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THE ONLINE MONTHLY FOR THE ALTERNATIVE INVESTMENT MARKET

AIM JOURNAL

AIM set for £5bn growth contribution

AIM is on course to be the source of around £5bn of investment funding for its constituent companies in 2009. That compares with £4.3bn last year. More cash was raised in October and November than in the whole of the second half of 2008. This indicates that AIM is still a significant source of cash for growing companies and it is likely to be increasingly so next year.

The mix has changed, with new entrants likely to raise little more than one-half the £1.1bn generated in 2008. However, secondary fundraisings by existing companies will be worth well over £1bn more than 2008's £3.2bn figure. Earlier in the autumn, AIM adviser Arbuthnot Securities predicted secondary issues would raise £3.6bn during 2009.

October 2009, thanks to the £620m raised by Canary Wharf-owner Songbird Estates, was the best month for secondary fundraisings since December 2007. There was £900m raised in October 2009, compared with £974m in December 2007.

The current figures do not include the £160m-plus raised by Borders & Southern and Falkland Oil & Gas to invest in oil exploration.

There are even signs of an upturn in new issues. The new entrants are all financial companies, though. Industrial and technology businesses may take a little longer to reach the market. The biggest is litigation funding firm Alvaro which plans to raise £50m. Cash shells Marwyn Capital I and Marwyn Capital II plan to join AIM before the end of December. Investment company Better Capital is also on the blocks. None of these have said how much cash they want to raise.

Potential VCT and EIS changes

Draft legislation is being published relating to Enterprise Investment Schemes and Venture Capital Trusts following the Chancellor's Pre-Budget Statement. This includes a new definition of 'small enterprise', which will replace things such as the gross assets test and limits to the number of employees. The exact details were not clear when we went to press.

VCT and EIS are important sources of investment for AIM companies. There are other changes planned to bring the schemes in line with EU regulations. VCTs will be expected to hold at least 70% of their investments in shares, against the current minimum of 30% and they will be able to list on any regulated European market. EIS companies will not be allowed to trade in partnerships.

There was good news for innovative small companies in the Pre-Budget Statement. They will no longer be required to own any intellectual property in order to claim R&D tax relief on research and development spending. This takes effect from 9 December.

In this issue

HubInvest publishes AIM Journal

www.hubinvest.com

general news

ERT censured for misleading AIM investors over cash call

The AIM Disciplinary Committee has publicly censured plastic waste recycling technology company Environmental Recycling Technologies for failing to use cash raised from investors for its stated purpose of paying off a loan. This was kept from the market for one year.

ERT raised £2.8m in August 2007 but did not pay off the loan from YA Global. The cash was used to pay off other loans, finance development and for working capital. ERT had not heeded a previous warning from AIM. In May 2006, a private warning letter admonished the company about failing to keep the market informed.

Chairman Ken Brooks argues that "ERT has undergone key board and operational changes since the matters referred to in this public censure took place during the period from July 2007 to June 2008". However, Brooks has been chairman and David Shepley-Cuthbert finance director since before the £2.8m was raised. Roger Baynham became managing director in February 2008 but he was a non-executive prior to that.

February 2008 was the time when the board was overhauled. Chief executive Niall Mackay and non-executives Bill Widger and Bill Lopshire resigned. Yet the market was not informed about the use of the cash until June 2008.

The AIM Disciplinary Committee seems to agree with Brooks, though, because it says that the board has "undergone significant changes". ERT wasn't fined because of its poor financial position.

ERT was in breach of six separate AIM rules over a number of separate occasions. ERT did not keep its nominated adviser or the market properly informed, it failed to inform the market about share issues to YA Global, did not apply for admission of the shares to AIM and did not make it clear how many shares were in issue. On top of this, between July and October 2007 the board did not make sure that its announcements "were not misleading, false or deceptive" – it implied the loan had been paid off.

ERT had debt of £3.11m at the end of June 2009 and all of that was in current liabilities. YA Global is owed £1.47m and this is due for repayment on or before 31 December 2009. Interest is being charged at 12% a year.

JSM directors ousted

San Francisco-based Passport Capital has removed three directors from the board of Vietnam and Cambodia-focused property investor and developer JSM Indochina. The new board will undertake a review of JSM's investment strategy and accelerate the return of cash to shareholders.

Chief executive Craig Jones, finance director Rowell Tan and chairman Michael Tanner were deposed and replaced by Scott Verges, Paul Kaju and John Duggan. However, Jones and Tan had already said that they would resign.

Numis has resigned as nominated adviser which means that the shares have been suspended. JSM has until 8 January 2010 to appoint a replacement nominated adviser or lose its quotation.

At the suspension price of 66 cents a share, JSM is valued at $150.9m. The NAV was $1.09 a share at the end of June 2009. There was still $169m in the bank at that time.

AIM directors' pay continues to rise

AIM directors do not seem to have suffered as much as investors in the past couple of years according to research by Growth Company Investor. The publication Directors' Pay on AIM 2009 shows the trend in AIM chief executives' pay is still upwards and chief executives of loss-making firms are increasing their income faster than those of profitable companies.

Admittedly the median chief executive pay of profitable companies only edged ahead from £215,000 in 2008 to £216,000 in 2009 but this is well ahead of the £174,000 median for 2007. The median chief executive pay figure for the most profitable 100 companies was £324,000 in 2009.

The median pay for chief executives of loss-making companies is nearly £172,000 in 2009, compared with £151,000 the year before and £123,000 in 2007.

One thing that has changed is the number of AIM chief executives earning more than £1m. The number fell from 24 in 2008 to five in 2009. There were 156 AIM boards where the total remuneration was more than £1m, down from 173 in 2008. Some of the larger companies have transferred to the Main Market and that could be part of the reason for this drop.

The highest-paid chief executive is Dr Raymond Chu of biometrics and RFiD firm RCG Holdings. He was paid £2.24m last year although the whole board only received £2.74m. Dr Chu's pay is equivalent to 1.6% of RCG's market capitalisation, whereas Trevor Allan's £1.42m pay packet is equivalent to 13.4% of MBL's market capitalisation.

Aero Inventory, which is in administration, paid its board £3.17m – the second-highest board pay on AIM.

advisors

Marechale plans deals

Former Noble and KBC Peel Hunt corporate financier Patrick Booth-Clibborn is selling his business to the AIM-quoted St Helen's Capital shell in return for a 9.9% stake and an initial £12,000 in cash. He will also become chief executive.

His business is called Marechale Capital, and St Helen's, which sold the eponymous business earlier this year, will change its name to Marechale Capital when the deal goes through. Marechale will be a tiny company so it makes no sense for it to stay as it is. The plan is to acquire other advisory businesses that can offer additional services to corporates and directors. Booth-Clibborn expects to push ahead with this strategy as soon as possible.

Booth-Clibborn has built up a number of contacts and clients in the small company arena over the years and he says that he has "a healthy pipeline of corporate finance and broking projects". This will be enough to make the current business profitable. Running costs will be kept to a bare minimum. The current office lease runs out at the end of the year so the company can move to smaller premises.

A share swap with Plus-quoted investment manager Bluehone, which will own 20% of the renamed Marechale, is also planned. Marechale will own 6% of Bluehone. Bill Brown, the boss of Bluehone, believes that Marechale will benefit from its relationship with Elderstreet Investments and Evolve Capital, whose subsidiary bought the original St Helen's business.

Booth-Clibborn is keen to retain the company's EIS status at least until the end of this tax year. In the longer term he may look to buy a fund management business.

Non-executive director Jon Pither acquired just over 5m shares from Hargreave Hale at 1.88p a share. This takes his stake to 16.5%, while Hargreave Hale retains 2.45%.

An AGM will be held on 17 December to approve the Marechale deal.

Falkland cash

Autumn has been a prosperous time for the advisers of Falkland Islands oil and gas explorers. The cash will be spent on drilling in the sea around the Falkland Islands. All the companies' share prices had been strong prior to the cash calls.

Panmure Gordon, Mirabaud and Ocean jointly raised £113.1m, after expenses, at 50p a share for Borders & Southern Petroleum. That more than doubled the share capital of the company. The previous day's closing price was 55p and it has risen strongly since then. Oriel is raising £50m at 115p a share for Falkland Oil and Gas. That is a 15% discount to the market price the day before.

Seymour Pierce raised £42m at 70p a share for Desire Petroleum and the oil explorer hopes to raise a further £20m via an open offer to existing shareholders. The shares closed the day before this announcement at 82p.

Canaccord Adams raised £50m at 54p a share for Rockhopper Exploration – a 16% discount to the prevailing market price.

ADVISER CHANGES - NOVEMBER 2009

COMPANY	NEW BROKER	OLD BROKER	NEW NOMAD	OLD NOMAD	DATE
Invu	Canaccord	Arbuthnot	Canaccord	Arbuthnot	02/11/2009
China Growth Opportunities Ltd	Singer	Collins Stewart	Singer	Collins Stewart	06/11/2009
Pressure Technologies	Fairfax IS	Brewin Dolphin	Fairfax IS	Brewin Dolphin	06/11/2009
AFC Energy	Allenby/Astaire	Astaire	Astaire	Astaire	06/11/2009
Trading Emissions	Cenkos	Cenkos	Liberum	Cenkos	09/11/2009
Croma Group	Brewin Dolphin	Seymour Pierce	Brewin Dolphin	Seymour Pierce	09/11/2009
Pittards	WH Ireland	Astaire	WH Ireland	Astaire	09/11/2009
Milestone Group	Hybridan/Arden	Arden	Arden	Arden	10/11/2009
Hightex Group	FinnCap	Singer	FinnCap	Singer	10/11/2009
Ascent Resources	Astaire	Cenkos	Astaire	Cenkos	11/11/2009
FFastFill	Canaccord/FinnCap	Canaccord	Canaccord	Canaccord	11/11/2009
PuriCore	Piper Jaffray	Nomura Code	Piper Jaffray	Nomura Code	12/11/2009
SpaceandPeople	Seymour Pierce	FinnCap	Seymour Pierce	FinnCap	16/11/2009
Solomon Gold	Fairfax IS	Westhouse	RFC Corporate	RFC Corporate	17/11/2009
Angel Biotechnology	Matrix	Dowgate	Grant Thornton	Grant Thornton	18/11/2009
Formjet	Rivington Street/Shore Capital	Shore Capital	Shore Capital	Shore Capital	23/11/2009
MediLink-Global UK	Allenby	SVS	Allenby	Astaire	23/11/2009
Strategic Natural Resources	SP Angel	Religare Hichens Harrison	Allenby	Allenby	24/11/2009
ATH Resources	Seymour Pierce	Seymour Pierce	Seymour Pierce	Evolution	25/11/2009
Kryso Resources	WH Ireland/Fox-Davies/Orbis	Fox-Davies/Orbis	WH Ireland	Astaire	26/11/2009
Designcapital	Rivington Street	Allenby	Allenby	Allenby	30/11/2009
ReThink Group	Merchant John East/Rivington Street	Rivington Street	Merchant John East	Merchant John East	30/11/2009

company news

Immunodiagnostic System benefits from automated vitamin D boost

Diagnostic tests *www.idsplc.com*

Lack of exposure to sunlight causes deficiencies in vitamin D. That can lead to various forms of illness. Diagnostic testing kits supplier **Immunodiagnostic Systems Holdings (IDS)** is benefiting from the increasing demand for vitamin D testing by doctors. A newly launched automated system will further increase opportunities.

Vitamin D is important in the development of bones and cells. That means that low levels of vitamin D are linked to bone diseases, such as osteoporosis, as well as cancer, cardiovascular problems, hypertension and diabetes. Therefore, measuring vitamin D levels is important when diagnosing and treating patients. Tests are also required to see how patients are responding to treatment.

Measuring vitamin D levels is important when diagnosing patients

The automated testing system is called IDS-iSYS. IDS will make money from selling the machines and then regular revenues from consumables used in the IDS-iSYS. The system can handle more than 100 tests an hour.

It is taking time to persuade hospitals and pharma companies to buy IDS-iSYS but momentum appears to be building. IDS admits to being two months behind plan but it has placed or sold 43 machines, including 16 in the past two months. Adding more tests will help increase those revenues. IDS hopes to be able to offer 10 different tests by the end of 2010.

IMMUNODIAGNOSTIC HOLDINGS (IDH)	602.5p		
12 MONTH CHANGE %	+197.5	MARKET CAP £M	159.5

Profits jumped from £1.59m to £4.58m in the six months to September 2009. That means that IDS has nearly reached last year's full-year profit of £4.78m.

IDS is normally second-half weighted and the chairman makes it clear that this year should be no exception. House broker Brewin Dolphin has increased its profit forecast for the year to March 2010 from £9m to £10.3m, rising to £16m the following year. The outcome will depend on the rate of take-up of IDS-iSYS.

Evans diagnoses new direction for Admiral firm

Diagnostics *www.iblplc.com*

International Brand Licensing is selling its Admiral-branded sports business and moving into the diagnostics market. David Evans is taking over as chairman – he holds the same position at Immunodiagnostic Holdings (above).

It may appear a strange move but a strong management team with experience of the diagnostics market is coming on board. Evans has guided a number of small diagnostics and pharma companies that have come to AIM or Plus-quoted. One of his former chairmanships was diagnostics firm BBI and IBL's new chief executive Julian Baines was boss of that business. BBI was acquired by Inverness Medical for £85m in 2007 – three years after it floated on Aim. New non-executive director Dr Kevin Wilson held the same position at BBI.

INTERNATIONAL BRAND LICENSING (IBL)	19.5p		
12 MONTH CHANGE %	+129.4	MARKET CAP £M	8.19

Management is looking to grow via acquisition and build up an in-vitro diagnostics business over a three to five year time scale. The focus will be on technology which enables diagnostic tests to be carried out at the point of care rather than in laboratories.

IBL is raising £1m from a placing at 12.75p a share. The majority of the shares are being bought by the new and existing directors. Additional cash will be raised from the sale of the Admiral business.

company news

Gooch & Housego diversification helps on road to recovery

Photonics *www.goochandhousego.com*

Gooch & Housego says that diversification has helped it weather the downturn in its core photonics markets. G&H is not as dependent on the Q-switch product for lasers thanks to recent acquisitions, including that of US-based General Optics, which increased the group's exposure to aerospace and defence.

The figures for the year to September 2009 cover the toughest period for G&H and there are signs of recovery. Revenues grew 9% to £36.4m thanks to the inclusion of General Optics but the like-for-like decline was 24%. Q-switch sales fell by 35%. Underlying profits were 43% lower at £3.1m. R&D spending is being maintained.

Cash generation should continue to be strong this year

G&H has completed investment in its new facility at Ilminster. That means cash generation should continue to be strong because there is no need for significant capital expenditure. Net debt was £12.1m at the end of September 2009 – after £12.4m was spent on General Optics during the year. There is £7.3m headroom on bank facilities.

GOOCH & HOUSEGO (GHH)	137.5p		
12 MONTH CHANGE %	-4.5	MARKET CAP £M	26.5

G&H also says that it has a "desire to return to dividends" but house broker Investec does not, as yet, forecast any payment for the current financial year. Investec expects a small improvement in profit to £3.3m in the year to September 2010, rising to £4.4m the following year. The order book is starting to rise and management says that it is "better quality" than before. Ongoing cost savings are running at £2.2m a year.

Pursuit's renewed commercial focus

Steam technology *www.pursuitdynamics.com*

Pursuit Dynamics' new chief executive Roel Piper is focusing the company on the best commercial opportunities. The nearest to significant revenue generation is likely to be the AQUASONIC water atomising fire suppression system.

Pursuit's partner Tyco is a world leader in the fire-prevention market. A complete product range should be available early next year and this is why Pursuit believes that it will generate revenues in 2010.

Decontamination and bioethanol are the two other core divisions of the company. The US ethanol market has been in turmoil for a couple of years since overexpansion on the back of subsidies. The US Environmental Protection Agency has delayed a decision on allowing up to 15% ethanol in gasoline but this would be good news if it happens.

PURSUIT DYNAMICS (PDX)	138.75p		
12 MONTH CHANGE %	+166.8	MARKET CAP £M	86.2

Brewing, a sector in which the old management lost interest, is being reassessed. Plus-quoted Shepherd Neame has installed a second PDX Wort Heater, which will reduce energy use by at least 47%. A pilot plant has been installed at a major European brewer. The food business has switched to a licensing model and royalties are expected in the second quarter.

Cash is always the most important thing where Pursuit is concerned. There was £5.7m in the bank following September's £4m placing at 110p a share. The cash outflow was more than £6.4m in the 12 months to September 2009. Pursuit says that the current monthly cash outflow is around £400,000. That suggests that Pursuit has around 14 months of cash. Revenues should help to reduce the outflow but it is difficult to assess how fast those revenues will grow.

company news

East London housing boost for Telford

Residential property developer *www.telfordhomes.plc.uk*

The housing market in east London appears to be recovering but don't expect other parts of the country to be doing as well. **Telford Homes** chief executive Andrew Wiseman reckons that there is "rock solid demand in east London" and an ongoing shortage of homes. The 2012 Olympics should mean that will continue.

Telford had a bumper first half. Sales of 224 homes were completed in the six months to September 2009. Most of these were homes sold off-plan a couple of years ago. Mortgages can still be difficult to obtain but most buyers are getting them eventually. When these pre-sales are not completed Telford retains the 10% deposit and can sell the homes for nearly 90% of the original sales price, thereby generating nearly as much as originally expected. That means failed completions are not a significant problem.

> When pre-sales are not completed Telford retains the 10% deposit

In the first half, Telford has sold more than three-quarters of the homes it expected to this year. Revenues jumped from £35.6m to £85.9m in the six months to September 2009 but second-half sales will be much lower. Full-year pre-tax profits are not likely to be much higher than the £5.74m made in the first half.

TELFORD HOMES (TEF)	103p		
12 MONTH CHANGE %	+100	MARKET CAP £M	41.2

There will be a greater proportion of social housing in the sales mix over the coming years. Telford has already started drawing down its £73m HCA grant for affordable housing.

Net debt has been cut from £107m to £71.3m by the end of September 2009. Telford is returning to the dividend list with an interim of 0.75p a share. Management intends to have a progressive dividend policy that smooths out any ups and downs in annual figures.

Telford is still selling homes that went into construction at the tail end of the boom. The reduced development levels since then mean that there will be less available to sell in the next two years. Profits are likely to be around £2.5m in 2010-11.

Cement sale signals upturn in Prosperity

Cement manufacturer *www.pmhl.co.uk*

China-based cement manufacturer **Prosperity Minerals** has signed a memorandum of understanding with TCC International Holdings to sell nearly all of its cement manufacturing interests for HK$4bn (£312m).

The deal is expected to be completed by the end of 2009 and the Prosperity interim results will not be published until the disposal is complete. The completion by TCC may be dependent on it raising money.

PROSPERITY MINERALS (PMHL)	118p		
12 MONTH CHANGE %	+883.3	MARKET CAP £M	158.7

The sales price is equivalent to 232p a share, according to Daniel Stewart. Net debt is likely to be eliminated.

Prosperity will be left with its iron ore trading business and a 33.1% stake in Hong Kong-listed Anhui Chaodong Cement, which is valued at around £63m.

When Prosperity joined AIM in May 2006 it raised £115m at 148p a share. The shares are trading below that price but Daniel Stewart reckons that they are worth 282p each – when fully diluted for options and warrants. The final valuation depends on the exact terms but it appears the company should be worth double its share price. Management will have to decide whether to reinvest the proceeds or return at least some to shareholders.

dividends

Hamworthy stays progressive despite cyclical decline

Marine and LNG pumps and equipment *www.hamworthy.com*

HAMWORTHY	(HMY)
Price	274.75p
Market cap £m	124.8
Historical yield	3.2%
Prospective yield*	3.3%

Dividend

Marine and offshore fluid handling systems manufacturer Hamworthy is a highly profitable business that understands the importance of dividends to investors. Hamworthy has had a progressive dividend policy since it joined AIM and it intends to continue with that strategy even though the short-term outlook is poor.

Hamworthy's revenue and profit fell in the six months to September 2009 and it is likely to continue to decline until 2011. Even so, the interim dividend was edged up 5% to 3.2p a share. Net cash increased from £55.5m to £63.9m in the six months to the end of September 2009 despite lower profits and cash payments for acquisitions. Advanced payments of £10m helped.

Earnings per share should reach a low of 18p in 2010-11 before they start to recover. A forecast 2010-11 dividend of 9.6p a share would be covered 1.9 times and cash should be maintained at around £60m.

Business

Hamworthy reported a fall in underlying interim pre-tax profits from £13.8m to £10.3m, on revenues 11% lower at £100m, in the six months to September 2009. That includes contributions from acquisitions so there was a greater like-for-like fall in revenues. Only the water systems division made an increased profit contribution in the first half because of strong demand for waste water systems for ships.

There are two main growth drivers for the company – environmental legislation and growing demand for energy. One of the key customer bases is new shipbuilding, whether it is gas carriers, tankers or cruise ships. New build contracts are almost non-existent at the moment but they are expected to start to recover in 2010. This is particularly true of gas carriers where low gas prices have delayed contracts.

Environmental legislation demands the treatment of ballast and waste water from ships. The recent acquisition of Krystallon also gives Hamworthy exposure to the market for the reduction of SOx emissions from ships.

The order book is 25% lower at £196m, with £103m due for delivery in the second half of this year. Cost savings of £11.1m have been made and are there are more to come. Hamworthy is still on course to make a full-year profit of around £19m, against £24.5m last year. A further decline to around £11m is forecast for 2010-11.

Dividend news

Qualifications and educational services provider **Education Development International** quadrupled its final dividend to 1.2p a share. The total dividend increased from 0.42p to 1.6p a share. Reported profits jumped from £2.77m to £8.03m in the year to September 2009. Earnings per share growth was slower because tax losses are running out. Basic earnings per share still rose from 6p to 11.3p. Cash in the bank improved from £3.23m to £9.49m. Profit is expected to exceed £9m in 2009-10 and EDI tends to beat expectations anyway. A total dividend of at least 1.8p a share is possible for 2009-10.

Membership and education software provider **Gladstone** plans a capital reorganisation so that it can pay dividends. Gladstone is a cash-generative business with a significant cash pile. The company has been investing in software development but it has managed to do that without having much impact on the cash. Last year, the capitalised development costs rose from £521,000 to £814,000 and the cash still increased from £4.58m to £5.44m.

Shareholders in **Niger Uranium** voted against the proposed special dividend distribution of Kalahari Minerals shares. Five large shareholders voted against the distribution. They controlled 54.3% of the shares voted. Just over 70% of the Niger share capital was voted on the resolution.

London & Stamford Property, which recently acquired a block of 146 apartments on the development at Arsenal FC's former ground, Highbury, increased its interim dividend by 10% to 2.2p a share. The dividend will cost £11m.

expert views

Expert view: The broker

Telecoms firms require acquisitions to prosper

By ANDREW DARLEY

The most striking thing in the telecoms services sector has been the stability of forecasts in the last six months. Share price improvement has, almost without exception, been derived from improvement in profit multiples rather than improved underlying fundamentals.

We can identify a clear operational trend where the mature B2B telecoms resellers are expected to achieve sales growth of between 0% and 10%. EBITDA margins for smaller SME resellers are around the 10-15% range. This is unlikely to change in the short term and unless these companies make acquisitions they are likely to tread water. Although the market appears to prefer the high yielders, we favour the cash-rich potential acquirers for their potential value creation.

Each small B2B telecoms company in the peer group has warned in the period in question. Post warnings, only telecoms maintenance services provider Maintel* has improved forecasts, while AT Communications was hit most severely and went into administration. Redstone* disposed of assets and raised convertible loan notes.

Preference for buy and build

The relative homogeneity of the companies means that dividends are (currently) the best differentiator of value. However, if there is an opportunity for growth via acquisition, our choice would still lean towards the cash-richer companies who can buy targeted growth and convert underappreciated cash balances into earnings which merit a multiple.

Operational growth is generally meagre. Appreciation leans towards current yield, almost completely the opposite of the pattern for dividend growth. Those companies which have other ways to use their cash, rather than to pay high dividends to shareholders, are not getting the rating they would like.

If chief executives want to create value in an environment if/when growth returns we need to consider that cash potential of each company as a route to the acquisition of growth.

Maintel* has refocused on its core maintenance business, and contracted recurring revenues are growing while it is, as other telcos, is looking for acquisitions. Daisy has been a serial acquirer of troubled assets using funds raised in an £83m placing in July 2009. Alternative Networks recently acquired customer relationship management and billing software company Aurora Kendrick James, but this is not expected to contribute to growth.

SpiriTel* has acquired both ADK and Edge Networks in recent months as part of its strategy to be a consolidator in the B2B telecoms services market. Typically of telco target acquisitions, these purchases provide a stronger contracted revenue base for the company, as well as cross-selling opportunities. Fully listed KCOM has restructured and gained immediate valuation upside, as we modelled: however organic revenue growth is a much more significant challenge, and one which KCOM has not historically delivered on.

Acquisitive challenges

We are sellers of Daisy on the basis that the challenges of integrating five troubled assets are significant. Daisy will undoubtedly be a telecoms force to be reckoned with in time but until then it's all about successful integration. Net cash at period end was £9.4m, although the Freedom4 WiMax and WiFi business is for sale, and potentially presents a further cash inflow opportunity which we estimate of the order of £20m. While we wish management luck we wouldn't recommend sharing the risk at this stage. There are more stable opportunities for the benefits of growth by acquisition in the market.

Alternative Networks results for the year to September 2009 show the company has continued to display strong cash generation in the face of a challenging economic environment, and a 3.9% yield. At 30 September, pre the AKJ acquisition, Alternative Networks had net cash of £8.1m and a £12m facility. This spending power is not appreciated in the market cap, and an acquisition at a PE ratio below the group's has the potential to be significantly value creative. We remain buyers, but this will only be justified by an acquisition.

Although the market appears to prefer the high yielders, we favour the cash-rich potential acquirers for their potential value creation.

Operational growth is generally meagre.

* FinnCap client

ANDREW DARLEY is a Research Director specialising in telecoms at FinnCap.

feature

Consolidators push ahead with deals

In the summer there were a number of AIM companies raising cash to enable them to make future acquisitions. Around six months later we look at how some of them are faring.

Raising cash to finance growth appears to have become slightly easier over the past six months or so but it is undoubtedly still difficult. Investors need to believe in the company's strategy and, most importantly, its management.

Investors particularly need to trust the management if they are going to give them cash before they have agreed any deals. In some cases they do. Getting the cash is only the first thing, though, and these companies need to show that they can invest that cash wisely.

A number of companies raised relatively large sums of money during the summer. It is still early days but it is interesting to chart their progress so far.

Investors need to believe in the company's strategy and, most importantly, its management.

Communications

Daisy Group, a consolidator in the market for the provision of telecoms services for small and medium-sized companies, wasted little time in pushing ahead with its strategy.

In July, the Daisy business was reversed into Freedom4 for £81m in cash and shares at 80p each. At the same time, Vialtus, which provides managed hosting to small businesses, was acquired for £42m in cash and shares. The company's name was changed to Daisy Group.

Institutional investors obviously saw Daisy chief executive Matthew Riley as the telecoms services consolidator to back. Daisy raised £83m at 80p a share when carrying out the reversal. New shareholders at that time include Invesco Perpetual, which went from no shareholding to a 11.25% stake, Schroders and Blackrock. More recently Credit Suisse took a 5% stake.

The fact that Peter Dubens returned to an executive role with the quoted company will also have encouraged those investors. Dubens has a successful track record as an internet and telecoms sector consolidator.

Daisy had pro forma net cash of £31.5m after the reversal. Riley was negotiating the acquisition of Eurotel when AIM-quoted AT Communications went bust. Riley says that he had been tracking AT for about six months but it "wasn't ideal timing".

Having the cash in the bank enabled Riley to act quickly. Riley says that there were three other parties interested in the AT businesses.

AT's maintenance and engineering operations were particularly attractive. They fitted well with Eurotel's operations. The Eurotel acquisition was competed at the same time in August and the two have been rationalised. Daisy was also talking to Redstone at around this time and acquired its telecoms division a few days later for £17m.

There are other companies interested in consolidating the telecoms sector, including Alternative Networks and Spiritel, but Riley says that valuations are "static at the moment".

Net cash is £9.4m and the sale of the group's WiMAX business could generate £20m. Riley says that Daisy is already enjoying the integration benefits of the acquisitions. Cross-selling services is another important part of the strategy and the benefits should start to show through in the future.

Public experience

In contrast to Riley, Vin Murria has a long track record in the public arena. Therefore, backing Murria could be seen as less of a risk because she has been a successful consolidator in the past.

Murria has worked in the software sector for more than two decades. She is probably best known in AIM terms for building up Computer Software Group. Turnover quadrupled to £25.2m in the three years to February 2006. Over the same period pre-amortisation profits jumped from £601,000 to £5m. The strategy at CSG was to acquire in niche software markets such as charity and field services.

Murria took CSG private via a 150p a share bid that valued it at £99.6m. After more deals it was acquired for $1bn by Hellman Friedman.

Murria joined Advanced Computer Software as chief executive when Adastra Software reversed into a shell company in August 2008. Adastra supplies software to the UK primary care market and the strategy for the group was to acquire more businesses in this area.

After ACS raised £43.75m in the summer it had more than £55m in

feature

cash to finance acquisitions. ACS was already in the process of bidding £15.5m for cash-rich AIM-quoted Business Systems Group.

ACS has made three more acquisitions since then. There was still £56.3m in the bank at the end of August 2009 prior to the latest £900,000 purchase of Healthy Software.

Motor dealer Vertu Motors' management used to be with Reg Vardy. Vertu raised £30m to expand its motor dealerships operations. The company was formed to acquire Bristol Street Motors in 2007 and it bought three other dealerships for a total of £12.1m prior to the latest fundraising.

This is a sector which has been tough in the past year or so. Margins have never been high and as trading becomes more difficult there will be people who want to get out and others whose businesses will run into financial difficulties.

Vertu has acquired seven dealerships since the cash was raised. They include Vauxhall dealerships in Ilford and Lichfield and a Renault dealer in Darlington. The biggest purchase was of four Ford and Mazda outlets from the receiver of Brooklyn Motors.

Vertu should still have around £17m to invest but some of this may be required for working capital.

Drug deal

Proximagen Neuroscience, which is developing treatments for neurodegenerative disease, differs from the other consolidators in that it is buying non-revenue generating assets.

Proximagen's plan is to acquire and in-license later-stage drugs. The £50m fund raising increased the size of the company by more than 160%. Nearly all the cash came from existing shareholders. Proximagen received £49m after expenses and already had cash in the bank. The structure of the first deal means that it won't make an initial dent in the £57m cash pile.

The first acquisition is Cambridge Biotechnology, which Proximagen is buying from Swedish biotech Biovitrum, which bought the business in 2005 and announced plans to sell it in January. Proximagen is also buying some pre-clinical stage programmes from Biovitrum.

No cash changed hands at the time of the acquisition. Proximagen will pay Biovitrum a percentage of future revenues generated from the acquired drug development programmes. Not all of the drugs are in Proximagen's core area and many will have their development funded by partners. Proximagen will go through the portfolio and decide which treatments warrant more spent on them.

Chief executive Ken Mulvany says that Cambridge Biotechnology was one of the early businesses on the list of potential acquisitions. He argues having the cash in the bank "certainly got us a seat at the table". Mulvany says that Proximagen is not just looking at UK companies. He believes that many mid-tier pharma companies will want to sell non-core assets.

Mulvany argues that there will also be a number of companies with potential treatments that are running out of cash and will find it difficult to raise more. Mulvany thinks that he has up to two years to take advantage of the consolidation opportunities.

Earnings growth

Making acquisitions is all very well but the true value of those purchases can't be assessed immediately. The longer-term performance of the group will be a better indication. The trouble with acquisitive companies is that it can be difficult to work out exactly what is going on.

> Raising cash is highly earnings dilutive because of low interest rates and it will take time to invest the cash.

Earnings per share growth is an important measure. Raising cash is highly earnings dilutive because of low interest rates and it will take time to invest the cash.

An example of how acquisitions could change things is provided by broker Arden in its recent note on Vertu. Arden forecasts 2012-13 earnings per share of 2.9p, compared with a forecast of 2.6p in 2009-10. However, Arden reckons that by investing the cash in acquisitions and improving margins Vertu could achieve earnings per share of 4.9p in 2012-13. There is no guarantee that this will happen but it provides a clear indication of what these companies would like to achieve as consolidators. They still have plenty of cash to spend to help them achieve this goal.

CASH FOR CONSOLIDATORS

COMPANY	NEW BROKER	AMOUNT RAISED (£M)	CURRENT MKT CAP (£M)	PLACING PRICE (P)	CURRENT PRICE (P)	% CHANGE
Advanced Computer Software	Seymour Pierce/Mirabaud	43.75	134.9	30	38	+26.7
Daisy Group	Liberum	83	254.3	80	98	+22.5
Proximagen Neurosciences	Evolution	50	63.0	140	110	-21.4
Vertu Motors	Panmure Gordon	30	75.6	30	38.5	+28.3

statistics

Market Performance, Indices and Statistics

AIM SECTOR INFORMATION

SECTOR NAME	% OF MARKET CAP	% OF COMPANIES
Financials	26.4	23.2
Basic materials	18.4	12.7
Oil & gas	16.6	8.9
Industrials	12.2	19.0
Consumer services	7.8	12.7
Technology	6.6	9.6
Health care	3.9	5.8
Consumer goods	3.8	5.2
Utilities	3	1.2
Telecoms	1.3	1.6

KEY AIM STATISTICS

Total number of AIM companies	1,353
Number of nominated advisers	63
Number of market makers	49
Total market cap for all AIM	£56.58bn
Total of new money raised	£63.23bn
Total raised by new issues	£32.68bn
Total raised by secondary issues	£30.56bn
Share turnover value (2009)	£23.95bn
Number of bargains (2009)	£3.08m
Shares traded (2009)	£145.64bn
Transfers to the official list	133

FTSE INDICES

ONE-YEAR CHANGES

INDEX	PRICE	% CHANGE
FTSE AIM All-Share	656.45	+65.2
FTSE AIM 50	2,682.21	+60.9
FTSE AIM 100	2,967.41	+64.3
FTSE Fledgling	3,957.68	+74.5
FTSE Small Cap	2,756.94	+55.7
FTSE All-Share	2,710.18	+33.7
FTSE 100	5,312.17	+30.7

COMPANIES BY MARKET CAP

MARKET CAP	NO.
Under £5m	334
£5m-£10m	207
£10m-£25m	298
£25m-£50m	202
£50m-£100m	132
£100m-£250m	95
£250m+	47

TOP 5 RISERS OVER 30 DAYS

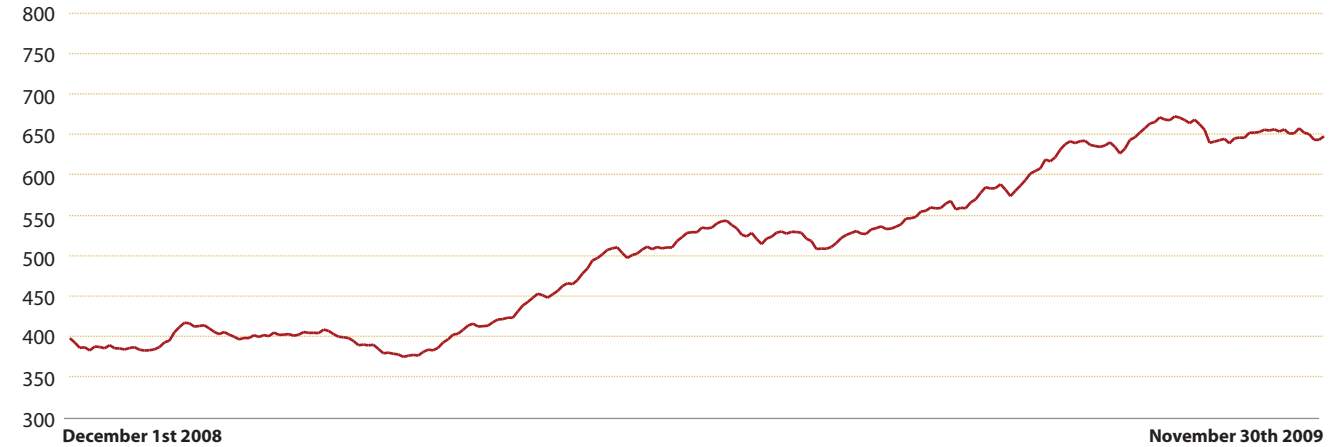
COMPANY NAME	SECTOR	PRICE (p)	CHANGE (%)
Moydow Mines International	Mining	45.25	+151.4
Arteon	Property	155	+121.4
Artilium	Software	11.25	+103.4
Leo Insurance Services	Financials	3.75	+87.5
Software Radio Technology	Technology	8.875	+86.8

TOP 5 FALLERS OVER 30 DAYS

COMPANY NAME	SECTOR	PRICE (p)	CHANGE (%)
Kurawood	Shell	0.5	-77.8
Payzone	Support services	0.3	-76.7
Voller Energy	Shell	0.3	-62.5
Sovereign Oilfield Group	Oil equipment	5	-56.5
HaiKe Chemical Group	Chemicals	20.5	-52.9

AIM - 1 YEAR INDEX CHANGE

Source: London Stock Exchange



Data: Hubinvest Please note - All share prices are the closing prices on the 1st December 2009, and we cannot accept responsibility for their accuracy.

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FinnCap is a client focused institutional broker and corporate advisor, with a strong track record in advising and raising capital, providing research and after-market care for both growing and established smaller companies. The institutional broking team provides a dedicated, bespoke agency broking service to fund managers and private client brokers.

FinnCap employs 39 members of staff and is 50% owned by JM Finn, an independent private client stockbroker founded in 1945. In 2008, FinnCap won 14 new clients and has a total of 60 clients. FinnCap is a Nominated Adviser (NOMAD) for AIM companies and a Corporate Adviser for Plus Markets.

In August 2007, JM Finn transferred its corporate finance, research and institutional broking business into a new subsidiary, JMFinn Capital Markets (FinnCap). The management team and employees of FinnCap have taken a significant equity stake in the business, meaning they have made a substantial financial commitment.

About J M Finn & Co

JM Finn is an independent private client stockbroker with approximately £4bn under management as at July 2007. Its 260 staff are based in London, Bristol, Leeds and Suffolk.

JM Finn was founded as a partnership in 1945, incorporated as a private limited company in 2006 and has been a member of the London Stock Exchange for over 60 years.

PUBLISHED BY:	Hubinvest Ltd,	**Mobile:**	07849 669 572
ADDRESS:	1C Beaufort Road, Kingston-upon-Thames, Surrey. KT1 2TH.	**EDITOR:**	Andrew Hore
		DATA:	Andrew Hore
TELEPHONE:	020 8549 4253	**PRODUCTION & DESIGN:**	David Piddington

SPONSORSHIP & ADVERTISING editor@aimmicro.com or telephone 020 8549 4253