

Smaller Companies Investor Survey

Volume 1 : May 2010

**Are Smaller Companies undervalued?
Will Smaller Companies outperform?
What are the highest conviction stock ideas?**

This and more in the Smaller Companies Investor Survey



Smaller Companies Investor Survey

WHAT IS IT?

The TNS-Execution Noble Smaller Companies Investor Survey (SCIS) is an online survey aimed at investors with a particular interest in the UK Small and Mid Cap market. The objective of the survey is to gain valuable insight into investors' views on this distinct area of the market and to track how this varies over time.

WHAT DO WE ASK?

We ask a variety of questions relating directly or indirectly to the Small Cap market under the broad headings of:

- **Corporate Profitability**
- **Relative Valuations & Expected Performance**
- **Financial Structure**
- **Sector Strategy**
- **Investor Intentions**

In addition we ask various questions relating to views on **portfolio allocation** and **attitudes towards IPOs**.

WHO DO WE ASK?

All individuals polled in the survey are either fund managers or buy-side analysts who have an active interest in the UK Small & Mid Cap market. All respondents provide data on issues such as investment style, exposure to equities, fund cash positions and investment horizons which allow us to relate investor attributes to views on Smaller Companies.

WHO'S BEHIND IT?

This survey is a collaboration between TNS Finance - the world's largest custom research agency with a dedicated global finance sector and Execution Noble one of the UK's leading independent investment banks with a team dedicated to the UK Small and Mid Cap sector.

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SURVEY HIGHLIGHTS

In the first of our Smaller Companies Investor Surveys (SCIS) the results provide some intriguing insights into the view on UK Smaller Companies. Key highlights as follows:

- **Corporate Profitability:**
 - 70% of respondents expect **corporate profitability** of small & mid companies **to increase** over the next 12 months.
 - 53% expect the increase in profitability to be accompanied by an **increase in operating margins**.
- **Relative Valuation & Performance:**
 - 43% of respondents believe **consensus earnings forecasts are too low** and that **Smaller Companies are undervalued**
 - 53% of the respondents believe that **Smaller Companies will outperform** UK large cap stocks over the next 12 months.
- **Financial Structure**
 - The majority (83%) of respondents believe **that Small Cap balance sheets are either appropriately (73%) or under leveraged (10%)**
 - Over half the respondents believe that cash flow should be retained to **strengthen balance sheets**.
- **Sector Strategy**
 - Most undervalued: **Healthcare, Technology, Ind. Goods & Services**
 - Most overvalued: **Real Estate**
- **Investor Intentions:**
 - **Appetite for Smaller Companies:** 19% of respondents expect to increase weighting to Small Caps over the next 12 months compared to 14% looking to decrease.
 - **Appetite for IPOs:** 17% of respondents have an increasing appetite for IPOs compared to 23% who have a decreasing appetite.

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RESPONDENTS ATTRIBUTES SUMMARY

While the survey is focused on investors' views relating to UK Smaller Companies we polled investors from a variety of backgrounds (all cap, long only, hedge fund, multi-asset etc) in order to achieve a more comprehensive view on Small Caps as a distinct asset class. A full description of respondents attributes is given in the last section of this report. Below is a brief summary.

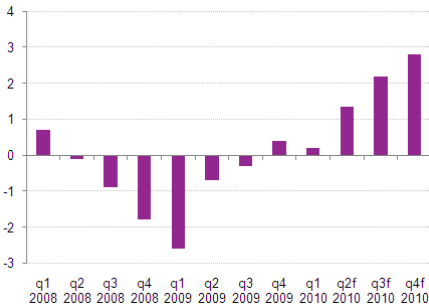
- **Investor Mandate:**
 - 70% of the respondents have an All Cap Equities mandate
- **Exposure to Equities:**
 - 80% of the respondents have a net exposure to equities of between 75% and 100%.
- **Cash Position:**
 - 37% of the respondents have 2% or less in cash compared to 29% who have 6% or more in un-invested cash.
- **Fund Size:**
 - 50% of the respondents run funds over at least £100m or more.
- **Investment Style:**
 - 45% of the respondents have a Growth or GARP investment style. 20% are value investors, while the remainder have a flexible approach.
- **Investment Horizon**
 - The majority (63%) of respondents have an investment horizon of over 12 months.
- **Favoured Valuation Measures:**
 - 50% of the respondents consider a simple P/E measure as the most useful valuation metric.

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INVESTMENT BACKGROUND

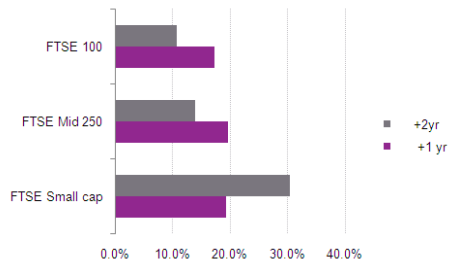
The charts below provide a brief summary of the environment that existed at the time the survey took place. In terms of share price, Small and Mid Cap companies had been outperforming Large Caps since the beginning of the year. Consensus EPS forecasts were higher for Small and Mid Caps and had been steadily rising since the end of 2009. Reported preliminary Q1 2010 GDP, however, had come in lower than expected.

GDP Growth % (actual & f'cast)



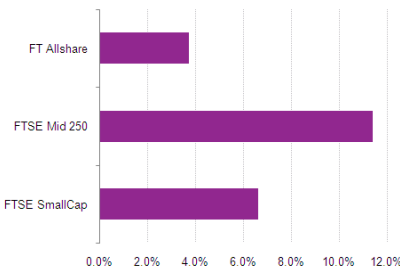
Source: Bank of England

Consensus EPS forecasts



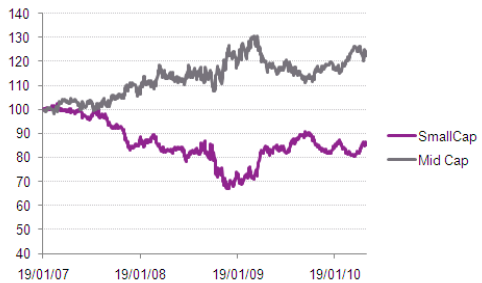
Source: Bloomberg / IBES

YTD share price performance*



Source: Bloomberg (* up to 30th April 2010)

3 yr rel. performance to the All Share

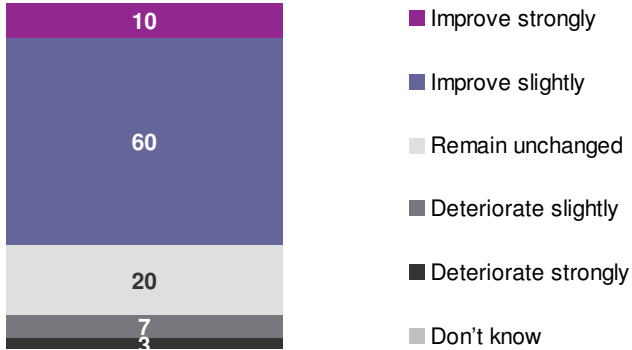


Source: Bloomberg

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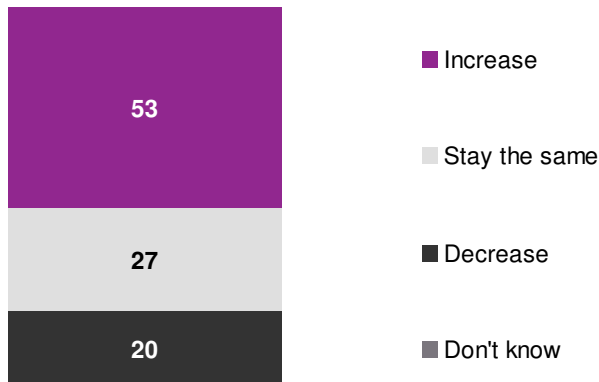
CORPORATE PROFITABILITY

Question: How do you think the outlook for UK Smaller Companies' corporate profits will develop over the next 12 months?



All Respondents

Question: Over the next 12 months, do you think that UK Smaller Companies' corporate operating margins will...?.

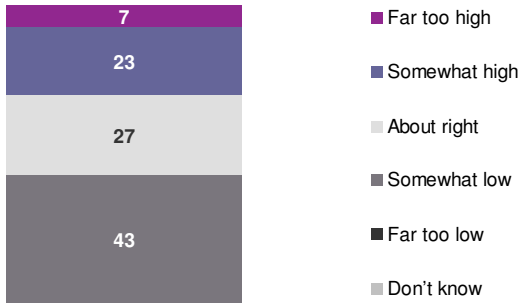


All Respondents

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RELATIVE VALUATION & PERFORMANCE

Question: Do you think that UKSC consensus earnings for the next 12 months are currently.....?

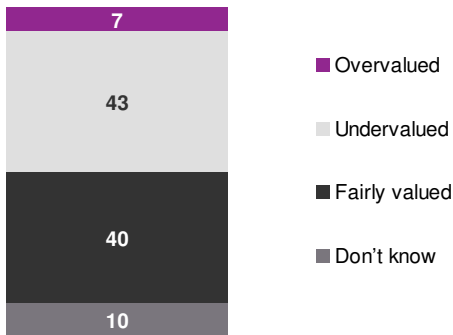


All Respondents

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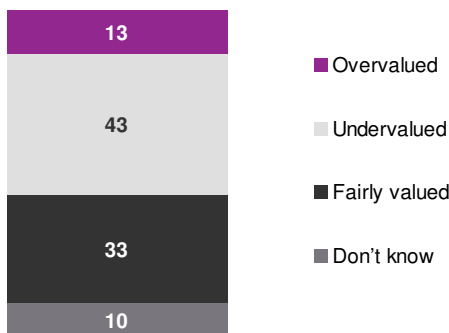
RELATIVE VALUATION & PERFORMANCE

Question: In absolute terms do you think that UKSC are under- or overvalued?



Absolute Basis

Question: Relative to Large Cap stocks do you think that USSC are under- or overvalued?

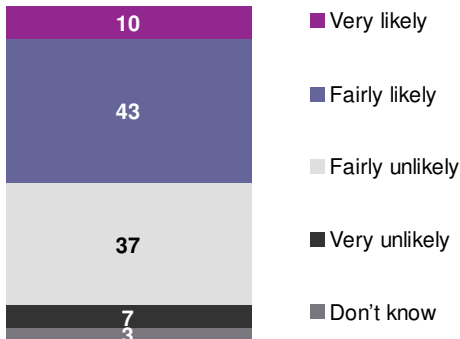


Relative to large-cap stocks

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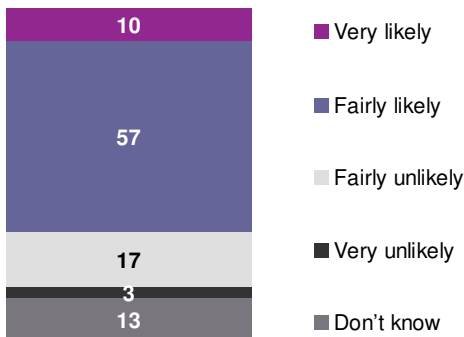
RELATIVE VALUATION & PERFORMANCE

Question: Over the next 12 months, how likely do you think it is that UKSC stocks will outperform UK Large Cap stocks?



UKSC stocks will outperform UK large-cap stocks

Question: Over the next 12 months, how likely do you think it is that “growth” stocks will outperform “value” stocks

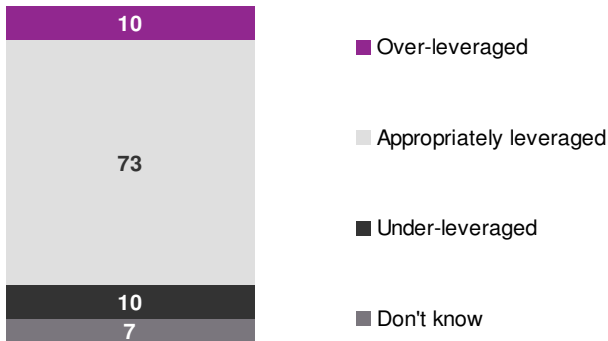


“Growth” stocks will outperform “value” stocks

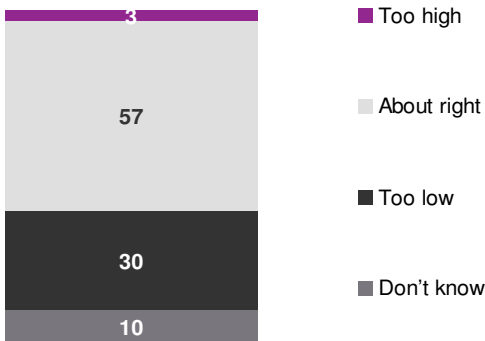
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FINANCIAL STRUCTURE

Question: Generally speaking do you think that UKSC corporate balance sheets are currently...?



Question: Generally speaking, do you think UKSC payout ratios are currently...?

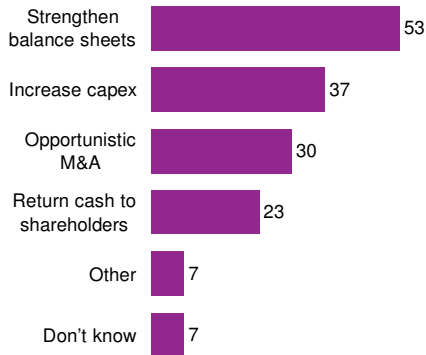


All Respondents

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FINANCIAL STRUCTURE

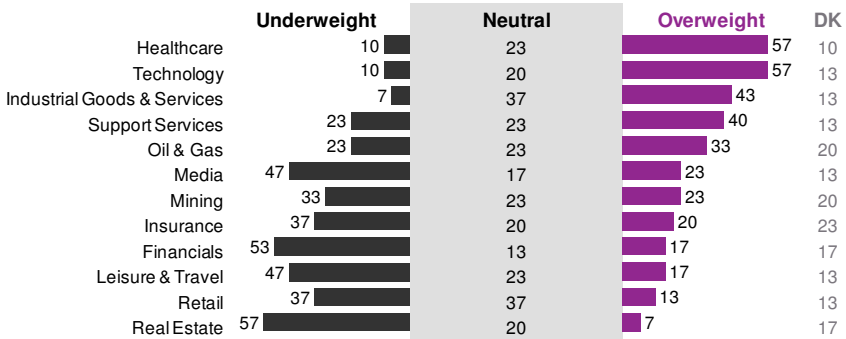
Question: What would you most like to see UKSC do with cashflow at the current time?



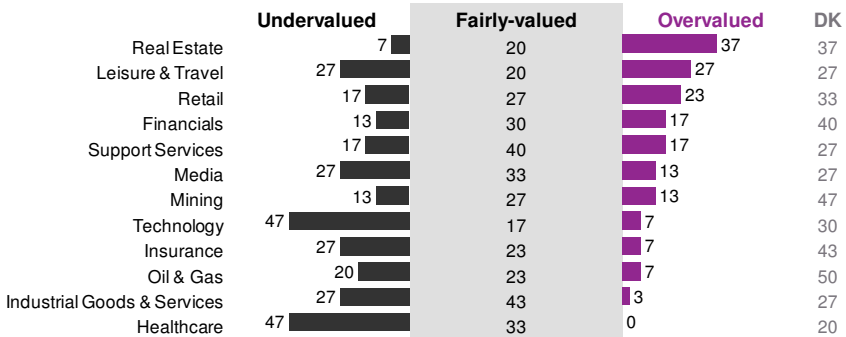
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SECTOR STRATEGY

Question: Would you say you were overweight, neutral or underweight in the following UKSC sectors?



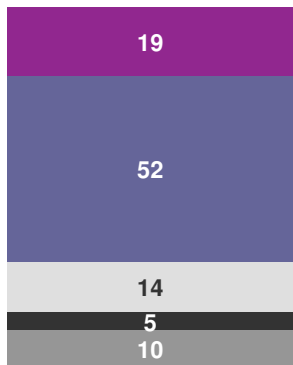
Question: Do you believe the following smaller company sectors are overvalued, fairly valued or undervalued at the current time?



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INVESTOR INTENTIONS

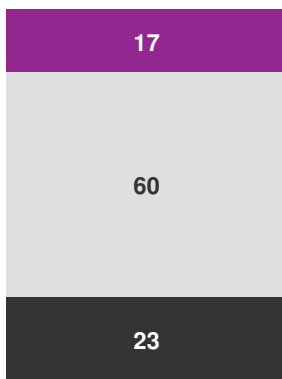
Question: Over the next 12 months, how are you expecting the proportion of funds allocated to UK Small and Mid Cap Equities (SMID)...?



- Increase significantly
- Increase moderately
- Remain the same
- Decrease moderately
- Decrease significantly
- Not Applicable (100% SMID fund)
- Don't know

All Respondents

Question: Is your appetite for participation in IPOs...?



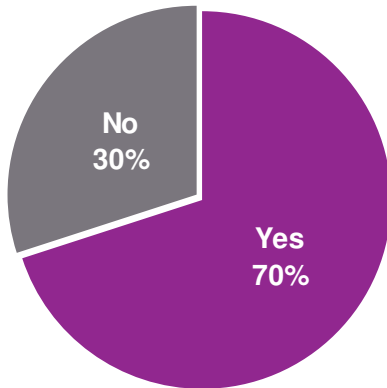
- Increasing
- The same
- Decreasing

All Respondents

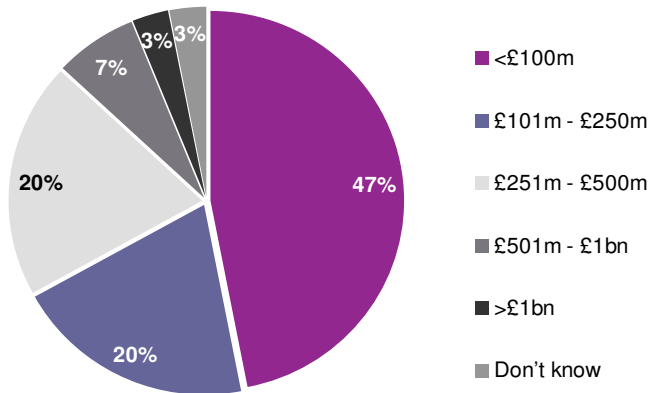
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INVESTOR ATTRIBUTES

Question: Do you have a mandate to invest in All Cap equities?



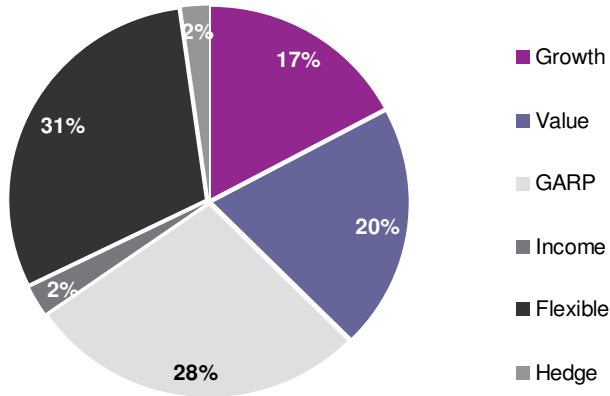
Question: What are the current funds under management with your primary investment fund?



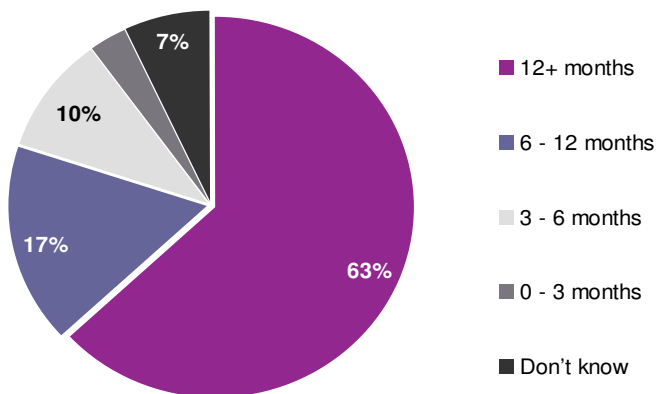
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INVESTOR ATTRIBUTES

Question: What is your investment style?



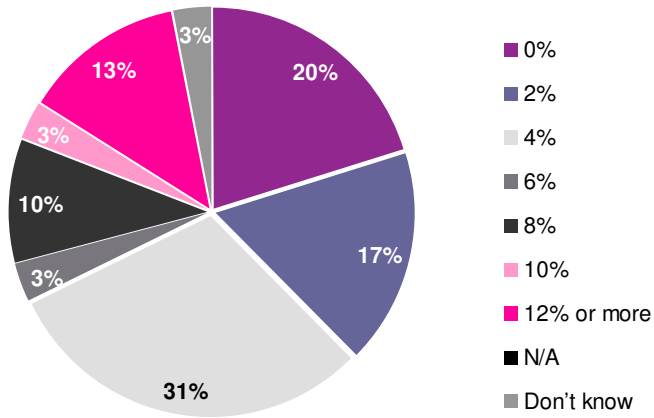
Question: What is your current investment time horizon?



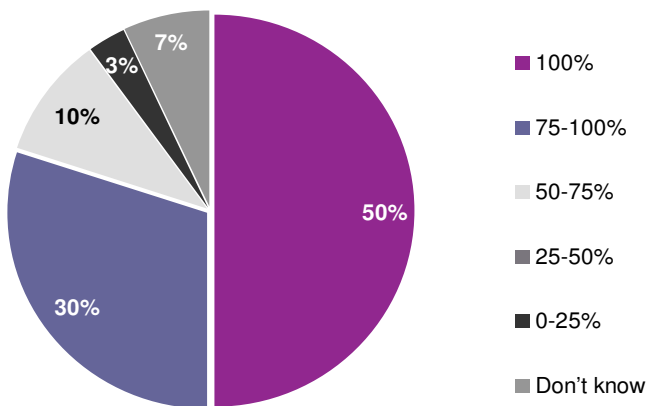
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INVESTOR ATTRIBUTES

Question: Which of the following comes close to your current cash position?



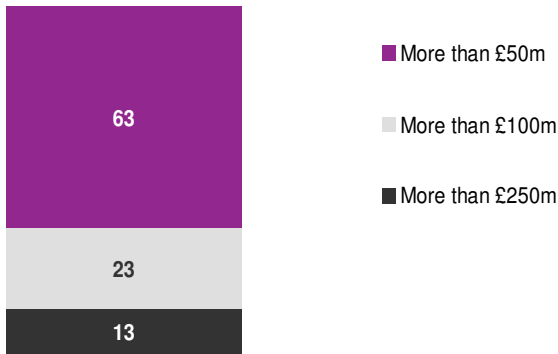
Question: Is your current net exposure to the equity market...?



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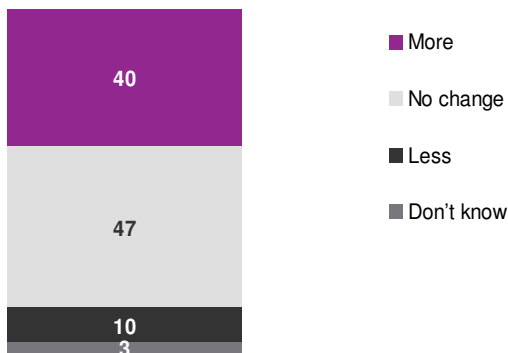
INVESTOR ATTRIBUTES

Question: At what stage do you become interested (in investing) i.e. market capitalisation?



All Respondents

Question: To what extent do you expect liquidity to become a consideration over the next 12 months?

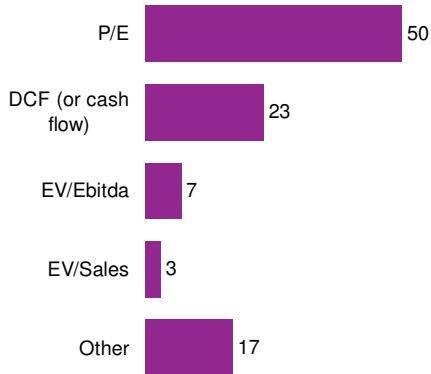


All Respondents

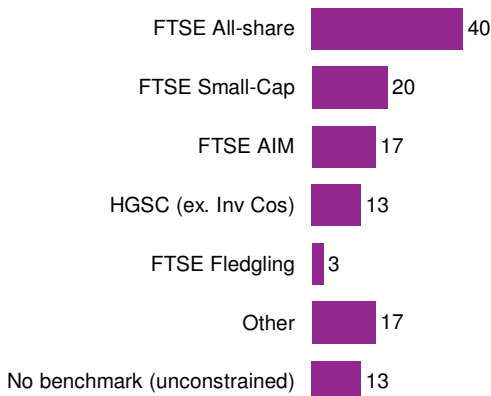
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INVESTOR ATTRIBUTES

Question: What is your favourite valuation measure?



Question: Which index (if any) are you benchmarked against?



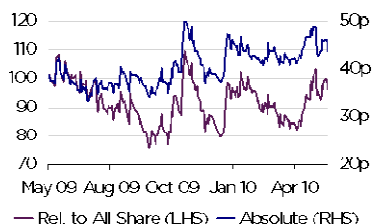
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HIGHEST CONVICTION STOCK PICKS

We asked all respondents to provide one company which they considered to be their highest conviction stock pick in the market at the time of the survey. Not surprisingly given the size and diversity of the UK equity market we received a variety of responses. Listed below are the two with the most mentions;

HARGREAVES SERVICES (HSP LN, market cap £178m, Transport)

Established in 1994 as a specialist bulk haulier, the Hargreaves Group has grown, both organically and via acquisition, into a major force in the supply, movement and management of mineral resources and the provision of support services to the energy and waster industries.



GRIFFIN MINING (GFM LN, market £80m, Minerals & Mining)

Griffin Mining has constructed the first new foreign owned and operated mine and processing plant in China at Caijiaying, which currently produces around 50,000 tones of zinc concentrate per annum together with gold, silver and lead.



Other companies mentioned (a selection):

Abcam; Advanced Medical Solutions; Brit; Devro; Healthcare Locums; Intec Telecom; Pace; Unite; West China Cement;

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YOUR FEEDBACK

We would very much welcome any feedback you have regarding the survey.

Our aim is for it to become the most useful reference point on investor sentiment in the Small and Mid Cap arena for professionals working in the sector, for corporates and institutions and for external commentators.

Any ideas for improvements we could make be it in the structure of the questionnaire, the way we gather the data, or the way we report the findings would be gratefully received.

In particular, if you would like to suggest a question for the next survey, please e-mail your suggestion (put "SCIS Question" in the subject line) to:

james.dunleavy@tns-ri.co.uk.

If your question is chosen for the next survey (all suggested questions will be put to a vote of respondents prior to the next round of fieldwork) we will be glad to send you a bottle of champagne or a donation for the same value to a charity of your choice.

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YOUR FUTURE PARTICIPATION

More importantly, we are keen to grow our panel, so if you would like to participate in the next survey, please send your contact details to:

marianne.headey@execution-noble.com

and we will be in touch with you before we send out details of the next online questionnaire.

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Contacts:

For media and other general enquiries contact:

Waheed Aslam
VP Global Financial Services, TNS
waheed.aslam@tns-ri.co.uk
t: +44 20 7160 5720
222 Grays Inn Road
London
WC1X 8HB
www.tns-ri.co.uk

Ben Thompson
Group Head of Marketing, Execution Noble
ben.thompson@execution-noble.com
t: +44 20 3429 1441
The Old Truman Brewery
91 Brick Lane
London
E1 6QL
www.execution-noble.com

www.tns-noble.com/investorsurvey

For respondents wishing to register interest in participating in the survey contact:

Marianne Headey
Corporate Access, Execution Noble
marianne.headey@execution-noble.com
t: +44 20 7426 4263



TNS recently merged with Research International. It is the world's largest custom research agency delivering actionable insights and research-based business advice to its clients so they can make more effective business decisions. TNS offers comprehensive industry knowledge within the Consumer, Technology, Finance, Automotive and Political & Social sectors, supported by a unique product offering that stretches across the entire range of marketing and business issues, specialising in product development & innovation, brand & communication, stakeholder management, retail & shopper, and qualitative research. Delivering best-in-class service across more than 75 countries, TNS is part of Kantar, the world's largest research, insight and consultancy network. Please visit www.tnsglobal.com for more information.



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In February 2010, Banco Espirito Santo de Investimento (BESI) agreed terms for the acquisition of a 50.1% stake in Execution Noble, to create the foundation for a new international leader in integrated investment banking services, with a significant distribution platform and critical mass in key emerging markets including Brazil and India.