



AIM M&A Survey 2009

Grasping the opportunity

- We present our first AIM survey. This thematic research focuses exclusively on M&A activity.
- Business confidence amongst AIM companies is buoyant. 61.9% of respondents anticipate conducting M&A in the next 12 months.
- Post-merger integration, due diligence and 'non-financial' due diligence emerge as critical success factors.

Thematic Research

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Introduction

Our M&A survey is the first to focus exclusively on the AIM market.

Survey Overview

There is a great deal of noise about M&A. M&A within the AIM market is attracting attention as valuations decline and the ability to finance larger transactions remains challenging. M&A is a significant issue for AIM listed companies as they elect to use it as a strategic option to satisfy the demand to demonstrate growth and sustainability. High levels of economic uncertainty place additional pressure on companies to succeed when executing M&A. AIM has grown rapidly to become a leading market for smaller quoted companies and as such represents an under-researched M&A sector. We are pleased to present our first piece of M&A research to focus exclusively on AIM.

This report highlights some of the issues which AIM directors feel are critical to M&A success. The central purpose of this study is to focus on the factors which AIM executives believe to correlate with M&A success. The report highlights the role of due diligence, 'non-financial' due diligence and post merger integration to improving the odds of M&A success. We hope that you find this study thought-provoking and commercially insightful.

Daniel Stewart's Corporate Finance team provide M&A advisory services throughout the transaction life-cycle from origination through to completion and beyond. We have been involved in many M&A transactions in the AIM market, providing us with experience and insight. If you are contemplating M&A in today's turbulent economic climate we would be delighted to discuss how we could help you achieve your business objectives.

Methodology

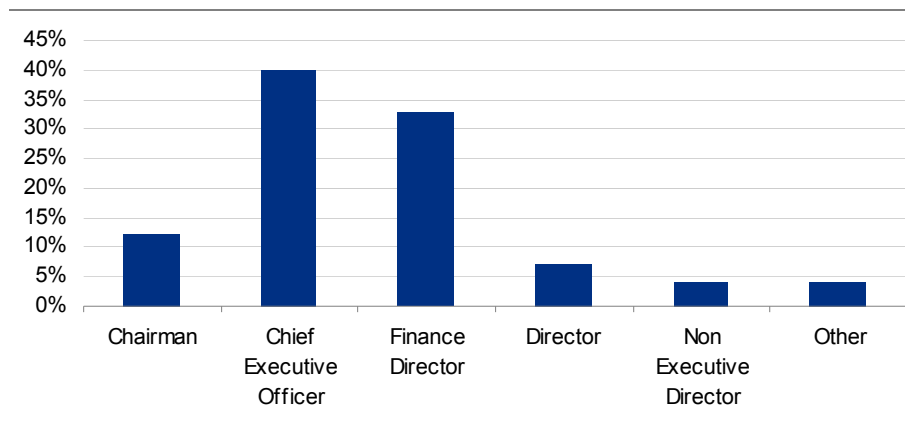
The survey is based on survey respondents from 98 AIM board level executives. We extend our thanks to all of the executives who have taken the time to participate in this survey.

AIM executives were asked to indicate the importance of M&A activities which contribute to M&A success and *post-ex* evaluate the success of completed transactions. Chief Executive Officers and Finance Directors accounted for the majority of the AIM boardroom respondents (72.5% in aggregate).

AIM executives report that due diligence, 'non-financial' due diligence and post merger integration are key to M&A success

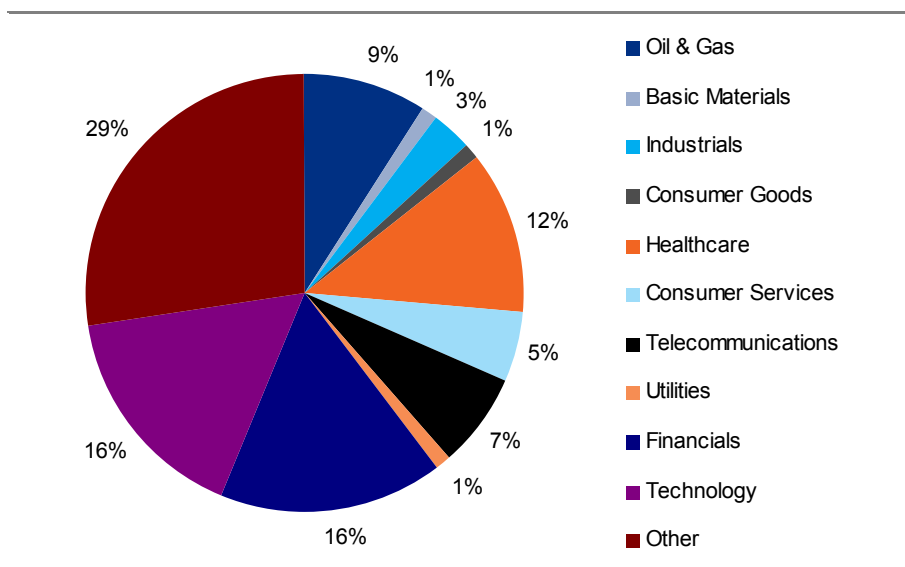
39.8% of survey respondents were CEOs

Chart 1: AIM M&A Survey Respondents by Boardroom appointment



Source: Daniel Stewart

Chart 2: AIM M&A Survey Respondents by Sector



Source: Daniel Stewart

All AIM sectors are represented

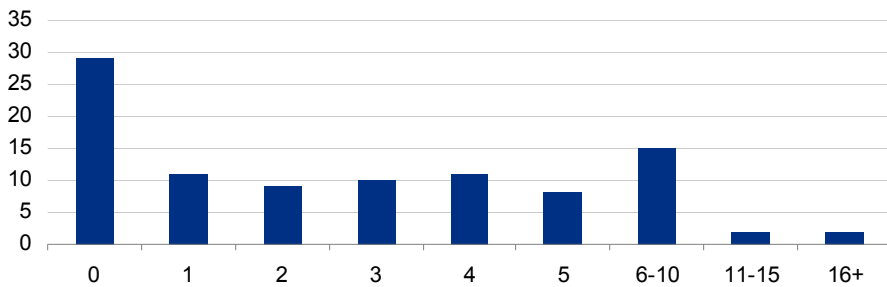
This paper is intended to give AIM executives and advisers a better understanding of the activities and actions which contribute to M&A success. Pragmatism, judgement and skill are required to apply these findings and navigate the highly competitive arena of M&A.

AIM M&A Activity

Transaction Trends

AIM companies often cite using listed shares as an acquisition currency as a reason for seeking a listing. However 29.9% of companies had not completed an M&A transaction since listing on AIM. Despite this there is evidence that some companies have established themselves as "serial acquirers". 15.5% of companies had completed 6-10 M&A transactions.

Chart 3: AIM M&A Survey Respondents by number of completed M&A transactions since AIM listing



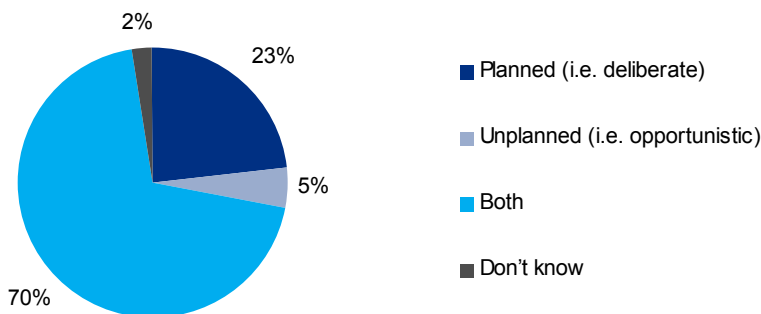
Source: Daniel Stewart

29.9% of AIM companies had not completed an M&A transaction

Conventional logic suggests that planned rather than reactive/opportunistic deals have a higher probability of success. The majority of AIM companies tend to pursue both planned (i.e. deliberate) and unplanned (i.e. opportunistic) M&A. Executives overwhelmingly indicated that they conducted related (i.e. seeking targets in the same industry or market) M&A to seek synergies. Some evidence exists to suggest that small and mid cap companies will seek to exploit opportunistic deals using their agility.

19.7% of AIM companies had completed more than 6 acquisitions

Chart 4: Type of AIM M&A conducted (Planned v Unplanned)

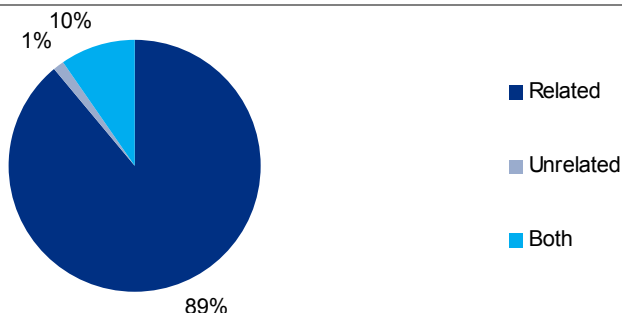


Source: Daniel Stewart

69.5% of AIM companies seek both planned and unplanned M&A deals

The relatedness of acquisition targets is often cited as a contributory factor in post-mortems of M&A failure. Our survey found that 45.6% of AIM executives attach 'high importance' to acquiring related M&A targets. 89% of AIM companies pursue related M&A perhaps reflecting the mantra of 'sticking to the knitting'.

Chart 5: Type of AIM M&A conducted (Related v Unrelated)



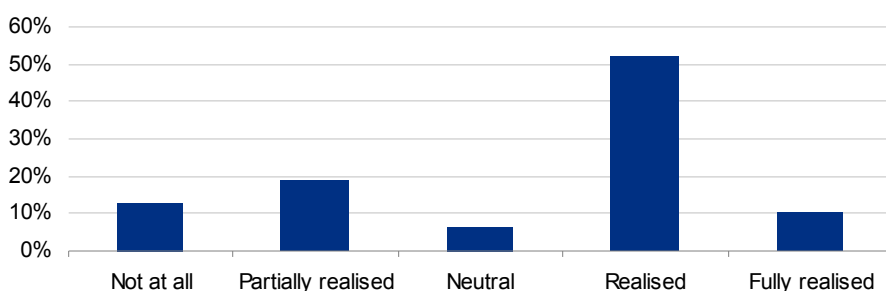
Source: Daniel Stewart

89% of AIM companies 'stick to the knitting'

Success Rates

A vast literature has been written on success rates of M&A deals. In a paradox to their popularity, some research estimates the success rate of M&A to be no greater than 50%. 41.8% of AIM executives believed that 76-100% of completed transactions were successful. This is supported further by responses which indicate that 51.9% perceived organisational pre-deal M&A objectives to have been 'realised' although only 10.1% classified them as 'fully realised'. The fact that nearly 30% of executives thought that they had not realised their objectives illustrates the importance of looking closer at small/mid cap M&A.

Chart 6: Achievement of organisational pre-deal M&A objectives



Source: Daniel Stewart

51.9% of AIM executives believed that pre-deal M&A objectives had been 'realised'

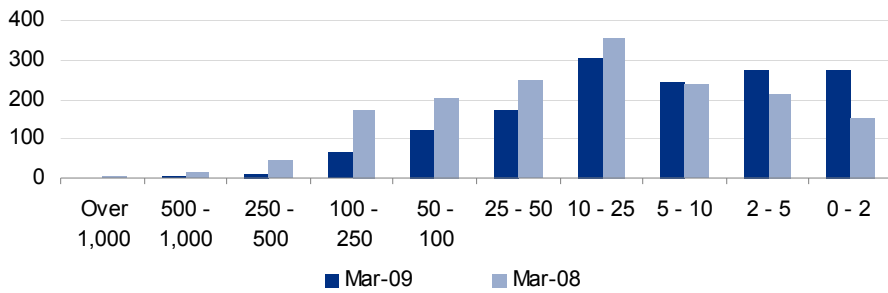
12 month outlook

The declining sentiment for larger, global M&A transactions has been well documented and largely underpinned by the diminishing availability of debt and equity. AIM executives appear contrarian as they express an upbeat attitude towards M&A over the next 12 months. 61.9% anticipate conducting M&A in the next 12 months. We propose the following explanations for this view:

Business confidence is buoyant

- Falling valuations (FTSE AIM All Share Index fell by over 60% in 2008) fuelling perceptions of 'cheapness' and opportunistic M&A
- Pressure on CEOs to deliver growth despite deteriorating economic conditions and thus some may see M&A as a 'quick fix'.
- Optimistic business confidence may reflect that executives see the economic turbulence as the 'new normal'; turbulence brings M&A opportunities

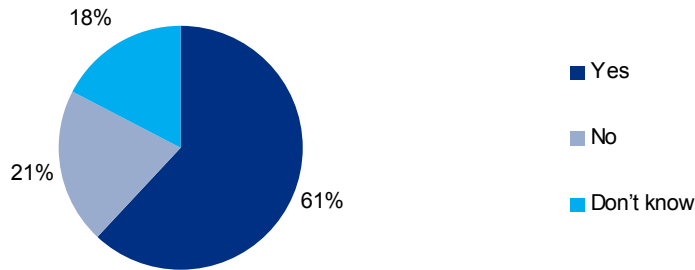
Chart 7: 12 month snapshot: falling valuations(March 2008-2009)



Falling valuations may create the conditions for opportunistic M&A

Source: London Stock Exchange

Chart 8: AIM executive anticipation of conducting M&A in the next 12 months



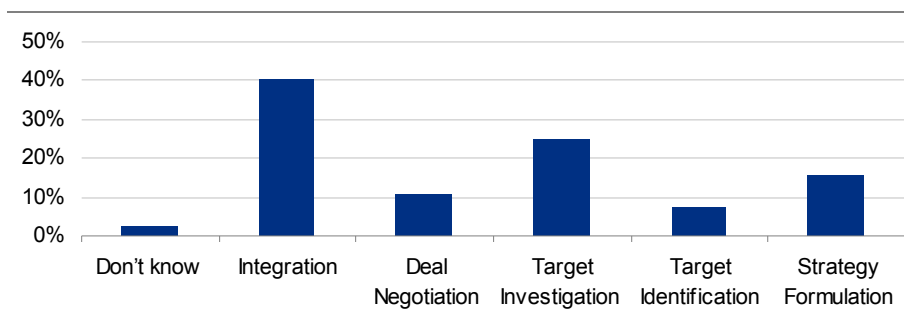
61.9% of AIM executives anticipate conducting M&A in the next 12 months

Source: Daniel Stewart

Delivering AIM M&A Success

The M&A transaction lifecycle can be broken down into phases to aid planning and execution. 40% of AIM executives assess integration to be most critical phase to delivering M&A success.

Chart 9: AIM executive perceptions of which M&A phase is most critical to M&A success



Source: Daniel Stewart

40% of AIM executives assess integration to be most critical M&A phase

Strategy Formulation

Strategy can be described as the engine that drives M&A success. M&A is one option that is available to executives but critically it must fit within the overall corporate vision and business planning processes. Too often it is not until the deal is done that the strategic rationale is made up to justify the deal to the markets. Although other survey evidence suggests that 40% of executives had no M&A investment thesis AIM executives, on average, attach 'high importance' to linking M&A and corporate strategy.

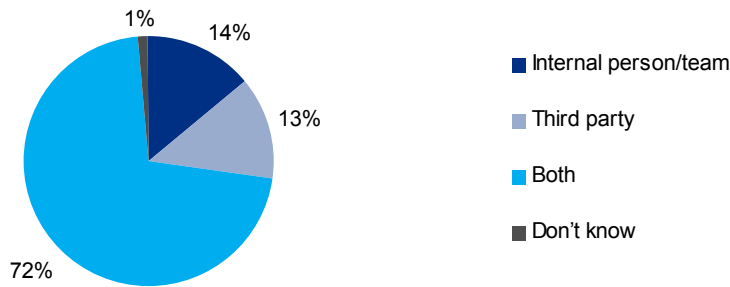
AIM executives attach 'high importance' to linking M&A and corporate strategy

Location & Investigation

Our findings show that 71.4% of AIM companies employ both internal and external resources to conduct due diligence. Due diligence and 'non-financial' due diligence were classified as 'vital' by 53.2% and 48.1% of executives respectively. The prominence of 'non-financial' due diligence is noteworthy as a growing lobby seeks to expand the scope of traditional due diligence beyond legal and accountancy matters.

71.4% of AIM companies employ internal and external resources to conduct due diligence

Chart 10: AIM companies approach to due diligence



Source: Daniel Stewart

The willingness of AIM companies to utilise precious resources on due diligence is significant. Due diligence is a necessity rather than a luxury for the following reasons:

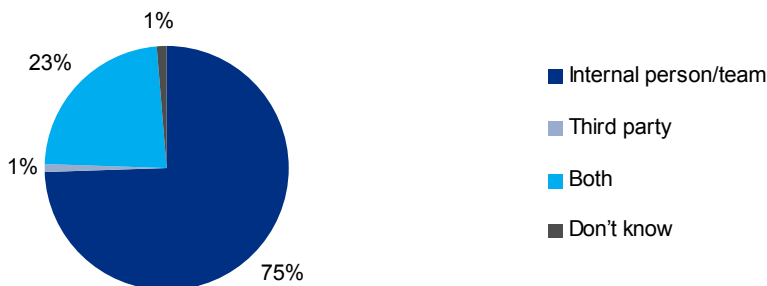
- The consequences of M&A failure can often mean corporate failure
- AIM companies often have little occurrence of in-house M&A expertise or experience
- An increasing litigious business environment and changing personal attitudes to risk
- Learning the lessons of high-profile M&A failure (e.g. ABN Amro)
- Economic volatility adds additional risk and uncertainty

Buyer beware

Negotiation

Deal negotiation can be a tense and competitive period. 74.4% of executives indicated that their companies conduct the deal negotiation process using only internal resources. This may reflect a view that mid market deals are insufficiently complex to merit external advisory services and/or a cost consciousness to minimise advisory fees.

Chart 11: AIM companies approach to M&A deal negotiation



Source: Daniel Stewart

74.4% of AIM companies employ only internal resources to conduct M&A deal negotiation

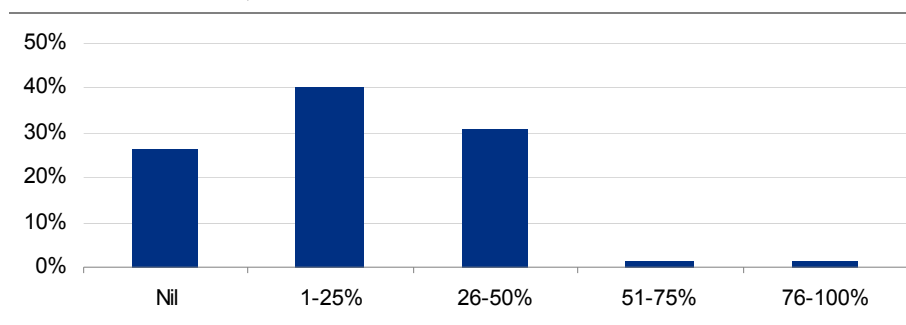
M&A premiums attract significant attention. Overpayment is commonly thought to be a leading cause of M&A failure suggesting a causal relationship between size of premium and transaction success. Valuation techniques encompass both art and science as they quantify the tangible and intangible. The third dimension to agreeing a price is management. Executives can be susceptible to 'deal fever' which can result in overpaying for seemingly attractive targets. Sensationalist media coverage exacerbates the myths and misconceptions however the feverish atmosphere of the

'...managerial intellect wilted in competition with managerial adrenaline. The thrill of the chase blinded the pursuers to the consequences of the catch'

Warren Buffett

M&A process, especially in hostile bids, can drive executives to unnecessarily increase the bid premium and succumb to the 'winners curse'. Seemingly rational financial transactions can be influenced by irrational human behaviour. Our research found that 40.3% of executives indicated that the optimal premium size is between 1-25% of the targets value.

Chart 12: AIM company optimal size of acquisition premium

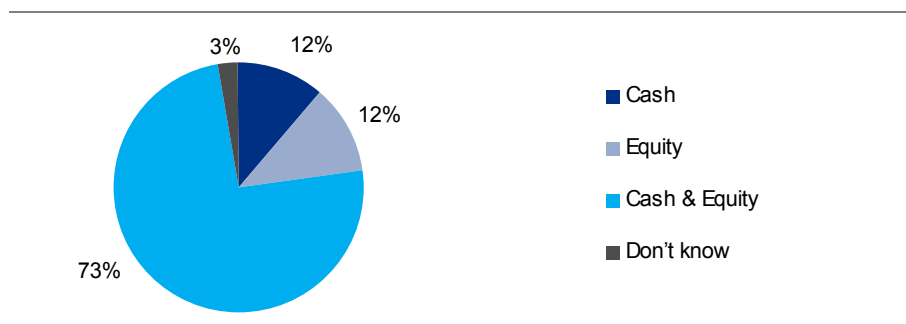


Source: Daniel Stewart

1-25% reflects the optimal size of acquisition premium

How a transaction is financed has attracted interest as a potential contributory M&A success variable. Recent research shows cash deals to have significantly higher returns than pure equity deals or mixed methods of payment. AIM executives report that their companies financed M&A deals using both cash and equity. This suggests that they are not optimising returns but in reality reflects the availability of funds in the mid market. Cash is a scarce, but highly priced, resource, while equity offers a practical, but potentially expensive (as valuations fall), acquisition currency. 50.6% of AIM executives ranked the method of financing of 'high importance' to M&A success.

Chart 13: How AIM companies finance M&A transactions



Source: Daniel Stewart

74.4% of AIM companies financed M&A deals using both cash and equity

Integration

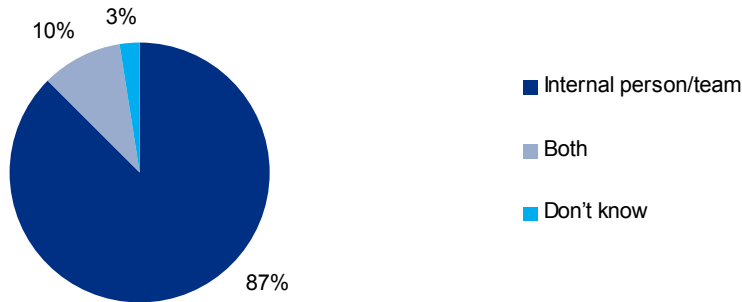
The collaborative nature of M&A creates significant integration demands. An M&A transaction in isolation does not create value; it is in the actual management of the post-acquisition phase that value is created or destroyed. 40% of AIM executives assessed integration to be the M&A phase most critical to success. Common integration challenges include opaque strategy for the enlarged entity, confused reporting relationships, cultural clashes and human resources issues. Integration is about change and change is quintessentially a human and emotional experience.

Different types of acquisition may require different integration approaches. However a consistent finding is the requirement to approach integration interactively and proactively. Starting the M&A process with an 'end-state' clearly visualised is imperative; research suggests that companies with sound post-merger integration

The merger before the merger

planning and execution outperform their competitors by 50%. The majority of AIM companies surveyed (87.3%) conduct post merger integration using only internal resources whilst 58.2% regarded post merger integration as 'vital'.

Chart 14: How AIM companies conduct post merger integration



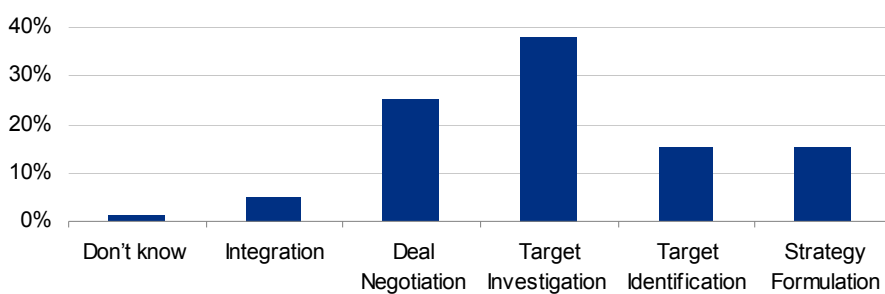
Source: Daniel Stewart

87.3% of AIM companies employ only internal resources to conduct post merger integration

Mid sized companies may have an advantage executing post merger integration owing to their limited complexity and flatter organisational structures giving them greater agility and flexibility than larger organisations. A further explanatory factor may be the high incidence of personal shareholdings by board members which combined with limited resources can create a 'fear of failure'. There is no alternative but to get post merger integration right; and right the first time.

93.7% of AIM companies begin post merger integration planning before the integration process actually begins. This leaves an alarming 6% of companies who conduct post merger integration on an *ad hoc* basis.

Chart 15: When AIM companies begin post merger integration planning



Source: Daniel Stewart

38% of AIM companies start post merger planning during due diligence

Although the majority of AIM companies start integration planning early, speed of transition can be a key factor when attempting to improve M&A performance. 60.8% of AIM executives assessed speed of integration to be of 'high importance' to M&A success. The need for speed is often externally driven by stakeholder/shareholder enthusiasm for evidence of value creation or synergies. Limited resources, competing demands for executive attention and associated distractions suggest that effective integration in carefully selected key areas to achieve maximum effect with maximum efficiency could be an optimal solution. We call it 'smart speed'.

'smart speed' for executing integration

M&A triggers unprecedented people issues. Accelerated change exacerbates human resource issues and uncertainty. Executive and employee retention are both accepted as having a positive influence on M&A success. For example, 53.2% of AIM executives classified minimising employee turnover as a matter of 'high importance'. Some explanatory factors for this attitude may be:

Minimising staff churn

- Retention of knowledge and skills
- M&A focused on purchasing specific capabilities and competencies
- Time, cost and disruption of redundancies are not advantageous in the short term

The majority of the issues raised so far have been inward-looking. Keeping a watchful eye on the external environment, especially client retention and competitor activity, is critical. Focusing on revenue growth rather than cost reduction should be a topic for boardroom discussion. The fact that 53.2% of AIM executives regarded maintaining existing client relationships as 'vital' is not unexpected which the following factors may explain:

Focus on revenue growth rather than cost reduction

- Economic turbulence demands greater customer focus and intimacy
- Predatory and opportunistic competitor behaviour requires continued high service levels

So what matters?

Putting it all into practice

M&A presents a series of managerial dilemmas. Executives are faced with a myriad of competing demands within a compressed time period. Executives must make choices and trade-offs. So what matters? Our analysis, based on AIM executive responses, suggests that the following M&A activities are the highest priority critical success factors:

- Post merger integration
- Due diligence
- 'Non-financial' due diligence

We asked AIM executives to rank the importance of M&A activities. The contribution each activity made to M&A success was graded from (1) "irrelevant" to (5) "vital". We aggregated responses weighted to the overall response rate.

Chart 16: AIM M&A success factor rankings

Ranking	Success Factor	Weighted Average
1	Post-merger integration	4.56
2	Due diligence	4.47
3	"Non financial" due diligence	4.43
4	Maintaining existing client relationships	4.42
5	Linking M&A and corporate strategy	4.37
6	Leadership	4.34
7	Communication (internal & external)	4.19
8	Method of financing	3.94
9	Speed of integration	3.94
10	Managing cultural issues	3.94
11	Managing human resource issues	3.84
12	Recommended (i.e. not hostile) deals	3.80
13	Prior M&A experience of the Directors	3.67
14	Acquire related M&A targets	3.57
15	Minimising employee turnover	3.54
16	Minimising executive turnover	3.32
17	Planned rather than unplanned M&A	3.22
18	Prior M&A experience of the Company	2.85

Post merger integration dominates AIM executive M&A priorities

Source: Daniel Stewart

We endorse the idea that each M&A transaction is different and therefore requires a bespoke approach. As such our proposals provide a useful starting point from which executives can selectively and intelligently focus managerial effort to maximise the probability of M&A success. A 'one size fits all' approach is doomed. By embracing these high priority success factors simultaneously AIM companies are increasing the odds of M&A success and perceived M&A success (51.9% believed that their pre-deal M&A objectives had been 'realised'). These levels of perceived M&A success are comparable with other research. Our survey highlights the complexity of M&A

processes and the importance of managing 'softer' human/organisational aspects in conjunction with 'harder' strategic/financial issues.

The results from executive surveys tend to contradict the conventional view of M&A success rates obtained by financial analysis and market-based returns. The following lines of explanation are proposed to reconcile the apparent contradiction:

- Executive surveys are susceptible to respondent bias and subjective personal rationalisation.
- A time-lag may occur before the effects of the transaction are reflected in the share price although strategic/synergistic objectives have been achieved.
- The definition of pre-deal objectives is imprecise.

Managerial Implications & Recommendations

The findings of our survey have practical managerial implications. As we believe that there is no standard way to manage a merger or an acquisition the following recommendations provide managerial guidance rather than gospel:

- M&A must be viewed not as a transaction but as a multi-dimensional process
- A multi-lateral and integrated approach is required
- Post-acquisition integration does not begin at the end of the deal
- Manage both 'hard' and 'soft' issues
- Consider intangible and tangible assets equitably
- Each M&A transaction is unique; success factors require intelligent and bespoke application



Daniel Stewart & Co

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