Global mid-cap markets outlook 2011

A Nexia International Special Report

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About this report

This report provides a snapshot of current sentiment towards and key issues facing a selection of mid-market stock exchanges around the world.

It is based on the views of a panel of experts drawn from Nexia International member firms in the relevant countries. Our respondents have considered the outlook for the capital market in their respective countries and some of the key issues impacting on corporate activity in those markets.

The views expressed are those of the individual authors as at December 2010.

Central & Eastern Europe

Warsaw leading the way

Warsaw is fast becoming the destination of choice – even rivalling Moscow – for initial public offerings (IPOs) for companies from Central Europe and the countries of the former Soviet Union.

Latest figures confirm the growing role of Warsaw as the most active market for mid-sized companies. While London was responsible for the highest value of IPOs in 3Q 2010 at EUR 1,697 million, the Warsaw stock exchange (WSE) ranked first in Europe by number of IPOs with 32 (compared to second-placed London's 20). WSE's placings were valued at EUR 60 million, the fourth highest in Europe.

Eastern European neighbour Prague, meanwhile, is lagging behind the Polish capital's stock exchange with no IPOs since 2008 and trading volume that has dropped 53% during the past two years.

The Balkan states appear to be unattractive to companies looking to raise money through flotation and stock markets in Baltic countries focus on Russian or Scandinavian capital.

Vienna has been hit by the struggling Austrian economy, as have Hungary and Romania, which means that, in the medium term at least, two 'players' are likely to prevail – Warsaw and Moscow.

Moscow will continue to concentrate on larger companies (mostly mining, energy and banks) from Russia, Ukraine, Belarus or even Kazakhstan.

But Warsaw seems to be an increasingly attractive choice for small and medium-sized firms from the former Soviet-dominated region, especially in manufacturing, food services or politically neutral industries.

Polish success factors

Poland's well-developed infrastructure of banks and independent brokers, together with the long-term Polish government policy of promoting well-designed IPOs of privatised former state companies, has established a wide and active group of private investors in the country.

With the Polish economy thriving, a stable and hard-working middle class is ready to put its cash into the WSE. The result is a WSE that looks good to foreign-origin firms doing business in Poland and across Central and Eastern Europe.

Warsaw's successful IPOs tally is largely down to its recently launched alternative market, NewConnect, aimed at the type of smaller companies that haven't previously had the option of growth through going public. In the period from July to September 2010, 29 companies debuted there.

As an example of the type of overseas business attracted to Warsaw, UK biotechnology company Lectus PLC recently announced plans for a Q4 listing on WSE's NewConnect. Lectus is seeking to raise up to PLN 40 million via a private placement that could be the largest to date prior to a listing on NewConnect.

Roland Kozlowski, chief executive officer of Lectus, said: "We are impressed with the potential of NewConnect. The recent successful listing of Mabion is also a good indicator of the increasing interest from local investors in the biotechnology sector. This is a positive signal for us going into the private placement."

Agroton, one of Ukraine's largest agricultural companies, raised cash through an IPO on the WSE in November. It says institutional investors took up 90% of the offering and individual investors 10%. Gross proceeds from the offering were PLN 153 million.

Sector focus

The flow of fresh capital to large companies and newcomers alike is one of the major factors in the recent Polish economic boom. This has meant diversity of risk and promoted a real, rather than virtual, economy of manufacturing, rather than the focus on financial services favoured by many other countries.

Nevertheless, banking is a sector also widely expected to drive economic prosperity, along with property, services, wholesale and EU-financed infrastructure projects.

The Polish business community knows it can't rely on government hand-outs, so has had to rely on its own initiative. In addition, Poland's shortcomings in the sort of wealth in natural resources that, say, Russia can boast has forced it to work harder in finding economic success.

Culturally too, Poles are more inclined to open and transparent investment of capital in Polish institutions, compared to some of their Eastern European neighbours.

Challenges ahead

There are, however, challenges facing companies who want to list in Poland. Investors are well educated and demanding so low-quality investments are soon recognised and rejected. Liquidity of shares is a key factor, with investors seemingly primarily interested in seeking value and returns, rather than dividends.

There are regulatory changes ahead that are likely to impact the market. Omnibus accounts for foreign investors will be allowed from 2011 and this should make it easier for private foreign investors when using non-Polish brokers (banks).

In the short term, Warsaw is unlikely to become a global financial centre, but it will continue to be an excellent place for going public, particularly for small and medium-sized companies from Central and Eastern Europe, whether EU members or not, and may become a happy hunting ground not just for Polish investors, but for venture capital and investment funds from further afield.

European Union

EU markets to encourage smaller companies

For many years, stock markets around the globe have cast an envious eye over AIM as it has become the most successful market for small and medium-sized, fast-growing companies. Most other countries with sophisticated stock markets have tried to launch their own versions of a growth company market, but all have largely failed to a greater or lesser extent.

AIM's success is largely down to balancing its regulatory framework and the costs of obtaining and maintaining an AIM quotation, with the confidence of the investor community in the reliability and quality of its constituent companies.

Although institutional investment attitude to AIM companies is undoubtedly more cautious now, there are signs that it is improving, and IPOs are starting to re-emerge. There are signs that may encourage more companies to join the market in the next few years.

The EU fights back

Many European finance ministers, in particular the French minister Christine Lagarde, recognise that recovery from the deepest recession since the Second World War will require the emergence of small and medium-sized companies and the provision of equity to them by European capital markets. However, the current suite of EU Securities Directives clearly provides a disincentive to new listings of smaller companies. This vital pool of capital therefore tends to be denied to the companies which not only need it most, but are also best placed to lead Europe out of recession through job creation.

Mme Lagarde recently commissioned a report with a brief to make recommendations on establishing a proportionate regulatory and financial environment for small and medium-sized issuers listed in Europe (SMILEs). The report recommends a suitable definition of a SMILE as a company which has a transaction value (i.e. money raised) of less than EUR 75 million at IPO, or, if admitted to trading, a capitalisation of less than 35% of the average of companies listed on the regulated markets of the issuer's home member state. These companies, the report says, would be subject to a more proportionate regulatory regime without prejudice to investor protection.

AIM very neatly avoided many of the compliance costs of EU Directives by becoming an exchange-regulated rather than an EU-regulated market in 2005, leading to a huge increase in the number of AIM companies admitted over the next few years. A dozen other exchange-regulated markets have been created in other European jurisdictions, but none with the success approaching that of AIM.

A contributing factor to this situation is the fact that the European investment community is less willing, or in many cases unable, to invest in companies which are not listed on an EU-regulated market. The hope and intention is that the changes recommended in the report will make EU-regulated markets, and a much wider pool of investment capital, more accessible to smaller companies.

UK

What next?

The last year has been a testing time for London's capital markets, and AIM in particular. However, the recent upturn in M&A activity and an increase in IPOs provide reasons for optimism.

Highs and lows on AIM

While there are some encouraging signs – the number of AIM admissions increased from 36 in 2009 to 65 in the first nine months of 2010 – there are a number of reasons why London's capital markets have failed to sparkle.

Sixty-five companies were admitted to AIM in the first nine months of 2010, 32 of which were new admissions. Six companies transferred from the main market and 27 were re-admissions. The number of companies delisting continued to exceed admissions. At the time of writing, 154 companies had delisted in 2010 and there were 490 fewer companies on AIM since its peak in December 2007, a decrease of 29%. The reduction has been concentrated, mainly, at the smaller end of the market capitalisation range. This reduction in the number of companies has had a consequent effect on the nominated advisers and brokers servicing AIM.

There was a general feeling at the start of 2010 that the market had bottomed-out and that the number of IPOs would start to increase. As it transpired, there was little activity as investors and company boards awaited the outcome of the UK General Election. The new Government has not yet been seen to have a positive influence on investor confidence. However, there is growing evidence that companies are considering IPOs again, particularly those backed by private equity firms. Valuations remain challenging though and investors are, naturally enough, reluctant to pay high prices for new companies joining AIM. Further fund raisings also suffered from misplaced optimism. 2009 had been viewed as a poor year for further fund raisings but the aggregate amount of further funds raised on AIM in the first nine months of 2010 increased to £2.95 billion (from £2.74 billion in 2009).

The main market

Investor scepticism was an even more prominent feature of the main market. 2009 was a record year for further fund raisings on the main market, with more than £75 billion raised – mainly through rescue rights issues. In 2010 to the end of September, further funds raised fell to £10.7 billion, from £57.3 billion in the equivalent period in 2009. The lower figure in 2010 was due to the fact that major companies did not have the same need to raise funds in order to restructure their balance sheets.

It has not been all bad news for the main market, with an increase in M&A activity in recent months and an increase in the monthly average of money raised from IPOs from £94 million in 2009 to £679 million in 2010. This monthly average increase reflects fund raisings by such high profile companies as Ocado (£955 million) and Essar Energy (£1.2 billion).

What's in store for 2011?

The direction of the markets continues to be uncertain and is likely to present challenges well into 2011. The ongoing reshaping of banking balance sheets (a legacy of the credit crunch), concerns over national governments' budget deficits, inflation and interest rate expectations will be the key factors influencing the analysts and the future direction of the markets. The level of optimism appears higher than a year ago and, arguably, justifiably so. However, there are some major challenges ahead if the market is to gain momentum and to find a new, more sustainable direction.

Singapore

An international market

The capital market in Singapore is one of the most international in Asia, with issuers from across Asia and Europe. Some 300 foreign companies make up nearly 40% of those listed.

Average market capitalisation on the Singapore exchange is slowly returning to pre-financial crisis levels and corporate fund-raising activities are increasing moderately, although they may be slower to return to normality.

IPOs dried up during the first half of 2009, with only three listings. The IPO market saw a recovery in the second half which was boosted by the IPO of Capitalmalls Asia Ltd (Capitalmalls), the biggest for the year, raising S$2.5 billion. In all, the Singapore Exchange (SGX) attracted 29 IPOs in 2009, a number which it exceeded in 2010.

The first half of 2010 saw the return of many companies which had delayed listing due to the financial crisis. By the end of 2010, there had been 39 IPOs on both the Mainboard and Catalist, which caters for growth companies. Highlights have included the launch of Global Logistics Properties Limited, a provider of logistics facilities in Asia, and Mapletree Industrial Trust, one of the largest landlords of privately owned multi-user flatted factory space in Singapore. Funds raised were approximately S$3.4 billion and S$1.2 billion respectively.

Despite renewed optimism, the environment for IPOs remains challenging as volume and liquidity continue to be low.

At the time of writing only a handful of 2010 IPOs were trading above their offer prices. These include Kreuz Holdings, an offshore installation/construction service provider, and STX OSV Holdings, a shipbuilder of specialist vessels for the oil and gas sector. The two companies gained around 65% and 39% respectively.

Admission criteria for the Mainboard in Singapore are likely to change. Currently, companies must have market capitalization of at least S$80 million based on issued price and post-invitation share capital, but this is likely to rise to at least S$150 million and possibly as high as S$300 million. Smaller companies are therefore likely to turn increasingly to Catalist, the specialist growth company market.

Sustaining the recovery

A sustained recovery in corporate activity will of course depend to a large extent on the stability of the global market and on economic performance in the region, especially China. The telecoms, internet and oil and gas sectors are set to lead the way. The secondary market is becoming more active and gearing up for larger issues. Opportunities for dual listings with countries in different time zones or markets have gained prominence.

Public listings are heavily dependent on institutional investors in Singapore and much will depend on levels of liquidity and demand from these institutions.

As with many markets around the world, the key for companies wishing to attract investors is to demonstrate the 'back to basics' virtues of a proven track record, healthy balance sheet and cash reserves, strong management, scalability and the potential for attractive price to earnings ratios.

These aside, the biggest challenges facing companies seeking a listing in Singapore include corporate governance issues, weak internal control systems and the high ongoing compliance costs involved in meeting listing obligations.

Australia

Building on solid foundations

As with most capital markets and general business activity around the world, 2010 saw a significant recovery for Australia from 2009. By way of background, Australia was one of only a handful of countries that did not have a recession in 2008 or 2009, and so entered 2010 with an economic base above that of many other developed countries.

The Australian economy grew steadily in 2010, aided by a resource boom which has earned it a place in the world as one of the largest global suppliers of raw materials.

Australia is ranked the 14th largest economy in the world and the fourth largest in the Asia-Pacific region, and enjoys a diverse investor group (40% foreign, 40% domestic institutions and 20% retail investors).

IPO activity has improved in the past 12 months, with 103 new listings in 2010 compared to 45 in the previous year. This signifies more positive trends in investor confidence levels. The best performing IPO in Australia for the year was Doray Minerals, which listed in February 2010 for 20 cents and saw its shares rise 630% to A$1.46 by December.

The value of floats is expected to increase to A$7.5 billion from A$3 billion in 2010. The primary drivers are the QR National A$4 billion listing and the A$2 billion float of Westfield Retail Trust. QR National was a spin-off from the Queensland Government and provides national coal haulage, train and track operations and has grown on the back of the resources boom. It was the biggest float in Australia since Telstra in 2006.

Trade execution activity levels recovered strongly in 2010, with the equities (number of trades) and derivatives (number of contracts traded) market activity both up, by 24.0% and 17.7% respectively.

Australian Stock Exchange developments

The Australian Stock Exchange (ASX) plans to examine opportunities to enhance disclosure by listed companies in extractive industries, with a view to improving capital market outcomes in these industries and providing the basis for more informed decision-making by investors.

The transfer of certain supervisory activities to the Australian Securities and Investments Commission (ASIC) in August 2011 should help ASX focus more on its compliance function. Careful management and integration by ASX and ASIC is important to ensure ASX continues to grow its core business, meet new and diverse challenges, and maximise opportunities in the competitive environment in the coming years.

The ASX and Singapore Stock Exchange (SGX) have announced plans to merge, to enable investors/customers on the global stage to capitalise on listing, trading, clearing and settlement opportunities created by the expanded platform. There is sentiment in Australia that the merger may not occur, but this will become clear in the early part of 2011.

Outlook for 2011

We predict a cautious but positive outlook for 2011. The resources market will still provide the platform for a strong Australian economy and opportunities for the right listings in the year ahead.

Canada

From strength to strength

With the help of a strong banking sector, coupled with strong commodity prices, the Toronto Stock Exchange (TSX) successfully emerged from the recent worldwide economic downturn in a strong position.

The TSX finished 2010 with 21 IPOs in December, to bring the 2010 total to 119, nearly double the number of IPOs from 2009. In 2010, the TSX added 187 new issuers, including 119 IPOs, compared to 100 new issuers, including 60 IPOs, in 2009. Even though overall financing activity was down in 2010 compared to 2009, IPO financing on the TSX more than doubled, with $10.7 billion raised in 2010, compared to $4.8 billion in 2009.

In 2010, TSX Venture Exchange exceeded 2009 figures in all measures, with 185 new issuers, including 142 IPOs, compared to 107 new issuers, including 72 IPOs, in 2009. Total financings raised during the year increased by 96% over 2009.

The international community is increasingly turning towards the TSX as a vehicle to listing. The Toronto Stock Exchange and TSX Venture Exchange together welcomed 71 new international listings in 2010, compared to the previous record of 49 in 2008.

Overall, mining sector listings increased to 208 in 2010, compared to the previous record of 184 in 2007. This is in sharp contrast to other mid-markets which have been unable to sustain their growth as international players.

Outlook for 2011

The TSX is in a position to gain from the continued rebound of the global economy. Growth will be fuelled by the rising commodity prices and the Canadian financial institutions with their robust balance sheets.

The main obstacle to growth continues to be the weak global economic climate, particularly the sovereign debt problems in parts of Europe.

With significant commodity following in Canada, 2011 will see more foreign companies listing in Canada. Concurrently, with an abundance of basic commodities in Canada, more international companies are acquiring local Canadian companies. Also, many of Canada's senior commodity companies and financial institutions are world-class names, well recognized beyond national borders and well represented throughout the world, which will continue to attract international attention.

The TSX should enjoy continued growth through 2011, continuing to cement its position in the international mid-market sector.

USA

Many companies still struggle to raise capital for growth

In 2010, for the second consecutive year, the US markets ended on an upbeat note as the Dow Jones Industrial Average (DJIA) closed up 11% from a year earlier, on top of a 19% increase in 2009. The gains have continued into January 2011, as the DJIA flirted with a 12,000 close – a high point that hadn't been seen for several years.

Concurrently, small- and mid-cap stocks performed better in 2010 than did their large-cap counterparts. The Standard & Poor's (S&P) Small-Cap 600 Index and the S&P Mid-Cap 400 Index both rose about 25% year-over-year.

Looking ahead, US economic growth is expected to continue its upward trend and, with the Federal Reserve committed to supporting the growth with substantial liquidity, many analysts continued their positive equities outlook with attractive valuations, strong expected profit growth, and increased merger and acquisition (M&A) activity. It's widely believed that equity markets hold more potential for 2011 than do bonds, and that stocks are being suppressed by concerns over issues such as government regulations, despite enthusiasm for the underlying potential of stimulus programs and upbeat job reports.

Key issues impacting US capital markets include the following:

- **Equity:** A substantial volume of new equity issues came to market through 2010, though at a lower volume than in both 2008 and 2009.
- **IPOs:** 2010 marked the return of the initial public offering (IPO) market, especially for small-cap issuers. Excluding the $15.8 billion General Motors IPO, 162 companies raised nearly $28 billion in the IPO market, for an average deal size of $173 million. Nearly half of the deals raised less than $100 million each.
- **Reverse Mergers:** Reverse mergers have traditionally been seen as a faster, less expensive way to go public; yet, even with a 25% market boost in 2010 and a cumulative value of $2.6 billion (up 53% over 2009), these deals are beginning to lose their shine. Market shifts and concerns over short sales, fraud, and greater regulatory oversight have slowed reverse merger activity and prompted investors to begin researching opportunities in expanded geographies, including Central America, South America and Canada.

As a result of cost-cutting decisions made by middle-market companies at the start of the financial crisis, many are now better positioned for substantial growth and are seeking to do so by expanding budgets, increasing payrolls, and boosting inventories. But, despite their trimmer financial profiles and the positive economic outlook for 2011, many middle-market companies are still unable to access the capital they need at a reasonable price.

A major impediment to these objectives is the continued caution on the part of some banks that lend into the middle market. Bank lending has traditionally been a first resort for companies to access low-cost capital to grow their businesses. In the past several years, however, that has not necessarily been the case. Substantial difficulty in securing necessary credit has left many small- and middle-market companies concerned about their ability to sustain operations over the upcoming year.

In some quarters, however, it's been predicted that lending to small- and middle-market businesses will increase over the course of 2011; so, while they may currently be 'capital starved', there is a glimmer of hope as some banks pronounce their reignited interest in lending in these categories.

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- Broking
- Post-deal integration and support

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