Liontrust UK Micro Cap Fund

August 2023 review

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The Liontrust UK Micro Cap Fund returned -1.3%* in August. The FTSE Small Cap (excluding investment trusts) Index and the FTSE AIM All-Share Index comparator benchmarks returned -2.4% and -2.9% respectively. The average return of funds in the IA UK Smaller Companies sector, also a comparator benchmark, was -2.2%.

The Bank of England implemented its 14th successive hike in this tightening cycle, taking interest rates to 5.25%. Wage and inflation data released later in the month confirmed the view that one or two more increases are likely to be needed before rates top out.

During August, investors were also paying close attention to trends in China, where interest rates are moving in the other direction. Having gradually disappointed this year against expectations of a post-Covid lockdown bounce in activity, China's economic woes weighed on investor sentiment during the month. China's central bank responded by lowering its one-year loan rate – the 'medium-term lending facility' – by 15 basis points, in a move that surprised markets and economists alike..

The UK market experienced broad-based declines with some pockets of deeper weakness in areas with greater exposure to Chinese demand – such as basic materials (-5.9%) and consumer discretionary (-3.3%).

The Fund's August return was helped by a positive showing from **Belvoir Group** (+15%), which has continued to trade well despite the upheaval to the property market caused by last year's UK mini-budget. Much of this resilience comes from its franchisee's c.80% exposure to lettings revenues, where a buoyant rental market has offset the impact of reduced housing transactions. An interim trading update also showed that, while Belvoir's financial services business suffered during the first half of 2023, it outperformed the wider market; a 7% underlying drop in the division's revenues compares with a 26% fall in UK gross new mortgage lending.

Short-term trading at **Tribal Group** (+14%) has been overshadowed by issues around its contract with Nanyang Technology University, which triggered a profit warning last December. The contract was terminated in March but still has the potential to rumble on as a distraction, with negotiations over settlement costs ongoing. Nevertheless, June's interim results served as a reminder of the solid underlying growth of the business. The software provider to the education sector grew revenues 1.5% to £43.4m in the first half of the year, with operating profit rising by a more impressive 21% to £8.1m.

Having rallied in April on a trading statement which upgraded profit guidance, shares in **James Cropper** (-14%) gave back some ground on the release of full-year results themselves. The global leader in advanced materials, luxury packaging and paper products has recently announced a strategic shift to better align the business with a low carbon economy, including a growth plan which emphasises advanced materials such as those used in fuel cells, carbon capture, batteries and wind.

Although there was good news on margins, a trading update from medical technology specialist **Inspiration Healthcare Group** (-12%) showed sales were hindered by unexpected delays to regulatory approvals for new product and some destocking from a major customer.

Returning to the positive movers, **Instem** (+35%) jumped on news that the software and services provider to the life sciences industry had agreed to be bought by Archimed, a European investment firm specialising in healthcare, with over €8bn in assets under management. Archimed's 833p offer represents a 41% premium to

Instem's prior share price. The Economic Advantage team has held shares in Instem since the IPO in October 2010.

Economic Advantage fund holdings – and the intangible barriers to competition the investment process seeks out – have frequently proven attractive to acquirers in the past, and it appears that the trend is persisting in 2023. While each individual potential takeover is considered on its own merits, the team are acutely aware of the importance of taking a long-term view, particularly given the extent of the de-rating of so many UK-listed smaller companies over the past 18 months. With the UK market as a whole, and smaller companies in particular, trading at record discounts to global peers and significant discounts to their own long run averages, we fear that too many holdings are 'sitting ducks', susceptible to private equity or corporate acquirers swooping in and taking them over at prices which do not reflect the intrinsic value of these businesses.

Instem, in particular, is an example of where the team feel strongly that the takeover price offered does not reflect the long term value of the business. The company has been on a determined path to improve the quality of earnings in recent years by growing recurring software income; furthermore, in May 2023, Instem announced that it had been selected to assume the management of ToxHub, a clinical and non-clinical data sharing platform incorporating data from 13 of the largest pharmaceutical companies in the world. Although it will absorb some investment in the short term, this was a fantastic endorsement of the high regard in which Instem is held by its clients and the wider industry, not to mention the longer term potential to earn significant subscription revenues from commercialising the platform.

Canaccord Genuity Quest, which is used explicitly within the Economic Advantage process to analyse companies' cash flow returns on capital, commented in a note shortly after the bid was announced: "[The bid] assumes the company is no better, in terms of cash flow generation, than two years ago... [Our model] forecasts a material ramp up in free cash flow generation over the next five years and we would argue that is not reflected in the recommended offer..."

Positive contributors included:
Virgin Wines (+37%), Instem (+35%), Belvoir Group (+15%), Tribal Group (+14%) and IG Design Group (+9.0%).

Negative contributors included:
Netcall (-16%), Bango (-14%), James Cropper (-14%), Churchill China (-12%) and Inspiration Healthcare Group (-12%).

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

Past performance does not predict future returns

	Jun-23	Jun-22	Jun-21	Jun-20	Jun-19
Liontrust UK Micro Cap I Acc	-3.8%	-15.9%	59.5%	4.6%	3.1%
FTSE Small Cap ex ITs	-0.3%	-14.6%	65.2%	-12.3%	-8.6%
IA UK Smaller Companies	-5.5%	-22.1%	53.1%	-6.5%	-6.2%
Quartile	2	1	2	1	1

*Source: Financial Express, as at 31.08.23, total return (net of fees and income reinvested), bid-to-bid, institutional class.

**Source: Financial Express, as at 30.06.23, 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/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.