LIONTRUST
COURAGE · POWER · PRIDE

# Economic Advantage

## January 2024 review

# Liontrust UK Smaller Companies Fund

Anthony Cross
Head of Economic Advantage

Julian Fosh
Fund Manager

Matt Tonge
Fund Manager

Victoria Stevens
Fund Manager

Alex Wedge
Fund Manager

The Liontrust UK Smaller Companies Fund returned 0.2%* in January. The FTSE Small Cap (excluding investment trusts) Index comparator benchmark returned -2.2% and the average return of funds in the IA UK Smaller Companies sector, also a comparator benchmark, was -0.1%.

The year kicked off with investors continuing to debate whether key economies will avoid recession and execute a 'soft landing' in the face of pressure applied by two years of rising interest rates.

Markets retreated slightly from their late-2023 conviction that this year will bring swift interest rate cuts as inflation comes down to target. There had previously been growing talk of Goldilocks conditions in which economic activity is sedate enough to allow for interest rate cuts but not so low that it might contract. On balance, January's data seemed to edge investors more towards the 'too hot' scenario in which evidence of economic strength might delay or reduce the extent of rate cuts.

The Economic Advantage investment process intentionally adopts a bottom-up focus and avoids any attempt to position portfolios based on a macroeconomic view. As such, we spend a lot of time gauging conditions through company-level news flow. In this respect, January is often an informative month due to the volume of companies providing trading updates for the period to 31 December.

Overall, trading updates coming through from the Fund's companies were solid, which is testament to the resilience many of these businesses display in the face of more challenging economic conditions. While many companies recognise that the outlook is more uncertain than normal – and contains headwinds and challenges in certain sectors – it also seems sufficiently benign that many companies have been able to successfully execute their growth plans.

It was notable that companies delivering such in-line updates were generally rewarded with a positive share price response, which we see as being indicative of generally more upbeat investor sentiment.

Beginning with the positive updates, Microlise (+29%) announced 2023 trading was slightly ahead of expectations, with revenue up 13% to almost £72m and adjusted EBITDA (earnings before interest, tax, depreciation and amortisation) up 14% to £9.4. Microlise provides telematics software and hardware to vehicle fleet operators. An improvement in new vehicle availability in the second half of the year allowed Microlise to speed up the delivery of its pipeline. The company expects further good growth in 2024, achieved through a combination of organic growth and the impact of recent acquisitions. It also expects profit margins to improve as it focuses on cost base management and scale efficiencies.

Alfa Financial Software (+23%) also commented that 2023 profits were ahead of forecasts. While 2023 revenue growth of 9% was in line, costs were £1m lower than expected. Alfa Financial Software is a provider of software that automates the core workflow and processes of organisations providing lease financing solutions. In Q4, it commenced 11 contracts, taking the year's total to 35. It has had good success recently converting pipeline to contracted sales, meaning its total contract value has grown significantly over the year. This is particularly true of subscription contracts, which have seen double-digit percentage growth.

Eagle Eye Solutions' (+18%) trading update covered the second half of 2023, showing in-line trading and including an upbeat outlook. The company provides a B2B software platform which allows large retail clients to manage customer loyalty schemes, offers and promotions. It saw 20% year-on-year growth in revenues to £24m as it won contracts with new retailers and expanded its relationship with existing customers.

Shares in video game developer Team17 Group (+46%) bounced back in January to recover much of the ground lost after a November profit warning. It previously said that although 2023 revenues were modestly ahead of forecasts, profits had been hit by cost overruns and an unfavourable shift in the sales mix between higher-margin own-IP titles and less lucrative third-party games. A more upbeat January trading update maintained the reduced financial guidance but also commented on positive Black Friday and Christmas trading, suggesting it enters 2024 in a good position.

Craneware (+23%) continued its own share price recovery. It had de-rated in the first half of 2023 on concerns that financial pressures on some US hospitals were impacting revenue growth from new orders. A reassuring set of full-year results in September, however, allowed the shares to rebound, and January's trading update provided more signs of positive trading momentum. Craneware provides IT solutions to the US healthcare market. It commented that revenue growth accelerated in the second half of 2023 as the US demand backdrop improved. Revenues rose 8% to $901m, in line with its expectations. With some contract wins yet to convert to sales, its annual recurring revenue is now running at around $171m. Craneware states that it enters the next six months in a strong position to benefit from its increased market confidence.

Of those companies to issue more disappointing updates, shares in Bango (-49%) were hardest hit. Its trading update disclosed some unexpected costs from its DOCOMO Digital acquisition which will constrain 2023 profitability.

Bango is a mobile payments specialist that provides a digital vending machine (DVM) service, allowing telecoms companies to offer a range of content and service options that can be bundled into subscriptions. It acquired the payments business of NTT DOCOMO Digital for €4m last year in a deal which is expected to significantly enhance future earnings but has resulted in unexpectedly high short-term costs.

Bango announced that adjusted EBITDA for 2023 will be below analyst expectations partly due to $3m of unexpected Docomo costs and unfavourable currency exposures. EBITDA for 2023 is now expected to be $5m - $6m, in-line with last year's outcome but below analysts' expectations of around $12m.

James Cropper (-44%) also fell heavily after issuing a trading update noting negative trends at both its legacy Paper Products unit and its faster growing Advanced Materials business. The former has seen supply chain destocking and high inflation hit customer demand, while Advanced Materials has suffered from delays to hydrogen energy projects – a sector it has targeted with specific technical fibres. It now expects revenues in the year to 31 March 2024 of £103m – which compares with analyst consensus of over £120m – and adjusted profit before tax only marginally better than breakeven, rather than the £6m expected.

Inspecs Group (-35%) was another to warn on profits, stating that softer December trading has caused it to fall short of market expectations. Full-year revenue of £200m was broadly flat on last year's £201m. While a focus on operational efficiencies helped lift profit margins and generate 16% growth in underlying EBITDTA to £18m, this is still below the consensus forecast.

Inspecs had previously delayed the planned expansion of its Vietnamese factory due to weak order intake in late 2022. Its latest trading update confirmed that this expansion will be complete in the first half of 2024, boosting production capacity. Having previously also experienced cash flow difficulties that led it to seek a relaxation of bank debt covenants, it is encouraging to see Inspecs highlight good cash generation in 2023, with net debt being reduced by £3.3m to £24.3m.

Big Technologies (-29%) confirmed that 2023 trading had been in line with expectations, with revenues of around £55m and adjusted EBITDA of £33m. However, its outlook for 2024 includes revenues retreating around 10% and US profit margins coming under pressure. The revenue shortfall results from a large Colombian contract which has been subject to short-term renewals since September 2021 but is now due to expire in the next few months. Big Technologies is a provider of integrated hardware/software solutions for the electronic monitoring of criminal offenders. It is investing in US expansion to accelerate medium-term sales growth, but it expects 2024 margins to be compressed as a result.

The shares were also adversely affected by the ongoing uncertainty around legal action being taken by former shareholders at one of its subsidiary businesses – Buddi – who are unhappy with the financial terms of its acquisition back in 2018.

## Positive contributors included:

Team 17 Group (+46%), Microlise (+29%), Craneware (+23%), Alfa Financial Software (+23%) and Eagle Eye Solutions (+18%).

## Negative contributors included:

Bango (-49%), James Cropper (-44%), Inspecs Group (-35%), Big Technologies (-29%), and Tribal Group (-21%).

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

| | Dec-23 | Dec-22 | Dec-21 | Dec-20 | Dec-19 |
|---|---|---|---|---|---|
| Liontrust UK Smaller Companies I Inc | -0.8% | -23.0% | 24.7% | 15.2% | 31.0% |
| FTSE Small Cap ex ITs | 10.4% | -17.3% | 31.3% | 1.7% | 17.7% |
| IA UK Smaller Companies | 0.5% | -25.2% | 22.9% | 6.5% | 25.3% |
| Quartile | 3 | 2 | 2 | 1 | 2 |

*Source: Financial Express, as at 31.01.24, total return (net of fees and income reinvested), bid-to-bid, institutional class. **Source: Financial Express, as at 31.12.23, 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/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.

## Disclaimer

This document is issued by Liontrust Fund Partners LLP (2 Savoy Court, London WC2R 0EZ), authorised and regulated in the UK by the Financial Conduct Authority (FRN 518165) to undertake regulated investment business.

It should not be construed as advice for investment in any product or security mentioned, an offer to buy or sell units/shares of Funds mentioned, or a solicitation to purchase securities in any company or investment product. Examples of stocks are provided for general information only to demonstrate our investment philosophy. The investment being promoted is for units in a fund, not directly in the underlying assets.

This information and analysis is believed to be accurate at the time of publication, but is subject to change without notice. Whilst care has been taken in compiling the content, no representation or warranty is given, whether express or implied, by Liontrust as to its accuracy or completeness, including for external sources (which may have been used) which have not been verified.

**This is a marketing communication.** Before making an investment, you should read the relevant Prospectus and the Key Investor Information Document (KIID) and/or PRIIP/KID, which provide full product details including investment charges and risks. These documents can be obtained, free of charge, from www.liontrust.co.uk or direct from Liontrust. If you are not a professional investor please consult a regulated financial adviser regarding the suitability of such an investment for you and your personal circumstances. All use of company logos, images or trademarks in this document are for reference purposes only.