LIONTRUST

ECONOMIC ADVANTAGE PROCESS

Liontrust UK Smaller Companies Fund

January 2023 review

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The Liontrust UK Smaller Companies Fund returned 1.0%* in January. The FTSE Small Cap (excluding investment trusts) Index comparator benchmark returned 5.2% and the average return of funds in the IA UK Smaller Companies sector, also a comparator benchmark, was 3.2%.

Equity markets started 2023 strongly, helped by expectations for a softer landing and fewer interest rate rises.

Although rhetoric from central bankers remained hawkish, futures pricing suggests investors expected – in the US at least – a slightly lower rates peak, followed by rate cuts later this year. Expectations for a June 2023 peak rate began to move below 5%, while the implied rate in a year's time fell towards 4.25%.

The IMF's latest economic forecasts for 2023 global economic growth were revised up from 2.7% (in October last year) to 3.2%, although it expects the UK to slide into recession after cutting its forecast from 0.2% growth to a 0.5% contraction. The IMF observed that global growth has proven "surprisingly resilient".

Some of the Fund's strongest performers in January showed evidence of recovery from 2022's headwinds. The most obvious was **Inspecs Group** (+152%), which issued two profit warnings in 2022 – in August and October – causing the shares to tumble in the second half of the year. With a more robust full-year trading update in January, it took the first steps to reclaiming this ground – the shares moving up towards the levels they had traded at prior to October's warning. As well as confirming that trading has not deteriorated any further from the October warning, the group also said it had agreed with its bank to relax debt covenants through to the end of September 2023, giving it some balance sheet breathing space.

Hilton Food Group (+19%) also staged a recovery from an Autumn profit warning, although not to the same extent as Inspecs. The specialist in processing and packing food for supermarkets had previously cut 2022 profit guidance due to cost pressures within its UK seafood business, but its latest update maintained the full-year guidance and provided a positive update on efforts to pass through the cost inflation.

Elsewhere in the portfolio, **Bango** (+24%) rallied on an upbeat full-year trading update. Revenue rose 59% in 2022 to $32.9m, as end-user spend rose to $5.6bn. Growth accelerated through the year, with the end-user spend run-rate hitting $8.6bn at the end of the year. Although EBITDA fell from $6.1m to $4.1m due to the costs of integrating its August 2022 acquisition of DOCOMO Digital, Bango commented that this process is going well; $11m of $21m planned cost synergies have been achieved and it still expects $10m of incremental adjusted EBITDA in 2024.

Learning Technologies Group (+22%) also issued a very positive full-year trading update. At the interim stage, the company had already commented that the integration of GP Strategies – its recent £284m acquisition – had progressed well, with margin improvements and organic revenue growth ahead of management's expectations. It has now upgraded guidance again, stating it is on track for revenues of at least £595m, ahead of consensus analyst expectations of £589m, and adjusted operating profit of over £100m, compared with expectations of £97.5m.

Specialist on-trade audio-visual equipment distributor **Midwich Group** (+17%) grew revenue 40% to £1.2bn in 2022, half of which was organic expansion. With gross margins maintained at 2021 levels, Midwich expects to report adjusted profit before tax "comfortably ahead" of market consensus of £41m.

Turning to the month's detractors, **Frontier Developments** (-50%) fell heavily as it issued a profit warning for the year to end-May 2023. The company attributed recent sales weakness in part to softening economic conditions, with typical price promotional activity over the peak Christmas trading period failing to generate the expected increase in volume of sales. However, the performance of one of Frontier's most recent releases, F1 Manager 2022, was particularly disappointing. This is not the first time Frontier's games releases have fallen short of expectations in recent years, and CEO Jonny Watts – a longstanding employee of Frontier who was recently promoted internally to the position – flagged the need for greatly increased focus on return on investment in allocating development spend in the future.

Animalcare Group (-19%) slid due to implication of a small profits miss in its comment that underlying EBITDA for 2022 will be "approximately in line" with market forecasts; its house broker subsequently cut its forecast by 7%. A trading update from the veterinary services specialist commented that growth continues to moderate across European from the exceptionally high levels experienced post-pandemic in 2021.

In its interim trading update, **Craneware** (-20%) noted that revenues for its Professional Services division had not recovered towards historical levels as expected, leading it to flag that full-year group sales will fall short of market expectations. Cash generation was also disappointing, with cash reserves falling to $38.7m from $41.7m a year ago, and investors will be keen for greater clarity on the causes when interim results are published in March. Due to cost cutting efforts, Craneware still expects to report adjusted EBITDA which is in line with consensus forecasts.

While some of the Fund's holdings have inevitably been impacted by company-specific issues or the wider macroeconomic challenges, the fund managers have so far been reassured by the trading resilience shown by many of them. Of the companies that have reported on trading so far in 2023, there have been seven downgrades, 22 'in line' statements and 12 companies which have delivered upgrades to expectations.

The fund managers believe that the Fund is invested in companies which are dependable, consistent businesses in possession of barriers to competition which give them pricing power. The Fund's companies often have a strong owner-manager culture, a consequence of a requirement for at least 3% senior management equity ownership. This tends to be accompanied by a more conservative business ethos focused on organic growth and lower balance sheet gearing.

Positive contributors included:
Inspecs Group (+152%), Bango (+24%), Learning Technologies (+21%), Hilton Food Group (+19%) and Midwich Group (+17%).

Negative contributors included:
Frontier Developments (-50%), James Cropper (-27%), Craneware (-20%), Animalcare Group (-19%) and Tristel (-17%).

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

	Dec-22	Dec-21	Dec-20	Dec-19	Dec-18
Liontrust UK Smaller Companies I Inc	-23.0%	24.7%	15.2%	31.0%	-6.0%
FTSE Small Cap ex ITs	-17.3%	31.3%	1.7%	17.7%	-13.8%
IA UK Smaller Companies	-25.2%	22.9%	6.5%	25.3%	-11.7%
Quartile	2	2	1	2	1

*Source: Financial Express, as at 31.01.23, total return (net of fees and income reinvested), bid-to-bid, institutional class.
**Source: Financial Express, as at 31.12.22, 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 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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