



QCA/BDO

SMALL & MID-CAP SENTIMENT INDEX

November 2013 Issue 9



INTRODUCTION

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THIS IS THE NINTH REPORT ON THE SMALL AND MID-CAP SENTIMENT INDEX AND IT IS CLEAR THAT WE ARE NOW SEEING FIRM TRENDS, GIVING US THE ABILITY TO FORECAST AHEAD. AFTER FIVE CONSECUTIVE QUARTERS, COMPANIES ARE

DEMONSTRATING AN INCREASING CONFIDENCE IN THE UK ECONOMY AND MY STRONG BELIEF IS THAT THE BUSINESS ENVIRONMENT IS IMPROVING.

With consumer confidence back at a multi-year high, it is encouraging to see that businesses are also feeling more upbeat about their prospects. Although the UK remains fragile and certain sectors are still facing challenging times, I get a real feeling the storm is finally passing. Despite my positivity, this isn't to say that companies should throw caution to the wind. The conversations I have every day with mining clients, for example, are inconsistent with this widespread positivity and it should be noted that prosperity is not yet universal. There is work yet to be done before we reach conditions even close to reminiscent of the pre-2008 market, but I believe there is no reason to suggest this is just another false dawn.

The findings of this survey suggest that small and mid-cap quoted companies have a strong year ahead, with almost three quarters of companies suggesting they will increase the size of their workforce in the next 12 months. We may see the creation of around 200,000 new jobs in the UK if this holds true.

I was both pleased and surprised with regard to how small and mid-cap quoted companies view the City of London. In the popular press, the City has such a strong stigma surrounding it and to see such refreshing positivity, one can't help but smile. 94% of companies believe that the City has a positive impact on the UK economy which is wildly at odds with what you read in the media.

I am also encouraged by the fact that the majority of small and mid-cap quoted companies believe they are well served by the City and for decades small companies grew to become large companies in a symbiotic relationship with the City. Whilst around a third of companies believe they are not well served by the City, the most commonly cited reason for this was a lack of risk appetite, which I suspect is not institutional but driven by the fear of the individual. As the economy continues to grow I would expect this to change, and in 12 months' time I believe we will see an even greater proportion of businesses feeling that the City of London is the place for small and mid-cap companies to grow.

THE FINDINGS OF THIS SURVEY SUGGEST THAT SMALL AND MID-CAP QUOTED COMPANIES HAVE A STRONG YEAR AHEAD, WITH ALMOST THREE QUARTERS OF COMPANIES SUGGESTING THEY WILL INCREASE THE SIZE OF THEIR WORKFORCE IN THE NEXT 12 MONTHS.

EXECUTIVE SUMMARY

TIM WARD, CHIEF EXECUTIVE, THE QUOTED COMPANIES ALLIANCE



In this quarter's Index, it is great to see that:

- confidence in both the UK economy and companies' own prospects is continuing to improve;
- job prospects continue to improve;
- sales growth targets are increasing; and
- more companies are expecting to raise capital in the next 12 months.

Pessimistically optimistic

During the course of the last 12 months we have witnessed a radical shift in economic sentiment which will, I hope, translate into healthier and more liquid capital markets. This will enable more small and mid-cap companies to raise money, to grow and to create employment.

Every company director I have met recently endorses this view; the landscape has changed for the better. But most are keeping their guard up as access to finance remains a key and untested issue. Our Index this quarter shows that companies believe that access to capital is getting easier; but it is interesting to see that advisors still do not think that any source of finance is "easy" to raise – 53% of advisors say that it is hard to raise bank finance and only 13% believe that it is easy to raise public equity. In contrast 45% of companies believe it is easy to raise public equity. When these two groups start to show a common view then we will be in a better place to be confident about economic prospects. Until then we need to be wary about overstating the position.

The City, priceless or without value?

We asked for views about the value the City brings to the UK economy and the small and mid-cap sector. There are some quite divergent answers. The general view is that the City has a positive impact on the UK economy and the majority of companies and advisors feel that small and mid-cap companies are well served by the City. But it is interesting to note that over a third of companies and advisors do not think that the City is serving the sector well.

Many believe that no single group in the City brings the most value to the sector or UK economy. But about one in five of our respondents pick out "public equity markets" as being the key value generator of the City to the UK economy, highlighting their role in raising capital.

The City could do more to make its case as to how it creates and delivers the primary markets for the UK economy. Much is made of the City's contribution to UK GDP, but there should be more regular updates on how financial services organisations serve the real economy, as well as create wealth for themselves.

Fuel for the engines of growth

We have asked again about how you would like the Government to change its fiscal policy. After major wins – AIM and ICAP Securities and Derivatives Exchange (ISDX) shares being eligible for inclusion in ISAs and the forthcoming abolition of stamp duty on trading in AIM and ISDX shares – we are keen to see continued improvements to the liquidity of the sector, either directly through share trading incentives or through fiscal policies designed to encourage employment, increase profits (and therefore encourage employment) or rebalance the costs of raising debt and equity finance.

There seems to be a fair following for any fiscal policy which helps to reduce the costs of, and reward, employment. We are finalising our budget representations ahead of the Chancellor's Autumn Statement so your responses are very welcome. These help to provide us with validity for the policies we propose, which we further support with case studies and examples drawn from our member companies and Quoted Companies Alliance Tax Expert Group.

Finally, I'd like to thank you all for responding to our survey. I know it can be irksome to be encouraged to complete the survey, but the results do help to effect positive change for the small and mid-cap sector. Thank you.

HIGHLIGHTS

83%

of small and mid-cap quoted companies are optimistic about their own business prospects – **up 7% on July.**

79%

of small and mid-cap quoted companies are optimistic about prospects for the UK economy over the next 12 months – **up 12% on July.**

82%

of small and mid-cap quoted companies expect sales to grow in the next 12 months, with the average expected growth in turnover put at +14.75%, **up on July (+12.49%).**

72%

of small and mid-cap quoted companies expect to increase headcount in the next 12 months, **with the average expected change in employment growth put at +5.77%, up on July (+4.66%).**

Small and mid-cap companies believe that **private equity, bank finance, listed debt issuance and public equity is easier to obtain since July.**

46%

of small and mid-cap quoted companies are considering raising capital in the next 12 months, **up 3% on October 2012.**

34%

of companies would like to see additional Employers NIC reductions/rebates for businesses that take on new workers or export announced in the Chancellor's 2014 Budget.

94%

of small and mid-cap quoted companies believe that the City of London (banks, insurers, investors, advisors etc.) **has a positive impact on the UK economy.**

85%

of small and mid-cap quoted companies believe that the City of London (banks, insurers, investors, advisors etc.) **has a positive impact on the European economy as a whole.**

BUSINESS CONFIDENCE

For a fifth consecutive quarter we have witnessed a boost in small and mid-cap companies' optimism in the UK economy for the next 12 months.

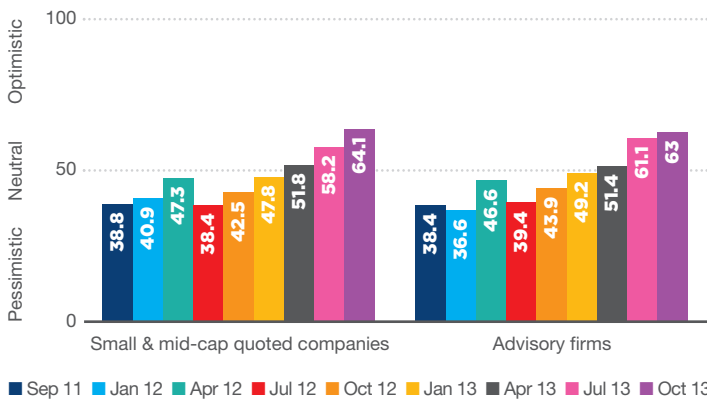
On a scale between zero and 100, where the 50 mark separates optimism from pessimism, small and mid-cap quoted companies currently rank prospects for the UK economy at 64.1 compared to 58.2 in July. Confidence in advisory firms has also increased, albeit at a slower rate, now standing at 63.0.

The preliminary estimate of 0.8% growth in GDP over the third quarter of 2013 is an encouraging sign that the UK's recovery is finally on the right track. The recent spate of strong economic data releases suggests that the UK's return to prosperity appears to be gaining momentum.

Consumer confidence is back at a multi-year high giving further credence to the notion that greater activity is yet to come. The International Monetary Fund, which accused George Osborne of "playing with fire" with his austerity programme, has made a drastic U-turn in its forecast for GDP growth with its current projection standing at 1.4% for the year – double the rate predicted in April.

Furthermore we have seen some robust activity from a variety of industries. Retail sales, investment spending and net exports are all on the up with further evidence from the BDO Business Trends survey, suggesting that the manufacturing and services sectors are also firmly entrenched in recovery.

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



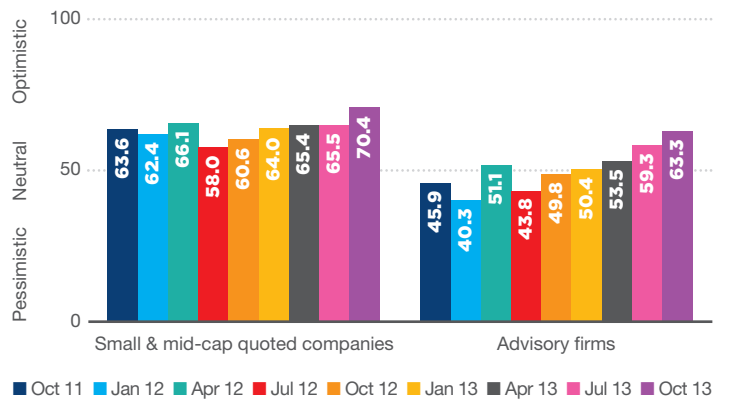
The housing market is showing signs of improved health with prices starting to increase. This is, however, far from uniform across the country with growth almost solely focused on the south, where demand from international markets has helped inflate prices.

Interest rates are set to remain low for the foreseeable future with the consensus amongst City analysts estimating we will see a rise of 25bp in Q1 of 2016.

With so much positive news in the public domain it is unsurprising to see small and mid-cap companies' confidence in the UK economy continuing on an upwards trend.

Alongside the strengthening confidence in the UK economy, small and mid-cap companies' confidence in their own prospects has received a boost. Small and mid-cap companies now rank confidence in their own prospects at 70.4 – the highest we have seen since the launch of this index. Furthermore, this increase represents the greatest quarter-on-quarter jump that we have witnessed. Advisors, whilst marginally less optimistic, are also showing signs that they believe the next 12 months will be positive by ranking small and mid-cap prospects at 63.3 – again, a record for this index.

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



GCA/BDO VIEW

The UK economy is 2% smaller than it was pre-2008. However confidence is returning and confidence is key to economic growth. Nonetheless, more companies go bust coming out of a recession than at any other time, so access to investment and working capital is critical.

FUTURE EXPECTATIONS

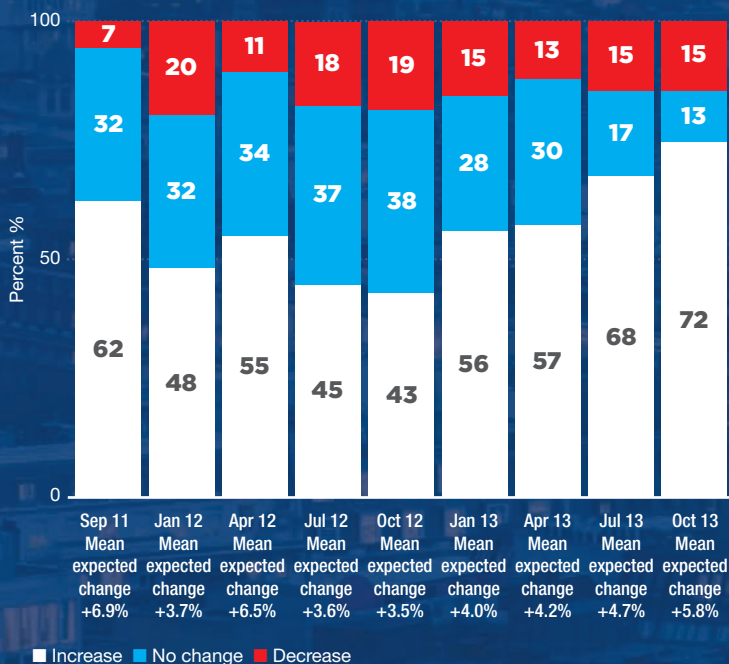
Despite the current buzz surrounding the UK economy, in real terms there are few signs to suggest conditions have actually improved. Unemployment of the economically active population remains high at 7.7% with little to suggest that this will begin to fall to acceptable levels over the next four quarters. Furthermore wage growth is still lagging behind inflation and as such consumers have less money in their pockets than they did 12 months ago. Inflation is still high at 0.7% ahead of the 2% target set by the Monetary Policy Committee.

Despite this, small and mid-cap companies are growing more optimistic regarding increasing the size of their workforce. The average amount by which companies expect their workforce to grow is 5.8%, which is the strongest result we have had since April 2012. Even more encouraging is the

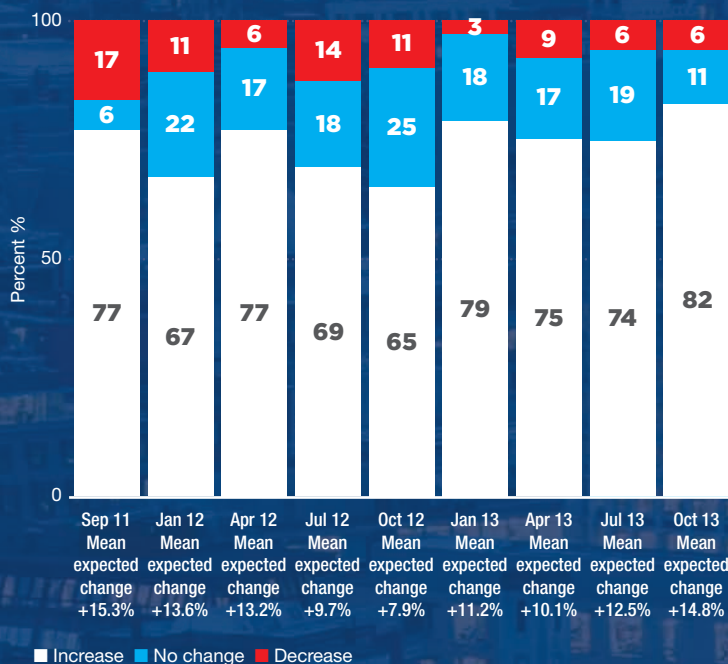
fact that 72% expect to increase the number of full time employees over the coming 12 months, which again is a record for this report.

Looking towards turnover prospects, things look very positive for small and mid-cap quoted companies. The number of companies expecting to grow sales over the coming 12 months has increased from the 74% we saw in July to the current high of 82%. We also saw the number of businesses suggesting turnover would remain unchanged fall from 19% to 11%. The number of small and mid-caps expecting a decrease in turnover increased very slightly from 6.3% to 7.1%. Mean expected turnover also improved to 14.8% this quarter, marking the highest level we have seen since September 2011.

Do you expect the number of full time employees in your business to change in the next 12 months?



By how much do you expect your turnover to change in the coming 12 month period?



QCA/BDO VIEW ▼

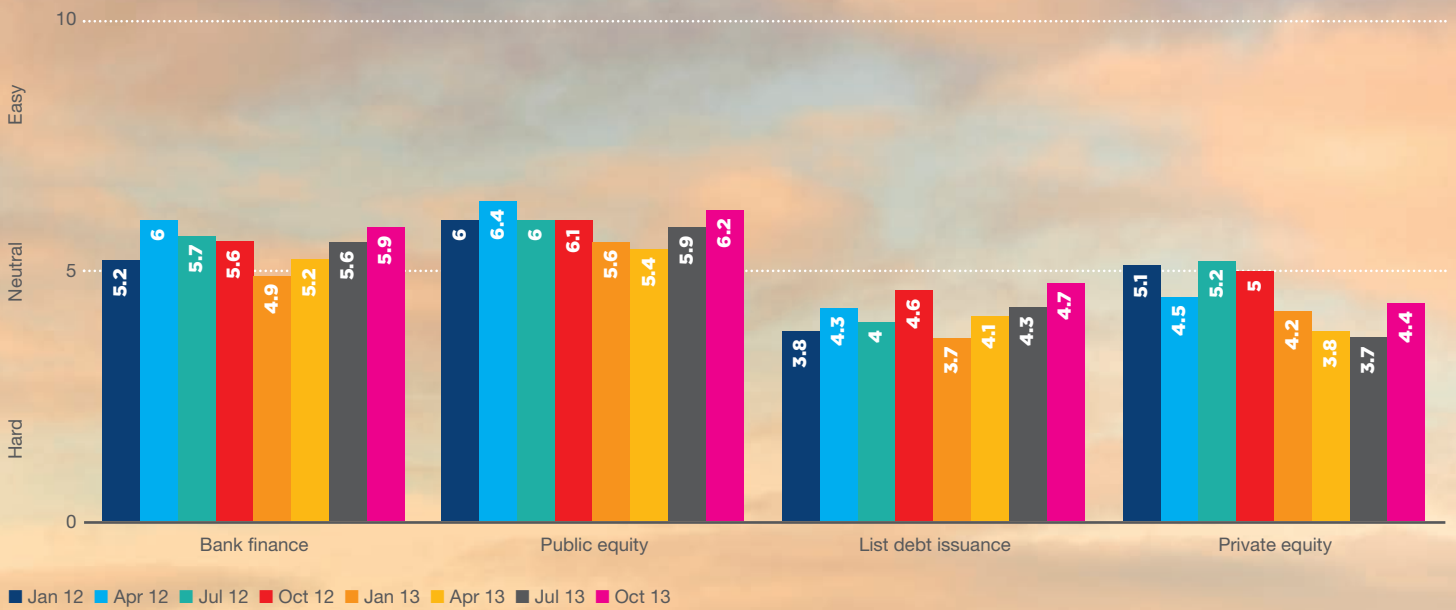
It is pleasing to see bullish attitudes shown by small and mid-cap companies regarding both employment and turnover growth. As the economy builds on what was robust growth over the past quarter, these figures can be expected to continue strengthening. We also expect small and mid-cap companies to be fundamental drivers of the recovery over the next few years.

It will be both exciting and interesting to see to what degree the recovery has on companies' views of turnover and employment growth in the next wave. The mean expected change in turnover and full time employment could well be breaking records for this index next quarter.

FUNDRAISING

Small and mid-cap companies have indicated that all forms of finance have become easier to obtain since last quarter. Private equity remains the most challenging form of finance for companies to obtain, whilst public equity continues to be perceived as the easiest. Small and mid-cap companies state that public equity is at its easiest to obtain since April 2012, whilst listed debt issuance is cited as the easiest since this survey began. Despite this, private equity and listed debt issuance both remain below the 5 point that separates forms of finance considered easy or difficult.

How easy or difficult would your company find it to raise capital through the following channels?



FISCAL WISH LIST FOR THE 2014 BUDGET

For the previous two years we have asked the small and mid-cap quoted company sector what they would like to see in the upcoming Budget.

We saw the inclusion of AIM and ISDX shares into ISAs as the measure that the sector thought would have the most positive impact on small and mid-cap quoted companies, with 34% of small and mid-cap quoted companies stating this in October 2012 and with 85% of companies believing that it would have a positive impact on their business in February 2012. It was a welcome move to see the Treasury bring this policy into effect from August 2013. Since then, there has been initial research suggesting that the amount of money raised and traded on AIM is increasing, which is good news for small and mid-cap quoted companies.

With the Chancellor set to deliver the Autumn Statement on 5 December, we have again asked the small and mid-cap quoted company sector which fiscal policies they believe would have the greatest positive impact on their businesses, were they to be announced in the 2014 Budget.

34% of small and mid-cap quoted companies and 44% of advisors say that additional Employers' National Insurance Contribution (NIC) reductions or rebates for businesses that take on new workers or export would have the most positive impact on their businesses.

With unemployment falling in the UK and the GDP growth improving, it is not surprising to see companies wanting a reward for taking on new employees. When asked the reasons for wanting the NIC reduction, companies say that the measure would encourage more hiring and that in general the cost of NIC is too high already, with one respondent saying "NIC is a tax on jobs...".

The sector is also calling out for tax simplification – 33% of companies and 35% of advisors want to see the abolition of numerous tax reliefs in exchange for a lower overall corporation tax rate. In March 2011, the Office of Tax Simplification published a report on tax reliefs, which recommended amendments to reliefs as well as a list of those that should be scrapped – all in an effort to simplify the UK tax system. However, tax legislation continues to grow in length and complexity and the small and mid-cap quoted company sector is demanding that the Government tackles this problem.

When asked for reasons for wanting tax reliefs scrapped in exchange for a cut in corporation tax, companies generally want to reduce red tape and administration costs, believing that, ultimately, the lower rate of corporation tax will be more competitive internationally and attract more investment.

Lastly, 39% of advisors and 22% of companies believe that making the costs of raising equity tax deductible (up to a certain limit) will have a positive impact on small and mid-cap quoted companies. At the moment, companies that raise debt can get tax relief on the costs of doing so. This imbalance between debt and equity has routinely been referred to as a direct contributor to the 2008 financial crisis.



One of the most expensive costs is staff.

Small and Mid-Cap Company Viewpoint

QCA/BDO VIEW ▼

Companies are clearly seeking NIC relief. Our index this quarter shows that a record 72% of companies expect to increase their workforce – the highest level we have seen since the survey started in 2011. With companies looking to hire more and the Government seeking to reduce unemployment, this is definitely a policy for the Chancellor to consider in order to stimulate economic growth. Companies are also calling for simplification of the tax system by abolishing reliefs in order to have a lower rate of corporation tax. This would not change the amount of tax raised, but it would make it much cheaper to administer for everyone.



“NIC is a one-size-catch-all tax that doesn’t help companies that are looking to take on more staff...”

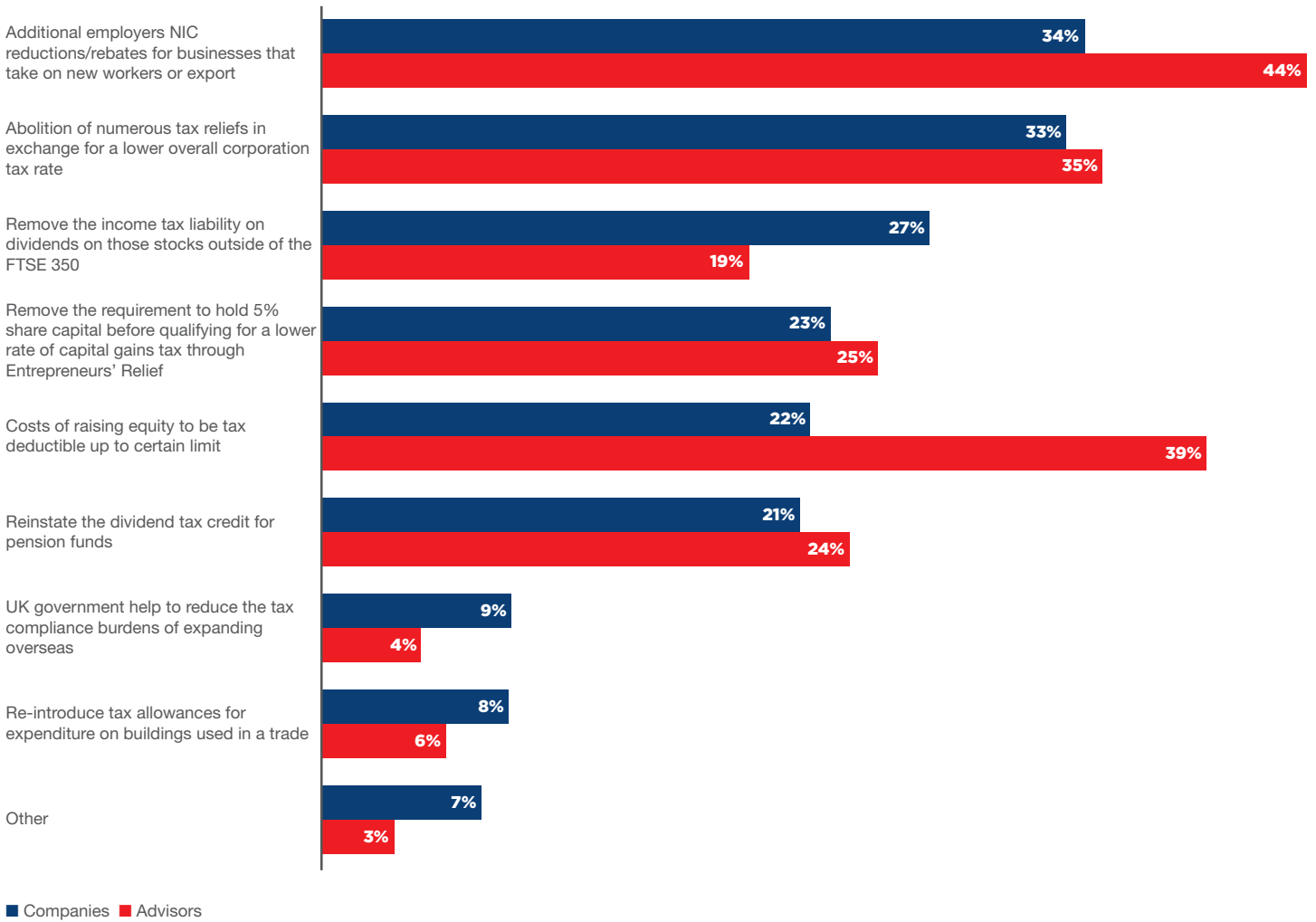
Small and Mid-Cap Company Viewpoint



“Simplify tax so that activity is driven by commercial drivers, rather than the distraction of tax planning.”

Advisor Viewpoint

Which two of these fiscal policies would have the greatest positive impact on your business/small and mid-cap UK quoted companies, were they to be announced in the Chancellor’s 2014 Spring Budget?



QCA/BDO VIEW ▼

The imbalance of the tax treatment of equity versus debt is a factor that many companies consider when looking at their options for raising finance. Research by the Quoted Companies Alliance shows that 16 European states have some form of tax relief for the costs of raising equity, while the UK has none. This is an interesting area to consider if the Government is keen to reduce companies’ reliance on temporary debt finance and to encourage more companies to raise permanent public equity.

ATTITUDES TOWARDS THE CITY OF LONDON

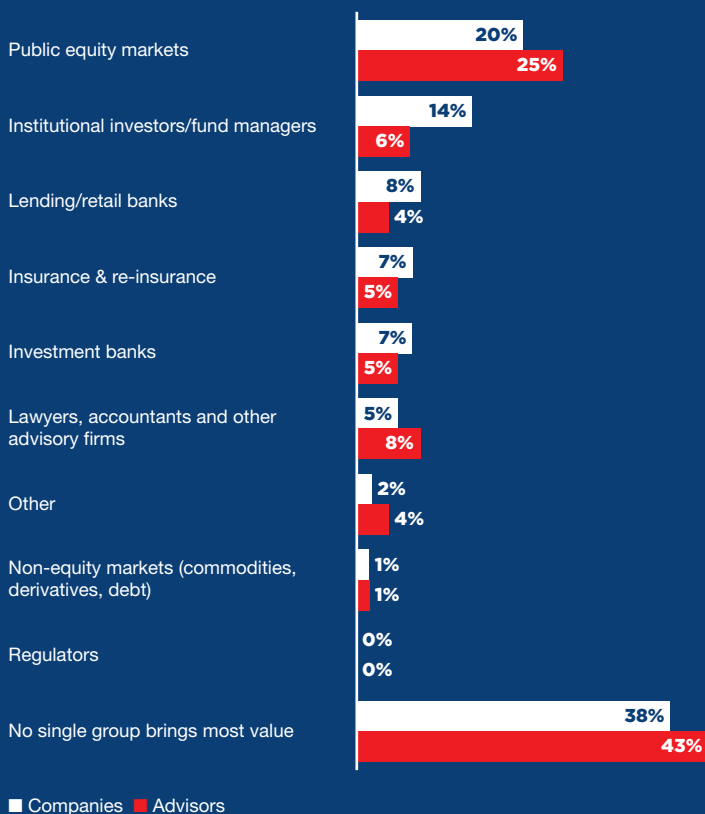


This quarter, we also included questions on attitudes towards the City of London to try to tease out its impact on the UK economy and small and mid-cap quoted companies, in particular.

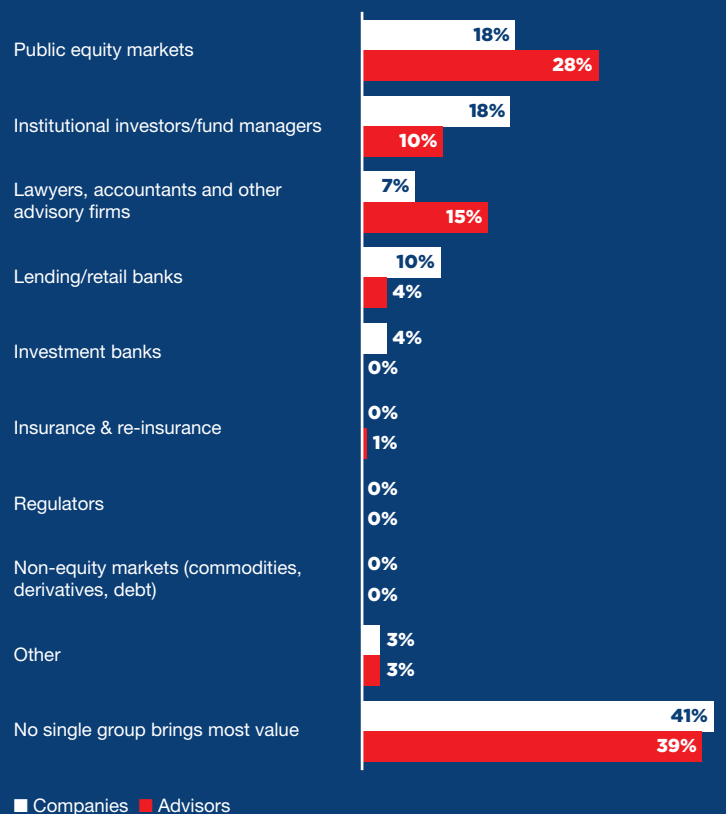
A large amount of companies (38%) and advisors (43%) say that no single group in the City of London brings the most value to the UK economy. However, those that do identify a single group as bringing value pointed to public equity markets (20% of companies and 25% of advisors), noting the important role that markets play in facilitating the raising of capital.

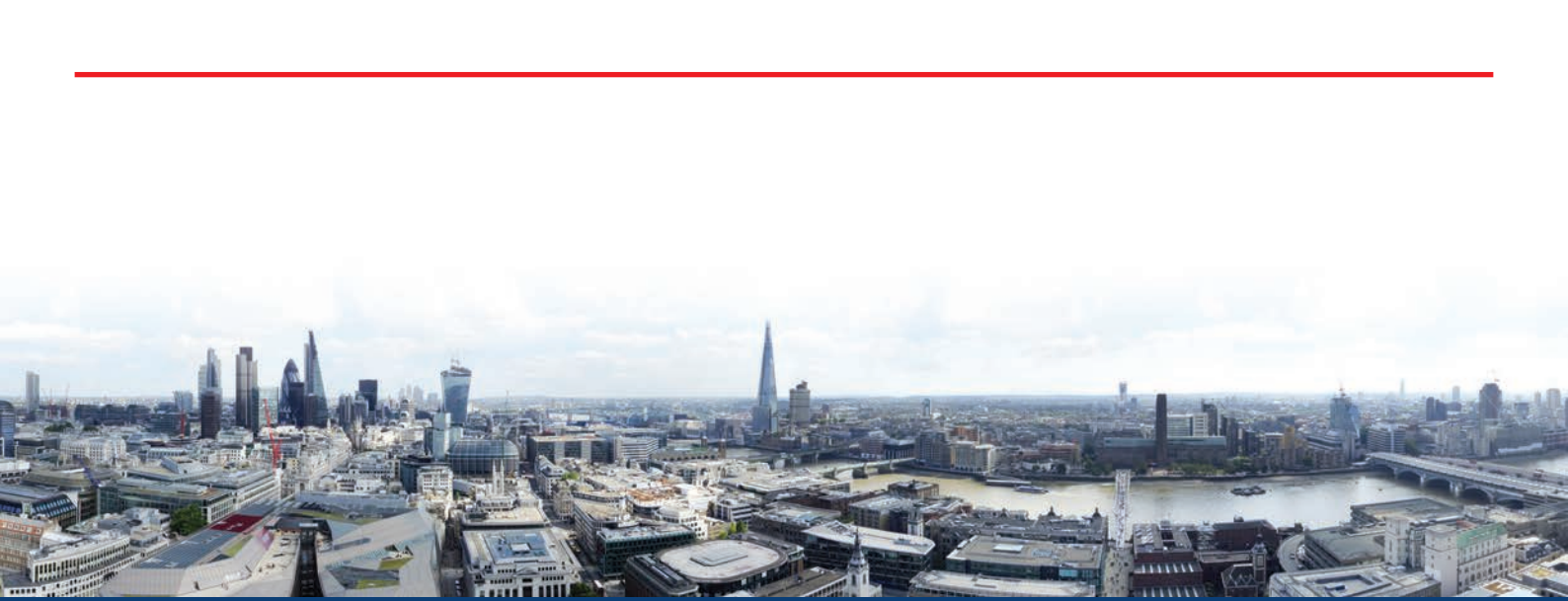
Again, a large amount of companies (41%) and advisors (39%) say that no single group in the City of London brings the most value to small and mid-cap quoted companies specifically. However, those that do identify a single group point again to public equity markets (18% of companies and 28% of advisors) and also to institutional investors (18% of companies and 10% of advisors). This further suggests that the City of London remains an important source of capital for growing companies.

Which group in the City of London brings the most value to the UK economy?



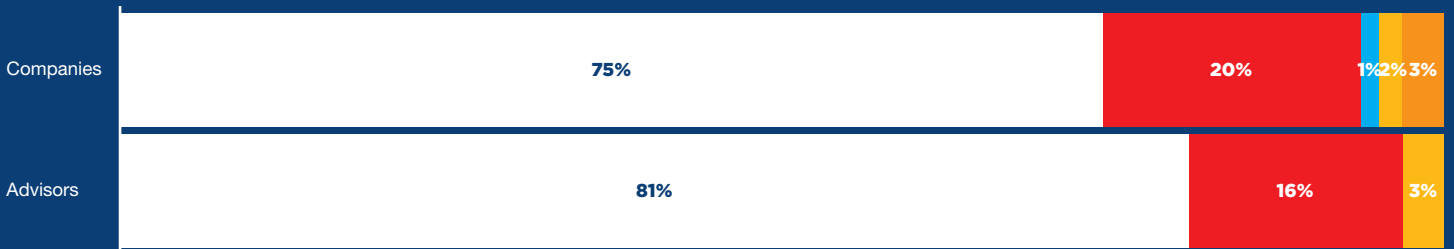
Which group in the City of London brings the most value to small and mid-cap UK quoted companies?





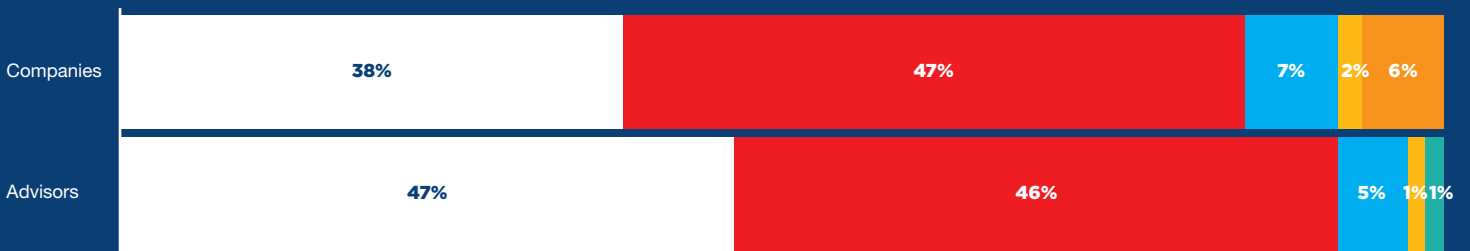
On balance, the majority of small and mid-cap quoted companies (94%) and their advisors (97%) believe that the City of London (ie banks, insurers, investors, advisors etc) has a positive impact on the UK economy, with a similar majority (85% of companies and 92% of advisors) believing that this positive impact extends to the European economy as a whole.

On balance what impact, if any, do you believe the City of London (banks, insurers, investors, advisors etc.) has on the UK economy?



■ Strong positive impact ■ Slight positive impact ■ No impact ■ Slight negative impact ■ Strong negative impact ■ Don't know

On balance what impact, if any, do you believe the City of London (banks, insurers, investors, advisors etc.) has on the European economy as a whole?



■ Strong positive impact ■ Slight positive impact ■ No impact ■ Slight negative impact ■ Strong negative impact ■ Don't know

It is less clear whether small and mid-cap quoted companies are being well served by the City of London. The majority of companies (56%) and advisors (58%) believe that the City of London is serving small and mid-cap quoted companies well, citing a strong understanding of business models of small and mid-cap quoted companies, as well as specialised support services and willingness to work with a wide range of business sizes as the reasons for this.

However, about a third of companies and advisors believe that small and mid-cap quoted companies are poorly served by the City of London. Out of the 44 companies that believe small and mid-cap quoted companies are poorly served by the City of London, the majority (56%) cite the lack of risk appetite, followed closely by a lack of understanding of the business models of small and mid-cap quoted companies (45%). Out of the 30 advisors that believe small and mid-cap quoted companies are poorly served, the majority (57%) put this down to the fact that advisors/service providers focus on short-term returns, followed closely by the feeling that there is a generic blue chip bias (53%).

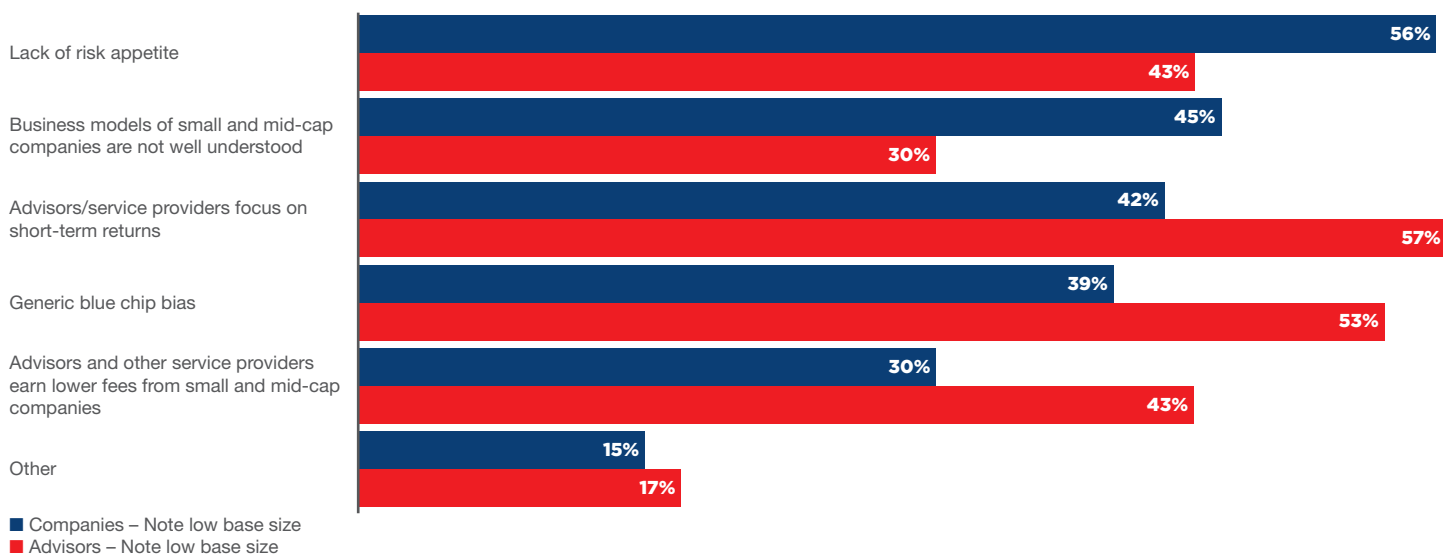
How well or poorly are small and mid-cap UK quoted companies being served by the City of London (banks, insurers, investors, advisors etc.)?



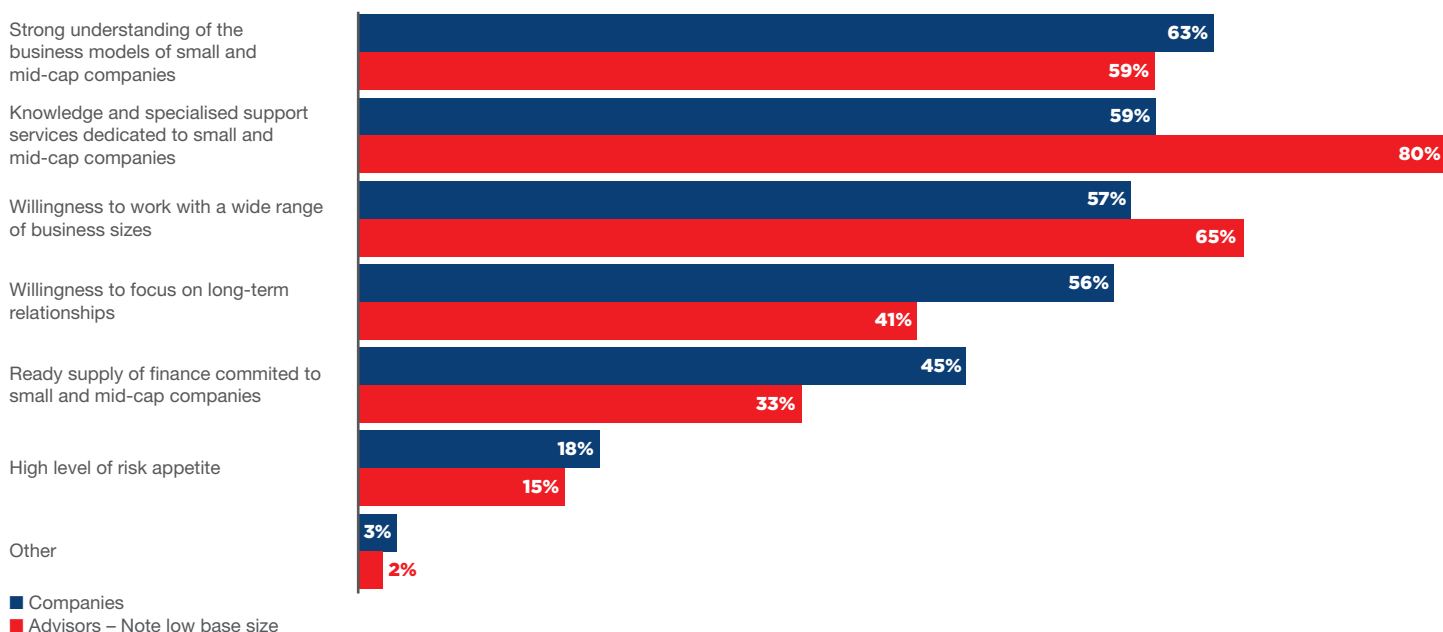
QCA/BDO VIEW ▼

Overall, the small and mid-cap quoted company community is positive about the role the City of London plays in contributing to the UK economy and the European economy. It is not surprising to hear that those who access public equity markets and, through them, institutional investors, believe that these players create value both for the UK economy and small and mid-cap quoted companies. However, it does seem that the City could do more to show how it is helping small and mid-cap quoted companies, part of the “real economy”, to grow, as a large minority feels poorly served by the City of London.

Why do you say that small and mid-cap UK quoted companies are being poorly served by the City of London (banks, insurers, investors, advisors etc.)? Please select all that apply.



Why do you say that small and mid-cap UK quoted companies are being well served by the City of London (banks, insurers, investors, advisors etc.)? Please select all that apply.



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 222 online interviews (133 small mid-cap quoted companies, 89 advisory companies) with members and associates of the QCA. The survey respondents included 85% of small and mid-cap company employees in a board level position and 55% of advisors in a senior management position. It was conducted between 2nd October and 21st October by research company YouGov.

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:

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34% OF SMALL AND
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SAY THEY WOULD BENEFIT
MOST FROM ADDITIONAL
EMPLOYERS' NIC REDUCTIONS,
OR FROM REBATES FOR
BUSINESSES THAT TAKE ON
NEW WORKERS OR EXPORT.



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