Liontrust UK Smaller Companies Fund

May 2022 review

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The Liontrust UK Smaller Companies Fund returned -2.3%* in May. The FTSE Small Cap (excluding investment trusts) Index comparator benchmark returned -1.9% and the average return of funds in the IA UK Smaller Companies sector, also a comparator benchmark, was -2.6%.

May's macroeconomic data showed further evidence of the inflationary pressures which are mounting as the year goes on. Consumer price inflation in the UK hit 9% in April, the highest level in 40 years, while the US equivalent was 8.3%. The central bank policy response was as expected: the Bank of England raised rates by 0.25% to 1.0% and the US Federal Reserve pushed through a 0.5% hike to a target range of 0.75% to 1.0%.

Against a market backdrop of geopolitical volatility and inflation concerns, we have recently been highlighting two themes which we think will be among the most influential this year: pricing power and takeover activity.

Cost pressures were one of the key takeaways from **Integrafin's** (-16%) interim results. Despite a fall in market levels over the six months to 31 March 2022, net inflows of £2.7bn on its Transact platform pushed funds under management up 3% to £53.5bn. This fed through to 12% growth in gross profit of £66m, but cost increases restricted operating profit growth to 2% (to £26m). Operating expenses rose by 24% year-on-year during the six months with the biggest factor being increased staff costs, partly as a result of acquisitions and new hires but also due to general wage inflation. With 50 additional software development and systems staff hires planned in the next 18 months, the cost headwinds look set to persist in the short term.

May also provided more evidence that market volatility is leading to corporate and private equity acquirers seeking out undervalued assets. We noted last month that a handful of the Fund's companies have already been the subject of takeover interest or speculation this year. One of these, **Clipper Logistics**, exited the portfolio in May as the fund managers sold the position ahead of completion of the takeover by US-listed GXO Logistics.

There were further developments on other portfolio bid situations. Having announced in April that it was in the early stages of considering a possible offer for **Ideagen (+48%)**, private equity investor Cinven subsequently withdrew its interest in May. However, Ideagen disclosed that it had recently also received proposals regarding cash takeovers from Astorg and Hg. Ideagen is a leading supplier of information management software to highly regulated industries including life sciences, banking and aerospace. On 9th May, Ideagen recommended an offer of 350p a share from Hg, an investor in software businesses which manages funds of over $40bn. Shares in Ideagen immediately jumped to trade at the offer level, while Astorg withdrew its interest a few days later.

Also last month, Baring Private Equity Asia VIII Fund announced that it was considering making an unsolicited offer for **RWS Holdings** (-10%), prompting the shares to rise strongly. In May, it stated that it was no longer evaluating an offer. Amid the takeover speculation and the slew of stock exchange updates required by the UK takeover code, RWS Holdings' interim trading update in April did not gain much attention. The intellectual property services provider expects to report profit before tax of at least £60m in the six months to 30 March. This is slightly ahead of its prior expectations, following good cost synergies from its SDL acquisition and volume-led margin expansion in its group-wide translation functions.

Another of the Fund's holdings, **Next Fifteen Communications** (-18%), became involved in a potential takeover as acquirer, rather than acquiree. Since early January, marketing agency M&C Saatchi – which is not a holding in the Fund – has been the subject of takeover interest from one of its directors, Vin Murria, who is Chair of an acquisition vehicle – AdvancedAdvT Limited (also not a Fund holding) – which acquired 10% of M&C Saatchi's shares. Unsurprisingly, M&C Saatchi's other Board directors didn't welcome Murria's bid for a change of control and, in May, AdvancedAdvT took its offer hostile, approaching M&C Saatchi shareholders with an offer worth 208p, comprising either 100% AdvancedAdvT shares or 80% shares-plus-cash. M&C Saatchi's Board rejected the offer, describing it as derisory.

A few days later, Next Fifteen Communications entered the fray, making a 247p counter-offer (40p cash with the rest in shares) which was recommended by M&C Saatchi. In recent years, Next Fifteen Communications has broadened its services from being a digital marketing specialist to offering data-driven growth consultancy. Acquisitions have formed a key part of the company's rapid growth, but a £300m+ purchase of M&C Saatchi would represent a step-change in the pace of its transformation. Investors showed some trepidation around the deal, and the drop in Next Fifteen Communications' share price over the month pushed down the value of its mostly-shares takeover offer, largely wiping out the premium to AdvancedAdvT's offer. AdvancedAdvT has maintained its hostile bid at its initial level, despite Next Fifteen's offer.

Judges Scientific (+19%) announced its twentieth acquisition, its largest to date. The transformative deal to buy Geotek, a developer of instruments for measuring and logging information on geological cores, was welcomed by investors. Judges Scientific will pay an initial cash consideration of £45m with further contingent consideration of up to £35m. Geotek's average operating profit over the last three years was £6.3m, and Judges Scientific expects the deal to be materially and immediately earnings enhancing. It also commented that Geotek's operations are highly complementary to GDS Instruments, another Judges subsidiary, offering the potential for operational synergies. The cash consideration is being financed from a new £100m banking facility

A buoyant UK M&A market was one of the factors cited by specialist advisory firm **FRP Advisory Group (+25%)** in an upbeat full-year trading update. It expects to report revenues of £95m and EBITDA (earnings before interest, tax, depreciation and amortisation) of £26m this year, both ahead of consensus forecasts. The company also commented that its restructuring services had seen more enquiries following the removal of government support measures.

Big Technologies (+15%) moved higher after an AGM update reassured on supply chain difficulties and predicted that 2022 results will be "at least in line" with market consensus expectations. In the first four months of the year, the provider of integrated hardware/software solutions for the electronic monitoring of criminal offenders recorded an 18% year-on-year increase in revenue to £13.9m. It is increasing its inventory levels on long lead-time components and describes its pipeline of future business opportunities as strong.

LSL Property Services (-15%) slid after downgrading its 2022 profits forecast to slightly below 2021's level, having previously expected to match it. An AGM update highlighted the role of UK conveyancing bottlenecks in holding up residential transactions and contributing to a 9% reduction in its estate agency revenues in the first four months of the year. Although market forecasts are for a pickup in activity in the second half of the year, the company cautioned that it is yet to see evidence of an improvement in transactions.

Positive contributors included:
Ideagen (+48%), FRP Advisory (+25%), Judges Scientific (+19%), Tristel (+19%) and Big Technologies (+15%).

Negative contributors included:
Next Fifteen Communications (-18%), Robert Walters (-19%), Craneware (-18%), Integrafin Holdings (-16%) and LSL Property Services (-15%).

Discrete years' performance (%), to previous quarter-end:**
Past performance does not predict future returns

	Mar-22	Mar-21	Mar-20	Mar-19	Mar-18
Liontrust UK Smaller Companies I Inc	2.6%	56.7%	-5.8%	1.9%	17.1%
FTSE Small Cap ex ITs	5.5%	74.9%	-24.4%	-3.1%	2.2%
IA UK Smaller Companies	-1.7%	65.7%	-17.9%	-2.6%	14.9%
Quartile	1	3	1	1	2

*Source: Financial Express, as at 31.05.22, total return (net of fees and income reinvested), bid-to-bid, institutional class.
**Source: Financial Express, as at 31.03.22, total return (net of fees and income reinvested), bid-to-bid, primary class.

For a comprehensive list of common financial words and terms, see our glossary at:
https://www.liontrust.co.uk/glossary

Key Risks:

Past performance is not a guide to future performance. The value of an investment and the income generated from it can fall as well as rise and is not guaranteed. You may get back less than you originally invested.

The issue of units/shares in Liontrust Funds may be subject to an initial charge, which will have an impact on the realisable value of the investment, particularly in the short term. Investments should always be considered as long term.

The portfolio is primarily invested in smaller companies and companies traded on the Alternative Investment Market. These stocks may be less liquid and the price swings greater than those in, for example, larger companies.

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