Liontrust UK Smaller Companies Fund

September 2023 review

Fund managers: Matthew Tonge, Anthony Cross, Julian Fosh, Victoria Stevens and Alex Wedge

The Liontrust UK Smaller Companies Fund returned -0.3%* in September. The FTSE Small Cap (excluding investment trusts) Index comparator benchmark returned 1.3% and 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%.

The most notable feature of the Fund's positive contributors this month was takeover activity. In last month's review, the team noted that the UK stockmarket's significant discount to long-run averages – a feature which is accentuated for smaller companies – is leading many companies looking vulnerable to opportunistic bids from private equity or corporate acquirers at levels below the intrinsic values of these businesses.

This month, **Ergomed** (+28%) recommended a cash offer of 1350p a share from private equity group Permira, a 28% premium to the share price before the deal announcement but a level at which the shares traded as recently as December 2022. Ergomed is a global contract research organisation providing fully outsourced drug trials to speciality pharma and biotech clients, with specialisms in oncology and rare diseases. Ergomed also boasts one of the largest qualified teams of pharmacovigilance professionals globally, helping clients manage the risks around portfolios of approved drugs.

Later in September **Alfa Financial Software** (+28%) announced – in response to press speculation – that it was in discussions with Thomas H Lee Partners (THL), another private equity firm, regarding a possible offer. This is the second round of inbound M&A discussions for Alfa within a few months, after Swedish investment house EQT tabled a possible offer at 208p per share in June, which was subsequently pulled.

As at early October 2023, the funds across the Economic Advantage range have seen 13 companies receive takeover approaches since the beginning of 2022. Of these approaches, five have completed, five are pending and three were more speculative and have fallen away. It is especially notable, given the extremity of de-rating experienced by smaller companies listed on the UK stockmarket during this period, that 12 out of these 13 companies experiencing inbound M&A approaches have been small cap stocks.

At the other end of the portfolio leaderboard for September, video game developer **Team 17 Group** (-21%) lost some ground despite reporting 31% revenue growth year-on-year to £69.7m in the first half of 2023, on track to meet full-year consensus for just over £140m. Profits dropped due to higher marketing expense head of a busy game release pipeline in the coming months. The company expects margins to rebound in the second half of the year as these costs phase out, and has maintained its full-year profit guidance. Investors, however, have de-rated the shares somewhat to reflect the increased concentration of delivery risk on the second half of the year.

Learning Technologies Group (-16%) also slid. The company specialises in workplace digital learning and talent management software. Over 70% of its revenues are on long-term service or recurring software-as-a-service (Saas) contracts, providing good visibility and resilience. But its remaining transactional or project-based sales have been weaker this year, which the company attributes to a tough macroeconomic backdrop. These headwinds were flagged to the market in an interim trading update in July, which cut financial guidance for 2023 as a whole.

While September's interims stuck by the recently reduced full-year targets (£560m revenue, a 6.7% drop on 2022, and £98m adjusted operating profit, a 2% fall), its outlook comments predict that lower transactional volumes will continue to offset its SaaS resilience. Amid an environment of weak sentiment, particularly towards stocks listed on the AIM market, this was enough to send the shares lower.

Soft sentiment also seemed to have affected **Big Technologies** (-15%), whose share price drop in September looked larger than justified by a modest downgrade to guidance. Big Technologies is a provider of integrated hardware/software solutions for the electronic monitoring of criminal offenders. Interims released during September showed further revenue growth of 19% year-on-year to £27.3m, with adjusted operating profit rising 15% to £13.9m. However, it issued full-year 2023 revenue and earnings guidance which was at the low end of market expectations.

Lastly among the detractors, **Alpha Group International** (-12%) was another to fall despite results showing trading resilience. Interims were in line with expectations, with 20% revenue growth and 9% underlying growth in profit before tax, excluding a very significant non-underlying boost from interest income on client cash balances, which drove statutory profit before tax almost 200% higher year-on-year thanks to higher prevailing interest rates.

Returning to the Fund's better performers, **Tristel** (+36%) registered the largest share price gain. 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.

Keystone Law Group (+18%) rose on interim results (covering the six months to 31 July) which described activity levels and client demand as strong and noted that lawyer recruitment dynamics have become more favourable. Keystone Law is a full-service platform law firm covering 50 industry sectors via a network of 400 self-employed lawyers. The company expects this benign environment to continue into the second half of the year, allowing it to predict that full-year results will be "comfortably ahead" of market expectations. Over the six months, Keystone grew revenue by 15% to £42.3m and increased profit before tax 25% to £5.7m.

Positive contributors included:
Tristel (+36%), Ergomed (+28%), Alfa Financial Software (+24%), Tribal Group (+20%), Keystone Law Group (+18%).

Negative contributors included:
Team17 Group (-21%), Learning Technologies Group (-16%), Big Technologies (-15%), YouGov (-14%) and Alpha Group International (-12%).

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

	Sep-23	Sep-22	Sep-21	Sep-20	Sep-19
Liontrust UK Smaller Companies I Inc	-1.6%	-28.9%	46.9%	12.8%	-5.0%
FTSE Small Cap ex ITs	12.7%	-24.4%	72.4%	-12.7%	-7.8%
IA UK Smaller Companies	2.2%	-31.9%	51.1%	-0.4%	-7.1%
Quartile	4	2	3	1	2

*Source: Financial Express, as at 30.09.23, total return (net of fees and income reinvested), bid-to-bid, institutional class.
**Source: Financial Express, as at 30.09.23, 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 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.