Liontrust UK Micro Cap Fund

July 2023 review

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The Liontrust UK Micro Cap Fund returned -0.3%* in June. The FTSE Small Cap (excluding investment trusts) Index and the FTSE AIM All-Share Index comparator benchmarks returned 4.1% and 1.6% respectively. The average return of funds in the IA UK Smaller Companies sector, also a comparator benchmark, was 1.5%.

Market gains were helped by some evidence of an easing in inflation. June data for the US consumer price index showed a retreat to 3.0% annual inflation, down from 4.0% in May and slightly below expectations for a 3.1% rate.

The US Federal Reserve had been on record as saying further interest rate rises should be expected after the pause in its tightening cycle in June, and the 0.25% hike delivered in July had been entirely priced in by markets. The outlook from here is less certain; with the Fed now saying that future rises will be data-dependant, many have taken the easing in inflation data as a sign that rates have already reached their peak at a 5.25% - 5.50% range.

The pattern was the same in the UK, albeit at a higher inflation level. June's data showed a 7.0% annual rise in consumer prices, well below the expected 8.2% rate and down from 8.7% last month. With inflation still well above the Bank of England's 2% target, at least two more quarter-point rises are currently priced into futures markets.

These macroeconomic developments presented a relatively benign backdrop for equity markets, allowing investors to focus on a busy month of company earnings updates.

Starting with the positives, revenue continues to grow rapidly at mobile payments company **Bango** (+16%). A trading update for the first half of 2023 showed an 88% increase to $20m, driven by its digital vending machine business, which secured two large contracts in the US during the period. This division allows telecoms companies to offer a range of content and service options that can be bundled into subscriptions. Bango now works with three of the top five telecoms operators in the US, covering 60% of consumers.

Last year, Bango acquired the payments business of NTT DOCOMO Digital for €4m, a deal which is expected to significantly enhance earnings in future periods. Despite integration costs pushing Bango to a small loss in the first half of this year, it expects synergies and its typical second-half weighting to help it to hit forecasts of £12m EBITDA for the full-year.

Investors also welcomed interim results from **Arbuthnot Banking Group** (+14%) which showed a jump in profit before tax to £26m over the first half of 2023, up from £3.4m a year earlier as it benefited from an environment of higher interest rates. Although credit appetite has tightened due to a weak economic backdrop, Arbuthnot grew customer loans by 7% year-on-year to £2.3bn, with customer deposits also growing year-on-year by 16% to £3.3bn.

Both **Eckoh** (+13%) and **Solid State** (+11%) had issued updates in April that said profits were slightly ahead of market expectations in the year to 31 March. Both went on to issue solid sets of full results in July which included encouraging outlook comments.

Eckoh grew annualised recurring revenue by 18% to £30m, with adjusted operating profit up 48% to £7.7m. The provider of secure payment products and customer contact solutions commented that the new financial year has started strongly, with total order value of over £7m in the first two months and prospects underpinned by industry trends towards hybrid contact centre working and rising regulation of personal data management.

Specialist electronics group **Solid State** reported 50% growth in revenues and adjusted profits despite component shortages during the year. It secured a contract worth £17m with NATO to supply communications equipment to a defence customer through the Group's Systems division. This contract has contributed to strong trading in the first quarter of its new year, and Solid State now expects to exceed market consensus for revenues and profits in the period to 31 March 2024.

Turning to the detractors, **Zoo Digital Group** (-43%) was a heavy faller. The company provides end-to-end cloud-based localisation and media services to the entertainment industry. A July trading update laid out the extent to which it has been affected by the long-running script writers strike in the US as well as a trend towards cost rationalisation at streaming companies as competition increases. Zoo Digital had already forecast revenues in the quarter to 30 June to drop compared to last year's level, but now expects the decline to be deeper than originally expected.

Despite this unambiguously negative shot-term development, it's striking how upbeat Zoo Digital's statement is. The company expects to be a beneficiary of the rationalisation trend, with several customers already having selected Zoo Digital as one of a smaller group of vendors. As a result, it anticipates increasing its share of the media localisation market once business levels normalise. Currently, it is expecting this to feed through in the second half of the year, driving a return to revenue growth.

One of the reasons the Economic Advantage investment process focuses on possession of barriers to competition is that it provides companies not only with resilience during downturns, but also the opportunity to emerge on the other side in a healthier competitive position.

Frontline healthcare services provider **Totally** (-28%) has endured a torrid year so far. It shares lost ground at the start of the year due to delays in the re-tender process for some contracts that were due to expire. It then took another leg lower in March after warning that profits in the year to 31 March 2023 would be below expectations, due not only to the contract delays but also higher costs incurred through a greater reliance on agency staff following clinical workforce shortages. While July's release of full-year results managed to meet the downgraded guidance, Totally disappointed investors by giving downbeat comments on trading so far in its new financial year. The company now expects revenues to fall this year. Earnings are also expected to drop, albeit by a smaller proportion due to improving margins.

Nexteq (-13%) fell on an interim trading update which detailed 6% revenue growth in the first half of the year but predicted full-year revenues only broadly in line 2022 levels due to customers unwinding their stock positions. However, Nexteq has "materially enhanced" operating margins, which it expects to help it meet market expectations for adjusted profit before tax. **Nexteq** changed its name form Quixant earlier this year to reflect the growth of its software and hardware solutions into industries outside of its initial core gaming market.

Fonix Mobile's (-14%) share price in July looked detached from its trading performance, as described in a full-year trading update. The mobile payments and messaging provider said both revenue and profit growth in the year to 30 June were marginally ahead of expectations, with recent contract wins and its high levels of recurring revenue giving it confidence heading into its new financial year.

Away from earnings updates, the Fund was provided with a boost through the 56% rise in shares for **Gresham House** (+56%) after the specialist alternative asset manager agreed to a 1105p/share takeover offer from private equity group Searchlight Capital Partners. This level represents a 63% premium to its prior share price and 10% higher than the shares' all-time high reached in 2022.

Cerillion was sold from the portfolio having exceeded the £275m market cap limit at which we begin to consider a managed exit from positions in the UK Micro Cap Fund.

Brick and tiles speciality distributor **Brickability** was sold for the same reason in 2021 but it has recently come back into Fund's investment range. The short-term prospects for the UK housebuilding sector have been clouded by a weak economic outlook and tightening mortgage market, pushing Brickability's shares into a downtrend. However, Brickability continues to expand strongly – 2022 saw 4% like-for-like sales growth and a number of acquisitions – and we continue to believe its distribution strengths, which combine national coverage with high market share, provide strong barriers to entry and competitive advantage.

Positive contributors included:
Gresham House (+56%), Bango (+16%), Arbuthnot Banking Group (+14%), Eckoh (+13%) and Solid State (+11%).

Negative contributors included:
Zoo Digital Group (-43%), Totally (-28%), Fonix Mobile (-14%), Nexteq (-13%) and Record (-11%).

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

	Jun-23	Jun-22	Jun-21	Jun-20	Jun-19
Liontrust UK Micro Cap I Acc	-3.8%	-15.9%	59.5%	4.6%	3.1%
FTSE Small Cap ex ITs	-0.3%	-14.6%	65.2%	-12.3%	-8.6%
IA UK Smaller Companies	-5.5%	-22.1%	53.1%	-6.5%	-6.2%
Quartile	2	1	2	1	1

*Source: Financial Express, as at 31.07.23, total return (net of fees and income reinvested), bid-to-bid, institutional class.
**Source: Financial Express, as at 30.06.23, total return (net of fees and income reinvested), bid-to-bid, institutional 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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