

Quoted Companies Alliance Small & Mid-cap Sentiment Index

Wave 23, Q4 2019

QUOTED
COMPANIES
ALLIANCE



Executive summary:

Tough times for small & mid-caps

This small and mid-cap sentiment survey conducted over Oct/Nov 2019 shows **near-record levels of negativity in many indicators for the 8+ years** that we have been running it.

110 small and mid-sized UK quoted companies & 39 advisory companies operating in the space gave their views and it reflects the dearth of activity in the capital markets in this period.

Raising capital via public equity is seen as the hardest it's been since 2013. This is for a number of reasons, but additional regulatory pressure has emerged that is deterring investment in less liquid smaller company stocks. This has made a bad situation worse and a pending Brexit for the past three and a half years has created uncertainty and resulted in the withdrawal of capital from the UK. This, combined with the rise of private equity, has left AIM having just 7 IPOs in 2019 (as of end-October). The lowest previous annual figure was 36 in 2009, in the wake of the global financial crisis ([source](#)).

The decline in smaller companies coming to the public markets has wide implications for the country, including reducing the opportunities for people's pensions to be invested for growth in the future.

At the QCA we emphasise the need for **proportionality** in policy and regulation for smaller quoted companies. There is a huge disparity in size in the UK's public equity markets with the largest 7% of companies accounting for 80% of market capitalisation. But small and mid-caps in the UK employ over 3 million people - an estimated 11% of total UK private sector employment, and contribute over £26bn in taxes - about 5% of total UK tax take ([source](#)). This is all at risk if we keep heading in the same direction.

Maybe there is some light at the end of the tunnel though. **44% of small and mid-caps in this survey say they are considering raising capital in the next 12 months.** It may be that the December General Election can dispel some uncertainty and be a trigger for activity. Brexit, however, will likely continue to be a factor until at least the end of 2020 – the current deadline for agreeing the future UK-EU trading arrangements – and possibly this will extend further in the same way the withdrawal negotiations have. The new government coming in and the key departments and regulatory bodies – namely HMT and the FCA – have a job to do in 2020 to create policies that recognise the importance of small-caps, policies that cannot wait until perfect conditions arise as turbulence may not settle for a long time.

Key findings

1. Economic outlook is uncertain

- Small & mid-cap outlook on UK economy is neutral but net optimism is lowest in over six years (since Q1 2013)

2. Business outlook is mixed

- Companies' outlook on their own prospects remains positive
- But, advisors' net optimism in small and mid-caps is the lowest it's been since 2012
- The mean expected turnover growth is 14.4%; positive but at a two-year low

3. Jobs are being created at a lower rate

- 64% of small & mid-caps expect to increase workforce, although this is the lowest since 2016
- Mean expected employment growth remains positive at 5.5%, but down from 9.4% 12 months earlier and lowest since 2016
- Only 28% of advisors think that small & mid-caps will create jobs in the next 12 months – the lowest level since 2012 and a big drop from 6 months earlier (51% in Q2 2019)

4. Raising capital is tough

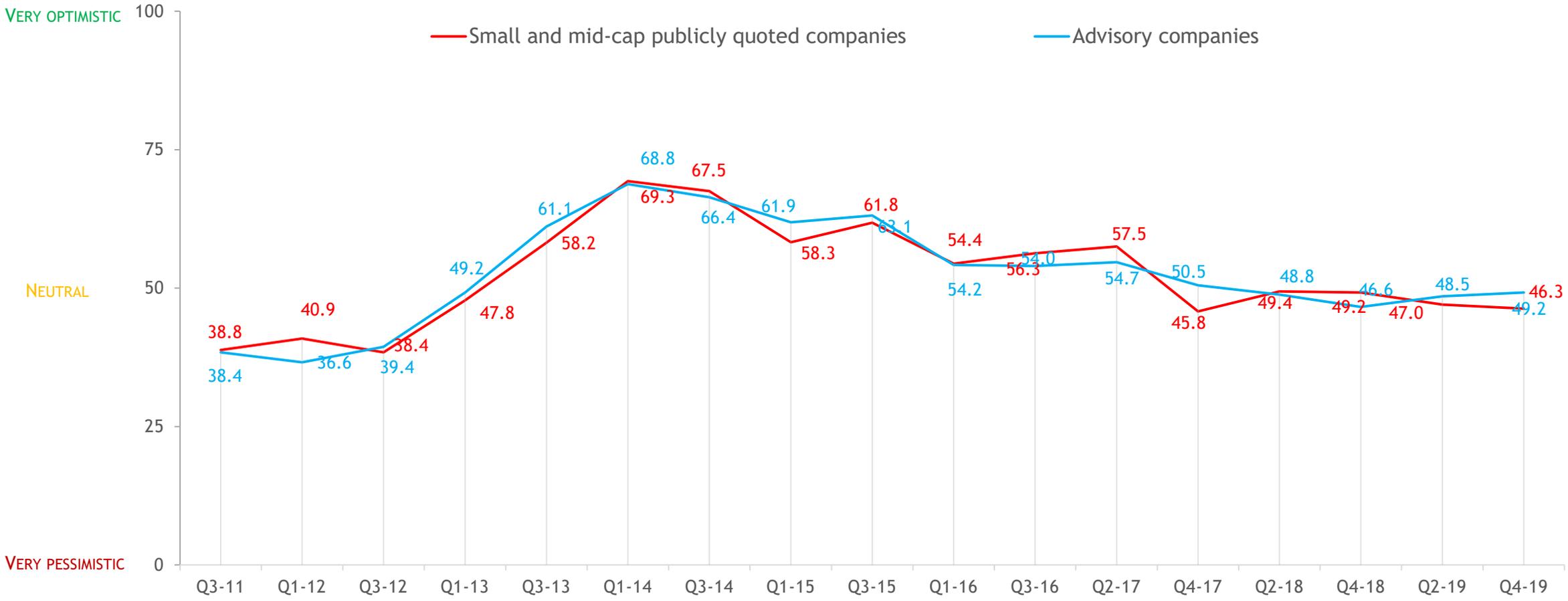
- 44% of small & mid-caps are considering raising capital in the next 12 months, up from 37% six months earlier
- 60% prefer to do this via public equity and 28% via bank finance. These figures have remained largely steady in the past two years
- But companies view raising capital via public equity as the hardest it's been since 2013
- Advisors also view raising capital via public equity as the hardest it's been since 2013, whilst raising capital via private equity is rated as equal easiest it's been in the history of this survey (back to Q1 2012)

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- Small & mid-cap outlook on UK economy is neutral but net optimism is lowest in over six years (since Q1 2013)

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

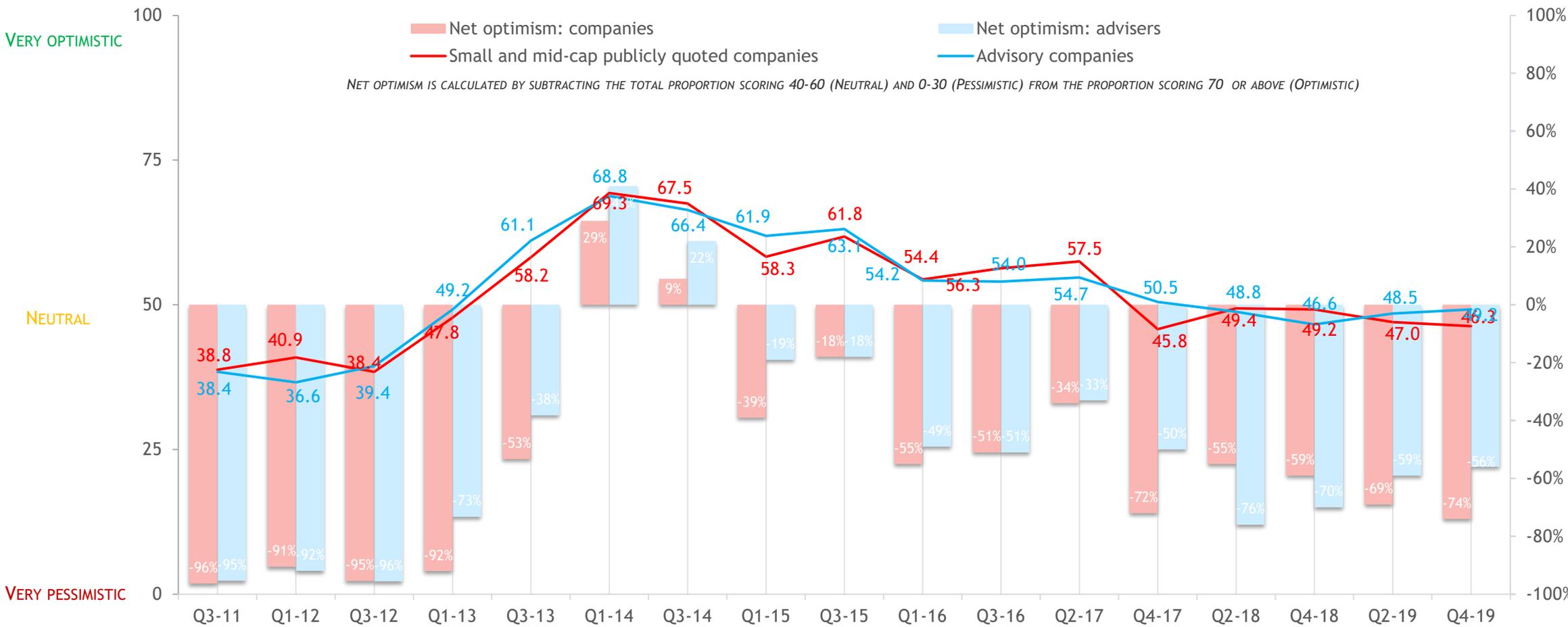
Mean scores (where 0 represents 'very pessimistic', 50 'neutral' and 100 'very optimistic')



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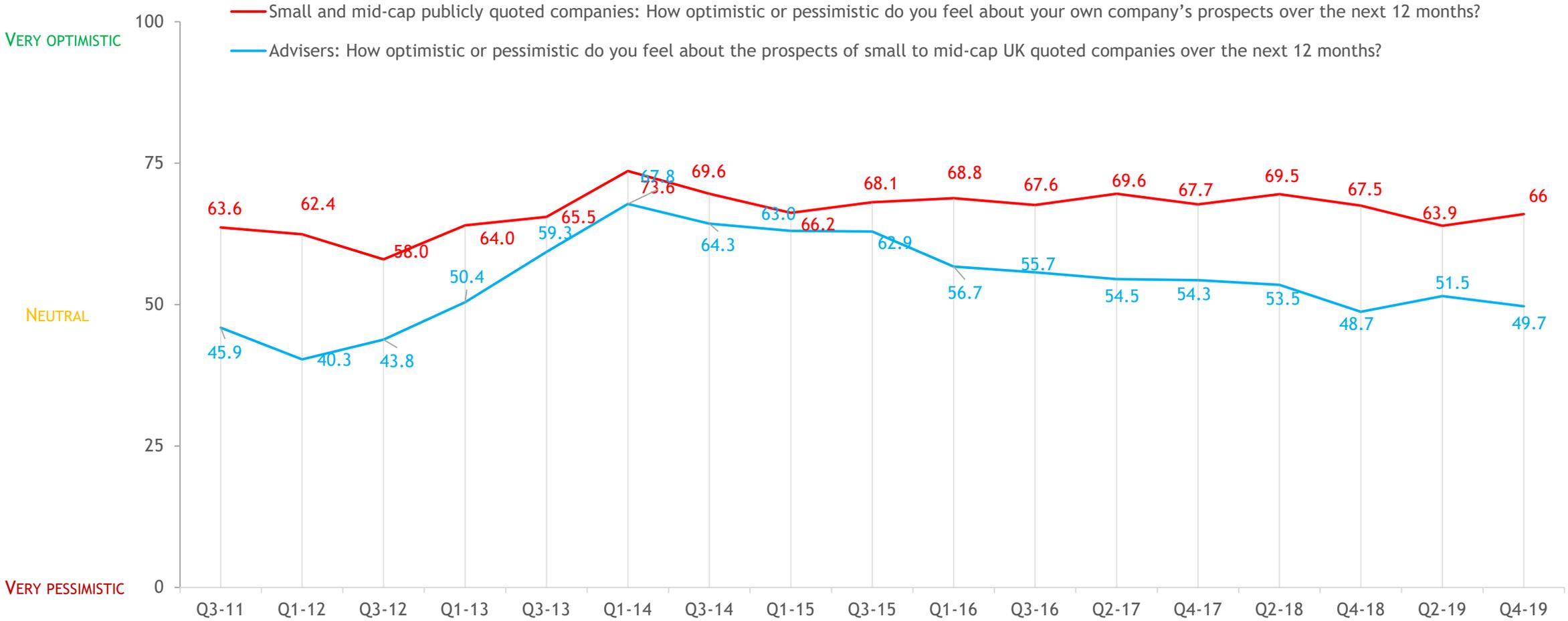
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Optimism/Pessimism toward business prospects

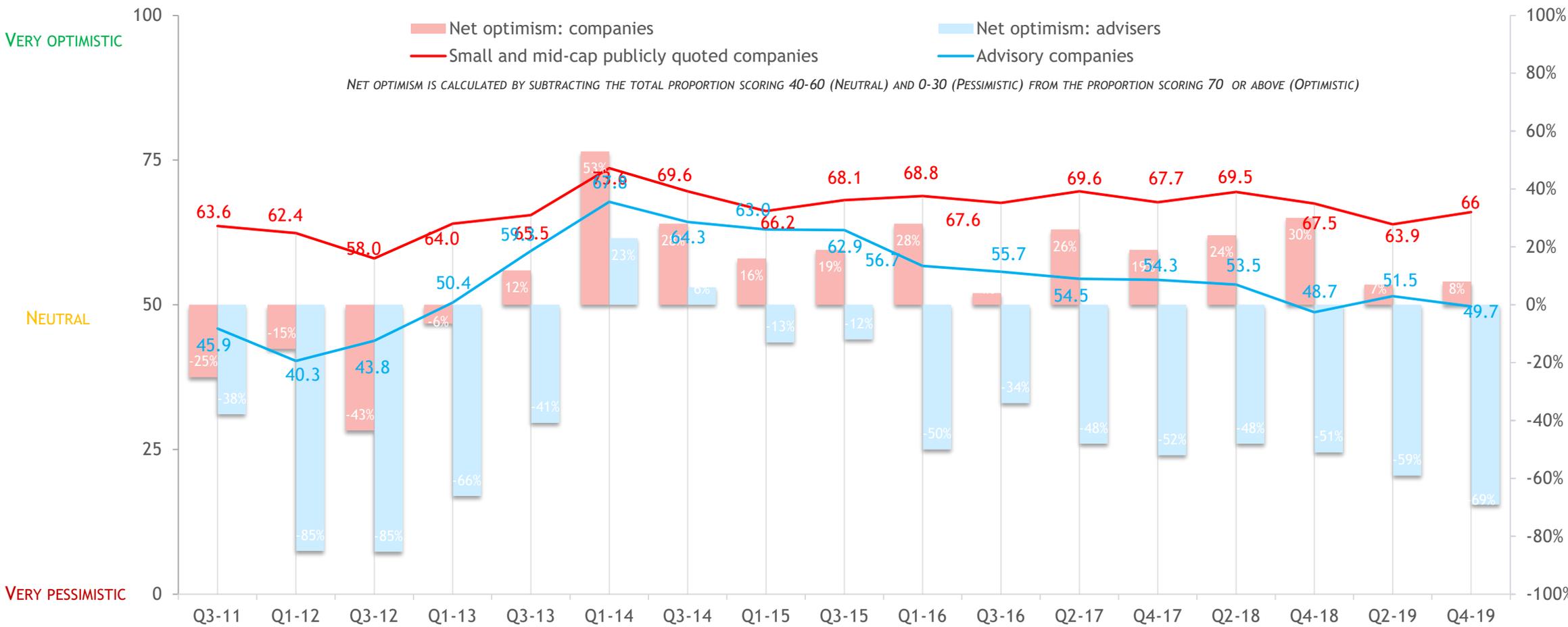
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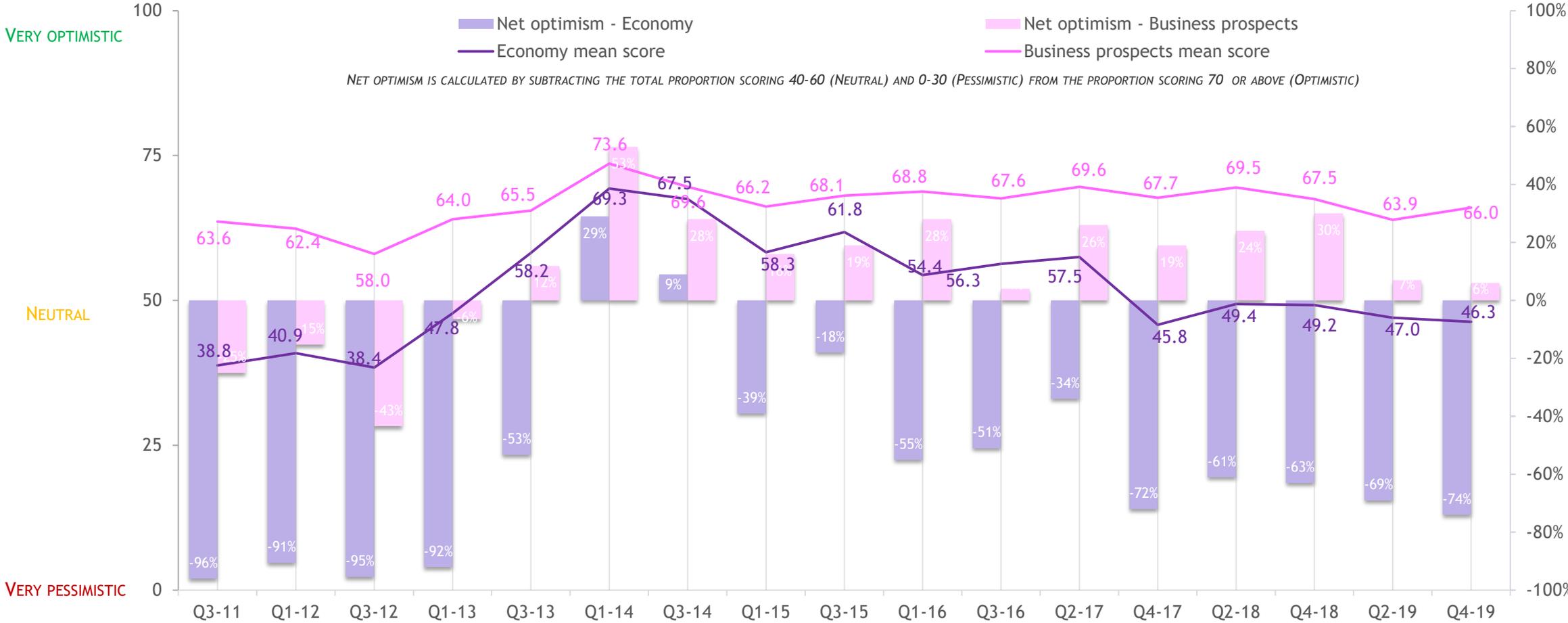
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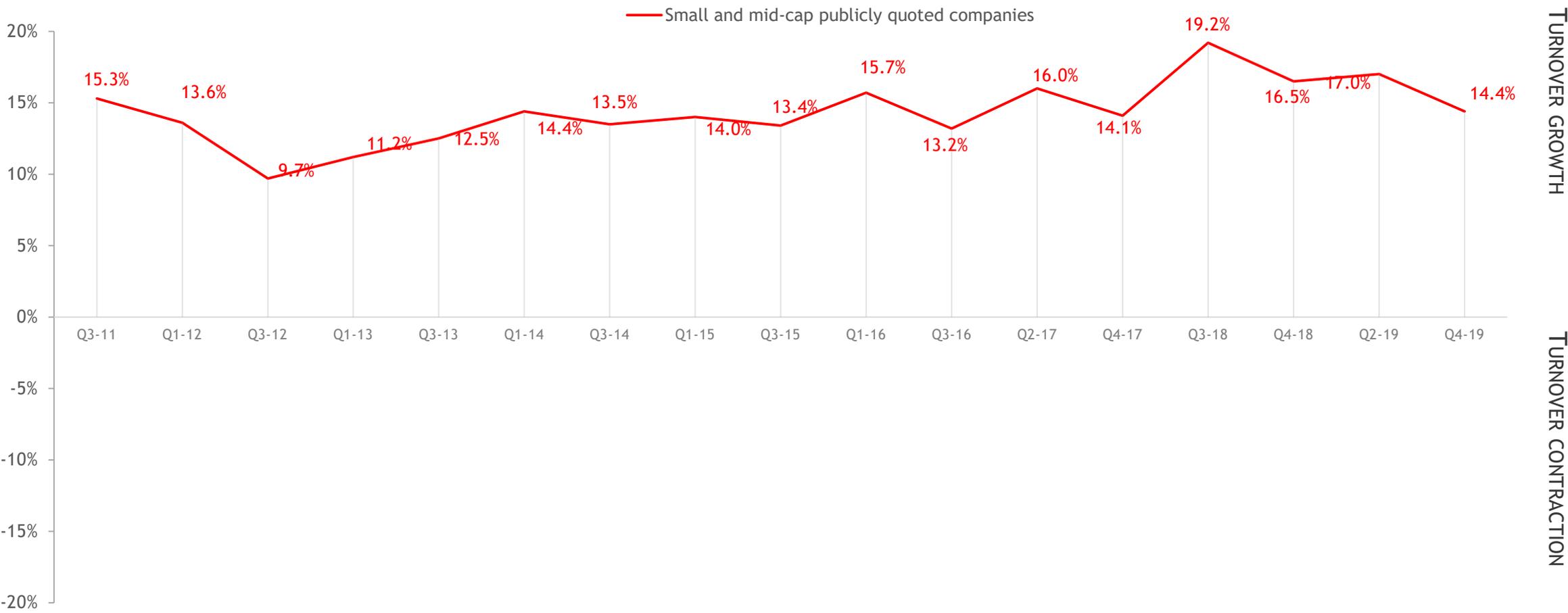
Optimism/Pessimism: UK economy vs. Business prospects

Mean scores (where 0 represents 'very pessimistic', 50 'neutral' and 100 'very optimistic')
Small and mid-cap quoted companies only



Expectations regarding turnover: Mean expected turnover change over the next 12 months

Small and mid-cap companies only (not asked to advisers)



TURNOVER GROWTH

TURNOVER CONTRACTION

With the General Election pending, Brexit remains an issue regardless of the outcome

“Positive factors are our acquisition growth strategy and sterling depreciation making our exports more competitive. Negative factors are UK and international economic outlook which is poor, the risk of trade wars, along with potential negative aspects of Brexit which I expect to cause some disruption over the short to medium term.”

“Negative: Uncertainty (Brexit, political, economic). Current fragility of public market sentiment for small and mid cap quoted companies. Positive: possibility of end to political deadlock following election.”

“From an operational perspective, Brexit uncertainty and the need to deal with regulatory and legislative changes once that comes through will be a burden. On the positive front - many UK cap stocks look very undervalued and weak currency will continue to help exporters.”

“Brexit and political uncertainty. Whatever happens, if there is a need for substantial change, small and mid-caps have less resource to help.”

“The main negative factors are potential for supply chain disruption due to Brexit and increases in material costs due to the weaker pound sterling.”

“Negative = Brexit uncertainty and global economic forecasts. Positive = innovation and adaptability within small cap/AIM market companies.”

Companies with international exposure less concerned by UK political situation

"We operate internationally, so Brexit is relatively unimportant for us. We have some new products and new personnel which gives us confidence for the future."

"We see strong growth, largely driven by a clear value-add from our services, which have relatively low cost and our businesses are not confined to the UK."

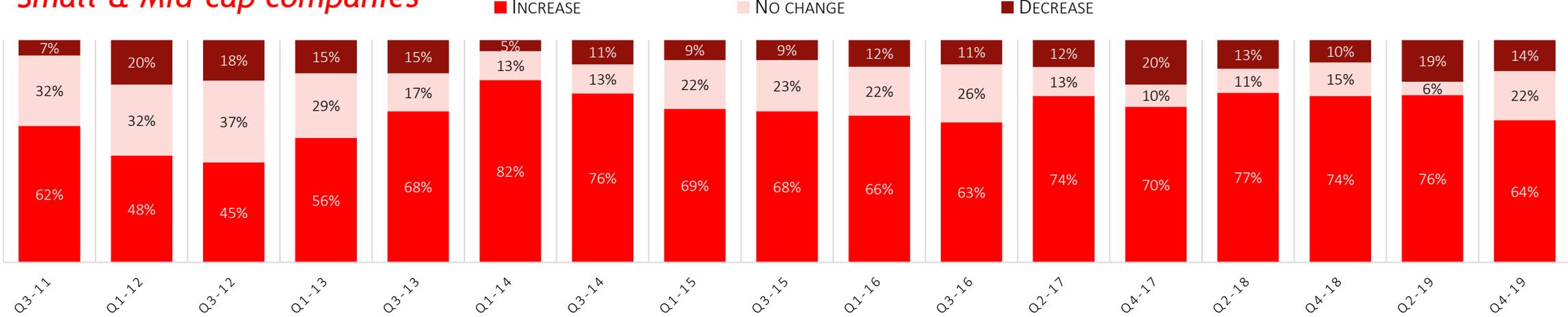
"95% of our business is outside the UK otherwise I would have been more pessimistic."

3. Jobs are being created at a lower rate

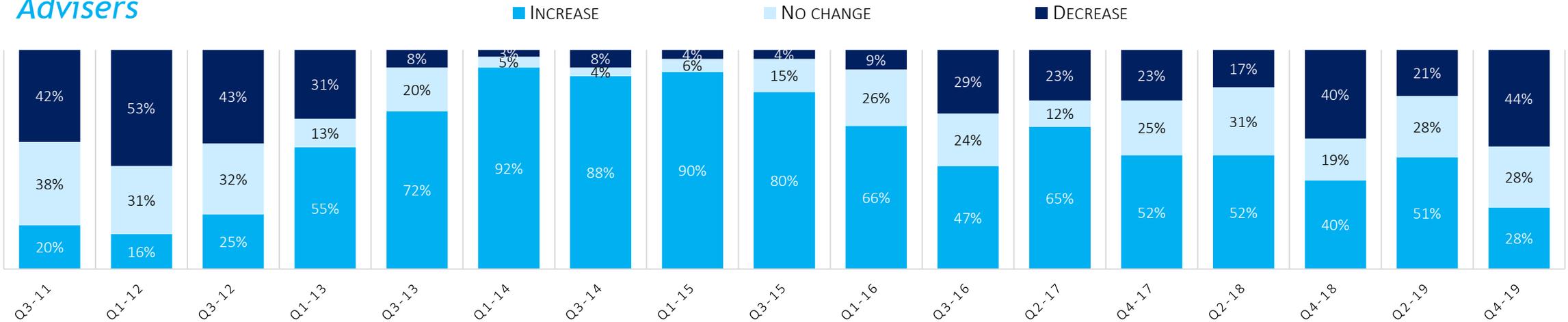
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Expectations regarding job growth

Small & Mid-cap companies

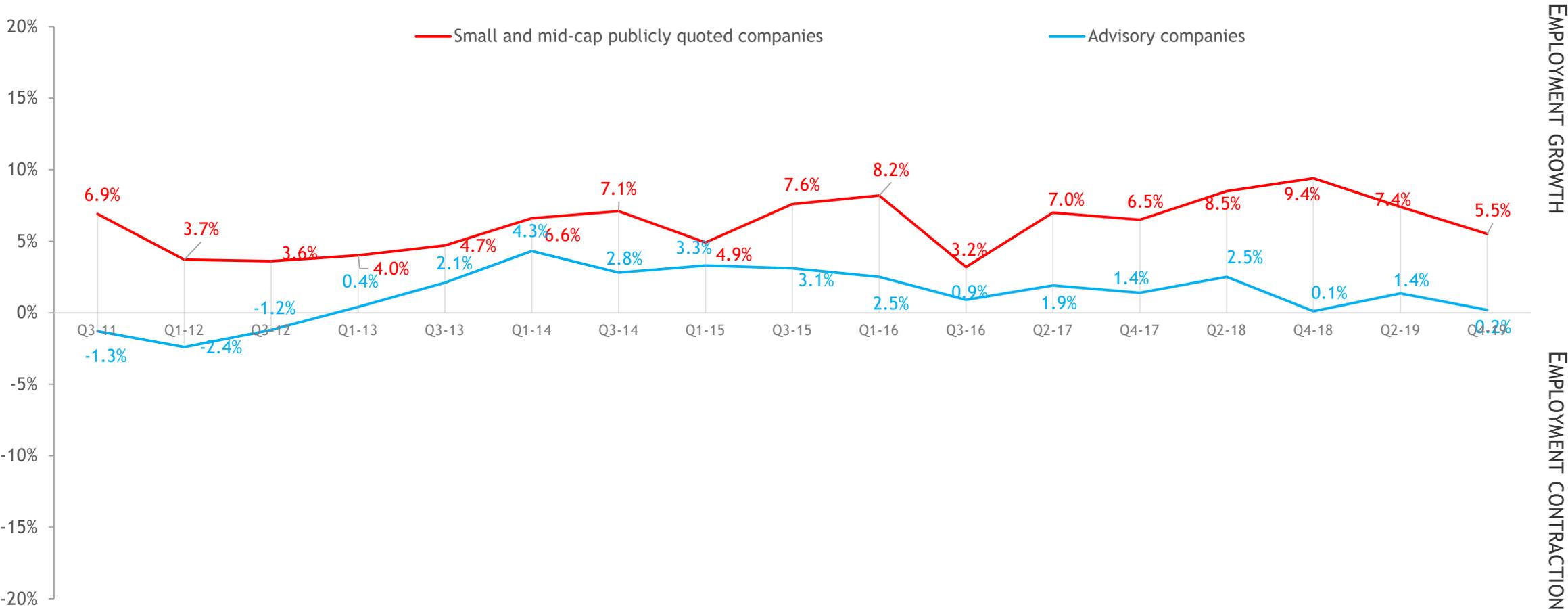


Advisers



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Expectations regarding job growth: Mean expected employment change over the next 12 months



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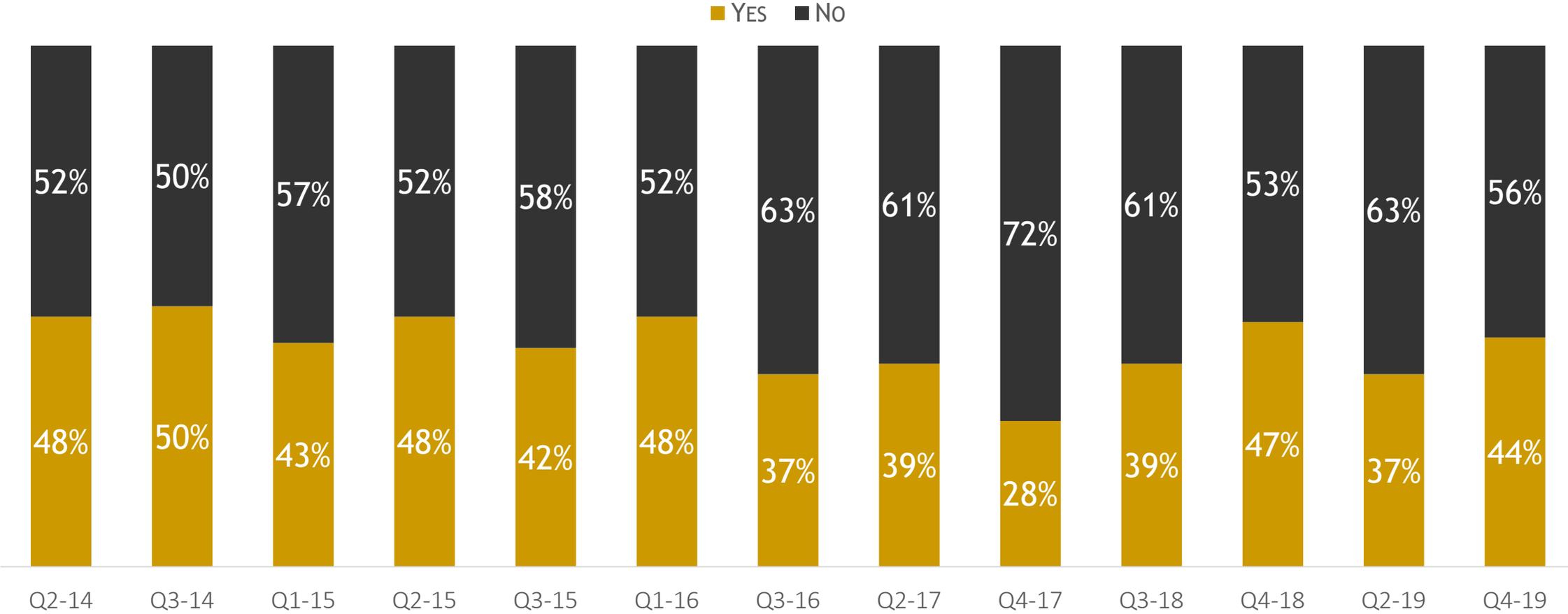
EMPLOYMENT GROWTH
EMPLOYMENT CONTRACTION

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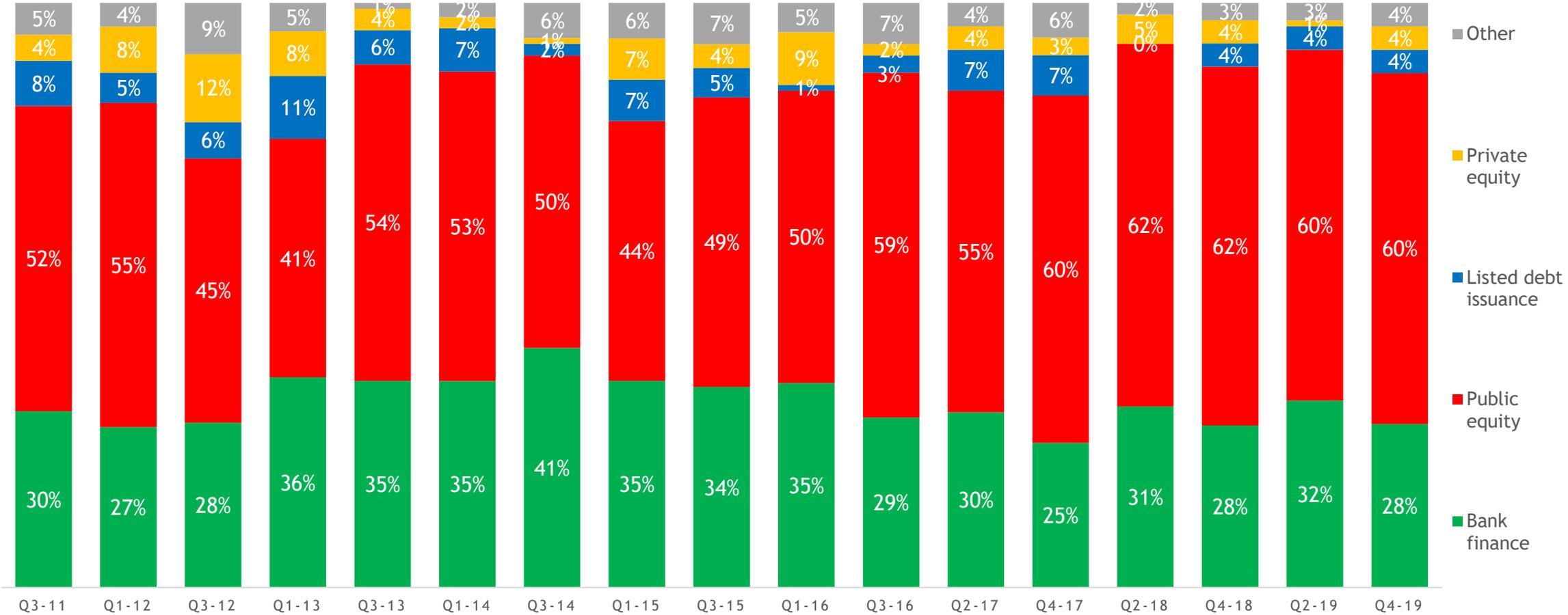
Raising capital for small and mid-caps

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



Raising capital (small and mid-caps only)

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



The collapse of the Woodford Equity Income fund has had a knock-on effect of deterring investment in small & mid-caps

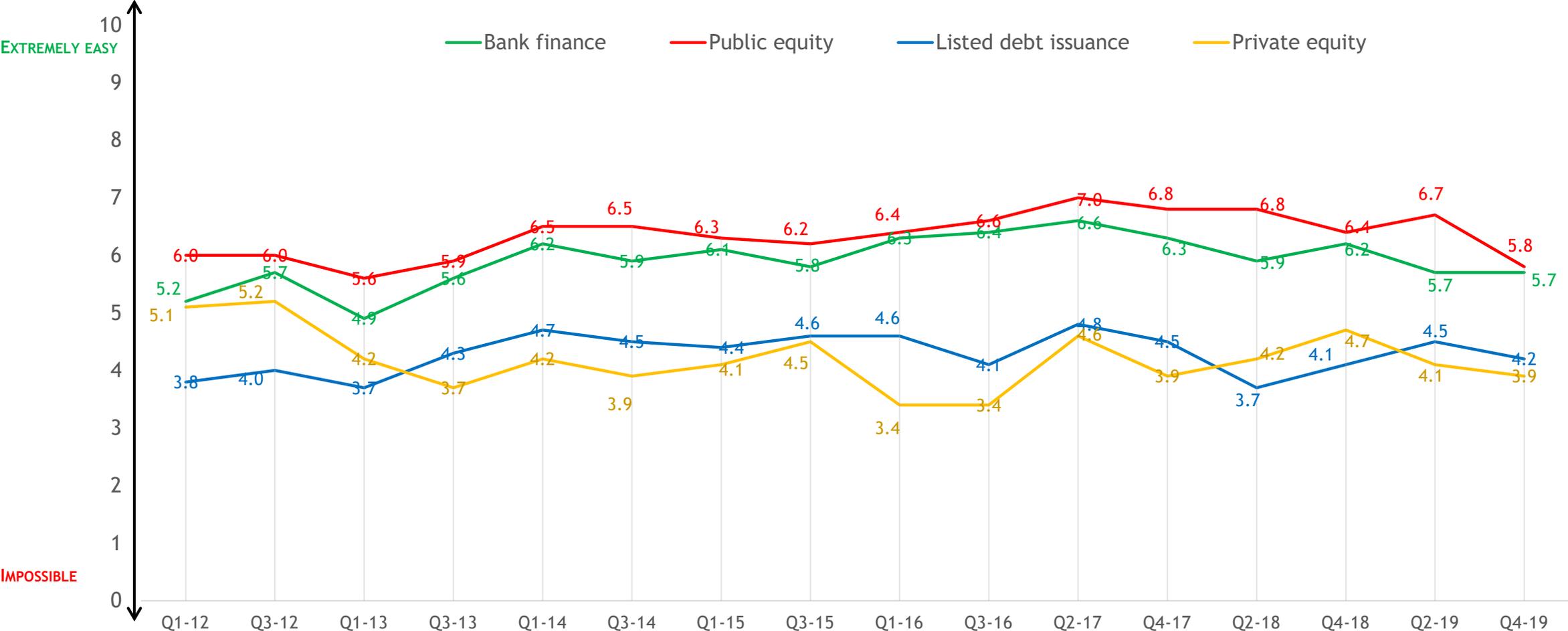
“The ‘Woodford effect’ is causing a lack of interest in SMEs.”

“Impact of Woodford fallout on small caps constraining ability to raise funds.”

“There is a lack of liquidity in the small cap/AIM space. The fallout from the Woodford problem is punishing stocks for things they didn't do.”

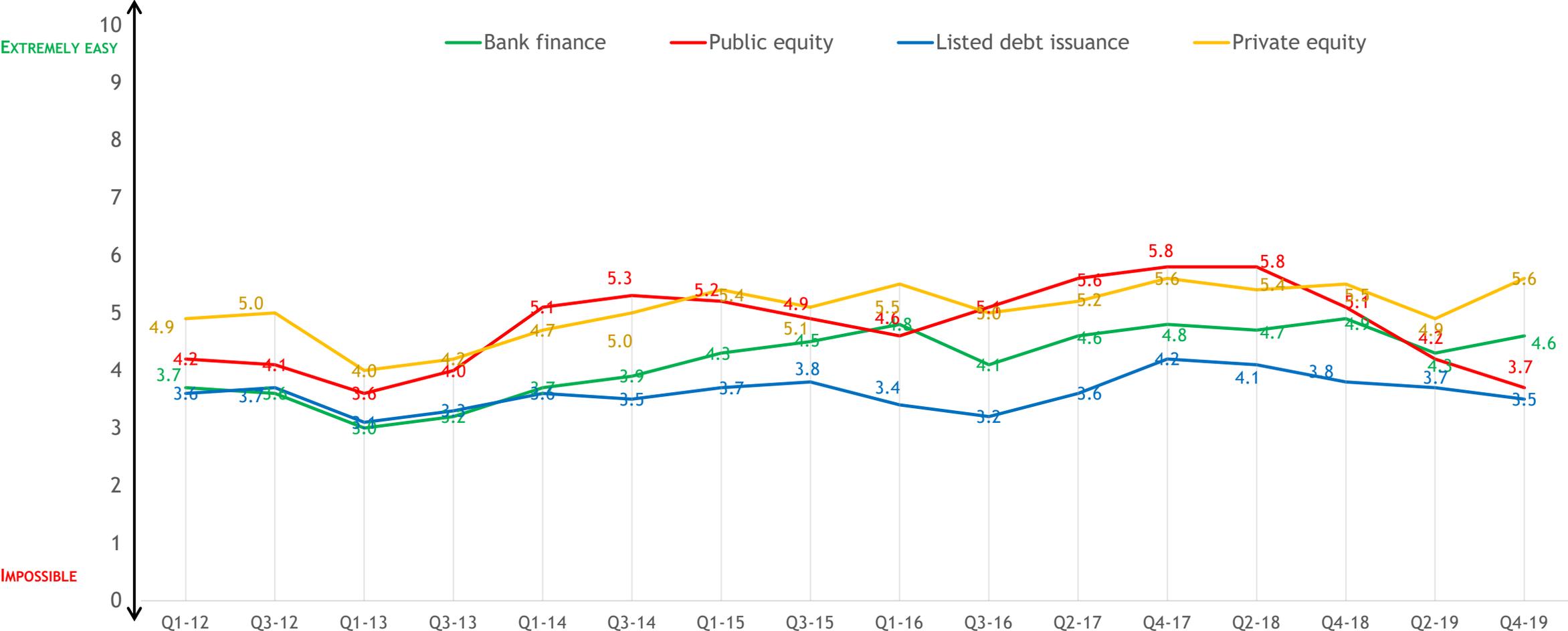
Ease of raising capital for small and mid-caps

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



Ease of raising capital for small and mid-caps

How easy or difficult would your company currently find it to raise finance through the following channels? **Mean scores - Advisers**



Most companies (60%) would prefer to raise capital via public equity. Why?

“Our company has traditionally been financed by equity and is not yet mature enough to take on significant debt.”

“[We are] already listed and public markets are a quicker route to fundraise.”

“We use a mix of debt and equity, however equity has been a successful model to fund R&D and growth.”

“In the long run the proceeds of the raise are more flexible and cheaper than bank debt.”

“Current shareholders have told us they would prefer us to raise equity in preference to debt if additional capital is required. This would increase liquidity in our stock and open up opportunities for new investors.”

“As a plc it provides growth capital without increasing leverage.”

28% of companies would prefer to raise capital via bank finance. Why?

“We do not wish to dilute shareholders.”

“Good capacity for borrowing / low interest rates.”

“Intend to look at both debt and equity but the equity markets are not in a good place, therefore [we will] look to utilise debt in the near term.”

“Debt is less dilutive than equity and our size limits our ability to issue bonds.”

Ease of raising capital for small and mid-caps

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

Quarter 4, 2019 (scale: 0 impossible - 10 extremely easy)

	Bank finance		Public Equity		Listed debt issuance		Private equity	
	Company	Advisers	Company	Advisers	Company	Advisers	Company	Advisers
HARD (0-3)	25%	33%	18%	59%	31%	46%	33%	10%
NEUTRAL (4-6)	23%	54%	34%	31%	25%	36%	25%	56%
EASY (7-10)	48%	13%	46%	10%	16%	5%	13%	31%
DON'T KNOW	3%	0%	2%	0%	28%	13%	30%	3%
MEAN	5.7	4.6	5.8	3.7	4.2	3.5	3.9	5.6

— Background & methodology

About the Small & Mid-Cap Sentiment Index

- The QCA/YouGov *Small & Mid-Cap Sentiment Survey* has been running since 2011.
- This is the 23rd wave and is conducted twice yearly. It is an established source of information about the small and mid-sized quoted company sector.
- 149 interviews were conducted between 22/10/19 and 18/11/19 by YouGov. 110 from small and mid-cap UK quoted companies, 39 from advisory companies.
- Methodology: This survey has been conducted using an online interview administered to members and associates of the QCA. An email was sent to the QCA database, inviting them to take part in the survey and providing a link to it. A link to the survey was also circulated by the QCA to their contacts. The sample definition is "small and mid-cap UK quoted companies and advisory companies". The responding sample is weighted by industry to be representative of small and mid-cap UK quoted companies, as derived from London Stock Exchange data, but the advisory companies are not weighted in any way.
- Note: Where the percentages for a chart are calculated on bases fewer than 40 respondents these must not be reported as they do not represent a wide enough cross-section of the target population to be considered statistically reliable. These questions and figures will be italicised.

About the QCA

The Quoted Companies Alliance:

- The Quoted Companies Alliance is the independent membership organisation that champions the interests of small to mid-size quoted companies.
- For more information please visit theqca.com.
- Contact us at mail@theqca.com or on 0207 600 3745.

The small & mid-cap sector in the UK:

- In 2019, there are around 1,250 small and mid-size quoted companies in the UK, representing 93% of all companies quoted on UK stock exchanges.
- They employ approximately 3 million people, representing 11% of private sector employment in the UK, and contribute over £26bn in annual taxes ([source](#)).