



QCA/BDO

SMALL & MID-CAP SENTIMENT INDEX

October 2011

EXECUTIVE SUMMARY

WELCOME TO THE FIRST EDITION OF THE QCA/BDO SMALL & MID-CAP SENTIMENT INDEX POWERED BY YOUNGOVSTONE. WE AIM TO GIVE THIS CRITICAL SEGMENT OF THE ECONOMY A VOICE THAT WILL BE HEARD BY GOVERNMENT, REGULATORS AND OTHER MARKET PARTICIPANTS.

In the next few years smaller public companies will undoubtedly be one of the engine rooms of job creation and growth. It is shocking to see only 6% of respondents believe that the UK Government cares about them. This is the heartland of entrepreneurship and for too long has been overlooked. However our survey findings also clearly show that there is a negative attitude to equity markets with issues around market volatility and lack of liquidity.

The position overall is not however negative. Our survey shows 75% of respondents are positive about their own company's performance over the next 12 months and a similar percentage expect growth in sales over the same period with an average growth rate of over 15%. This shows the heart of the sector continues to beat strongly, just imagine what it could achieve with some significant support.

In the coming quarters we will be tracking the key components of business sentiment and looking for movements that indicate the direction of travel but we will also be focussing on specific issues that impact on the small and mid-cap public company sector and trying to bring a megaphone to hundreds of whispers. We welcome feedback of whatever form and will be listening for issues that need to be tested in our survey and reported on. We do however need market participants to engage with the survey and make it as powerful as possible.



It is clear that if Government creates the right environment for small and mid-cap quoted companies they will make a greater contribution to the UK economy. Companies are telling us that they are confident about their ability to grow and create jobs; but they are pessimistic about the economy at large. With small and mid-cap quoted companies feeling that Government does not care about them and that regulation will increase over the next year, they are having to look to themselves and not rely on external factors to create this growth.

In addition, small and mid-cap quoted companies are telling us that equity markets are hindering their company's development at a time when many are looking to raise finance. Small and mid-cap quoted companies are not convinced of the value of a London quotation, with 35% feeling neutral about their London listing and 28% of companies actually saying they are unsatisfied. Volatile and illiquid markets, coupled with a stand-off with the banks, is leading to a finance drought that is preventing these companies from making the fullest contribution to the UK economy.

Something needs to change – It's time for the regulators, market providers and policymakers to start thinking and working on behalf of companies.

Almost half (49%) of companies that responded want to see the UK Government introduce tax incentives for investors in small and mid-cap quoted companies to help overcome this. The Quoted Companies Alliance is currently campaigning to create new ones and extend current incentives, such as reforming Entrepreneurs' Relief so that capital gains tax relief is available for all that contribute to the success and growth of a business.

There is a general wish for the European Parliament to enable retail investors to be better able to invest in small and mid-cap quoted companies and also for a lighter – more proportionate – regulatory regime to be implemented. The Quoted Companies Alliance has been pushing this forward in both Brussels and Whitehall, and we believe the concept has gained some traction as shown through recent reviews of regulation which explore a proportionate regime for small and mid-cap quoted companies.

The results of this survey serve as a call to action from small and mid-cap quoted companies themselves. Regulators, market providers and policymakers must introduce an overarching policy that positively incentivises this sector, which is vital to the growth and success of the UK economy as a whole. All in all, small and mid-cap quoted companies are looking for a lighter, more appropriate regulatory regime which enables (and protects) investors to find growth companies.

**ALMOST HALF (49%) OF
COMPANIES THAT RESPONDED
WANT TO SEE THE UK
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SMALL AND MID-CAP QUOTED
COMPANIES.**

49%



Scott Knight
Partner
BDO LLP



Tim Ward
Chief Executive
The Quoted
Companies
Alliance

HIGHLIGHTS

70%

of small and mid-cap quoted companies are pessimistic about prospects for the economy in the next 12 months, **but 75% are positive about their own company's performance over the same period.**

72%

of advisory firms are also downbeat about the economy, **with 46% pessimistic about the prospects for small and mid-cap companies.**

77%

of companies expect sales to grow in the next 12 months, **with the average expected growth in turnover put at 15.3%.**

62%

of companies expect to employ more workers in the next 12 months, **with the average expected growth in employment put at 6.9%.**

42%

of companies anticipate further fundraising in the coming year, **with 52% likely to use public equity.**

75%

of companies think the amount of regulation impacting businesses will grow in the next 12 months, **with 18% feeling it will increase significantly.**

28%

of companies are unsatisfied with a quotation on a London exchange, **while 35% remain neutral about the value of a London listing.**

6%

of companies and advisors feel that the Government cares a great deal about small and mid-cap quoted companies.

60%

of companies believe equity markets are hindering their company's prospects.

BUSINESS CONFIDENCE

WEAK ECONOMIC OUTLOOK

Confidence in the UK economy amongst small and mid-cap quoted companies is weak with the majority of firms pessimistic about prospects for economic recovery in the next 12 months. Advisory firms across the sector also share this downbeat view, with lingering fears about a double-dip recession and a lack of bank financing.

On a scale between zero and 100, where zero represents very pessimistic and 100 equals very optimistic, small and mid-cap companies ranked prospects for the UK economy at a lowly 39. Just 11% of companies scored prospects above the neutral score of 50. Advisory firms mirrored this outlook also ranking prospects at a similar low level.

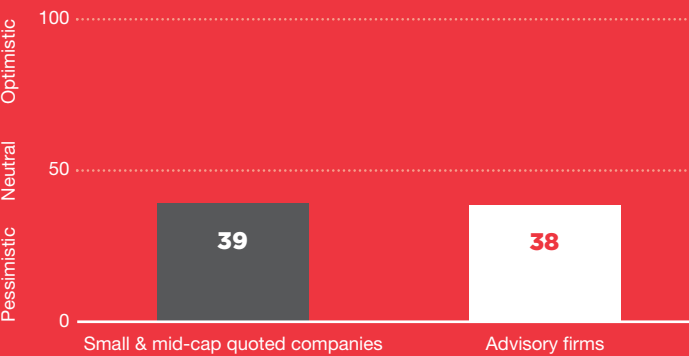
However, companies are significantly more positive about their own company's prospects. Three-quarters (75%)

ranked prospects above the neutral 50 level, with the average score equalling 64. In contrast, advisory firms were less optimistic ranking prospects for small and mid-cap quoted companies at 46.

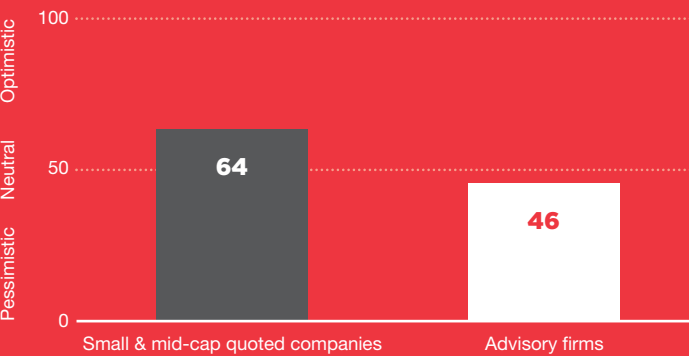
Future Expectations

The vast majority of companies (77%) expect turnover to grow in the next 12 months with the average expected change in sales put at +15.3%. Similarly, employment expectations are also positive, with 62% of companies believing they will need to take on more workers in the coming 12 months, with the average expected change in employment growth put at +6.9%.

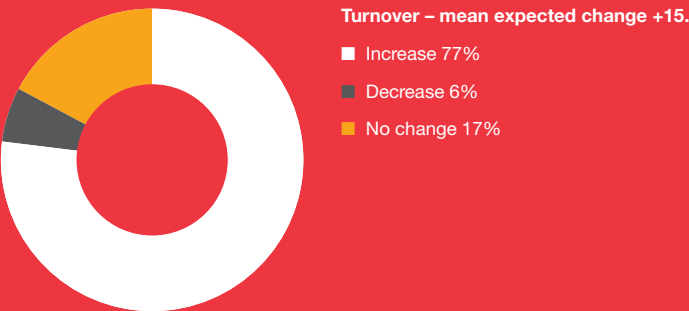
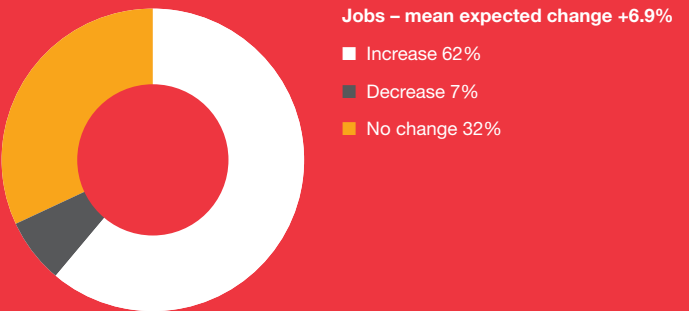
How optimistic or pessimistic do you feel about the UK economy over the next 12 months?



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



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



BUSINESS CONFIDENCE

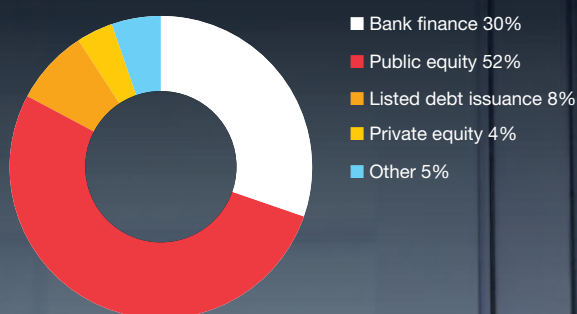
RAISING CAPITAL REMAINS A BATTLE

Fundraising

Despite these upbeat growth expectations, there is a relatively subdued appetite for fundraising. Less than half of companies (42%) plan to raise capital in the next 12 months.

Of those looking to raise finance 52% anticipate using public equity, 30% bank finance, with only 18% preferring other sources. Given the relatively tight debt markets and current difficulty raising public equity finance it is somewhat surprising that more companies are not considering alternative sources.

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

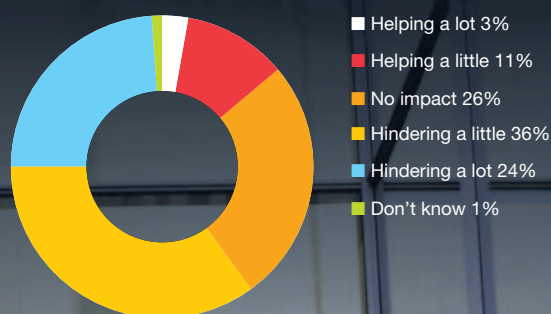


Equity Markets

Attitudes to equity markets are generally negative with the majority of companies (60%) believing that markets are currently hindering their own company's development.

In particular, a lack of liquidity was overwhelmingly stated as the most significant hindrance with market volatility in general also a source of disquiet. One respondent commented that there was a "general unwillingness to invest in anything speculative," while an advisor observed currently that "general market sentiment is prohibitive."

Are equity markets currently helping or hindering your company's development?



BUSINESS CONFIDENCE

INCREASING REGULATION AND ITS IMPACT ON GROWTH

Regulation

Although the Government has pledged to cut red tape respondents still nevertheless believe regulation will increase. Three quarters of companies (75%) and over half of advisors (54%) think the amount of regulation impacting businesses will grow over the next 12 months, with 18% of companies and 9% of advisors feeling it will increase a lot.

Opportunities

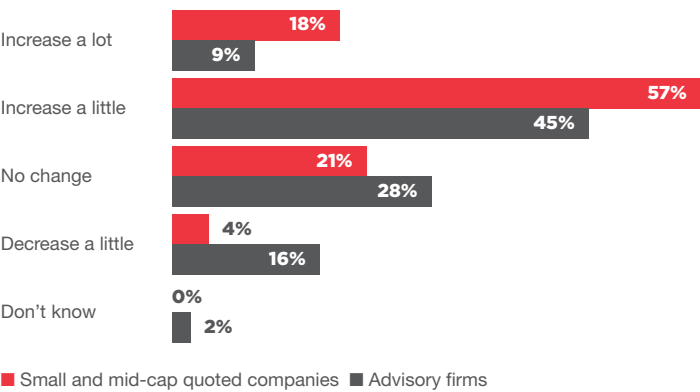
New product development and new markets were identified as the main opportunity areas. Just over half of companies (52%) and 63% of advisors ranked these as holding the biggest potential in the next 12 months.

“Export markets as we start a drive to sell our product to newly deregulated markets” commented one respondent, while “niche service,” and simply “China, China and China” were also priorities.

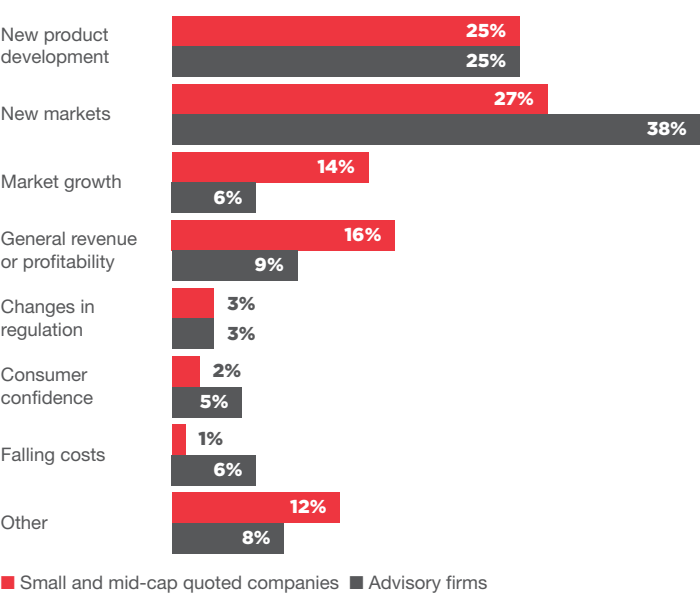
Possibly reflecting negative sentiment about the state of the economy, both market growth and general profitability were not considered the main major opportunity areas. Although some companies believed that “consolidation and rationalisation was more likely than in previous downturns,” others felt that “big is not always beautiful and more people are beginning to realise this.”

Advisory firms shared this view ranking market growth and profitability low down, with one advisor observing the “main opportunity is in balancing the impact of any decline in the domestic market with investments in and hopefully additional sales generated in new markets.”

Do you believe the amount of regulation affecting small and mid-cap quoted companies is likely to increase, decrease or stay the same over the next 12 months?



What is the number one opportunity for small and mid-cap quoted companies over the next 12 months?



CHALLENGES AND OPPORTUNITIES

BARRIERS TO GROWTH

Challenges

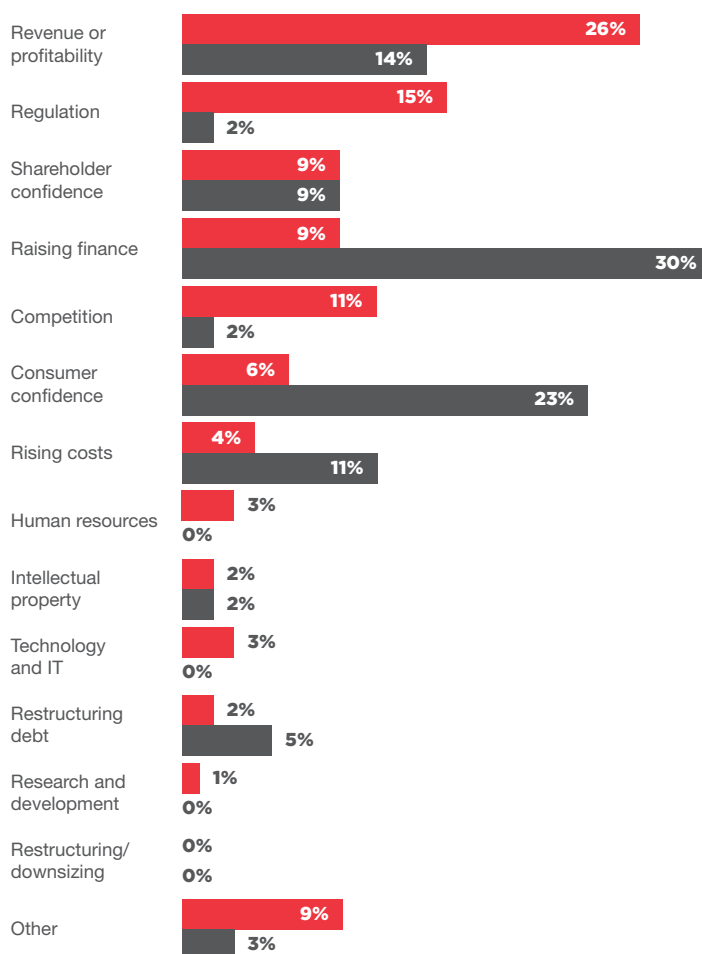
Concerns over revenue and profitability were singled out as the biggest challenge with a quarter of companies viewing this as most significant worry over the next 12 months. “Convincing customers to spend to develop their business rather than save and stagnate” was how one respondent put it.

Advisory firms took a different view believing that raising finance was the number one challenge for small and mid-cap quoted companies. Many agreed with the view that “the (largely taxpayer owned) banks have gone back into the mode of only being prepared to lend you an umbrella when the sun is shining.”



MANY AGREED WITH THE VIEW THAT “THE (LARGELY TAXPAYER OWNED) BANKS HAVE GONE BACK INTO THE MODE OF ONLY BEING PREPARED TO LEND YOU AN UMBRELLA WHEN THE SUN IS SHINING.”

What is the number one challenge for small and mid-cap quoted companies over the next 12 months?



■ Small and mid-cap quoted companies ■ Advisory firms

CHALLENGES AND OPPORTUNITIES

EXTERNAL SOLUTIONS

Action desired from the banks

Predictably, increased lending was the main action desired from banks. However, whilst lending was overwhelmingly viewed as a priority area by advisors, for companies it was not so clear cut. They also ranked reduced charges and fees, as well as giving relationship managers more decision making power, almost equally as important.

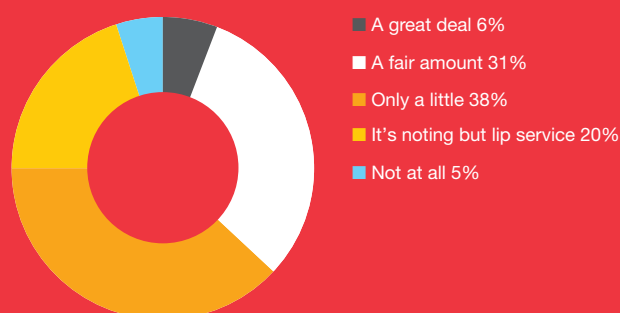
Action desired from the European Parliament

A proportionate regulatory regime for small and mid-cap quoted companies was the leading action desired from the European Parliament. Measures enabling retail investors to access small and mid-cap quoted companies was ranked second, followed by a reduction in regulation.

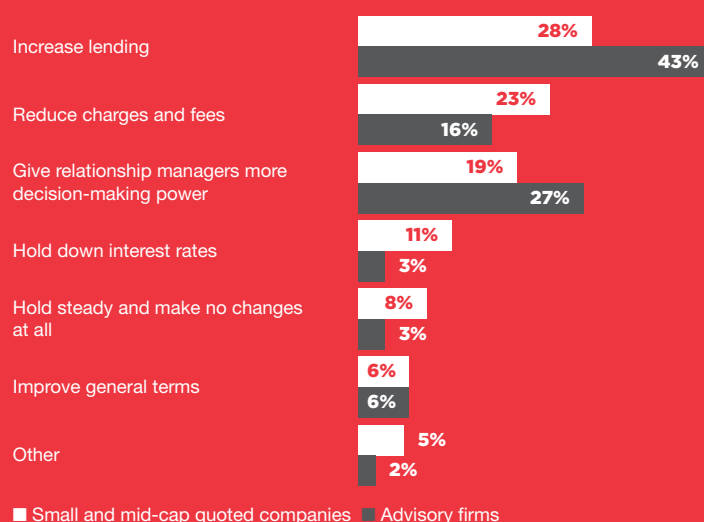
View about UK Government

Only 6% of respondents believe the UK Government cares a great deal about small and mid-cap quoted companies, with a further 31% saying 'a fair amount', and 38% saying only a little.

How much do you believe that the UK Government cares about issues faced by small and mid-cap quoted companies?



Which one of the following actions by the banks would be the most helpful to small and mid-cap quoted companies in the next 12 months?



Which one of the following actions by the European Parliament would be the most helpful to small and mid-cap quoted companies in the next 12 months?



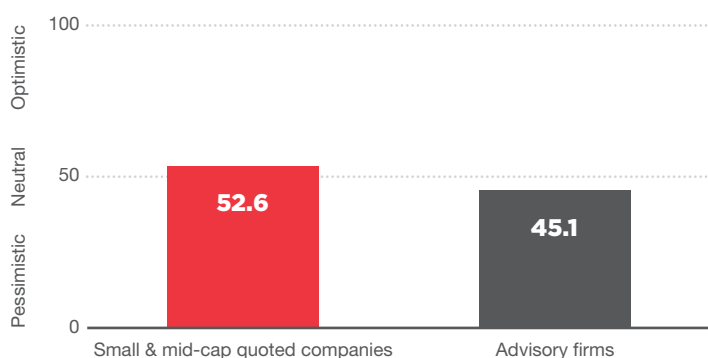
CHALLENGES AND OPPORTUNITIES

HOW USEFUL IS A LONDON EXCHANGE QUOTATION?

Satisfaction with quotation on a London exchange

Both companies and advisors were broadly neutral regarding satisfaction with a London quotation. The issue of liquidity was highlighted as the biggest concern, with one advisor stating that “the myth of liquidity overshadows the benefits of the market.” Another commented that “markets do not like overseas businesses and do not trust them as much as UK based companies.” However, the general consensus was that a quotation on a London exchange “could be better but could be worse.”

How satisfied is your business/how satisfied do you think small and mid-cap quoted companies are with a London quotation?



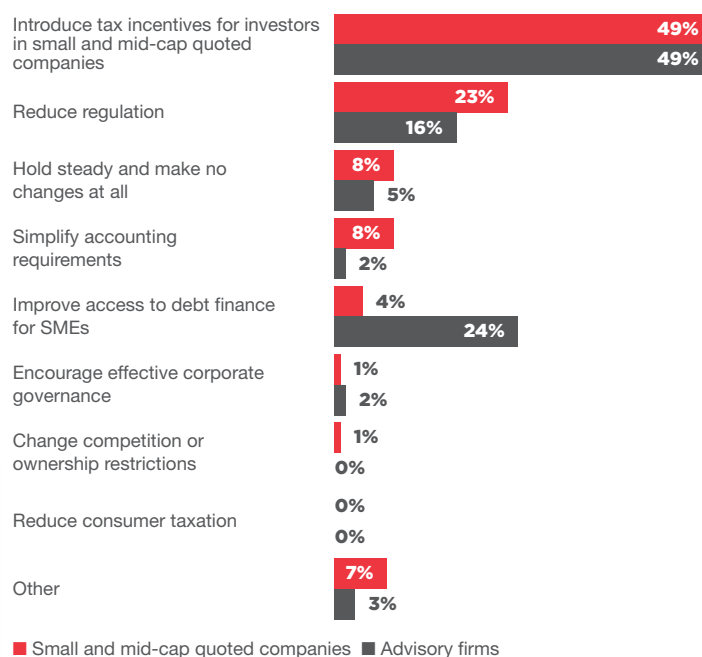
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Action desired from the UK Government

Companies and advisors both agreed that the most helpful action the UK Government could take in order to aid small and mid-cap quoted companies would be to introduce tax incentives for small company investors.

A general reduction in regulation also scored highly, while advisors also believed that actions to improve access to debt finance should be a priority. However, this view was not shared by companies, with only 4% believing that new actions were required to improve access to debt finance for SMEs.

Which one of the following actions by UK Government would be the most helpful to small and mid-cap quoted companies in the next 12 months?



METHODOLOGY

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

The report is based upon 164 online interviews (100 small and mid-cap quoted companies, 64 advisory firms) with members and associates of the Quoted Companies Alliance. It was conducted 6 Sept–19 Sept 2011 by leading research company YouGovStone.

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

Please note not all scores in this report may add up to exactly 100% due to roundings.

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

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BELIEVE THE UK GOVERNMENT
CARES A GREAT DEAL ABOUT
SMALL AND MID-CAP QUOTED
COMPANIES**

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