



LIONTRUST

LIONTRUST UK SMALLER COMPANIES FUND

MANAGER'S SHORT INTERIM REPORT
FOR THE PERIOD ENDED 31ST OCTOBER 2011



Managed by Anthony Cross &
Julian Fosh in accordance with
The Liontrust Economic Advantage

THE LIONTRUST ECONOMIC ADVANTAGE

LIONTRUST UK SMALLER COMPANIES FUND IS MANAGED BY **ANTHONY CROSS** AND **JULIAN FOSH** IN ACCORDANCE WITH THEIR INVESTMENT PROCESS FOR UK SMALLER COMPANIES, **THE LIONTRUST ECONOMIC ADVANTAGE.**



The Fund aims to produce long-term capital growth. With over 2,000 smaller companies quoted on the London Stock exchange, investing in smaller companies requires a disciplined investment approach to identify companies with good long-term potential and avoid the remainder. The Fund's investment approach is to invest exclusively in companies demonstrating two criteria which we believe are the key to what makes some companies successful and others less so. These are: the strength, sustainability and exploitation of a company's Economic Advantage (its intangible strengths), and how key employees (who create this Economic Advantage) are motivated and retained, preferably through direct ownership of the company's equity. The Fund will only invest in those smaller companies that can demonstrate that they have met these two criteria.

MARKET REVIEW

The Market

The UK market has been very volatile over the last six months. The overriding concern has surrounded the high levels of western sovereign and banking debt as well as the sustainability of the euro. There have been particular worries about Europe but at times the focus has shifted onto the US and the UK. Allied to debt worries have been periods of pessimism about economic growth. In general the outlook for European and UK growth has worsened whilst that of the US has been more mixed. Emerging market demand has remained reasonably strong but there have been signs, more recently, that it has become more hesitant in some countries and industries. The FTSE Small Cap. Index fell by over 14% whilst the FTSE All-Share dropped by more than 7%.

The Fund

The Fund fell by just over 5%. Whilst disappointing, this performance was considerably better than the fall in the FTSE Small Cap. Index and ahead of the broader FTSE All-Share.

The Liontrust Economic Advantage investment process, which has been applied since the Fund launched in 1998, continues to be rigorously applied. We aim to find businesses which are either international and have built a 'world-beating' position or that have a strong domestic position which is frequently backed by high recurring income. All of our companies have motivated management who own equity in their

businesses, the required threshold being Board ownership of 3% but the average in the portfolio actually being around 20%. We believe that equity ownership is important for motivation as well as the attention it brings to financial discipline and long-term shareholder returns. A common feature of our companies is their financial strength; this has obviously been critical since the beginning of the credit crunch.

A strong market position requires barriers to competition. Our process is built upon the premise that today's barriers are built through intangible assets. Three in particular are very powerful, and companies can only enter the Fund if they have at least one of these.

The first is Intellectual Property (patents, copyrights, trade secrets and know-how). Intellectual Property (IP) is usually legally protected and is built from accumulated spending on research and development.

The second is distribution networks. These can be either physical, such as the international distribution network built up by an engineer, or electronically embedded, which is typical of many software companies. Physical distribution networks have often been built over a number of years and cannot be replicated overnight. Embedded distribution networks form a very powerful barrier to competition because it is difficult for competitors to force out the embedded incumbent.

MARKET REVIEW CONTINUED

The third asset is repeat business. We look for companies with 70% contracted recurring income. Such an income stream is not threatened by persistent price changes and it provides management with a certainty of income and therefore the ability to plan for the long term. Fee-based fund management companies enjoy high recurring income, as do software companies and some outsourcing businesses.

If a company has passed our test of having one, or a combination, of IP, distribution strength and repeat business, we will then evaluate other important intangible assets such as customer relationships, databases, licenses and franchises, procedures and formats, culture and brand.

We expect our businesses to demonstrate strong financial returns either through high margins or returns on capital employed (ROCE). Strong financial returns show that our required barriers to competition are working. In immature businesses the focus tends to be on gross margin, whereas with more mature businesses the focus switches to operating margins and ROCE. With cyclical businesses, operating returns will obviously move around but during a downturn we would hope that our businesses will be gaining market share before seeing returns rise again into a recovery.

Risk plays an important part in our decision of how much of a company to buy. We grade our companies accordingly, taking into account such factors as customer spread, product spread, financial gearing and market maturity. New holdings have to be profitable companies, headquartered in the UK and with directors that are subject to UK law.

Over the six months, there have been some very strong performers. *iomart* (data centres and hosting), performed well again. It continues to win new business and drive up earnings growth. *Cupid* (internet dating) was up by over 50% after a series of earnings upgrades. Other technology businesses *NCC* (software escrow and internet security), *EMIS* (healthcare IT) and *Workplace Systems* (manning software) also performed well. Other notable performers were *Concurrent Technology* (specialist computer boards), *Brooks Macdonald* (private client fund management), *Brainjuicer* (market research), *Paypoint* (payment platform) and *Waterman* (engineering consultancy), which saw a recovery in its depressed share price.

There was no corporate activity. The Fund enjoyed a number of takeovers earlier in the year and the proceeds were invested in building up new positions in *Smart Metering Systems* (gas metering), *Idox* (software) and *Advanced Computer Software* (software).

Poor performers included *Empresaria* (recruitment), *Penna* (recruitment and outplacement) and *UK Mail* (parcel distribution). All have suffered from weakening economic conditions. *Panmure Gordon* (broking) continued to suffer from a lack of corporate finance whilst *Bango* (mobile payment platform) has yet to see a significant uptake in new business. *Renishaw* (measurement) fell after its growth rates were pulled back. This international industrial company is cyclical and its more subdued trading is perhaps a forewarning of more a general slowdown in global growth.

Outlook

Stock markets will continue to be volatile whilst there is so much uncertainty surrounding the euro as well as the solvency of certain countries and banks. It is likely to take many years for the high levels of sovereign and personal debt to diminish across many countries.

Our process takes a long-term view and this is reflected in low levels of stock turnover within the Fund. We do not take macroeconomic bets but instead focus on the underlying strengths of each business. The companies have defensible barriers against competition and are frequently exposed to fast-growing markets. Those that have a UK focus often have high levels of contracted recurring income and when compared to our benchmark we are underweight in UK consumer sectors. The balance sheets of our businesses tend to have net cash and we are attentive to the dangers of leverage. Our companies continue to have management who, via their own equity ownership, are committed to delivering shareholder returns. We remain very optimistic about the long-term attractions of our investment process.

Anthony Cross & Julian Fosh

Partners, Liontrust Investment Partners LLP
December 2011

FUND PROFILE

Investment Objective and Policy

The investment objective of Liontrust UK Smaller Companies Fund is to provide long-term capital growth by investing primarily in smaller UK companies displaying a high degree of Intellectual Capital and employee motivation through equity ownership in their business model. To achieve this aim, the Fund will invest in a portfolio of UK smaller companies' shares, the majority of which are contained within the FTSE Small Cap., the FTSE Fledgling and the AIM indices. Companies within the Fund that graduate into the FTSE 250 Index will be held until a suitable replacement company is found. The Fund may also invest in transferable securities, money market instruments, warrants, cash and near cash and deposits. The Fund may also invest up to 10% of its property in units or shares in collective investment schemes. The Fund is permitted to use derivatives for the purposes of efficient portfolio management and for investment purposes.

Investment Approach

With over 2,000 smaller companies quoted on the London Stock Exchange, investing in smaller companies requires a disciplined investment approach to identify companies with good long-term potential and avoid the remainder. The Fund's investment approach is to invest exclusively in companies demonstrating two criteria which we believe are the key to what makes some companies successful and others less so. These are: the strength, sustainability and exploitation of a company's Economic Advantage (its intangible strengths), and how key employees (who create this Economic Advantage) are motivated and retained, preferably through direct ownership of the company's equity. The Fund will only invest in those smaller companies that can demonstrate that they have met these two criteria.

Risk Profile

The Fund is invested exclusively in UK securities. It invests exclusively in smaller companies, which may be less liquid than larger companies. The price swings may therefore be greater than in those portfolios comprising shares of larger companies. Furthermore, the Fund has a significant proportion of its assets in companies which are traded on the Alternative Investment Market (AIM). The nature of AIM investments is such that prices can be volatile and realisations may not achieve current book value, especially when such sales represent a significant proportion of that company's market capital.

Total Expense Ratio: 1.66% (30th April 2011: 1.65%)

Fund Calendar

Ex-dividend date	1st May
Income payment date	30th June
Accounting period ends	31st October (interim) 30th April (final)

PERFORMANCE

Net Asset Values

	31st October 2011	30th April 2011	% Change
<i>Pence per unit</i>	419.93	429.12	-2.14

Based on a mid price NAV

Distributions:

The Fund distributes income once per annum, on 30th June. The ex-dividend date is 1st May each year. Income can be reinvested to purchase units at no initial charge.

On 30th June 2011, the Fund paid a distribution for the year ended 30th April 2011 of 1.40 pence per unit (2010: 3.16 pence per unit).

Total Return (%)

	6 months	3 years	5 years	Since launch*
Liontrust UK Smaller Companies Fund	-5.3	76.3	31.3	279.5
FTSE Small Cap. Total Return Index (excluding investment trusts)	-14.3	51.1	-24.4	43.8
Quartile Ranking	1	3	1	1

Discrete Years' Performance (%)

To previous quarter, 12 months ending:	Sept '07	Sept '08	Sept '09	Sept '10	Sept '11
Liontrust UK Smaller Companies Fund	11.2	-23.6	13.3	24.8	10.9
FTSE Small Cap. Total Return Index (excluding investment trusts)	4.8	-38.4	25.5	-0.6	-4.5

Up-to-date past performance information may be obtained from the Fund's most recent fact sheet, available on our website (www.liontrust.co.uk) or by calling our Administration and Dealing team on **0844 892 1007**.

Past performance is not a guide to future performance. The value of investments and the income from them can fall as well as rise and are not guaranteed. Investors may not get back the amount originally subscribed. The issue of units in the Fund may be subject to an initial charge, which is likely to have an impact on the realisable value of the investment, particularly in the short term. Equity investment should always be considered as long term.

Performance data source: Financial Express as at 31.10.11, total return, bid-to-bid.

* Launch date 08.01.98

PORTFOLIO

Top 10 Holdings

As at 31st October 2011	%	As at 30th April 2011	%
iomart	4.38	Dialight	4.41
Brooks Macdonald	4.36	System C Healthcare	4.31
Dialight	4.21	RWS	3.91
RWS	4.10	Animalcare	3.70
Next Fifteen Communications	4.07	Brooks Macdonald	3.65
NCC Group	3.59	Renishaw	3.65
Charles Stanley	3.41	FFastFill	3.55
Tikit	3.27	Next Fifteen Communications	3.47
Concurrent Technologies	3.26	iomart	3.41
Craneware	3.24	Craneware	3.31
Total	37.89	Total	37.37

Sector Weightings

	FTSE Small Cap. Total Return Index (excluding investment trusts)		Liontrust UK Smaller Companies Fund	
	31st October 2011 %		31st October 2011 %	30th April 2011 %
Basic Materials	2.14		-	-
Consumer Goods	6.63		-	-
Consumer Services	16.85		13.21	14.68
Financials	24.89		12.54	11.28
Healthcare	5.92		2.42	2.15
Industrials	34.83		25.87	25.20
Oil & Gas	3.02		-	-
Technology	7.60		38.39	38.02
Telecommunications	-		-	-
Utilities	-		-	-
			92.43	91.33
Cash (including SSgA* cash deposits)			7.57	8.67
			100.00	100.00

*State Street Global Advisors

FURTHER INFORMATION

Unitholder Notice: Investment & Borrowing Powers – Investment in other Collective Investment Schemes

Paragraph 13 (e) of the Fund's Prospectus sets out the limitations for the Fund investing in other Collective Investment Schemes. We have amended the rule references in this clause of the Prospectus so that they reflect the COLL regulations of the FSA Handbook, which replaced the CIS regulations, as previously noted within this clause. Whilst this has the potential to widen the universe of available collective investment schemes available, it is not intended that this will affect the way the Fund is currently invested. The investment limits have not changed.

Liontrust Asset Management PLC

Liontrust provides portfolio management services in UK, European, Asian and Emerging Markets equities. These are managed on a long-only, long/short and absolute return basis through unit trusts, individual savings accounts (ISAs), offshore funds, pooled pension funds and segregated institutional accounts. The Group currently manages £1.354 billion (as at 10th November 2011).

We market our investment products to professional investors, predominantly in the UK and Continental Europe. These include pension funds and other institutional investors, family offices, private banks, private client managers, multi-managers, stockbrokers and financial advisers. Some private clients, to whom no advice has been given, have chosen independently to invest with us.

FURTHER INFORMATION CONTINUED

Further Information, Report & Financial Statements

Further information on the Fund and its portfolio, the Manager's Long Final and Interim Reports & Financial Statements and the Prospectus and Simplified Prospectus are available free of charge from the Manager upon request, and from www.liontrust.co.uk.

The Manager

Liontrust Fund Partners LLP, 2 Savoy Court, London WC2R 0EZ.

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Authorised and regulated by the Financial Services Authority.



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