Liontrust UK Micro Cap Fund

September 2023 review

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The Liontrust UK Micro Cap Fund returned 0.2%* in September. The FTSE Small Cap (excluding investment trusts) Index and the FTSE AIM All-Share Index comparator benchmarks returned 1.3% and -1.9% respectively. The average return of funds in the IA UK Smaller Companies sector, also a comparator benchmark, was -1.2%.

The Bank of England (BoE) held interest rates at 5.25%, ending a 14-month streak of hikes, following data which showed inflation slowing from a 6.8% yearly rate to 6.7% in August, rather than rising to 7.0% as economists had forecast. Although the US Federal Reserve also opted to hold rates steady, the market environment remained one of adjustment to a period of higher rates. This is because while further short term rate rises may be limited, investors are increasingly accepting that rates may remain around these levels rather than being swiftly reduced.

Against this backdrop, company size continued to be a significant driver of stock returns. On the UK market, the all-cap FTSE All-Share Index's 1.8% return was driven by a 2.4% gain for the large-cap FTSE 100. The FTSE 250 mid-cap index retuned -1.5%, while the FTSE Small Cap Index registered a 0.5% gain and the FTSE AIM All-Share Index lost 1.2%.

Gear4Music (+57%) registered a sizeable bounce in September on the back of a more upbeat trading update, although the gains need to be viewed in the context of an 18 month period in which the shares have lost the majority of their value. The online retailer of musical instruments has a leading market position in the UK and a growing share of the European market but has recently downgraded sales and profit growth targets as a result of weaker-than-expected consumer demand.

Investors were pleased that the latest AGM statement ended the run of downgrades and confirmed that trading so far this year (since 31 March) has been in line with its expectations. In the face of top-line headwinds, Gear4Music is focusing on gross margin improvement and cuts to its cost base. In March, the company launched a platform for trading second-hand instruments, and early trading has been encouraging. Gear4Music thinks it will evolve to become a key contributor to future revenue growth, and has now launched the platform into Europe.

Tristel (+36%) also enjoyed a large share price rise. Early in the month, the infection control specialist announced that it had successfully submitted its high-level disinfectant foam product for endocavity ultrasound probes and skin surface transducers to Canadian regulators. The submission came earlier than anticipated and brings an expected commercial launch into Canada forward into the current fiscal year. The Canadian submission comes on the back of a successful regulatory approval for the same product into the key North American market in June, in an announcement which had been eagerly anticipated by investors for some time.

As announced in a July trading update, **Bango** (+11%) saw an 88% increase in revenues to over $20m in the first half of 2023. The mobile payments specialist has seen strong takeup in the US of its digital vending machine (DVM) business, which allows telecoms companies to offer a range of content and service options that can be bundled into subscriptions. It has secured partnerships with three of the top five US telecoms operators, covering 60% of consumers, and Bango's interim results statement also comments that it has a healthy pipeline of potential new DVM deals.

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. Integration costs pushed Bango to a small loss in the first half of this year – although lower than anticipated in its trading update – but it expects synergies and its typical second-half weighting to help it to hit full-year market expectations for profits.

The long-running script-writers strike in the US and a trend towards cost rationalisation at streaming companies triggered another profit warning from **Zoo Digital Group** (-37%). The company provides localisation and dubbing services to globalise TV and movie content, underpinned by an innovative, cloud-based platform. Having previously commented on the expected impact of the US writers strike on revenues, it updated the market that it expects it to take longer for normal order levels to resume.

In the short term, the company is cutting costs to allow it to cope with an extended period of subdued trading. It has also postponed completion of its acquisition of a Japanese partner business in order to preserve cash. Having raised £12.5m in a placing earlier this year, the company now has net cash of over £16m. Zoo Digital's longer-term ambitions remain more positive; it expects to be a beneficiary of the media 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. 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.

Surgical Innovations Group (-36%) warned that it is on track to do little better than break even at the EBITDA level in 2023. While a trading update commented that its order book remains strong and revenues are on track to meet expectations, it has experienced supply chain disruption that has affected manufacturing productivity. This was flagged in an June AGM statement but now looks to be worse than first anticipated. The maker of medical technology for minimally invasive surgery has commissioned an independent review of its manufacturing and supply chain operations, and has agreed with its banks to waive a debt servicing covenant that it would currently breach. It has £2.3m borrowing headroom and expects its cashflows to improve as its high levels of inventory are destocked in the remainder of the year.

Frontline healthcare services provider **Totally** (-31%) has had an exceptionally tough 2023 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. July's full-year results met the downgraded guidance, but also included downbeat comments on the trading outlook for the new financial year.

Its latest statement – a short AGM update – commented that its outlook for the year to 31 March 2024 remains consistent with that communicated in July, but also failed to give any hope that it is close to turning a corner with the short-term challenges it is facing.

Crimson Tide (-17%) owns a cloud-based mobile workflow solution called mpro5. Having previously focused on driving revenue and scaling the business, interims results in September showed a successful return to profitability, with EBITDA swinging from a £0.3m loss a year ago to a small £0.1m profit. Revenues rose 31% to £3.0m, with annual recurring revenues rising 35% to £5.9m. While the results are largely upbeat, they did include the disclosure that one of its enterprise customers has gone into administration, which Crimson Tide expects to temper growth in the second half of 2023.

The position in **Gresham House** was sold ahead of the expected completion later this year of its takeover by private equity investor Searchlight Capital.

Positive contributors included:
Gear4Music (+57%), Tristel (+36%), Tribal Group (+20%), Netcall (+12%) and Bango (+11%)

Negative contributors included:
Zoo Digital (-37%), Surgical Innovations Group (-36%), Totally (-31%), Crimson Tide (-17%) and Bigblu Broadband (-13%).

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

	Sep-23	Sep-22	Sep-21	Sep-20	Sep-19
Liontrust UK Micro Cap I Acc	2.4%	-26.6%	63.2%	10.6%	-2.5%
FTSE Small Cap ex ITs	12.7%	-24.4%	72.4%	-12.7%	-7.8%
FTSE AIM All Share	-8.3%	-34.3%	30.8%	11.0%	-19.4%
IA UK Smaller Companies	2.2%	-31.9%	51.1%	-0.4%	-7.1%
Quartile	2	1	1	1	1

*Source: Financial Express, as at 30.09.23, total return (net of fees and income reinvested), bid-to-bid, institutional class.
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For a comprehensive list of common financial words and terms, see our glossary at:
https://www.liontrust.co.uk/glossary.

Key Risks
Past performance does not predict future returns. You may get back less than you originally invested. We recommend this fund is held long term (minimum period of 5 years). We recommend that you hold this fund as part of a diversified portfolio of investments.

- The Fund may invest in companies listed on the Alternative Investment Market (AIM) which is primarily for emerging or smaller companies. The rules are less demanding than those of the official List of the London Stock Exchange and therefore companies listed on AIM may carry a greater risk than a company with a full listing.
- As the Fund is primarily exposed to smaller companies there may be liquidity constraints from time to time, i.e. in certain circumstances, the fund may not be able to sell a position for full value or at all in the short term. This may affect performance and could cause the fund to defer or suspend redemptions of its shares. In addition the spread between the price you buy and sell units will reflect the less liquid nature of the underlying holdings.
- Outside of normal conditions, the Fund may hold higher levels of cash which may be deposited with several credit counterparties (e.g. international banks). A credit risk arises should one or more of these counterparties be unable to return the deposited cash.
- Counterparty Risk: any derivative contract, including FX hedging, may be at risk if the counterparty fails.

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.

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