THE SMALL AND MID-CAP SENTIMENT INDEX

PULSE

MAKING THE LEAP TO THE MAIN MARKET

Does it take superhuman courage to make that jump - and is it something you should be considering *this* year?

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QUOTED COMPANIES ALLIANCE
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BDO

Making the leap into the big leagues needn't take a superhuman amount of courage...

...although it might take a considerable amount of investment.

Our lead story on page 03 looks at why companies are moving to the Main Market and why many are choosing to stay put.

THE SMALL AND MID-CAP SENTIMENT INDEX

PULSE

PULSE is a joint publiction by BDO LLP and the Quoted Companies Alliance based on research conducted by YouGov

Welcome to PULSE, the new report of our triannual QCA/BDO Small and Mid-Cap Sentiment Index.

We have created PULSE to give you more access to and flavour of the views that you and others have expressed through our regular survey of the small and mid-cap quoted company sector. You will find a number of articles, some of which will become regular features and others will be of topical interest.

SCOTT KNIGHT
Partner, BDO LLP

TIM WARD
Chief Executive, Quoted Companies Alliance

As ever, the vast majority of the people responding on behalf of over 100 companies are in a board level position. This is an unrivalled survey of the leaders of small and mid-cap quoted companies and their advisors. PULSE is designed to give you up-to-date information on the key issues affecting the small and mid-cap quoted company sector.

In this edition, we have looked at our usual indicators: business and economic prospects, attitudes towards access to capital together with expectations of job and sales growth over the coming 12 months. We have seen a marked fall in confidence in the UK economy, which seems to be largely related to various political and economic issues happening (or about to happen) in the UK, Europe and further afield. This leads us to consider whether business has generally become more resilient and confident after the financial crisis or more cautious.

In addition to this, we have sounded out companies on whether they are considering moving markets and the drivers behind a move. 20% of small and mid-cap quoted companies on AIM are considering a move to the Main Market at some point in the near future.

This number seems high when compared to the actual number of companies – 86 – that have made the move in the last 15 years.

Regardless, there appears to be some enthusiasm from the sector to grow and progress, which is promising.

We have also worked out the costs of being quoted on AIM (on average around £220,000 per annum) and the costs of being listed on the Main Market (on average around £360,000 per annum). These costs include financial PR, investor relations, NOMAD/broker, auditors and more and should not come as a surprise to companies either just joining or new to the market. However, it does serve as a reminder that a listing is not cheap. Companies should be seeking to use the market to their benefit and to raise finance – otherwise, the cost is just an overhead.

> *"Overall, uncertainty seems to be spooking everyone, so wise companies should be preparing for a potentially rocky next twelve months of business"*
>
> TIM WARD

In conjunction with this, we consider the benefits and drawbacks of being listed. We note that some of the benefits are taken for granted and we would like to see these publicised more. These include the kitemark of a listing and its positive commercial impact when dealing with customers, suppliers and bankers.

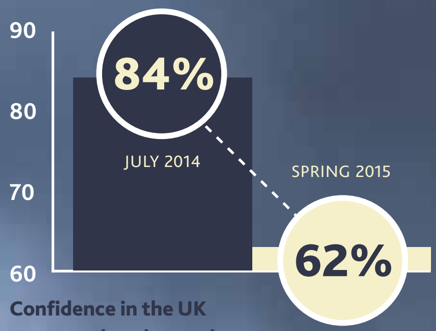
The process of choosing a broker or NOMAD is fraught with possibilities and so we wanted to understand what people in the sector value the most from their advisors. Unsurprisingly, we have found that trust is key when considering who should be your company's advisors.

> *"A listing is not cheap. Companies should be seeking to use the market to their benefit and raising finance – otherwise that cost is just an overhead"*
>
> SCOTT KNIGHT

Finally, investment research (or the lack thereof) is always an issue for small and mid-cap quoted companies, with many not receiving regular coverage. Our survey suggests that many small and mid-cap quoted companies continue to struggle to attract analyst coverage. However, research is still valuable with 50% of companies believing that research written on them in the last two years has increased investor interest.

All of this is aimed at ensuring that companies and their advisors are asking the right questions in different market circumstances. We hope you find this report useful and we look forward to hearing your comments.

2015: an uncertain outlook



Confidence in the UK economy has dropped significantly. 62% of small and mid-cap quoted companies are optimistic about the UK economy over the next 12 months (compared to 84% in July 2014). This score is now back to the July 2013 level.

Companies' business prospects remain stable

80% of small and mid-cap quoted companies are optimistic about their business prospects - a slight fall from **85%** in July 2014. Expected turnover growth has remained stable, but hiring expectations have fallen back to July 2013 levels.

Most companies *are not* planning on raising more money

Only **43%** of companies are planning on raising capital (down from 50% in July 2014) despite predictions that the next 12 months are going to be difficult. Companies' perceptions of the ease and difficulty of raising various forms of finance have remained broadly the same.

Most companies *are not* planning on moving markets

66% of AIM companies are not planning to move to the Main Market. However, 20% say that they are planning to move in the future, which is not really reflective of the reality of how many AIM companies have made the leap in the last 20 years (a figure which is actually less than 1%).

The costs of being a quoted company are high

On average, Main Market companies spend around **£360,000**

On average, AIM companies spend around **£220,000**

per annum on maintaining their listing.

Research on small and mid-cap companies is patchy

21% of small and mid-cap quoted companies have not had a piece of research written on them by their house broker in the past two years.

61% of small and mid-cap quoted companies have had at least one piece of research written by another broker in the last two years.

The majority (69%) of companies have not paid for research in the last two years.

Trust is key when choosing an advisor

TRUST

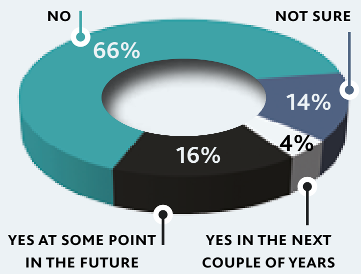
66% of companies say that they look for someone they can work with and trust when choosing a NOMAD or broker.

63% of advisors say that companies should look for knowledge of a company's sector or industry when choosing a NOMAD or broker.

MAKING THE LEAP TO THE MAIN MARKET

AIM is commonly viewed as a breeding ground for the Main Market, with companies using the junior market to find their feet before graduating to the more complex Main Market. However, two thirds (66%) of AIM quoted companies state that they do not plan to move to the Main Market and a further 14% say that they are unsure. So, its status as a "feeder" market does not necessarily reflect reality.

QUESTION Does your company plan to move onto the Main Market at some point?



Base: 87 AIM Quoted Companies

The performance of AIM has led some to be wary: since the market launched in 1995, its aggregate performance has been unremarkable. Elroy Dimson and Paul Marsh, finance professors at the London Business School who developed the Numis Smaller Companies Index, claim the market has returned -0.7% a year on average.

Over the past 15 years, just 86 companies have graduated from AIM to the Main Market, and many of the companies with the largest capitalisation on AIM are choosing to stay put.

For example, ASOS has a market capitalisation in excess of £2bn and would not look out of place in the FTSE 100. The top 25 or so on AIM might earn a place in the FTSE 250 if they were on the Main Market. In the past year, only 6 AIM companies moved to the Main Market; just 0.7% of the total companies on AIM.

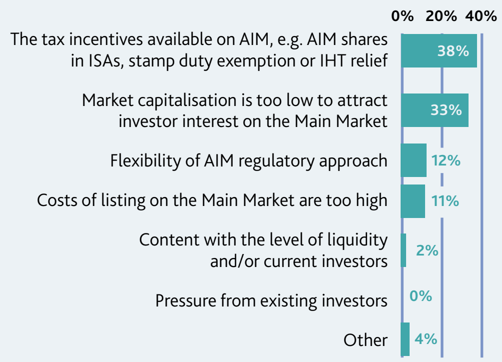
The staying power of AIM demonstrates the attractiveness of the market. It remains a popular option for young, fast-growth companies looking to raise between £5m and £10m – an amount which is becoming significantly more prevalent now that more institutions systematically invest in companies on the market.

The lack of red tape, liquidity requirements and trading history together with ongoing tax incentives makes AIM an attractive option.

Our survey shows that the primary reason for companies wanting to stay on AIM is for these tax incentives, such as the inclusion of AIM shares in ISAs, the stamp duty exemption on the trading of these shares and Inheritance Tax relief.

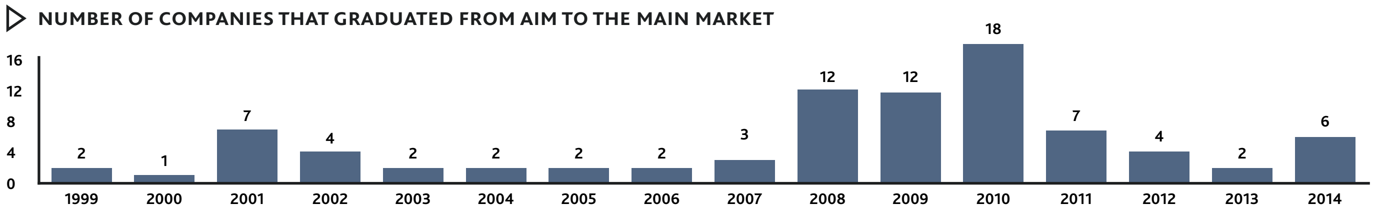
The extra financial cost of moving to the Main Market is also considered a barrier for 11% of AIM companies.

QUESTION What is the primary reason your company is not planning to move onto the Main Market?

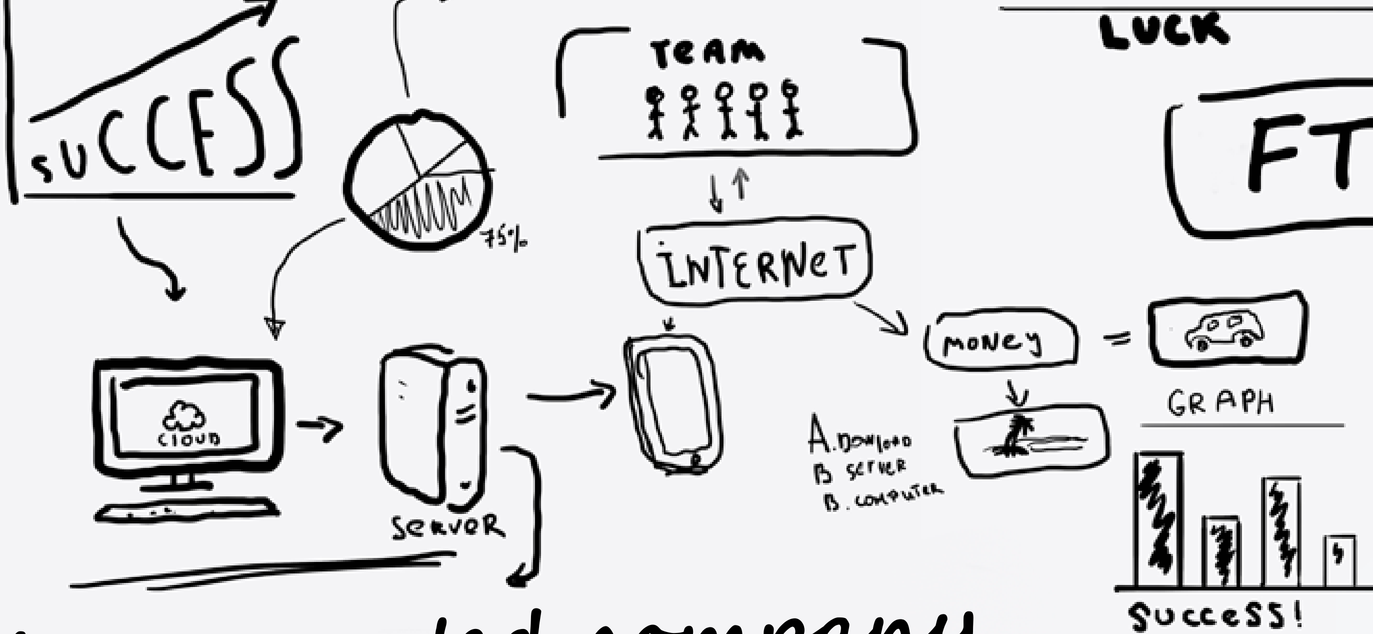


Base: 54 AIM Quoted Companies

NUMBER OF COMPANIES THAT GRADUATED FROM AIM TO THE MAIN MARKET



Source: London Stock Exchange



Being a quoted company comes at a (calculated) cost

Without doubt, being a public company has a greater cost compared to being a private company.

When equity markets are buoyant, these additional costs are seen as a deferred or prepaid fundraising cost.

However, when equity markets are tight, they will often be seen as an overhead, which, when an appropriate PE ratio is applied, represent a significant drain on shareholder value.

Only 15% of small and mid-cap quoted companies believe raising equity from the public markets at present is hard. Anecdotally, we see a number of management teams looking for new innovative funding solutions due to the relative tightness of the equity markets, and a number of these companies are coming under pressure to reduce their cost base.

According to the results of our survey, the average cost of being quoted on AIM is around £220,000 per annum, whilst the average cost of maintaining a listing on the Main Market is around £360,000 per annum. This is consistent with a straw poll of market experts we conducted at the recent Mining Indaba conference.

However, this captures only the external costs; the internal costs of time spent on investor relations and regulatory compliance will almost double this cost. Therefore, as a rule of thumb, the real annual cost for an AIM company is on average £500,000 and £750,000 for a Main Market listing.

Given the number of companies with a market capitalisation below £20m on AIM, this makes the cost of equity very expensive.

Nonetheless, despite these costs, being a public company does have benefits and equity markets can provide a great platform for growing a company. 54% of small and mid-cap quoted companies and 57% of advisors believe that the greatest benefit of being a quoted company is that the market provides a source of capital on a continuing basis. That is the obvious benefit, but a listing brings many other benefits that are more difficult to quantify.

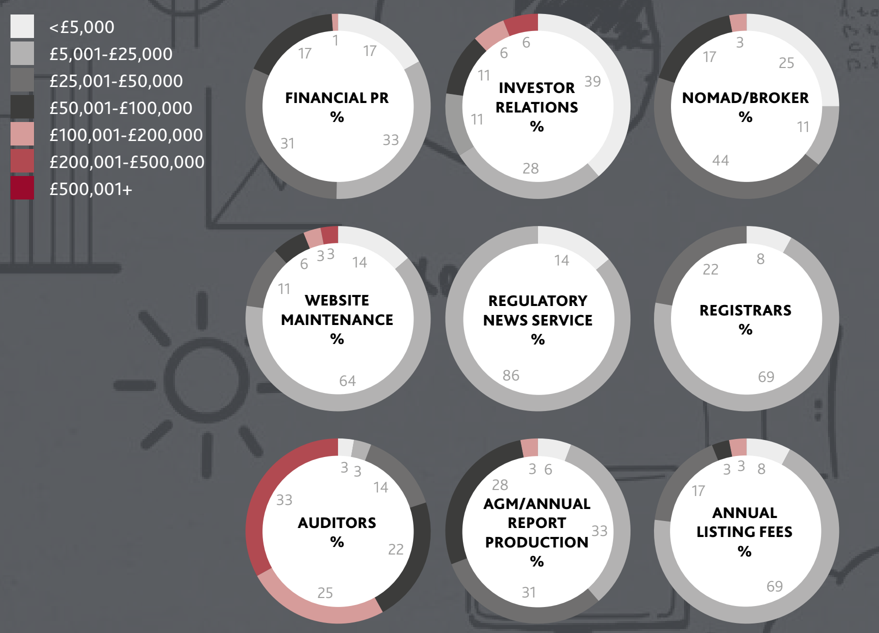
QUESTION

What are the costs of each of the following in maintaining your company's listing on AIM?

Base: 69 AIM Quoted Companies

QUESTION

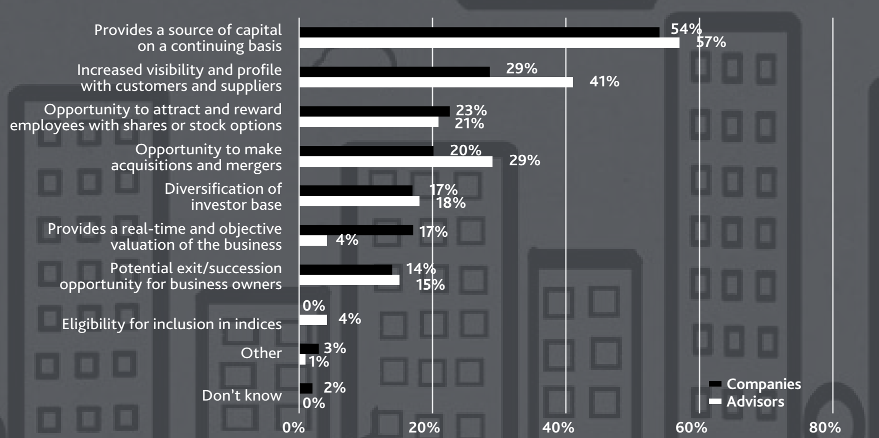
What are the costs in maintaining your company's listing on the Main Market ?



Base: 34 Main Market Listed Companies

QUESTION

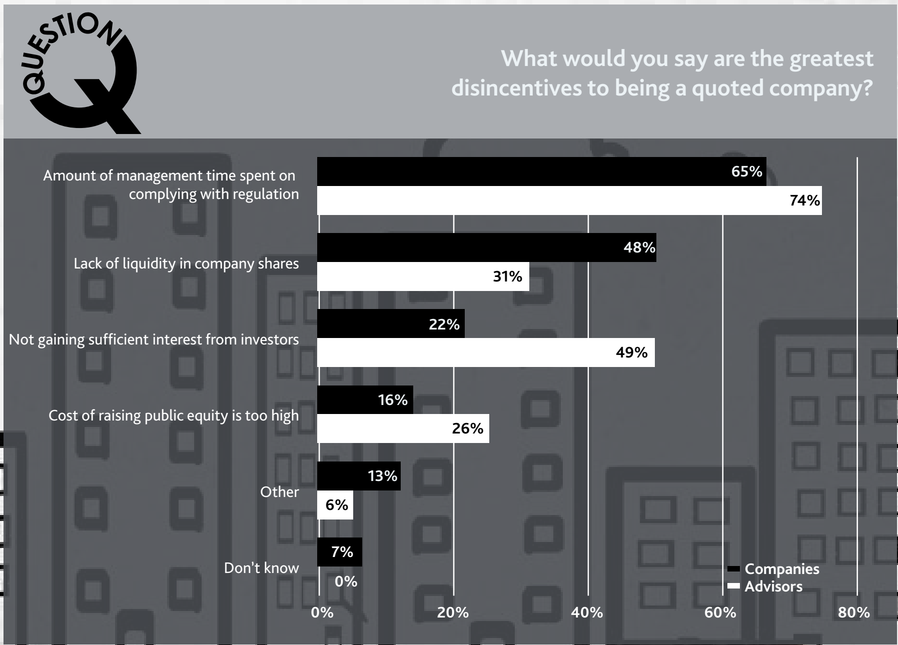
What would you say is the greatest value of being a quoted company?



For example, an equity market listing brings the advantage of a kitemark – an endorsement that a company is fit and proper, with published information for all to see. Customers, suppliers and other stakeholders do not have to make lengthy enquiries as to the probity and financial health of a company; so, in tendering situations and contract negotiations, being on a public equity market is a huge advantage. 29% of small and mid-cap quoted companies believe that this increased visibility is the greatest value of being a quoted company. More companies should recognise this benefit. A London listing, in particular, brings valuable prestige.

The regulatory environment for public companies will not get any easier. Most would agree that the London Stock Exchange, the Takeover Panel, the Financial Reporting Council and the Financial Conduct Authority have all become tougher than a few years ago and this trend is unlikely to reverse. 65% of small and mid-cap quoted companies and 74% of advisors believe that the greatest disincentive to being a quoted company is the high amount of management time spent complying with regulation.

The costs of falling foul of any of the above are highly significant. Increasingly, management teams may well need to look for savings to mitigate the time they spend on compliance issues, thus ensuring that the benefits of being on the market outweigh the costs.



GETTING**NOTICED**

Research on small & mid-cap companies

Investment research is one of the many ways that companies can attract interest from new investors and convey information to existing investors. Historically, levels of investment research in small and mid-cap quoted companies have been low and many companies struggle to get regular coverage by analysts.

According to our survey this wave, 21% of small and mid-cap quoted companies have not had a piece of research written on them by their house broker in the past two years. This figure is high, especially as companies pay their brokers a retainer, of which part should be to produce some form of research on the company.

Nonetheless, 46% of small and mid-cap quoted companies have had between one and five pieces of research written on them by their house broker in the last two years. 69% of small and mid-cap quoted companies have not paid directly for any research to be produced.

It is also clear that analysts who write research generally understand the company that they write on, with 66% of small and mid-cap quoted companies expressing the view that analysts understand the business either reasonably or very well. Only 4% expressed the view that they understood it poorly.

High quality analysis that interprets the fast-moving environment is the lifeblood of a vibrant equity market. 50% of small and mid-cap quoted companies believe that research written on their company increased new investor interest, whilst 38% believe that the research increased existing investor interest.

These numbers are not reflecting a large majority and brokers will undoubtedly point to examples of companies with no real change to the story to write about. Companies will point to the correlation between the analyst's level of interest and the proximity of the next fundraising commission.

However, everybody would benefit from more research being published, as it has knock-on benefits: research leads to increased visibility, which leads to new investor interest, which leads to the share price going up.

Europe and the UK's Financial Conduct Authority (FCA) are having a close look at how investment research is paid for. Research is seen as an inducement provided by brokers to encourage fund managers to trade in particular stocks. There is a desire to make paying for these inducements more transparent.

At the moment, it is often bundled up in dealing commissions and fund managers allocate a proportion of the commission they pay for dealing in shares to the brokers that have provided them with the research. They have the benefit of hindsight and they pay for what they deem to be research that has helped them.

All that will change if Europe and the FCA are successful in banning the use of dealing commissions to pay for investment research, which is what has been proposed. Fund managers will have to be clear about who they think will provide them with valued research.

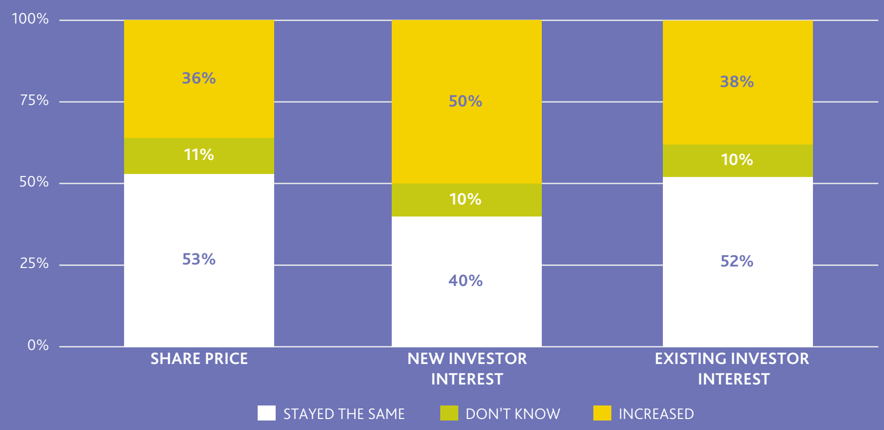
We may see a move towards a subscription service where fund managers pay in advance for a research service. As a result, we could see research gravitating towards the larger brokers and investment banks, which can afford to pay for a larger group of researchers.

The consequences of this could be that there is less research devoted to small and mid-size quoted companies, with the number of companies that have no research published on them increasing. Funds and brokers that concentrate on small and mid-cap quoted companies will have even less spending money.

This could have a profound effect on small and mid-size quoted companies' ability to raise finance on public equity markets and grow. It could lead to a reduction in the number of research pieces on small and mid-size quoted companies (which is already low) and a drop in liquidity (undoing hard won battles such as getting AIM and ISDX shares into ISAs).

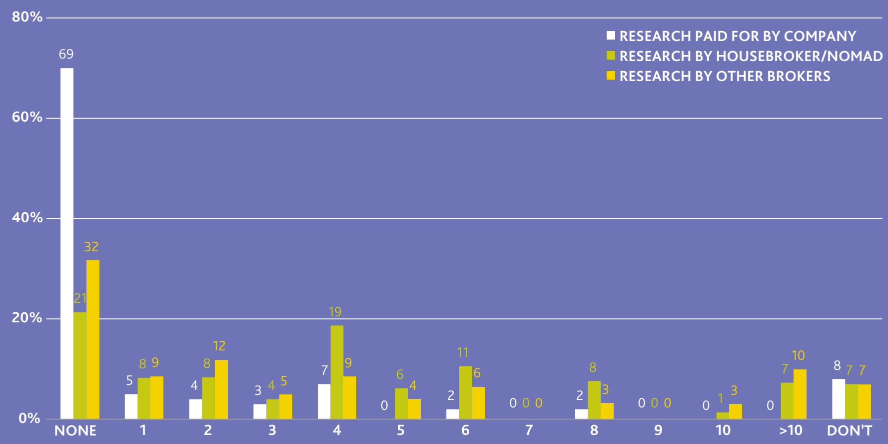
QUESTION

In general, what impact did the research mentioned above have on these aspects of your company?



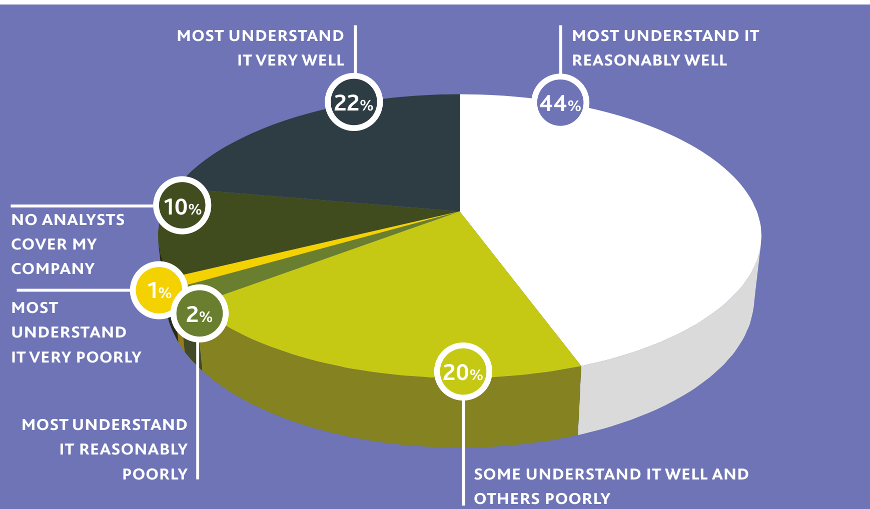
QUESTION

How many times in the last two years have you had research written on your company by each of the following?



QUESTION

Do you feel that analysts who write research on your company understand you well?



Trust is key when seeking a broker or nominated advisor (NOMAD): 66% of small and mid-cap quoted companies said it was a key attribute they looked for when seeking an advisor, with cost labelled as a priority by just 19%.

Whilst the key role of a NOMAD is to help clients meet regulatory obligations and to ensure their company is presented well to investors, an often overlooked role is that of a mentor to the board of the company: many management teams have very little knowledge about how to operate as a publicly-listed entity. A good NOMAD will guide them on how to build the best strategy, gain good liquidity and build a strong presence in a competitive market.

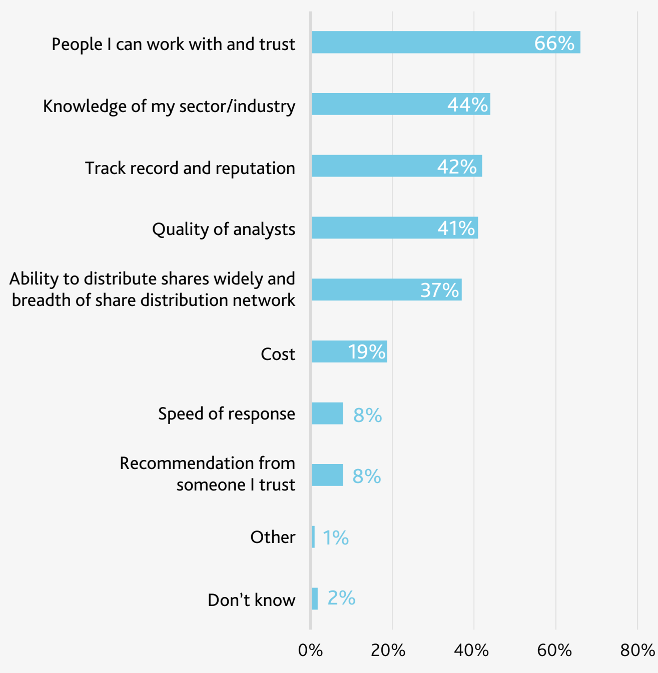
Some of the best NOMADs become near-business partners and help the company build M&A strategies and seek partner opportunities.

Interestingly, advisors themselves placed knowledge of an industry sector higher than trust: perhaps an assumption that trust is a pre-requisite of a company/advisor relationship.

CHOOSING YOUR ADVISORS

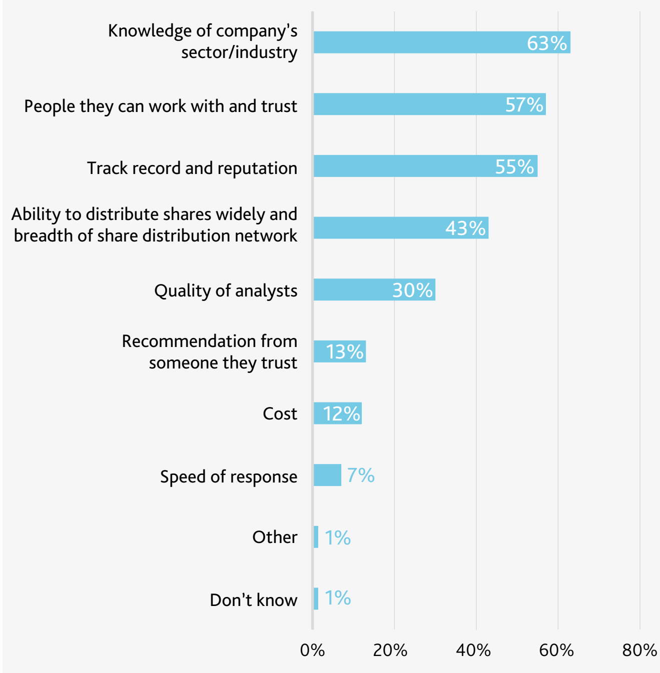
QUESTION

What key attributes do you look for when choosing your broker or Nominated Advisor (NOMAD)? (Companies' responses)



QUESTION

What are the key attributes that companies should look for in a broker or Nominated Advisor (NOMAD)? (Advisors' responses)



ECONOMIC CONFIDENCE DIVES

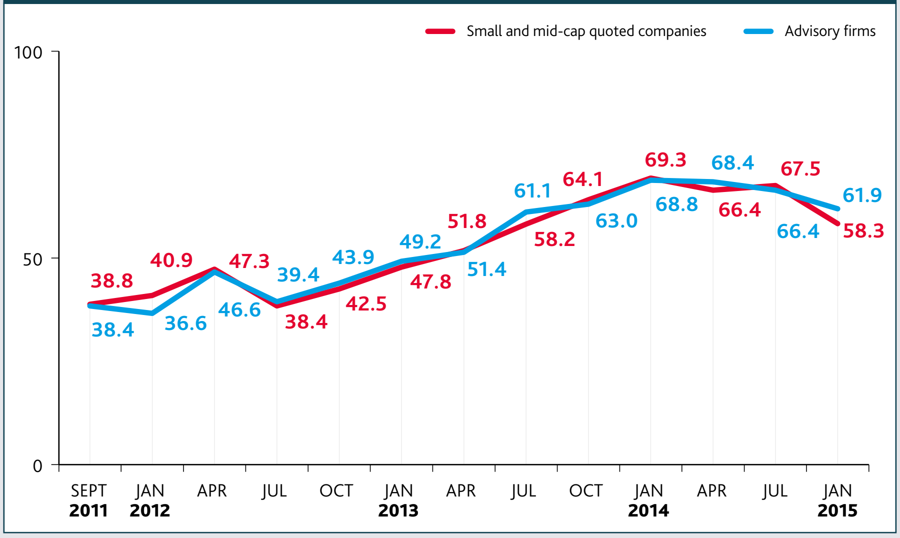
The headline confidence levels amongst small and mid-cap quoted companies are back to where they were 18 months ago, and the optimism of January 2014, when we hit record confidence levels, is a fading memory.

Whilst the majority of companies (62%) are still optimistic about the UK's economic prospects, this figure has fallen 20% in the last six months. Advisors' views follow a similar trend (albeit slightly less dramatic), falling to 75% being optimistic about the UK's prospects (down from 83% in July 2014).

Companies' confidence in their own business prospects follows a similar path, dropping from 85% being confident in July 2014 to 80% now. Advisors' predictions for UK small and mid-cap quoted companies' business prospects are also down from 77% being optimistic in July 2014 to 74% in January 2015.

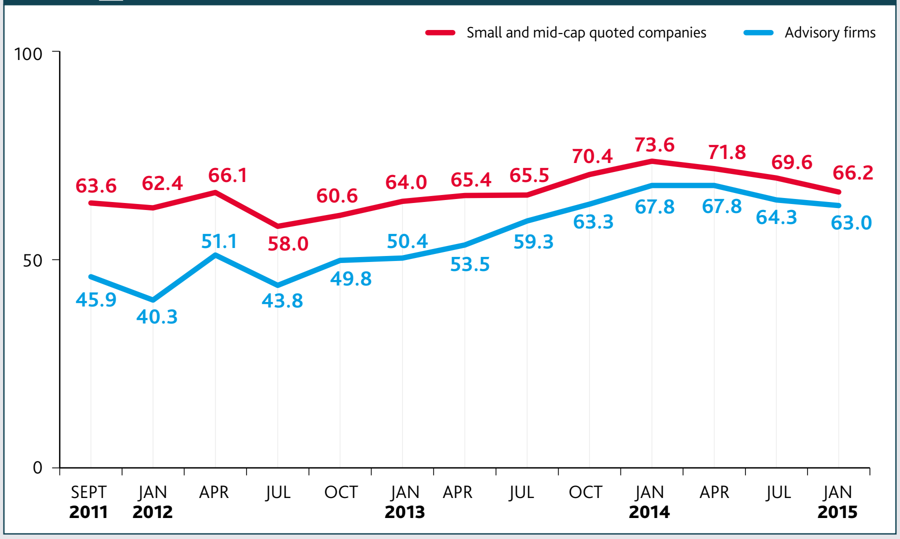
QUESTION

How optimistic or pessimistic do you feel about the UK economy over the coming 12 months? (Mean scores)



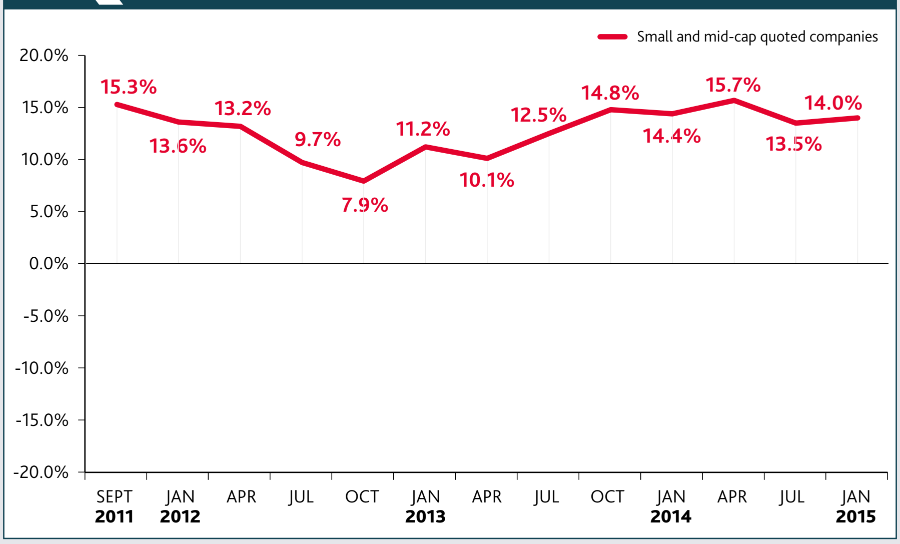
QUESTION

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



QUESTION

Mean expected turnover change over the next 12 months



These drops in confidence seem to be attributed to fears of economic and political instability in the UK, Europe and beyond.

Many companies and advisors cited concerns that the UK General Election is going to postpone investment and market activity, as well as concerns about the Eurozone and low oil prices. On the other hand, many companies are positive about their company's performance and their order/sales pipeline, which may help to counter some of their concerns about political uncertainty.

The UK General Election (or potentially elections, if the first election is inconclusive) may create some local uncertainty, but is this enough to have such a significant impact on confidence levels? Since the global financial crisis, businesses have strengthened their balance sheets, reduced leverage, driven efficiencies out of cost structures, exited parts of the business with the wrong risk to reward ratios and diversified into new markets to reduce risks. All combined, this should have made small and mid-cap quoted companies more resilient to external shocks than ever before.

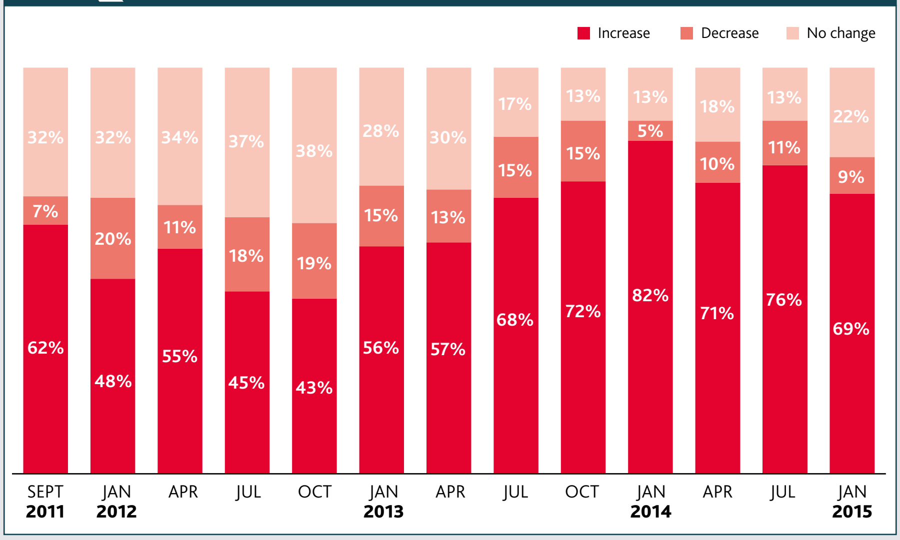
The explanation for this inconsistency may be due to a 'fear factor'. We have seen so many external political and economic shocks over the last seven years that, rather than confidence being more resilient (what does not kill us makes us stronger), nerves have become somewhat frayed and we anticipate a greater risk than actually exists.

There is no doubt that we live in uncertain times. It is difficult to point to a corner of the globe that does not have severe geopolitical risks. However, most small and mid-cap quoted companies should be sufficiently diverse to absorb any local uncertainty – perhaps that is why their predictions on their own business prospects remain relatively stable.

Small and mid-cap quoted companies expect turnover to grow by 14% on average, which is consistent with what we saw in July 2014. The majority of companies (69%) expect to increase headcount, which is down 7% from July 2014. The mean expected employment change was at an all-time high in our last survey, but has fallen this time to 4.9%, which could be reflective of the more sombre mood.

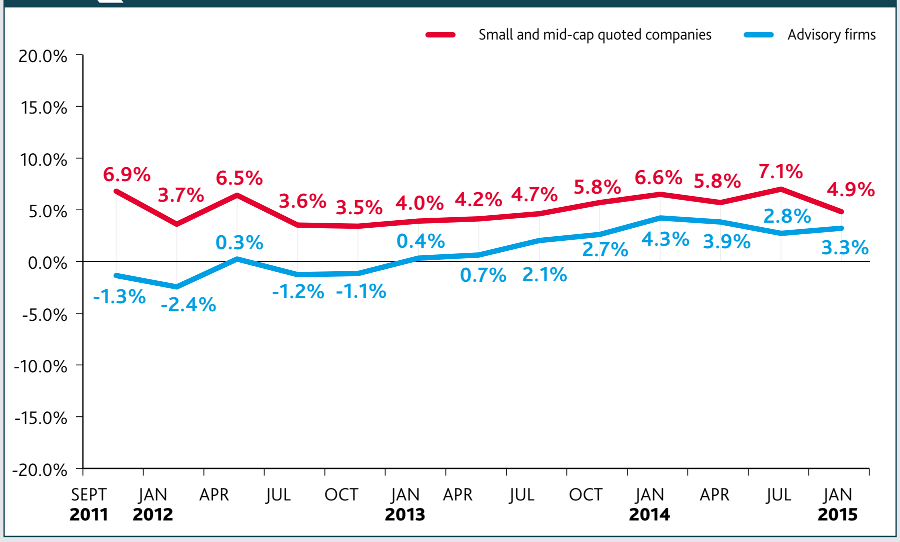
QUESTION

Do you expect the number of full time employees in your business to increase or decrease over the next 12 months?



QUESTION

Mean expected employment change over the next 12 months



Top tips

FOR NAVIGATING THE MARKET IN 2015

Overall, uncertainty seems to be spooking everyone, which indicates that we should all prepare for a potentially rocky 12 months. So how do you get through it? Here are some tips for navigating the market in 2015:

PLAN NOW FOR THE DIFFICULTY THAT IS TO COME

This is stating the obvious, but still worth highlighting. Larger macroeconomic and political issues are going to take their toll on the market somehow, so make sure you are ready for them. For example, have you worked out how lower oil prices will affect your business and your customers? Have you incorporated this into your business planning? Share prices may drop, despite strong business performance.

1

DON'T OVERPROMISE ON WHAT YOU ARE GOING TO ACHIEVE THIS YEAR

Investors are just as worried as companies about how these macroeconomic and political events will affect the market and the value of their investments. It is vital that companies communicate to investors their plans for the year early on and deliver the results that they promise. Manage your investors' expectations so that you can continue to have their support through potentially difficult times.

2

PREPARE FOR A LULL JUST AHEAD AND AFTER THE GENERAL ELECTION

We have heard a number of companies and advisory firms saying that they are going to postpone decisions on major business transactions until after the General Election. So, it may be quiet in the market, which could provide both opportunities and challenges for companies. Again, this is just another point to factor into your business plans for the year.

3

SMALL AND MID-CAP QUOTED COMPANY VIEWPOINT:

"The improving economy is good for our business as is the need for continued investment in education and healthcare. The election and any major political change in direction and /or confidence is [sic] not good."

SMALL AND MID-CAP QUOTED COMPANY VIEWPOINT:

"[We are] well positioned to deliver on significant milestones. [Our] main concern is [the] impact of election uncertainty and/or the possibility of a Labour election victory, which would undermine equity capital markets."

ADVISOR VIEWPOINT:

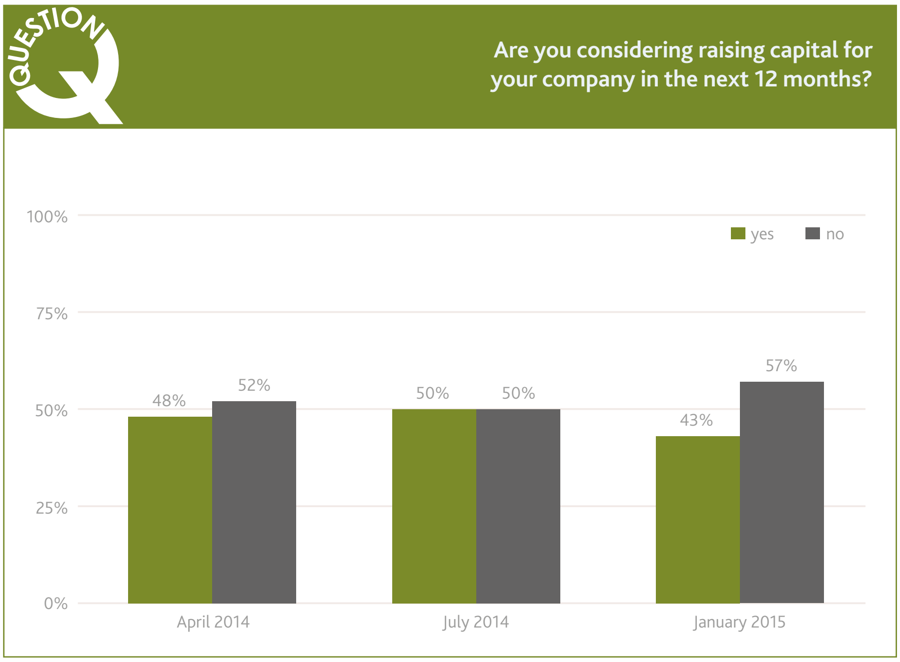
"Continuing low inflation environment, suppressed oil prices and increased hiring is [sic] positive. But, ongoing significant structural issues in the Eurozone are a major negative factor. Also the rate of recovery in the UK is still too slow to address the structural deficit in Government finances."

FINANCING FOR GROWTH

Despite concerns of economic and political turmoil, access to finance for small and mid-cap quoted companies remains similar to what we saw in July 2014.

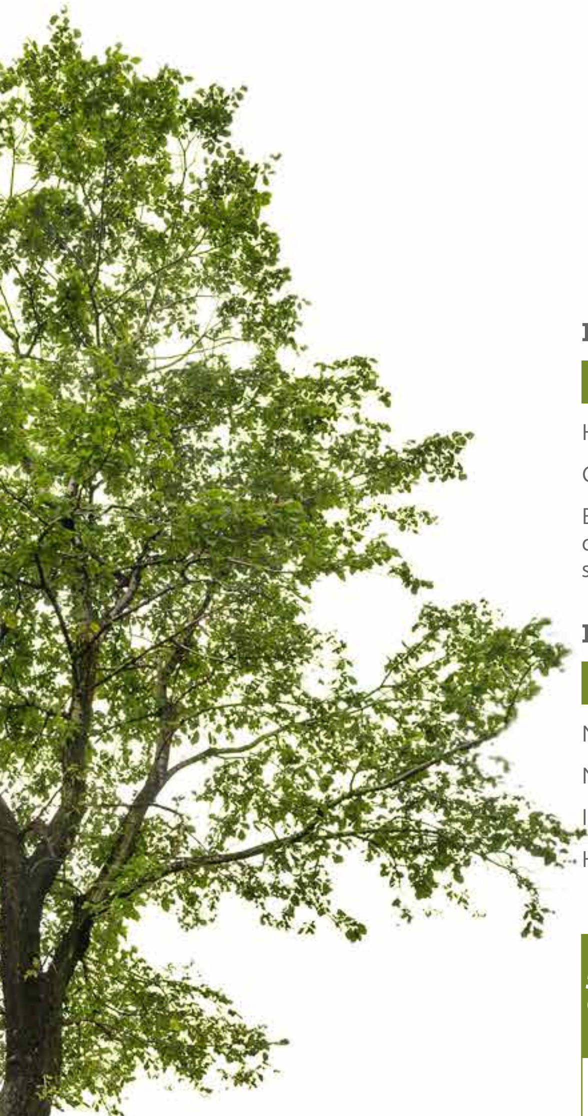
Companies are fearful that they may soon fall on hard times; the number of small and mid-cap quoted companies which are considering raising finance in the next 12 months has slipped from 50% in July 2014 to 43% in January 2015. This is the lowest level since we started asking this question in April 2014.

Small and mid-cap quoted companies' preferred ways of raising finance, if the need arose in the next 12 months, remain via public equity (44%) and bank finance (35%). Nonetheless, more companies are now considering alternative routes, with 7% proposing to seek private equity, 7% through listed debt issuance and 6% to use other unspecified sources. Although these moves are not significant, it may be reflective of quoted companies fearing that traditional sources of capital may dry up as a result of the uncertainty that is overshadowing 2015.



The perceived ease of raising various forms of finance reflects what we found in July 2014, with public equity (6.3 mean score – where 0 is impossible and 10 is extremely easy) and bank finance (6.1 mean score) being the easiest to obtain, unsurprisingly. Despite the varying economic conditions, over the past three years these figures have remained consistent.

On the other hand, advisors currently believe that it is slightly easier to raise private equity (5.4 mean score) than public equity (5.2 mean score). Overall, advisors rated all forms of finance as slightly easier to obtain than in July 2014.



REASONS FOR RAISING PUBLIC EQUITY

IF THE NEED AROSE IN THE NEXT 12 MONTHS

Have a supportive shareholder base

Cheap as already on a public equity market

Bank finance is not available because companies are considered too risky/early stage

Want to remain debt free and have a strong balance sheet

Know the process

General perception that banks are 'greedy' or not lending to small businesses

REASONS FOR RAISING BANK FINANCE

IF THE NEED AROSE IN THE NEXT 12 MONTHS

No shareholder dilution

No impact on Earnings Per Share (EPS) ratio

Interest rates are low and so it is cheap

Have credit facilities already in place

Know the bank's expectations, whereas the market is a bit more uncertain

Equity finance is too expensive due to the time associated with preparing all the paperwork

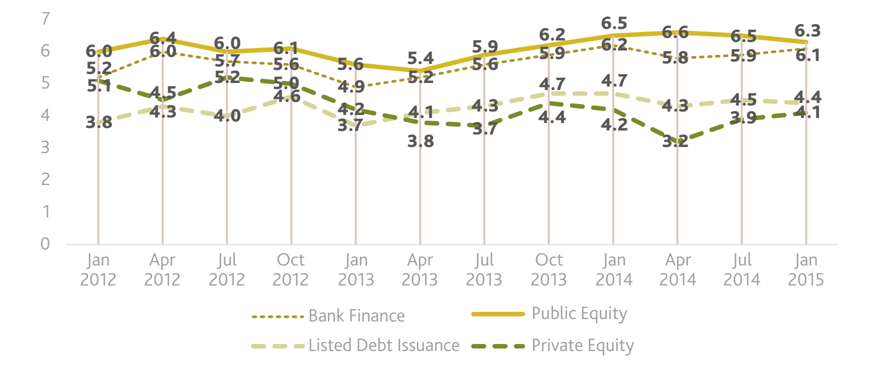
SMALL AND MID-CAP QUOTED COMPANIES VIEWPOINTS:

"Equity finance is too expensive in terms of time to prepare the paperwork and the discount that investors expect real businesses to be valued at."

"We are a quoted company and [raising public equity] is the easiest and cheapest, albeit less certain way to achieve success."

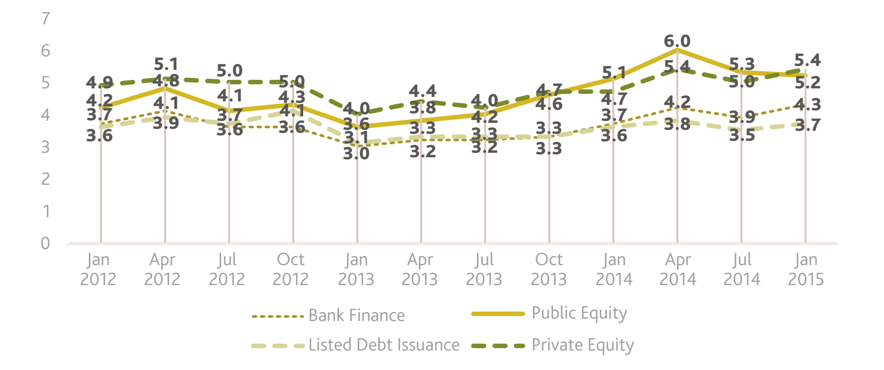
QUESTION

How easy or difficult would your company currently find it to raise finance through the following channels? (Mean scores – Companies)



QUESTION

How easy or difficult do you believe small and mid-cap quoted companies are currently finding it to raise finance through the following channels? (Mean scores – Advisors)



Methodology

The QCA/BDO Small and Mid-Cap Sentiment Index by BDO and the Quoted Companies Alliance (QCA) is a triannual survey across the mid-cap quoted company sector. PULSE is the report of the survey's results.

The PULSE report is based upon 202 online interviews (133 small and mid-cap quoted companies and 69 advisory companies). It was conducted between 12th to 23rd January 2015 by research company YouGov.

Please note that scores in this report may not add up to exactly 100% due to rounding.
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 the issues covered in this report please contact:

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