DIRECTAIM

A QUARTERLY UPDATE FOR AIM COMPANIES | Q2 2014

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WELCOME
TO DIRECTAIM Q2 2014

The decision to allow AIM shares to be included in ISAs appears to be paying off. Trading volumes immediately soared in the wake of the change, and far from tailing off (as many feared they might) this increase in activity is holding up well. The change marks a very real graduation for AIM to a new level of maturity, and it will be fascinating to see how it continues to develop.

Although AIM's evolving make-up is shifting away from its historical dominance by resources companies, these remain a cornerstone of the junior market. Our sector focus this time is on one natural resource in particular: diamonds. Although we don't consume diamonds in the same way as we do oil, for example, it is sobering to reflect that one day humanity will have dug up every accessible diamond in the earth's crust. It would appear that the world's supply of diamonds has already started to run down – but as it does so, the rewards for investors should rise.

Another resource that seems to be dwindling is the .com suffix to internet domain names. More and more top-level domains (TLDs) are being introduced to meet the snowballing demand of new companies and websites, and the AIM-quoted CentralNic is capitalising on this opportunity. A registry services provider, CentralNic assists clients who bid for much-coveted TLDs, with a 100% success rate to date. We talk to their CEO, Ben Crawford.

In addition to bringing you a summary of the biggest current AIM stories, in this issue we also offer a quick overview of the key announcements in the recent Budget that could affect AIM-listed companies.

If you have any questions, feedback, or suggestions for companies we might cover in future issues, please get in touch.

JEFF HARRIS
Partner – BDO LLP

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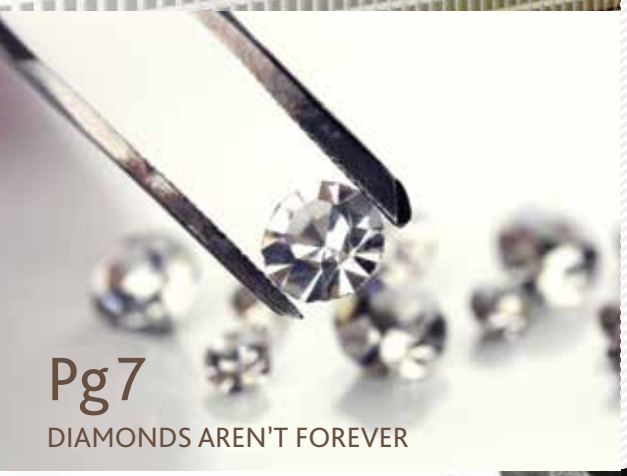


NEWS

AIM GAINS MORE REASONS FOR CONFIDENCE

Compared to its stellar 2013 performance, AIM has admittedly had a more modest year to date. An impressive rise of 20.3% last year across the junior market was nevertheless dwarfed by the showing of the FTSE AIM 50 index, which jumped by 43.4% over the same period. Undoubtedly a big factor in the second half of the year was the inclusion of AIM shares in ISAs, helping to drive that strong performance.

Growth is continuing in 2014, albeit at a more sedate pace. In the first eleven weeks of 2014, AIM as a whole rose by 2% and the FTSE AIM 50 index rose by a similar percentage. This compares favourably with the FTSE All Share index which is 1% lower, while the FTSE Small Cap index is 1.7% higher.

Fund manager Douglas Lawson of Amati has observed that increased investment in inheritance tax portfolios has also helped the performance of AIM. He argues that numerous investors are seeking alternatives now, as many of the lower risk, larger businesses are looking more fully valued.

High net worth investors have more confidence in stock markets than at any time since 2007, according to research carried out by financial adviser the de Vere Group. Such individuals are also expected to invest more in the coming year. This positive attitude (57% of those surveyed said that they were feeling bullish about the investment market over the next 12 months) is good news for all markets, including AIM. Back in March 2007 the figure was slightly higher (at 59%) but it fell to 44% in 2011. The survey is based on 756 de Vere clients around the world, each of whom has investable assets of more than £1m.

There could be further demand for AIM shares thanks to the 2014 Budget, which increased the annual ISA limit to £15,000 and also made it easier to switch from shares into cash without the immediate need to reinvest. This should attract more funds into ISAs, with AIM receiving its fair share.

Another positive development (though not so dramatic as the ISA reforms) is the ending of stamp duty on AIM share deals. Trading volumes have started the year strongly, with the average daily value of trades in the first two months of 2014 hitting £211.6m. Only 2006 and 2007 have posted higher averages for the full year, although the average for the first two months of 2008 was also higher. The average daily number of bargains in the first two months of 2014 was 26,325, or nearly 10,000 higher than the average in the first two months of 2007. That shows how much more activity there is now compared to the market's peak, even though the figures are not so high in terms of value. That suggests many more small deals in AIM shares, encouraged at least in part by the stamp duty reform.

Advisers continue to exit AIM, but the flow is not all one way. Allenby Capital has acquired fellow AIM-focused broker First Columbus, while Credit Suisse Securities (Europe) has asked to be removed from the nominated adviser register. Nevertheless, there always seem to be new brokers popping up. Whitman Howard is involved with the flotation of book dealer Scholium Group, having picked up its first two AIM brokerships in the past six months.

A BUOYANT YEAR FOR FLOATS

New AIM admissions are picking up the pace in 2014 with some sizeable flotations. Among these was online fashion retailer boohoo.com, which raised £300m in one of the largest cash raisings on AIM for many years. Douglas Lawson, the fund manager of the Amati VCTs, puts the recent surge down to companies which had been keeping their powder dry for better markets.

So far this year more than £1bn has already been raised by new admissions, and already the figure is approaching the £1.19bn raised in the whole of 2013. It is already a certainty that more cash will be raised by new admissions than in any year since 2007 – though it is unlikely to rival that year's figure of £6.58bn.

In many recent flotations, such as Manx Telecom and DX Group, the private equity backers of the businesses have completely sold out as part of the placing. Lawson concedes that private equity backers do need an exit strategy, but his preference is for them to retain some equity in the business.

At present there seems to be no shortage of companies that would like to come to AIM. In the Close Brothers Business Barometer survey conducted at the end of 2013, 15% of the companies surveyed expressed this wish (while an additional 15% of the sample are already AIM listed companies). Of course not all of those ambitions will come to fruition, but the survey does reveal how prominently AIM is figuring in the vision of growing companies.

DIVIDENDS DRIVE HIGHER PERFORMANCE

AIM companies that pay dividends have been the stronger performers of recent years. In its publication "Dividends on AIM", broker Allenby reports that last year the top 50 dividend payers on AIM significantly outperformed the junior market as a whole. It was the third year in a row in which the dividend payers outperformed their rivals – although Allenby believes that 2014 may upset this trend.

"With markets recovering and investors' risk appetite increasing, we feel that it is unlikely that high yielders will outperform low yielders yet again," the broker warns, but adds, "We feel that they should still form a core part of any portfolio."

The top 50 AIM dividend payers produced an average 12 month return, including dividends, of 37.1%, against 21.8% for the market as a whole. The performance is measured over the 12 months since the previous year's "Dividends on AIM" publication in March 2013. At that time, the top 50 AIM dividend payers had an average yield of 4.2%. Even though AIM share prices have increased, Allenby reveals that there are still 33 companies yielding more than 4%.

The broker estimates that around 250 of the 1,100 companies quoted on AIM will pay dividends in 2014, which is similar to last year. The average market capitalisation of a dividend payer is £110m, compared with the average for AIM companies of £69m.

Some new entrants to AIM have attracted investors with the prospect of an attractive yield, such as Manx Telecom which promised a 7% dividend yield at the placing price of 142p a share. That valued the fixed line, mobile, broadband and data centre services business at £160m. The share price has risen since then, but the yield is still more than 6%.

INSIGHTS FROM NEW FINNCAP INDICES

Broker finnCap has launched three new indices covering smaller companies in the mining, oil & gas and technology sectors. The big difference between the new indices and existing sector indices is that each constituent has an equal weighting, which means that the largest companies will not dominate any index movements.

The finnCap 40 Mining index takes liquidity into account, and a constituent of the index must have a minimum market capitalisation of £30m. Furthermore, there are no diversified miners or royalty businesses. The finnCap E&P index concentrates on the oil & gas exploration and production companies, rather than on major integrated oil companies, and the minimum market capitalisation there is £50m. Meanwhile the finnCap 40 Tech index does not include any globally diversified telecoms businesses, and sets a maximum market capitalisation of £1.5bn.

Most of the constituents of each index are listed on AIM, although Main Market companies also make their presence felt. Each index will be rebalanced and redefined every three months to ensure its ongoing consistency. This task will be handled by the investment committee, which includes the finnCap sector team and GB Indices, which is a specialist in creating indices that narrow down the stock market into smaller niches.

CHIEF QUITS AS UK GOES COLD ON MULBERRY

Bruno Guillon has stepped down as chief executive of Mulberry, the AIM-quoted luxury branded goods supplier, two years after taking the job. Attempts to take the brand upmarket have not yielded the hoped-for benefits, with disappointing financial results and a share price decline of more than 60% since Guillon joined the board.

It is not merely that UK sales of Mulberry handbags are down. A recent trading statement admitted that total retail sales fell by 3% in the 17 weeks to 25 January 2014, with all the decline in the UK. This happened predominantly over the Christmas and New Year period, while Mulberry also warned of significant cancelled orders from Korean customers. Guillon has largely been successful in increasing international retail sales, but not to the extent of offsetting the UK decline.

Guillon joined Mulberry in March 2012 from French luxury goods brand Hermes Sellier, where he had been employed for more than a decade. Godfrey Davis, whom he replaced as chief executive, is returning to the role of executive chairman (having been non-executive chairman for two years). A new chief executive is now being sought. In related news, last June it was announced that creative director Emma Hill was leaving Mulberry, and her replacement has yet to be appointed.

SIGMA SECURES RIVERSIDE VIEWS

AIM-quoted Sigma Capital has agreed to acquire the first London site for its private rented residential portfolio. The site in Barking Riverside is set to be one of the largest residential regeneration schemes in the UK, with 318 new homes planned by Sigma in four separate apartment blocks. There are further plans to acquire more sites in the South East and London.

The heads of terms have been agreed with a joint venture between the Greater London Authority and Bellway Homes. The overall cost of constructing the apartment blocks will be more than £50m. If all goes to schedule then construction will commence before the end of 2014, with the project expected to take two years to complete. When finished, Barking Riverside will be a major development comprising more than a mile of Thames river frontage, near Barking town centre and close to the City of London and Canary Wharf.

This latest deal follows Sigma's joint venture with Gatehouse Bank, which will invest approximately £700m in developing up to 6,600 rental homes in Greater Manchester and Liverpool, where Sigma already has relationships with the local authorities.

KOOVS SETS THE TREND IN INDIA

Investors have a new doorway to the growth in the Indian online fashion retailing sector, thanks to an AIM-quoted investment company whose board includes two former directors of ASOS. Koovs plc, the majority owner of Koovs.com (the Indian equivalent of ASOS), was valued at £36m when it joined AIM. Koovs is chaired by former ASOS chairman Lord Alli and raised £22m at 150p a share to finance the purchase of a 57.5% stake in Koovs India, which owns Koovs.com.

Set up by Lord Alli together with Robert Bready, Koovs plc became a consultant to Koovs.com in September 2012. Formerly product director at ASOS, Bready is now the creative and brand director at Koovs, and in July 2012 he raised £2.6m by selling his ASOS stake. Then in October 2012 he resigned after seven years with ASOS. Bready owns 3.5% of Koovs and Lord Alli owns 19.6%.

The company's non-executive directors include Emily Sheffield, the deputy editor of British Vogue (and sister of Samantha Cameron) and Penguin Books boss Dame Gail Rebuck. The third non-executive director is Anant Nahata, whose family interests currently have a controlling interest in Koovs India and own 15% of the enlarged share capital.

NEW STARS BORN THANKS TO IP GROUP FUSION

IP Group, the Main Market-listed investor in university spin-out companies, has snapped up its smaller AIM-quoted rival Fusion IP. A share swap valued Fusion IP at £87.8m, which when added to a fundraising of £72.9m means that the combined group will have a cash pile of more than £110m to invest in existing and new university spin-outs – some of which could themselves end up floating on AIM.

The two companies have already been working together for more than four years. IP Group first got involved with Fusion IP at the end of 2009, when it took a 19.8% stake as part of a £3m net placing at 27p a share. The original deal also gave IP Group 20% of any new stake that Fusion IP took in a university spin-out.

IP Group already has a number of deals with universities, while Fusion IP adds agreements with the University of Sheffield, Cardiff University, the University of Nottingham and Swansea University. This will give IP Group a total of 15 direct relationships with universities, including Oxford, Leeds, Southampton, Bristol, Manchester and King's College, London.

IP Group has already floated a number of companies on AIM, including gas-to-liquids technology developer Velocys and virology healthcare business Retroscreen Virology. The most recent flotation was Bath-based Actual Experience, which ended the first day of trading 350% higher than its introduction price. The company has used 10 years' worth of research by Queen Mary, University of London to develop software that helps businesses to make the most of their website and digital services. Although the share price has fallen back since, it is still more than three times its introduction price.

The next IP Group company to float on AIM will be Xeros, which has developed reusable polymer beads that reduce the amount of water required in washing machines. Xeros is a 2006 spin-out from Leeds University, and IP Group will own 18.6% after the flotation, which values Xeros at £80m.

PINEWOOD ROLLS INTO WALES

Pinewood Shepperton, appointed by the Welsh government to advise on a new Welsh media fund, is to run a new four stage studio near Cardiff Bay, which will be known as Pinewood Studio Wales. The AIM-quoted company is also advising on the design of a new TV and film studio complex in China.

Pinewood Shepperton is already the largest provider of studio space in Europe. The Welsh government will acquire and fit out the new studio, with Pinewood taking a minimum lease of five years as well as investing £800,000 in equipment. The Welsh media fund is worth £30m which, along with the existing advisory agreement for a similar Isle of Man fund, takes Pinewood's combined advisory investment funds to £55m.

WOLF TO PRODUCE HEAVY METAL

AIM-quoted tungsten and tin miner Wolf Minerals Ltd has raised £99.2m to finance the construction and commencement of operations at its Hermedon tungsten project in Devon. The issue price of 16.3p a share is at a discount of one-third to the market price at the time off the announcement, but the cash call does mean that the project will definitely go ahead.

Hermedon will be the first new metals mine in the UK for more than four decades, and offers the third largest tungsten resource in the world. The open cast mine, situated south of Dartmoor, should provide 200 new jobs. Work has already started on the project, with production scheduled to commence in 2015. The target production level is 3,450 tonnes of tungsten concentrate each year.

The cash will be used to repay the £75m bridge finance facility provided by Resource Capital Fund and also to complete the mine's construction. There will also be spare cash to cover over-runs and other contingencies, as well as working capital. The cash should be sufficient, along with debt facilities of £70m, to finance Wolf until the mine starts to generate cash of its own.

RCF will subscribe for enough shares to give it 41.8% of the enlarged share capital of Wolf, while Todd Corporation will buy enough new shares to give it a 32.5% stake. This represents an increase in their current stakes of 36.4% and 19.9% respectively. The general meeting to approve the fundraising will be held on 5 May, and everything should be finalised later in the month.

DOMAIN MAN

Is the internet's address book filling up? As websites proliferate, the choice of domain names needs to expand in order to maintain competition. This change is bringing rich new opportunities for companies such as the AIM-quoted CentralNic. We talked to CEO Ben Crawford about the revolution in what comes after the dot.

BEN CRAWFORD

Television viewers from the early 1990s may have fond memories of the BT adverts in which Maureen Lipman's character, Beattie, moaned about the change in the London dialling codes. Adding an extra digit relegated her home to the suburbs – she snootily insisted she was actually "Greater London".

Now the problem that once confronted the telephone system – the sheer surging numbers of users all needing a unique identification – is being felt on the internet. The most popular and recognisable top level domain (TLD) is of course .com, but therein lies the problem. Currently there are more than 110m domain names that end in .com, which is making it increasingly difficult to find a succinct web address for a new site. And with the numbers of people gaining access to the internet rising by tens of millions each year, pressure is mounting.

Despite the existing variety of global top level domains (gTLD), such as .com and .net, and country code top level domains (ccTLD) such as .uk, the internet sector has welcomed the increase in options. Many more TLDs are now being made available to the public, with more descriptive or specific suffixes such as .website and .blog. This widening of the playing field is being hailed as a major boost to the sector, and one company in a strong position to benefit is the AIM-quoted CentralNic, which is run by Ben Crawford.

AN OLYMPIC PEDIGREE

With a business dating back to 1995, CentralNic is a registry services provider – effectively a distributor of domain names to the registrars or retailers from which companies or individuals purchase them.

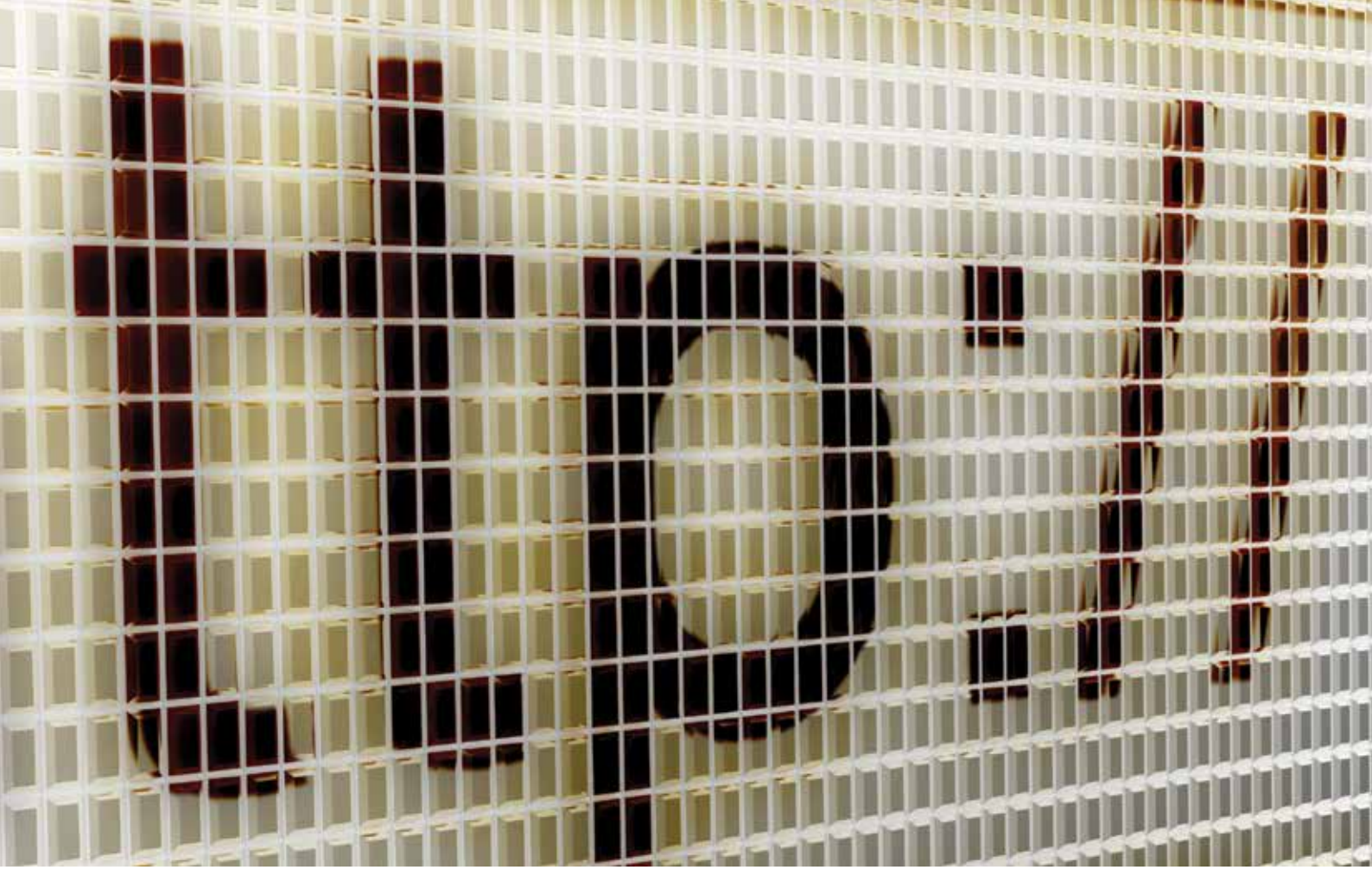
"It was never intended that there should be a limited amount of choice of domains," says Ben. "Now CentralNic is at the forefront of correcting that situation, so I see this as a great opportunity for us."

Ben's background proved to be excellent training for the fast-evolving world of the web. "I started working in the internet back in Australia in 1996, having previously worked in the media," he recalls. In what were then very early days for the internet, he was involved in providing content for Microsoft before making an even bigger mark. Ben led the team that won the tender to run the website for the 2000 Olympics in Sydney, and was executive producer of the Sydney Olympics website between 1998 and 2000. At that time it was the highest traffic website in history.

After this Ben moved to the UK, staying in the sports media sector as Managing Director of SportBusiness Group. There he was involved in several acquisitions and the launch of iGaming Business. He then joined Louise Blouin Media, a global arts business based in New York, where as founding President he was involved in acquisitions and their integration into the business.

Ben joined CentralNic in 2009. One of the things that attracted him to the business was the IT platform that had been developed to connect rights holders to the retailers. Whenever a new retailer is taken on, it has to be integrated into the system. As Ben explains, "Once the retailer is integrated, purchases and domain name creation are all automated." The platform is a fixed cost, and the new domains mean that there is more inventory to sell through it.

Another attraction for Ben was the recurring revenues. As a subscription-based business with high rates of renewal, there is effectively an annuity income. "We collect the cash for the domain name owners and they pay from one to ten years in advance, and most retailers pre-fund their accounts with us as well," he reveals. This makes the business highly cash generative.



CentralNic also owns a number of domains, including second level domain (SLD) extensions such as .uk.com, .us.com, .eu.com and .cn.com, which are valuable in themselves. "Other two-letter .com domains have sold for £3-6million each over recent years," Ben points out.

CHOICE DRIVING COMPETITION

The launch of so many additional options for domain names will dramatically increase choice in the sector, and so help to drive competition. It should also mean that specific sectors will tend to gravitate towards particular TLDs – so, for instance, bars would typically have one TLD, while cafés would have another.

It may be a surprise to some that this move has been so long in coming. The Internet Corporation for Assigned Names and Numbers (ICANN) is the non-profit organisation that oversees the TLDs on behalf of the US government. Ben reveals: "It was always part of ICANN's mission to introduce new TLDs as well as ensure the internet's security." ICANN recognised the need to increase competiveness in the sector with more domain name choice, but the move required consensus, so it took time for the process to commence and for the domains to be awarded. CentralNic is partnering with applicants for these new domains.

To date CentralNic has been involved in 60 bids for new TLDs. Bids are time consuming and costly, with a thorough application process even for those domain applications that are uncontested. "These are 200 page tenders covering security, financials and technology," Ben reveals. First the bidder pays $185,000 and then ICANN does due diligence on the bid. This is where CentralNic's role becomes so important – having CentralNic as a preferred technology partner in the bid helps to reassure the authorities about the technology aspects of the application. CentralNic's clients have been successful in all their applications, with 25 of these being uncontested. These include .wiki, .xyz and .bar, which were launched in the first quarter of 2014.

Furthermore, individual businesses can now apply for their own TLDs. For example, the Guardian newspaper has been awarded .theguardian and .observer, and CentralNic will be paid a fee for providing services to them. Clients of the company are still in contention for a further 27 TLDs, including .golf, .app and .blog.

Some new domains may require assurance that the purchaser is qualified to use it. "Each domain has its own policies, and some have panels of people to judge whether to approve an application," says Ben. One example of this is .REIT (the TLD for Real Estate Investment Trusts). However, decisions typically do not take long – a matter of days.

JOINING THE DOTS TO GROWTH

CentralNic floated on AIM last September, raising £7m at the time. Some of that cash is earmarked for investments to help with some of the TLD applications in return for a share stake. The company also has other avenues for growth, one of which is winning contracts to distribute country codes. CentralNic currently manages .pw on behalf of Palau and .la for Laos and has a revenue sharing agreement with them. They also sell .la domains in California via CentralNic's own website http://www.la – thus moving into the retail area themselves.

CentralNic does not need to raise money at the moment for working capital, but Ben is happy to have that option to hand. "It is extremely useful to have access to funds to accelerate our growth through the AIM quotation," he says. But he also sees other advantages to being on AIM, quite apart from raising funds. The reputational boost stands the company in good stead when dealing with governments and discussing country codes. "Being quoted is useful when we are meeting a minister," he confirms. CentralNic is now poised to take advantage of the next big stage of internet evolution, with many exciting prospects in store as it helps shape the future face of the web.

DIAMONDS AREN'T FOREVER

With no major new resources discovered for nearly 20 years, world diamond production is looking at a slow long term decline. But it's not all bad news, as the tightening supply is raising the value of existing mines, while emerging markets and increased global affluence fuel demand. DIRECTAIM explores a sector that still shows plenty of sparkle.

In the oil sector we are used to hearing experts talk about "peak oil" – meaning the estimated point at which global oil production peaks and enters a permanent decline. But the concept can also be applied – albeit with less severe potential consequences – to the production of diamonds.

"We are already at peak diamonds," argues Dr Stephen Grimmer, chief executive of Paragon Diamonds. Stephen, who has more than 25 years' experience in the diamond industry, believes we have seen all the supplies we ever will. "It is unlikely that any more large kimberlites will be found," he says. Kimberlite (the deepest-forming variety of igneous rock) is the source of the largest diamond deposits – but very few of the world's kimberlites actually contain commercial diamonds.

Today there are around 30 significant kimberlite diamond mines that are currently in production – the most recent of which was discovered in 1997. With the dearth of new discoveries in the past two decades, many of the larger mines are moving from open pit to more costly underground mining.

Which is not to say that the world's diamonds are running out – or even close to it yet. AIM-quoted Paragon is developing the Lemphane kimberlite pipe project, where it has an 85% stake. Lemphane is near to the Letseng diamond mine, which is operated by fellow AIM-quoted diamond miner Gem Diamonds. The estimated value of Lemphane is $900m-$1,800m, with open pit production expected for at least 10 years followed by underground production. The initial phase of production should commence before the end of 2014. The mine is in a region which is famous for large, high quality diamonds, many of which are bought by investors.

STILL AN INVESTOR'S BEST FRIEND

Diamonds have lost none of their sparkle when it comes to luring investors. Evidence of their enduring attraction can be seen in the finance package secured by Firestone Diamonds. The AIM-quoted miner has raised more than $222m to finance the development of the Liqhobong mine in Lesotho, where it owns a 75% stake. This fund raising began last November when Firestone secured $82.4m of project debt financing from Absa Bank, following this up in January with a $140m (£85.4m) finance package to fund the construction of the main treatment plant at Liqhobong. The latest financing package includes bridge and mezzanine debt plus share subscriptions by two strategic investors, Pacific Road and RCF VI. The downside for AIM investors is that the finance package is dilutive – Pacific Road now owns 23.5% of Firestone's enlarged share capital and RCF VI owns 46.9%. Once all the preconditions are fulfilled, the cash will finance the construction with a view to achieving full production at Liqhobong by early 2016 (trial production started in July 2011).

The potential decline of global diamond production in the long term is prompting buyers to try and secure supply now. Last year, AIM-quoted DiamondCorp secured project funding and a partnership agreement with jeweller Tiffany & Co, which enabled it to restart production at the Lace mine in South Africa. In return for a $6m loan from Tiffany, the jeweller will be offered the right to purchase the diamonds produced on commercial terms, subject to them being of suitable quality and colour.

A DIAMOND PEAK?

Historically the world's diamonds have come from two distinct sources. Most of the earliest discoveries were secondary or alluvial deposits, where rivers had eroded the softer surrounding rock and carried diamonds downstream to deposit them in sediments. However, modern production is dominated by primary deposits in kimberlite, which is volcanic rock from deep beneath the Earth's crust. Diamonds are now mined in around 25 countries worldwide, but without new kimberlite discoveries the existing primary sources will eventually run out.

Diamond production is actually forecast to rise in 2014, up to 135 million carats (from just over 130 million carats in 2013). However, that is still below the peak output of 176 million carats in 2006, which was followed by a three-year decline and then a slump to 120 million carats in 2009.

The Marange diamond fields in Zimbabwe accounted for around 13% of total diamond production in 2013, but lower production is expected this year. The current largest mine in terms of the value of diamonds produced is the Orapa mine in Botswana, which is forecast to produce $1.9 billion worth this year.

The Letseng mine in Lesotho has regularly produced a large proportion of the highest value diamonds in the world. Although Letseng has the lowest grade of any diamond mine (an estimated 3.4 parts per billion of the ore body is of economic value), the size and quality of its diamonds makes up for their thin spread, lifting the average value per tonne of ore to around the industry norm. Letseng rough diamonds can command around $2,000 per carat, compared to the industry average price of just $130 per carat.

Political instability has strangled some other areas of potential diamond supply. Sierra Leone is a case in point, where the AIM-quoted Stellar Diamonds is developing the Tongo kimberlite project in the east. One dyke has a JORC (Joint Ore Reserves Committee) resource of 1.1 million carats, and further exploration in the area should increase this significantly, but war in the region has delayed the development of this and various other projects.

THE BRIGHTEST SPARKLERS

Diamond production tends to be dominated by its own big four, which account for more than three-quarters of the revenues from diamond sales. The Russian state-controlled diamond company ALROSA claims to have the largest diamond reserves in the world. The leading volume producer since 2009, it churned out 36.9 million carats in 2013, up from 34.4 million in 2012. This year ALROSA expects to produce 36 million carats but to sell 38m carats, with the excess coming from its stockpile. However, although ALROSA produces the most carats each year (operating eight out of the top 15 producing mines), it is De Beers that holds the top spot in terms of monetary value.

Anglo American generated more than £1 billion of underlying operating profit from De Beers in 2013 (having taken full control of De Beers in August 2012). This was a major factor in De Beers's operating profit contribution to Anglo American more than doubling in that year, although profit also benefited from improved prices and a weaker rand. Diamond output increased by 12% to 31.2 million carats, helped by Jwaneng in Botswana returning to full production during the year and higher production in Canada.

De Beers is the only one of the major diamond producers still involved in the retail market, since BHP Billiton sold its diamond interests (including the Ekati mine in Canada) to Dominion Diamond in 2012. The fourth slot in the diamond big four belongs to Rio Tinto.

Total global reserves of diamonds stand at 2.3 billion carats. More than two-thirds of these reserves are in Africa and Russia, with Canada and Brazil the next largest territories by volume. Additional potential resources, excluding the reserves, are found predominantly in Africa.

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DIAMONDS IN DEMAND

2013 saw a rise in diamond jewellery sales in local currency terms in nearly all major markets. The only exception was India, where the tough economic conditions and devaluation of the rupee led to a decline in demand, and trading conditions there will continue to be tough. China is already the second biggest market for diamonds, behind the US which accounts for 37% of consumption. Last year jewellery consumption in the US hit a six year high.

The days of De Beers controlling the market ended more than a decade ago, but diamond prices are not as volatile as other mineral prices. Although the market was not immune to the global downturn in 2008, and took time to recover, the market is much stronger now after the blip of 2012, and the outlook is positive for all types of diamond.

The Global Diamond Report 2013, published by Bain, sets out forecasts for demand over the coming decade. It estimates that global rough diamond demand will increase at a compound average growth rate of 4.2% to 6.4% between 2012 and 2023. These calculations take a number of factors into account. These include growth in global GDP, increasing numbers of high net worth individuals, the rising size of the middle class and greater penetration of diamond jewellery. China and India are expected to be major drivers in this growth of demand.

Bain cites eleven new mines that are expected to commence production over the next ten years, which could increase output by 18m carats a year. Of these, the largest single mine is Gahcho Kue in Canada's Northwest Territories, which could produce up to 6.1 million carats a year, although this is expected to decline to 2.8 million carats in 2023. Together, the new mines will help to offset declines in production from existing mines. For instance, Rio Tinto's Argyle mine, which produced 11.3 million carats in 2013, is expected to be depleted by 2023.

However, bringing new mines into production is not necessarily straightforward. Gem Diamonds hit major snags in developing the Ghaghoo mine in Botswana, going over budget due to problems in tunnelling through the sands of the Kalahari. Ghaghoo should still commence production later this year, although this will be a year later than expected.

Bain estimates that world diamond production could reach 153 million carats in 2023, but the value of production is forecast to grow more significantly (based on 2012 prices). The compound average growth rate of the value of diamonds over the decade is 2%, compared with 1.7% for volume. The gap between supply and demand is expected to grow rapidly between 2017 and 2023, which should mean rises in diamond prices. Charles Stanley forecasts a 2% rise in diamond prices in 2014, followed by 1.5% increases in each of the following three years. However, the first half of 2014 is expected to be flat with the rise in prices coming in the second half of the year.

In the medium-term, Kieron Hodgson of Charles Stanley Securities expects growth to be supported by the global economic recovery, although he does point out that banks reducing liquidity could hold back prices. For example, ABN AMRO provides 75% of the purchase value instead of 100% as it did previously.

As the supply of smaller diamonds suitable for jewellery declines, synthetic diamonds could start to replace natural diamonds. Bain is sceptical about this, but Dr Grimmer believes that synthetic diamonds will come in, albeit only at the smaller end of the market. "It will never be economic to produce prime diamonds synthetically," he explains.

There have been problems in India with jewellery manufacturers mixing natural stones with synthetic stones. India's Gems & Jewellery Export Promotion Council is cracking down on these practices in order to retain confidence in the market.

The share prices of most of the AIM-quoted diamond miners have declined over the past few years, but recent months have shown signs of a recovery. As some of the companies, such as Stellar Diamonds, Paragon Diamonds and Firestone Diamonds, move into production at their mines and start to generate cash, the share prices should start to recover. There is even the potential for future dividends from the already profitable Gem Diamonds.

As long as the AIM diamond miners can produce the diamonds commercially, the outlook for such companies is relatively bright. As overall supply declines, prices will rise in response and so increase the value of production. The earth may be yielding up fewer diamonds than in the past, but the rewards of digging these gems could still be some way off their peak.

TECHNICAL UPDATE

INSIDE THE MACHINERY OF THE BUDGET

This year's Budget announcements were good news for businesses planning to invest in new plant and machinery but not so good for those using agency workers or those entering auto-enrolment. We explore the highs and lows most likely to have an impact on AIM-listed companies.

Introduced in 2008, the annual investment allowance (AIA) allows businesses to claim 100% tax relief for business investment in plant and machinery (up to a maximum amount) in the year it is bought. Since then the annual maximum amount has changed many times, and from April 2014 (1 April for companies and 6 April for other businesses) it rises from the current £250,000 to £500,000. However, the new limit will apply only until 31 December 2015, when it is scheduled to revert to £250,000.

If your accounting year runs to 31 March, it is relatively straightforward to see how much of your business investment is eligible for tax relief. Sadly, it's not so simple if your accounting period straddles April 2014 (or any of the dates on which the AIA limit has changed).

As a starting point, you must treat the parts of the accounting period which fall before and after the change as stand-alone periods, then calculate the allowance due for each part and add them together. So for example, for an accounting year ending 31 December 2014, the allowance would be: (3/12 x £250,000) plus (9/12 x £500,000) = £437,500.

To complicate matters further, there are also maximum expenditure limits for amounts spent before each straddling date – these are calculated as if the AIA had not changed. In the above example, the maximum expenditure incurred before 1 April 2014 that qualifies for the AIA is £250,000. If this maximum amount is spent in that part of the accounting period, there is a remaining £187,500 available for expenditure from 1 April to 31 December 2014. However, the limit for purchases between 1 January 2015 and 31 December 2015 will be £500,000. Clearly, it is wise to double check your entitlement before you invest!

AGENCY RULES TOUGHEN UP

Businesses that use agency workers may be affected by new rules targeting "false" self-employment. Where workers are categorised as self-employed rather than as an employee, there is a direct saving of employer's NIC, PAYE is no longer collected at source, and the engager potentially avoids various legal obligations that apply to employees. The Government is concerned that intermediaries (typically agencies) are being used to obtain this saving for end user businesses.

Changes that take effect from 6 April 2014 will strengthen existing employment agencies legislation by removing the obligation for "personal service" and focusing on whether the work is subject to supervision, direction or control over the manner in which the duties are carried out. For workers who are engaged by or through an agency, there will be a presumption that there is control or supervision. Many more workers supplied through agencies are likely to be treated as employees of the agency, so the agency will need to deduct PAYE and account for employers' and employees' NIC. These increased costs are likely to be passed on to end users.

THE SWINGS AND ROUNDABOUTS OF PENSION AUTO-ENROLMENT

All employers could be affected by the major reforms proposed to the way that individuals taking pension benefits are taxed. Fundamental changes are proposed from April 2015 onwards to give individuals in defined contribution pension schemes more freedom. Individuals would still be able to take 25% of their pension fund as a tax-free lump sum, but would then be able to draw down the rest of their funds as income (in one go if they wish) or buy an annuity from age 55 (rising to 57 by 2028). Under the proposals there would no longer be a need to have a guaranteed pension income before drawdown is permitted. All withdrawals, aside from the 25% tax-free cash, would be taxed at the individual's marginal rate of tax, rather than at 55%.

This increased flexibility is expected to make it more attractive for individuals to make pension savings. This means that employers who have reached their staging date for automatic enrolment may find that there is a lower opt-out rate among their workforce than they previously expected. It is certainly better news for employees – but companies may face a greater burden.

FACTS AND FIGURES

A MILESTONE FOR THE JUNIOR MARKET

Trading rises thanks to ISAs, the top end of the market is growing more diverse, but natural resources lose some of their lustre as investors target the big AIM names.

The past six months have seen AIM move emphatically to a whole new level of trading activity, thanks to the decision last August to allow its shares to be included in ISAs. Despite some initial uncertainty over whether the increased volumes would continue, they have been holding up well. Activity surrounding the most popular companies remaining relatively consistent – as long as they not involved with natural resources.

We can see the significant and consistent uplift of recent months when we compare the pre-ISA figures with performance from August 2013 onwards. Even more revealing are year-on-year comparisons, as these remove potential seasonality. February 2013 saw a total of 372,596 bargains on AIM; fast-forward to February 2014 and the figure was 521,925 bargains, with a total value of £4.26bn – nearly £2bn higher than in February 2013. The improvement is even more marked if we compare the July 2013 figure of just 326,621 bargains (there are more trading days in July than in February, although summer trading levels can be lower).

THE SHIFT AWAY FROM RESOURCES

Of the top ten traded companies in February 2013, six remain in the top ten for February 2014. These are ASOS, African Mining, Monitise (the mobile banking services provider), Blinkx (an internet media company), Gulf Keystone Petroleum and Rockhopper Exploration. It is particularly notable how non-resources companies are attracting more trading activity, while certain previously popular resources companies are not attracting as much investor interest as in the past. This reflects the general decline of interest in the resources sector, although there are some exceptions, such as IGas Energy, where publicity about shale oil and gas has increased interest and trading activity.

Sure enough, three of the four companies to drop out of the top ten were resources companies, with far lower trading activity than they experienced a year ago. One might suppose that this is because investors are seeking dividend payers to put in their ISAs, and the resources companies do not pay dividends. But this assumption is challenged when you consider that ASOS, Monitise and other heavily traded companies do not pay dividends either. The truth is that only a handful of the top 25 traded AIM companies pay dividends.

AIM STARS SHINE BRIGHTER

The number of bargains in ASOS has more than quadrupled – it alone accounts for more than 18% of the bargains on AIM in February 2014, compared with less than 6% a year earlier. The value of those trades is more than one-fifth of the value of AIM trades during the month, again up from 6% a year earlier. But the biggest swing in activity in the top ten is at GW Pharmaceuticals, where its dual listing on Nasdaq has heightened interest in the company. In February 2013 there were 235 bargains with a value of just over £1m – this has risen to 16,396 bargains worth £66.6m. There was also a jump in activity levels for insurance services and software provider Quindell, particularly in terms of value, thanks to the sharp improvement in its share price over the year.

Activity on AIM has become increasingly focused on the most traded companies, with the top ten accounting for 52% of bargains in February 2014, up from 39% a year earlier. This suggests that investors are gravitating towards the more well known AIM companies, and that success is breeding success.

MOST TRADED AIM SHARES - FEBRUARY 2013

Company	Business	Bargains	Value (£m)
ASOS	Online retailer	96,049	894.1
Blinkx	Internet media	34,495	178.6
Quindell	Insurance services provider	33,073	593.2
Monitise	Mobile bank services	30,556	198.5
GW Pharmaceuticals	Pharmaceuticals	16,396	66.6
African Minerals	Mining	16,060	56
Gulf Keystone Petroleum	Oil and gas	14,840	87.9
Optimal Payments	Online payments	14,008	71.7
Rockhopper Exploration	Oil and gas	9,247	34
Abcam	Online pharma retail	7,761	43.5

MOST TRADED AIM SHARES - FEBRUARY 2014

Company	Business	Bargains	Value (£m)
African Minerals	Mining	31,931	154.9
Gulf Keystone Petroleum	Oil and gas	22,126	146.9
ASOS	Online retailer	21,360	145.6
Bowleven	Oil and gas	13,440	73.7
Rockhopper Exploration	Oil and gas	12,876	48.4
Blinkx	Internet media	9,561	43.9
London Mining	Mining	9,252	36.4
Nanoco	Nanotechnology	8,244	58.5
Sirius Minerals	Mining	7,840	35.9
Monitise	Mobile bank services	7,361	81.5

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