementation package. It included model domestic legislation to help governments bring in reporting requirements consistently and a multilateral competent authority agreement (MCAA) to enable the sharing of reported information: a model that the UK Government has largely followed.

CbCR is an addition to the transfer pricing documentation requirements and will be limited to multinational enterprises with total consolidated group revenues of at least

€750m in the preceding fiscal year. AIM listed companies exceeding that threshold will need to file under CbCR for periods beginning on or after 1 January 2016, with a filing due date of twelve months from the fiscal year end.

ACTIONS FOR BUSINESS

We recommend that businesses review their transfer pricing policies to ensure that they are robust and trial their processes for CbCR to ensure that their systems can produce the required data, that there are no unexpected outcomes, and that the appropriate level of disclosure can be agreed in advance with key stakeholders.

[Read more information on this subject here.](#)

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INTEREST DEDUCTIONS AFTER BEPS

The OECD began its work aimed at addressing tax base erosion and profit shifting (BEPS) by multi-national enterprises in 2012 at the behest of the G20 and released its final recommendations on the majority of issues on 5 October 2015. The programme was divided into 15 action points of which Action Point four deals with debt and interest structuring arrangements. Related recommendations on the transfer pricing treatment of financing arrangements are due to follow in 2017.

The conclusion of Action Point four is a range of recommended conditions for allowable interest deductions:

- A fixed cap on interest deductions should be implemented at 10% to 30% of EBITDA (calculated as taxable income plus interest and depreciation/amortisation) on an entity or domestic group basis
- Relief may be given to allow group-wide ratios to be used where they are higher than the fixed ratio
- Relief may be given to allow excess deductions to be carried forward or backwards, or surrendered to the domestic group
- A de minimis level may be used to exclude groups with low net interest charges.

Although the UK does currently have worldwide debt cap rules, the proposed conditions are expected to be more restrictive. The UK Government is now consulting how these conditions will be applied in practice but it does now seem likely that the UK's rules for allowable interest deductions will include some form of fixed cap in the future.

[Read more information on this subject here.](#)

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APPRENTICESHIP LEVY UPDATE

WHAT'S NEW?

In the Summer Budget 2015, it was announced that the Government would introduce a new levy on large employers to help it meet a national target of creating three million apprenticeships.

The levy will commence in April 2017. It will be set at a rate of 0.5% of an employer's total wage bill and will be collected via PAYE (akin to a supplementary employer's NIC charge). All employers will be included in the scheme; however, each employer will receive an allowance of up to £15,000 to offset against their levy payment. This means that an employer will only start to pay the levy where their total annual payroll bill exceeds £3m and the Government expects that more than 98% of employers will be exempt from this charge.

ACTIONS FOR BUSINESS

For businesses that expect to pay the apprenticeship levy, it should be remembered that from April 2016, a new NIC exemption for employing apprentices aged under 25 will apply, so that no employer's NIC is charged on their earnings up to the NIC upper earnings limit (£43,000 for 2016/17). Therefore, reviewing your recruitment policy now and taking on young apprentices could help you save on payroll taxes for 2016/17, offset at least part of the apprenticeship levy costs from April 2017 and ensure that you can use some of your levy credit against apprentice training costs in future.

Speak to your usual BDO contact for more information on any of these matters.

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