QCA/BDO
SMALL & MID-CAP SENTIMENT INDEX

November 2012 Issue 5

QUOTED COMPANIES ALLIANCE

YouGov What the world thinks

BDO

INTRODUCTION
SCOTT KNIGHT, PARTNER BDO LLP

THE NUMBERS TELL THE STORY. DESPITE A SLIGHT UPTURN IN CONFIDENCE OVER THE LAST THREE MONTHS SMALL AND MID-CAP QUOTED COMPANIES REMAIN VERY CAUTIOUS. IT SEEMS EVEN THE MOST OPTIMISTIC ARE STILL WARY ABOUT MAKING INVESTMENT COMMITMENTS AND ARE FUNDAMENTALLY FOCUSED ON REDUCING RISK. AS A RESULT, COMPANIES HAVE REVISED DOWN THEIR EXPECTATIONS FOR BOTH TURNOVER AND EMPLOYEE GROWTH WITH MANY OPTING TO SIT ON THEIR CASH RATHER THAN INVEST.

This batten down the hatches approach is understandable given current uncertainty. At present it is the not knowing where things are heading that is the most damaging.

In the meantime, as many companies this quarter point out, more needs to be done to restore confidence. The Government is now half the way through its five years and very little has been done to promote growth. The party political conferences did little to suggest that any of the parties have specific policies that will kick start growth.

Respondents to our survey have highlighted two main areas for Government action to help with this problem. Firstly, they are calling for an end to the tax on jobs through a National Insurance holiday. Secondly, they want greater levels of investment in large infrastructure projects.

In my mind, although implementing these ideas would be far from easy given the budget deficit, both ideas should now be given serious consideration in Whitehall.

The other main finding this quarter is that the UK is still a very good place to be headquartered, but increasingly overseas markets offer greater growth opportunities. It doesn't therefore take a genius to work out that if the current situation of low confidence persists we could begin to see companies moving overseas. Politicians need to recognise this and quickly put into place growth measures before it's too late.

RESPONDENTS TO OUR SURVEY HAVE HIGHLIGHTED TWO MAIN AREAS FOR GOVERNMENT ACTION TO HELP WITH THIS PROBLEM. FIRSTLY, THEY ARE CALLING FOR AN END TO THE TAX ON JOBS THROUGH A NATIONAL INSURANCE HOLIDAY. SECONDLY, THEY WANT GREATER LEVELS OF INVESTMENT IN LARGE INFRASTRUCTURE PROJECTS.

EXECUTIVE SUMMARY

TIM WARD, CHIEF EXECUTIVE, THE QUOTED COMPANIES ALLIANCE

COMPANIES ARE NOT TRAVELLING ON A CLEAR PATH AT THE MOMENT. THEIR ENVIRONMENT IS CONFUSING AND SIGNS OF ECONOMIC RECOVERY ARE FEW AND FAR BETWEEN. WHILST THERE SEEMS TO BE A LATENT OPTIMISM WITHIN OUR SMALL AND MID-CAP QUOTED COMPANIES, THIS IS NOT BEING TRANSLATED INTO REAL ACTION WHICH COULD LEAD TO ECONOMIC GROWTH.

Small and mid-cap quoted companies remain relatively confident about their own business prospects. Their optimism has increased a bit since our last survey in July, but still remains below the levels in previous surveys. Advisors continue not to be able to make their mind up about whether they are optimistic or pessimistic. They sit on the knife edge of neutrality: a painful place to be.

However, companies' optimism in their own business prospects does not seem to translate to a greater desire to employ more people (only 43% of companies expect to grow their workforce in the next 12 months) nor to grow their turnover, which continues to weaken with a mean expected sales growth of just under 8% against 9.7% in July.

This leads me to suggest that a summer of sporting success has given rise to a general feeling of pleasure and goodwill, which is not supported by the real economic conditions we are facing.

The key barrier to growth is cited as being "a lack of confidence in the market in general". So, whilst companies are relatively confident about the prospects for their own company, general market conditions are seen as a major impediment. This is further confirmed by a majority of companies (59%) which believe that growth will come from overseas markets rather than the UK.

Despite the seemingly negative attitude towards the UK market, the majority of small and mid-cap quoted companies and their advisors still believe that the UK remains a good place for quoted companies to headquarter their business with proximity to key markets, capital markets and availability of talent being cited as the top reasons.

So how do we get the engines of growth generating growth in the UK? Ahead of the Autumn Statement, we wanted to know what the sector thinks are incentives for growth and how the Government could kick start the economy. Companies believe that the key ingredient for growth of our sector is reforming equity market regulation; advisors highlight employment law. In structural terms, the small and mid-cap sector is split as to which change will help the sector grow, but national insurance subsidies (22%) and large infrastructure projects (22%) are favourites. On the fiscal front, allowing AIM and PLUS (now ISDX) shares to be included in ISAs is the policy most chosen as having the largest potential positive impact on our sector. This endorses previous findings.

A watery optimism blighted by poor market conditions, less appetite for finance and less sales growth and employment add up to a confusing picture for a serial optimist like me. What is clear though is that opportunities to create growth need to be taken. We need decisive and incisive policy decisions. As we approach the 'not-so' Autumn Statement on 5 December, we can only hope that the Chancellor will be presenting some incentives which allow our engines of growth to re-fuel and operate to the greatest benefit of our "on hold" economy.

HIGHLIGHTS

64%

of small and mid-cap quoted companies are optimistic about their own business prospects – **up from 55% in July.**

55%

of small and mid-cap quoted companies are pessimistic about prospects for the UK economy in the next 12 months – **down from 71% in July.**

65%

of companies expect sales to grow in the next 12 months, with the average expected growth in turnover put at +7.9%, **down from July (+9.7%) and Sept 2011 (+15.3).**

43%

of companies expect to increase headcount in the next 12 months, with the average expected change in employment growth put at +3.5%, **down from July (+3.6%) and Sept 2011 (+6.9%).**

46%

of companies cite a lack of confidence in the market **as the main impediment to growth.**

41%

of companies believe equity market reform would be the **most effective form of regulation change in order to help them grow.**

22%

of companies think the single most effective structural economic change to help the sector grow is infrastructure investment, **while an equal number believe it should be a National Insurance holiday.**

34%

of companies and 37% of advisory firms think allowing AIM and PLUS-quoted shares into ISAs would have **the biggest positive impact on the sector were it to be announced in the Spring Budget.**

59%

of companies and 49% of advisory firms currently **see greater growth opportunities for the sector overseas rather than domestically.**

BUSINESS CONFIDENCE
MODEST IMPROVEMENT BUT REMAINS WEAK

Confidence across the small and mid-cap quoted community has edged higher in recent months, but it remains low with both companies and advisory firms still generally pessimistic about the outlook for the UK economy.

On a scale between zero and 100, where zero represents very pessimistic and 100 equals very optimistic, small and mid-cap quoted companies currently rank prospects for the UK economy at 42.5 compared to 38.4 in July. A similar increase has also occurred across advisory firms with confidence levels slightly higher.

This small bounce in sentiment coincides with some tentative signs that the much anticipated economic recovery is finally gaining ground. Better than expected employment data, as well as encouraging signs from the services and manufacturing sectors suggest that the economy has moved out of recession. This has been further supported by a 1% growth in GDP in the last quarter.

Spirits also seem to have been lifted by the Olympics and Paralympics which provided a welcome distraction to the gloomy economic news. Although the undoubted feel good factor generated by the Games has not readily translated into improved confidence, consumer spending in general, and retail spending in particular has risen.

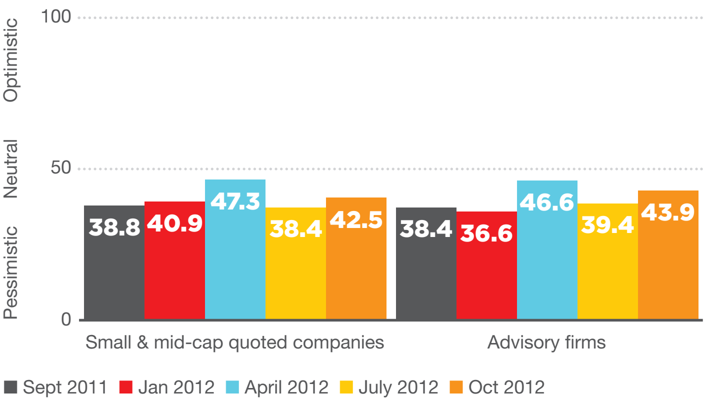
However, understandably companies and advisory firms continue to be cautious. Growth globally has slowed and despite colossal efforts the Eurozone crisis is still rumbling along proving stubbornly resistant to all initiatives.

As a result, businesses remain uncertain and consequently confidence essentially is stuck in a rut, neither improving nor worsening, but remaining weak. This is holding back investment with many companies choosing to build cash reserves rather than invest for growth.

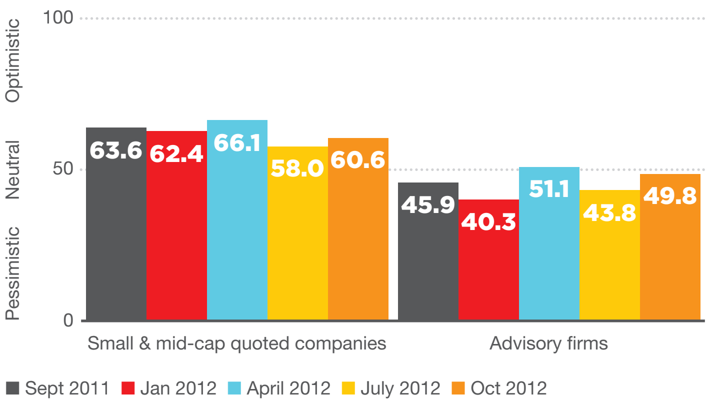
On the other hand, companies are still optimistic about their own business prospects over the next 12 months, with optimism levels marginally improving in recent months. Just over 60% of small and mid-cap quoted companies rank prospects above the neutral 50 level, with the average score equalling 60.6 compared with 58.0 in July.

Advisory firms are also more positive about the prospects for small and mid-cap quoted companies, ranking prospects at 49.8 compared to 43.8 in July.

How optimistic or pessimistic do you feel about the UK economy over the next 12 months?



How optimistic or pessimistic do you feel about your own company's prospects/small and mid-cap prospects over the next 12 months?



QCA/BDO VIEW

This is likely to be the trend over the medium term. Statistics will show cautious optimism but often contradictions in data. Forecasting will be more difficult than ever.

FUTURE EXPECTATIONS

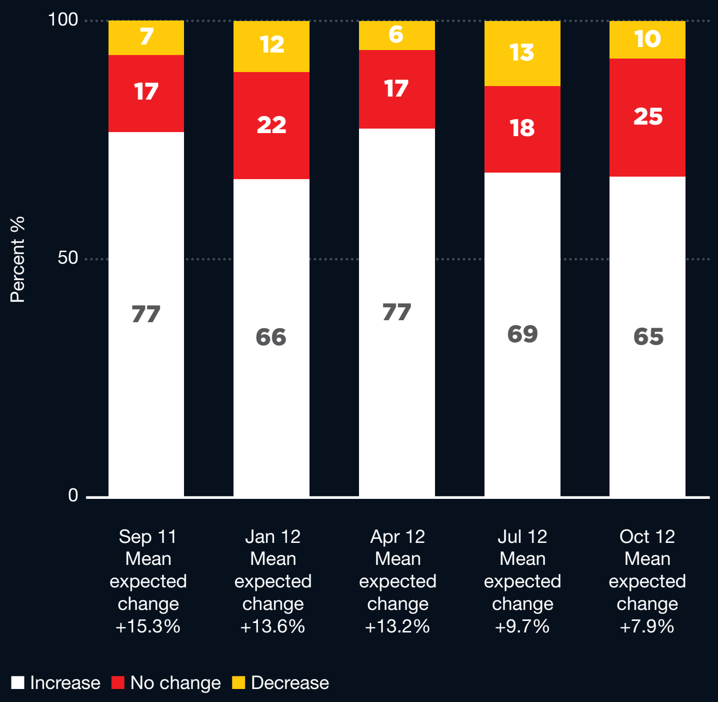
TURNOVER AND EMPLOYMENT GROWTH CONTINUES TO SLIDE

Despite being slightly more confident about the prospects for the UK economy and their own prospects, small and mid-cap quoted companies have revised down their own expectations for turnover growth. Although the majority (65%) of companies still anticipate positive sales growth in the next 12 months, the magnitude of expected sales growth has almost halved since September 2011.

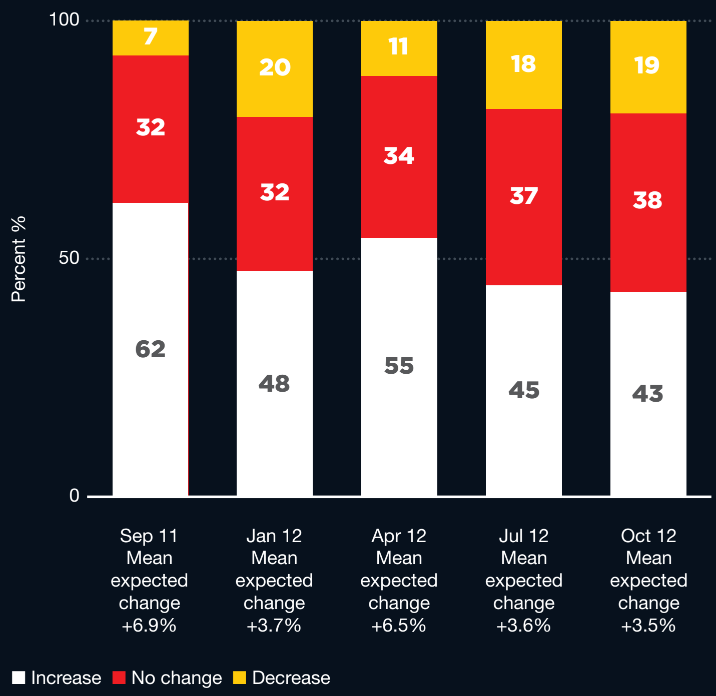
This worrying downward trend means that on average companies now believe their sales will grow by 7.9% over the next 12 months. This compares to growth of 9.7% in July, and 15.3% in September 2011.

Employment expectations are also on a downward trend with hiring intentions across small and mid-cap quoted companies weak. Just 43% of companies now expect to increase headcount in the next 12 months, down from 45% reported in July. Although the sector is still set to be a net creator of jobs, the average expected change in employment growth in the next 12 months has remained about the same from last quarter at +3.5%.

By how much do you expect turnover in your business to change in the next 12 months?



By how much do you expect the number of full time employees in your business to change in the next 12 months?



QCA/BDO VIEW

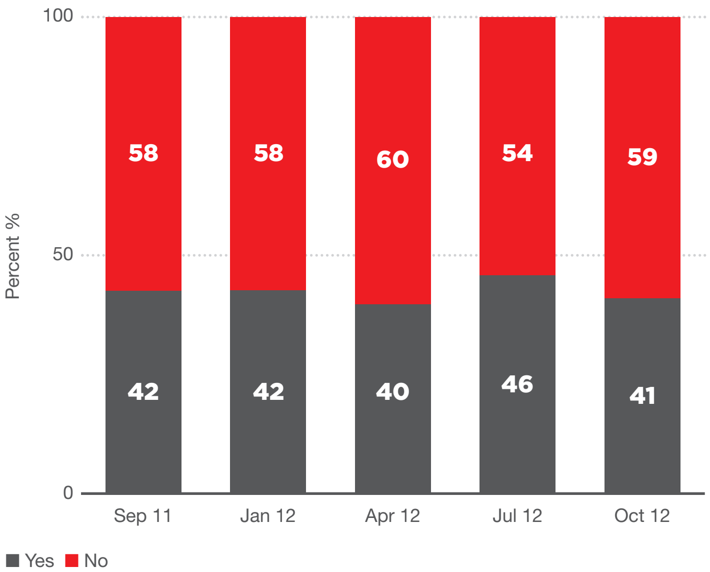
Confidence has increased but it seems to be accompanied by a dose of economic reality. Sales and employment growth forecasts have been reined in.

FUNDRAISING
CREDIT CONDITIONS LARGELY UNCHANGED

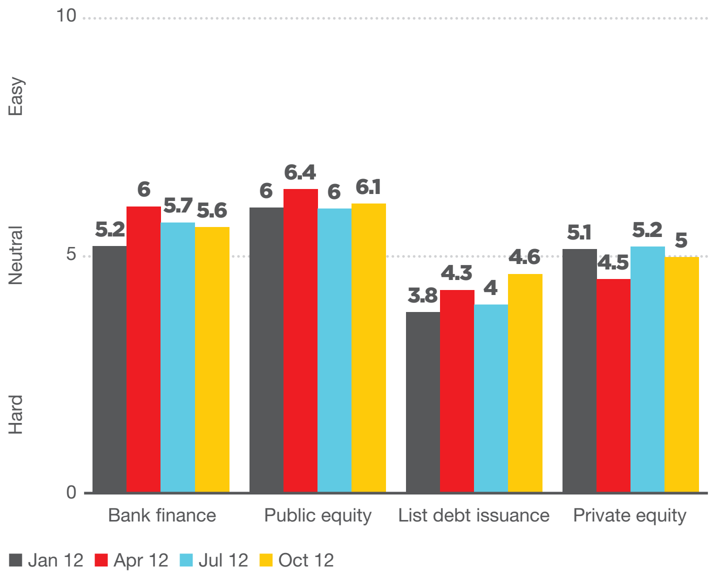
The appetite for general fundraising has deteriorated in recent months despite efforts by most of the major banks to increase lending. Less than half (41%) of small and mid-cap quoted companies are now planning to raise capital in the next 12 months, down from 46% reported in July. This relatively low appetite for finance suggests many companies have scaled back their investment plans over the summer reflecting the uncertain economic environment.

The credit situation for companies is also not showing any real signs of improvement. Although opinions regarding the ease of raising public equity and listed debt issuance have improved slightly over the summer, the reverse has happened with regard to bank finance and private equity. Essentially, companies are still not witnessing a major breakthrough in lending with views regarding the availability of finance still largely neutral.

Are you considering raising capital for your company in the next 12 months?

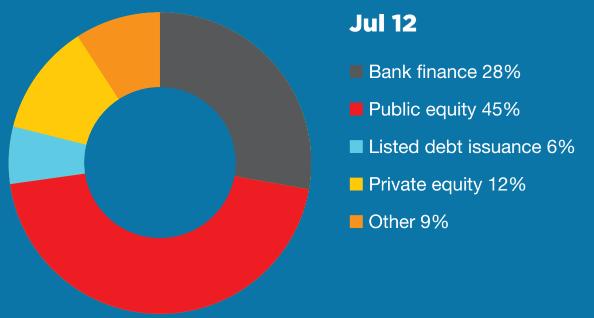


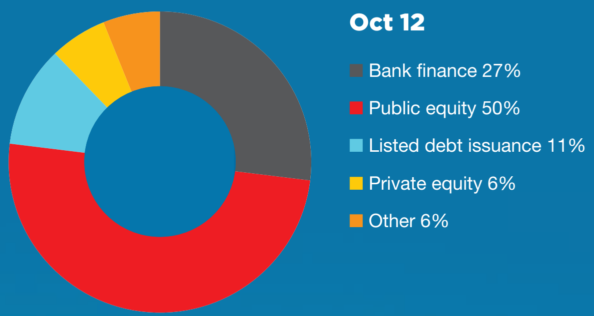
How easy or difficult is it to raise finance through the following channels?



In terms of funding sources, public equity and listed debt issuance are both gaining in attractiveness at the expense of bank finance and private equity. This could reflect greater awareness of these sources following a number of recent successful corporate bond issues.

What would be your preferred way of raising capital if the need arose in the next 12 months?





QCA/BDO VIEW

There is an enduring fuel supply constraint for the engines of growth. Public markets for debt and equity are becoming more preferable than other sources.

INCENTIVES FOR GROWTH

BUSINESS FRIENDLY INITIATIVES ARE NEEDED TO HELP RESTORE CONFIDENCE

A general lack of confidence in the market is the principal factor currently hampering small and mid-cap quoted companies. 46% of companies and 51% advisory firms have singled out this issue above all others when asked to pick the single main restriction on growth at the moment.

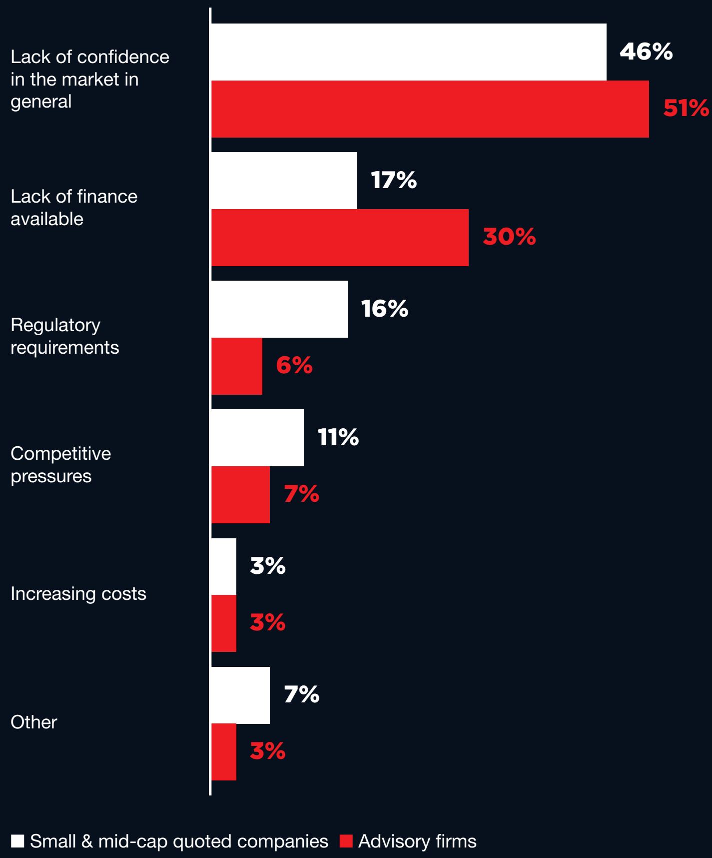
Other less significant factors include a lack of finance, which is viewed as the major shackle by 30% of advisory firms and 17% of companies, while regulatory requirements are the negative factor according to 16% of companies.

Opinions are extremely mixed regarding structural economic changes to help the sector grow. Small and mid-cap quoted companies jointly favour measures to subsidise employment through a National Insurance holiday and investment in large infrastructure projects.

However, other measures such as allowing the new Business Growth Fund to invest in quoted companies, and expanding existing Government financing schemes are also preferred by a sizeable proportion of companies.

Advisory firms generally share these views with investment in large infrastructure projects favoured slightly more than a National Insurance holiday. Interestingly, a Government guarantee of retail bonds of mid-cap companies is ranked highly by advisors but not by companies.

Which one of these is hampering your company's/small and mid-cap quoted companies' ability to grow the most at the moment?



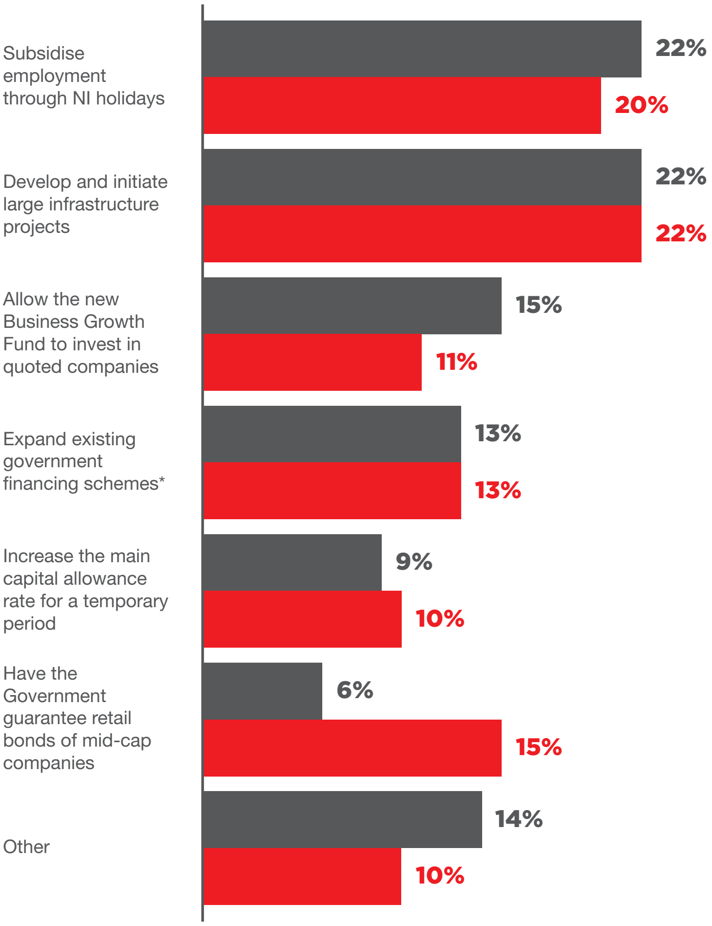
The UK economy is all about confidence; we need stability, consistent messages and support for those businesses that can see opportunities for growth."

Small and mid-cap company's viewpoint

At present as soon as a smaller business, which has been funded in part through angel finance, lists on AIM it misses out on a potentially large pool of finance because of the exclusion of investment via ISAs"

Small and mid-cap company's viewpoint

What would be the single most effective structural economic change which would help your company/small and mid-cap quoted companies grow?



■ Small & mid-cap quoted companies ■ Advisory firms

*Such as Funding for Lending, Enterprise Finance Guarentee, National Loan Guarentee Scheme

In terms of specfic regulation to help the sector grow, 41% of small and mid-cap quoted companies cite equity market regulation as the area needing most reform. Many believe the current rules covering small quoted companies are overly onerous, particularly regarding financing and equity.

Employment law is the other main area where companies feel that changes are needed, a view that is strongly held by advisory firms. Greater flexibility in recruitment and termination of employees is seen as the most pressing issue for advisors.

In terms of fiscal measures, both companies and advisors agree that the inclusion of AIM and PLUS-quoted shares in ISAs would have the biggest positive impact on the sector were it to be announced in the Spring Budget. Many believe this move would help create a more stable investment environment, as well as generating more investor interest in smaller quoted companies.

This mirrors findings from our survey in February 2012 where companies and advisors again both stated that this measure would have the greatest positive on the sector, out of a list of possible policies.

All other potential fiscal measures are significantly less popular in comparison. However, there is support for the reinstating of the dividend tax credit for pension funds, and the abolition of numerous tax reliefs in exchange for a lower overall corporation tax rate.

QCA/BDO VIEW

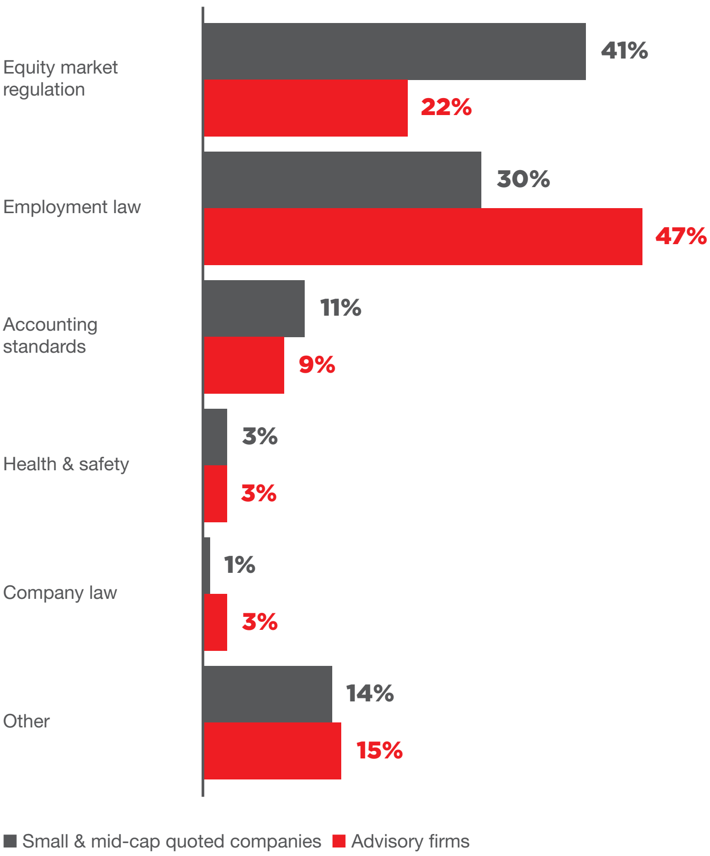
The Government needs to address it fiscal policy in order to incentivise more investment – the fuel – for the engines of growth. And urgently.

Once again, we are told by the sector that AIM and PLUS-quoted shares in ISAs would help these businesses the most. However, the Government still maintains a fixed, negative position on this. We hope that they will show some movement in the Autumn Statement.

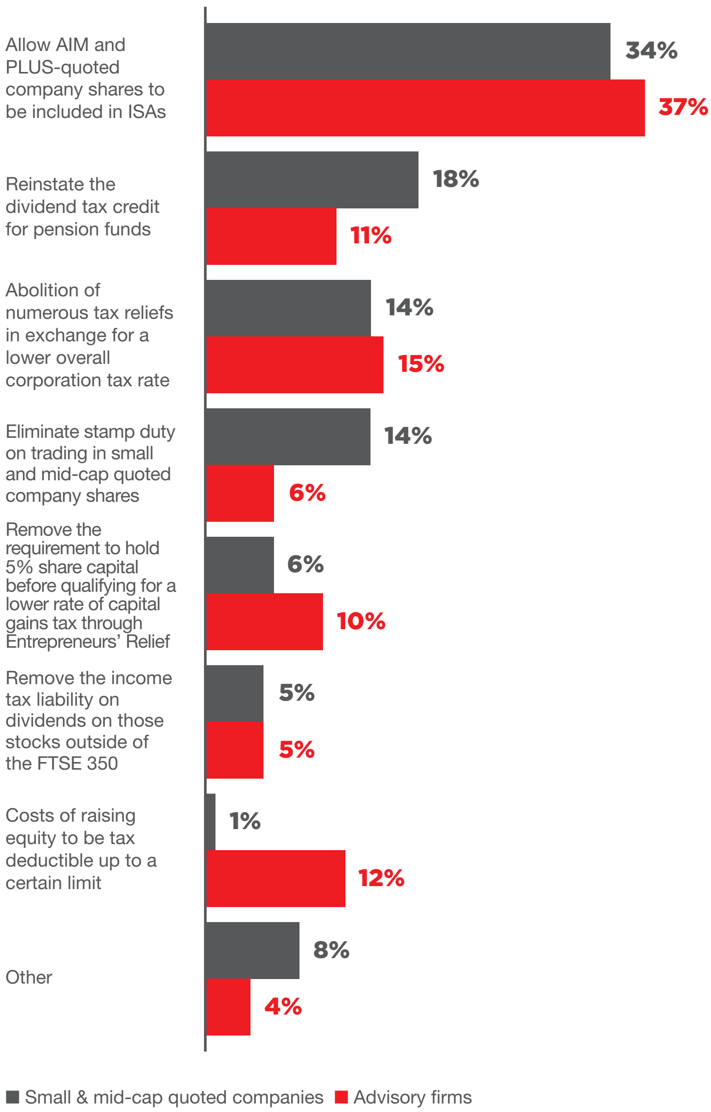
> **There is undoubtedly money to invest – by making AIM attractive to small investors they would buy our shares, this would push our price up and then we could raise further money from the market"**

Small and mid-cap company's viewpoint on including AIM and PLUS-quoted shares in ISAs

Which one of these areas of regulation would you want changed the most in order to help you grow/to help small and mid-cap quoted companies to grow?



Which one of these fiscal policies would have the greatest positive impact on your company/small and mid-cap quoted companies were it to be announced in the Chancellor's 2013 Spring Budget?



GROWTH PROSPECTS

DOMESTIC OR OVERSEAS?

The majority of small and mid-cap quoted companies (59%) currently see greater growth opportunities overseas rather than domestically. Many companies are looking abroad for sales in spite of the Eurozone crisis and slowing growth in many established overseas markets.

Advisory firms are less certain about the merits of overseas markets with just under half (49%) believing they offer enhanced growth prospects.

The vast majority of companies (84%) and advisors (96%) believe that the UK remains a good place for quoted companies to be headquartered despite the current lack of growth prospects.

Proximity to key markets, capital markets and the availability of talent are the three main reasons why companies believe the UK is a good place to be based. Advisors place stronger emphasis on capital markets and view the UK legal framework as the key reason.

Do you see greater growth prospects for your company/small and mid-cap quoted companies overseas or domestically?

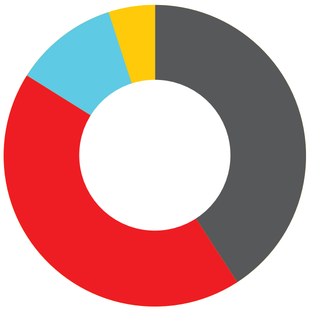
Small & mid-cap quoted companies

- Overseas 59%
- Domestic 31%
- Same 11%

Advisory firms

- Overseas 49%
- Domestic 15%
- Same 35%

Is the UK still a good place for your company/small and mid-cap companies to be headquartered?



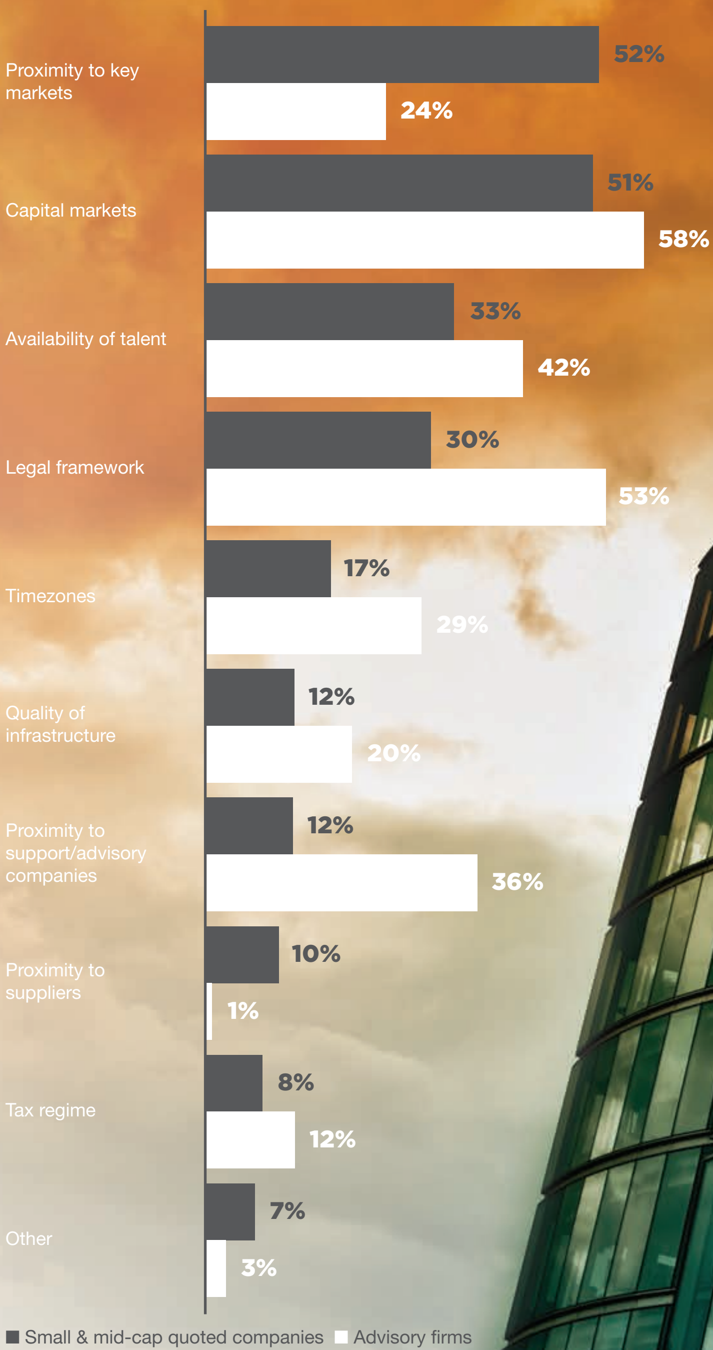
Small & mid-cap quoted companies

- Definitely yes 41%
- Probably yes 43%
- Probably no 11%
- Not UK headquartered 5%

Advisory firms

- Definitely yes 35%
- Probably yes 61%
- Probably no 4%

What are the top three reasons why the UK is a good place for your company/small and mid-cap quoted companies to be headquartered?



84%

THE VAST MAJORITY OF COMPANIES (84%) AND ADVISORS (96%) BELIEVE THAT THE UK REMAINS A GOOD PLACE FOR QUOTED COMPANIES TO BE HEADQUARTERED DESPITE THE CURRENT LACK OF GROWTH PROSPECTS.

QCA/BDO VIEW

There is a real risk that the UK becomes the HQ of Global Plc but with jobs and investment going overseas to more attractive local markets.

METHODOLOGY

The QCA/BDO Small & Mid-Cap Sentiment Index by BDO and the Quoted Companies Alliance (QCA) is an online quarterly survey across the small and mid-cap quoted sector.

The report is based upon 200 online interviews (114 small mid-cap quoted companies, 86 advisory companies) with contacts of BDO and members and associates of the QCA. The survey respondents included 74% of small and mid-cap company employees in a board level position and 45% of advisors in a senior management position. It was conducted between 12 September and 3 October 2012 by research company YouGov.

The responding sample is weighted by industry to be representative of small and mid-cap UK quoted companies, as derived by the London Stock Exchange.

Please note that not all scores in this report add up to exactly 100% due to roundings. The margin of error for the survey is +/- 8%.

Thank you to everyone who supported and participated in this survey.

If you would like further information on any of the issues covered in this report please contact:

Scott Knight
BDO LLP
55 Baker Street
London W1U 7EU
T: 020 7893 3319
E: scott.knight@bdo.co.uk

Tim Ward
The Quoted Companies Alliance
6 Kinghorn Street
London EC1A 7HW
T: 020 7600 3745
E: tim.ward@theqca.com


1.2925
1.2870
1.2815
1.2746
1.2705
1.2650

www.bdo.co.uk

www.theqca.com

www.yougov.com

BDO awards:

2012 WINNER OF 'AUDITOR OF THE YEAR'
2011 WINNER OF LEXISNEXIS TAXATION 'BEST TAX TEAM IN A LARGE FIRM'

This publication has been carefully prepared, but it has been written in general terms and should be seen as broad guidance only. The publication cannot be relied upon to cover specific situations and you should not act, or refrain from acting, upon the information contained therein without obtaining specific professional advice. Please contact BDO LLP to discuss these matters in the context of your particular circumstances. BDO LLP, its partners, employees and agents do not accept or assume any liability or duty of care for any loss arising from any action taken or not taken by anyone in reliance on the information in this publication or for any decision based on it.

This report relies on data, conclusions and recommendations from primary and secondary sources (including third parties) that were gathered in good faith. Although believed to be accurate, this information is not guaranteed and, as such, The Quoted Companies Alliance, YouGov and BDO LLP can accept no liability for action taken based on any information in this report.

BDO LLP, a UK limited liability partnership registered in England and Wales under number OC305127, is a member of BDO International Limited, a UK company limited by guarantee, and forms part of the international BDO network of independent member firms. A list of members' names is open to inspection at our registered office, 55 Baker Street, London W1U 7EU. BDO LLP is authorised and regulated by the Financial Services Authority to conduct investment business.

BDO is the brand name of the BDO network and for each of the BDO Member Firms.

BDO Northern Ireland, a partnership formed in and under the laws of Northern Ireland, is licensed to operate within the international BDO network of independent member firms.

BDO LLP is the Data Controller for any personal data that it holds about you. We may disclose your information, under a confidentiality agreement, to a Data Processor. To correct your personal details or if you do not wish us to provide you with information that we believe may be of interest to you, please telephone contact Tracey Fordham on 020 7893 2015 or email tracey.fordham@bdo.co.uk.

The Quoted Companies Alliance is the independent membership organisation that champions the interests of small to mid-size quoted companies. It is a company limited by guarantee registered in England under number 4025281.