

PRINCIPLES OF CORPORATE GOVERNANCE

The Company's board of directors appreciates the value of good corporate governance not only in the areas of accountability and risk management but also as a positive contribution to business prosperity. It believes that corporate governance involves more than a simple "box ticking" approach to establish whether a company has met the requirements of a number of specific rules and regulations. Rather the issue is one of applying corporate governance principles (including those set out in the Corporate Governance Guidelines for AIM companies published by the Quoted Companies' Alliance in July 2005) in a sensible and pragmatic fashion having regard to the individual circumstances of the Group's business. The key objective is to enhance and protect shareholder value.

BOARD STRUCTURE

The Board is responsible to shareholders for the proper management of the Group. A statement of directors' responsibilities in respect of the accounts is set out on page 9.

The non-executive directors have a particular responsibility to ensure that the strategies proposed by the executive directors are fully considered. The non-executive directors are considered by the Board to be independent of management and free of any relationship, which could materially interfere with the exercise of their independent judgement. All non-executives receive a fixed fee for their services.

To enable the Board to discharge its duties, all directors have full and timely access to all relevant information and there is a procedure for all directors, in furtherance of their duties, to take independent professional advice, if necessary, at the expense of the Group. The Board has a formal schedule of matters reserved to it and meets monthly. It is responsible for overall group strategy, approval of major capital expenditure projects and consideration of significant financing matters.

The following committees have been set up, which have written terms of reference and deal with specific aspects of the Group's affairs.

1. The Remuneration Committee, consisting of the non-executive directors and chaired by P Hogarth, is responsible for making recommendations to the Board on the Company's framework of executive remuneration and its cost. The Committee determines the contract terms, remuneration and other benefits for each of the executive directors, including pension rights and compensation payments. The Board itself determines the remuneration of the non-executive directors. The Committee meets at least twice a year including immediately before the submission of the annual and interim financial statements to the Board.
2. The Audit Committee comprises the non-executive directors and is chaired by P Sinnett. Its prime tasks are to review the scope of the external audit, to receive regular reports from Baker Tilly UK Audit LLP, and to review the half-yearly and annual accounts before they are presented to the Board, focusing in particular on accounting policies and areas of management judgment and estimation. The committee is responsible for monitoring the controls, which are in force to ensure the integrity of the information reported to the shareholders. The committee acts as a forum for discussion of internal control issues and contributes to the Board's review of the effectiveness of the Group's internal control and risk management systems and processes. It advises the Board on the appointment of external auditors and on their remuneration for both audit and non-audit work, and discusses the nature and scope of the audit with the external auditors. It reviews and monitors the independence of the auditors especially with regard to non-audit work. It meets at least twice a year.

Any new non-executive directors will be asked to join both committees.

No formal Nomination Committee exists in view of the stage of growth of the Group. Instead, appointments to the Board are considered by the Chief Executive and other executive directors, and discussed with the non-executive directors. Appointments are made after an evaluation of the skills,

knowledge and expertise required to ensure that the Board as a whole has the ability to ensure that the Group can continue to compete effectively in its market place.

INTERNAL CONTROL

The directors are responsible for the Group's system of internal control and reviewing its effectiveness. The Board has designed the Group's system of internal control in order to provide the directors with reasonable assurance that its assets are safeguarded, that transactions are authorised and properly recorded and that material errors and irregularities are either prevented or would be detected within a timely period. However, no system of internal control can eliminate the risk of failure to achieve business objectives or provide absolute assurance against material misstatement or loss.

The key elements of the control system in operation are:

- a. The Board meets regularly with a formal schedule of matters reserved to it for decision and has put in place an organisational structure with clear lines of responsibility defined and with appropriate delegation of authority;
- b. There are procedures for planning, approval and monitoring of capital expenditure and information systems for monitoring the Group's financial performance against approved budgets and forecasts.

The process adopted by the Group accords with the guidance contained in the document "Internal Control Guidance for Directors on the Combined Code" issued by the ICAEW.

The Audit committee receives reports from the external auditors on a regular basis and from executive directors of the Group. During the year, the Board has reviewed the effectiveness of the system of internal control as described above. The Board receives periodic reports from all committees.

The Board has considered whether the Group's internal controls processes would be significantly enhanced by an internal audit function and has taken the view that at the Group's current stage of development, this is not required. The Board will continue to review this matter each year.

There are no significant issues disclosed in the financial statements for the year ended 31 December 2008 and up to the date of approval of the report and financial statements that have required the Board to deal with any related material internal control issues.

RELATIONS WITH SHAREHOLDERS

The Group values its dialogue with both institutional and private investors. Effective two-way communication with fund managers, institutional investors and analysts is actively pursued and this encompasses issues such as performance, policy and strategy. During the year the directors have had meetings with analysts and institutions and will continue to do so.

There is also an opportunity, at the Company's Annual General Meeting for individual shareholders to raise general business matters with the full Board and notice of the Company's Annual General Meeting is circulated to all shareholders at least 20 working days before such meeting. The Chairmen of the Audit and Remuneration Committees will be available at the Annual General Meeting to answer questions.

There is information for investors on the Group's website, www.cavanagh.co.uk

GOING CONCERN

The directors confirm that they are satisfied that the Company and Group have adequate resources to continue in business for the foreseeable future. For this reason, they continue to adopt the going concern basis in preparing the financial statements.