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Economic Advantage

November 2023 review

Liontrust UK Micro Cap Fund

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The Liontrust UK Micro Cap Fund returned 7.3%* in November. The FTSE Small Cap (excluding investment trusts) Index and the FTSE AIM All-Share Index comparator benchmarks returned 4.0% and 5.3% respectively. The average return of funds in the IA UK Smaller Companies sector, also a comparator benchmark, was 6.0%.

Evidence of decelerating inflation helped propel a broad rally across asset classes, with investors largely disregarding central bankers' efforts to promote the possibility of further policy tightening. By the end of the month, financial markets had moved to price in a peak at current interest rates in the US, UK and eurozone.

We've recently highlighted the low valuation of UK stocks – particularly small caps – relative to both their own history and to other international equity markets. While the former of these two discounts narrowed slightly during November's strong equity market performance, the rally was global in nature, meaning that the UK still sits at a substantial valuation discount to other markets. We think this represents a very compelling longer-term investment opportunity in UK stocks.

A number of stocks have experienced meaningful share price gains on the back of 'in-line' statements. These relief rallies are emblematic of the level of pessimism currently priced into many share prices.

Having been heavily affected by the Hollywood writers' and actors' strike so far this year, shares in **Zoo Digital Group** (+49%) bounced as interim results showed signs of recovery in activity. The company provides localisation and dubbing services to globalise TV and movie content, underpinned by an innovative, cloud-based platform.

While Zoo Digital's revenues fell by almost 60% year-on-year in the six months to 30 September, the strikes were resolved by November and the company now expects sequentially stronger trading in the coming months, with sales increasing significantly in the next financial year and earnings on track to meet market expectations. In the long term, Zoo Digital expects to be a beneficiary of the media rationalisation trend, as customers select a smaller group of vendors. As a result, it anticipates increasing its share of the media localisation market once business levels normalise

A soft macroeconomic backdrop has led many of **Calnex Solutions** (+43%) telecoms customers to take a cautious approach to investing, meaning lower demand for the test and measurement tools Calnex provides. Having downgraded profit forecasts more than once this year, investors were relieved that November's interim results maintained guidance. Having seen a revenue decline of 38% to £7.8m in the six months to 30 September, Calnex expects to return to growth in the next financial year, starting 1 April 2024.

Rather than relief rally**, Intercede's** (+43%) strong gain followed a guidance update. It now thinks that results for the year to 31 March 2024 will be ahead of prior market expectations. Interim results showed 10% constant currency revenue growth and an improvement in adjusted EBITDA margins to 21% (from 16%) as cost control efforts yielded benefits. The cyber security software specialist has a strong pipeline of future opportunities and announced several contract wins during November.

Mercia Asset Management (+30%) is a specialist venture capital and private equity investment company. It focuses on investing in regional high-growth SMEs, which often face a struggle to access investment capital compared to the relatively saturated London market. Shares in the company rose on news of the sale of its 33% stake in virtual reality games developer nDreams – Mercia's largest direct investment – for a consideration of £30m, a £4.4m uplift to its 31 March carrying value. It also released a robust set of interim showing a 1.7% increase in assets under management to £1.46bn – with not redemptions in the period – which yielded revenue of £15m, up 23%.

In a trading update covering the six months to 31 October, commercial law firm **Gateley Holdings** (+23%) described activity levels improving throughout its second quarter. Revenue grew by around 7% to over £81.5m, with underlying profit before tax on course to exceed £10m, growth of 4%.

Despite a backdrop of much improved investor sentiment in November, the environment is still one in which trading setbacks are being heavily penalised. **Pebble Group**, for example, fell 39% after lowering its 2023 revenue guidance due to reduced order intake at its Brand Addition unit. This promotional products division has seen lower demand from the technology and consumer sectors. Pebble's Facilisgroup division – a digital commerce platform for promotional products – continues to trade robustly. Pebble now expects revenues of £124m, lower than the £134m achieved last year. This negative impact will be partially offset by improved margins.

Advanced materials, luxury packaging and paper products producer **James Cropper's** (-19%) £57m revenue in the half-year to 30 September – down 8% on last year – was only "broadly" in line with its expectations as its Paper Products unit continued to face market headwinds. The division is being restructured, a process which is expected to complete by year end. Cropper's Advanced Material's division continues to post strong growth.

Totally (-16%), the outsourced (and insourced) healthcare services provider for the NHS, has withdrawn financial guidance until it has greater visibility over its short-term growth trajectory. Earlier in 2023, Totally shares sold off heavily after a combination of delays in the re-tender process for some expiring contracts and high costs due to clinical workforce shortages leading to a greater reliance on agency staff. The latest results reported a 21% fall in turnover to £56m in the half-year to 30 September, resulting in a £1.9m loss before tax. Totally is cutting costs and treating the next six months as a restructuring period, before it looks to return to growth and profit.

Eckoh (-15%) reported a 4% decline in revenues for the half-year to 30 September after the loss of a large UK client – already disclosed to the market several months ago. Eckoh is transitioning to cloud-based delivery of its products, a process which it says is tempering growth in the short term but having a positive impact on recurring revenues, raising the visibility of its earnings.

Instem left the portfolio in November following the completion of its takeover by Archimed.

A position in **ActiveOps** was initiated. This is a high-recurring Software as a Service (SaaS) business that automates back office operations for large, complex organisations – mostly in financial services. The team has been following ActiveOps since its IPO and it becoming profitable allowed an entry point.

Overall, it was notable that there was a more 'risk on' feel to the market in November, with investors looking through short-term trading headwinds for more cyclical names. The outperformance of mid and small-caps was another welcome sign of improving investor appetite for the UK market. The large-cap FTSE 100 has fairly relentlessly outperformed for the last two years, so it was encouraging to see the FTSE 250, FTSE Small-Cap (ex-investment trusts) and FTSE AIM All-Share return 7.1%, 4.0% and 5.3% respectively, versus the 2.3% from the FTSE 100. As we move towards the New Year, we are optimistic that the depressed share prices in this area of the market are due a strong bounce as investors gain sufficient confidence on inflation being under control, rates having peaked and macroeconomic gloom lifting.

Positive contributors included:

Zoo Digital Group (+49%), Intercede (+43%), Calnex Solutions (+43%), Mercia Asset Management (+30%), Gateley Holdings (+23%).

Negative contributors included:

Pebble Group (-39%), James Cropper (-19%), Totally (-16%), Eckoh (-15%) and BigBlu Broadband (-14%)

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Discrete years' performance (%) to previous quarter-end:

	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%

*Source: Financial Express, as at 30.11.23, 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, institutional class.

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

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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