Liontrust UK Micro Cap Fund

January 2023 review

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The Liontrust UK Micro Cap Fund returned -1.0%* in January. The FTSE Small Cap (excluding investment trusts) Index and the FTSE AIM All-Share Index comparator benchmarks returned 5.2% and 4.5% respectively. 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".

While the fund managers by no means claim that any of the Fund's companies will be immune from a contraction in the UK economy, they have so far been reassured by the trading resilience shown by many of them. 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.

Of the companies that have reported on trading so far in 2023, there have been five downgrades, 16 'in-line' statements and eight companies which have delivered upgrades to expectations.

Looking at January's newsflow in more detail, **Bango** (+24%) rallied on an upbeat full-year trading update. Revenue rose 59% in 2022 to $32.9m, as end-user spend increased 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.

Intercede Group (+21%) upgraded its guidance for the financial year to 31 March 2023. It now expects to exceed market forecasts, with revenue on track to be 5% to 8% ahead of consensus. Shares in the cybersecurity software company specialising in digital identities had moved higher in October after a positive interim trading update and rallied further in January as it confirmed the positive trading momentum had been sustained.

Churchill China (+13%) also lifted guidance. It now expects 2022 profits to be at the upper end of the analyst consensus range of £8.0m - £8.8m. Churchill is a supplier of extremely durable ceramic tableware which is predominantly sold into hospitality customers such as restaurants, bars, pubs and hotels. Although margin levels are still lower than in previous years, there has been some improvement in the second half of the year as it has had some success in addressing material and energy cost pressures. Its order book remains at higher-than-normal levels, while it has also improved supply to customers towards the end of the year.

On The Beach (+12%) was added to the portfolio in November after its market capitalisation dropped into the Fund's investment universe following two years of significant business disruption from the pandemic. The addition has proven well timed, with last month's upbeat full-year results announcements propelling the position to the top of the Fund's monthly risers. The shares rose again in January after it issued a short AGM update stating that total transaction value since the start of its new financial year on 1 October 2022 is up 68% year-on-year, with a particularly strong uplift in bookings since Christmas.

While trading newsflow from the Fund's companies at the start of the year has been generally encouraging, a handful of holdings have inevitably been impacted by company-specific issues or the wider macroeconomic challenges.

Shares in **Totally** (-27%), a provider of outsourced urgent and specialist healthcare services, fell on the back of a negative press article regarding its contract to run four NW London urgent treatment centres, alleging "performance concerns". The company, in several statements to the market, rebutted the concerns over performance, citing a CQC inspection in August 2022 which rated the services as "Good" overall. It explained that the contracts were due to expire at the end of January 2023 and that it continues to await the results of a re-tender for services from 31 January onwards.

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.

Although customer acquisition has shown signs of improving despite cost-of-living pressures, **Virgin Wines** (-23%) suffered operational difficulties over the Christmas period led it to cut guidance for the year to 30 June 2023. Problems with a new warehouse management system at two of its warehouses created a backlog of orders in the peak weeks prior to Christmas. It incurred extra costs as it allocated extra labour to both warehouses to mitigate the delays. The postal strikes and bad weather compounded matters; as a number of couriers brought forward delivery cut-off dates, Virgin Wines moved its order cut-off to one week earlier than usual, costing it around £1.5m in revenue. As a result, it has trimmed revenue guidance to around £63m, around 10% below consensus, with EBITDA margins of between 4% and 5%, reduced by 2 percentage points due to exceptional factors.

In December, insolvency, restructuring and company sales advisory group **K3 Capital** confirmed the receipt of expressions of interest from multiple parties and announced it was in advanced discussions with Sun European Partners regarding a possible cash offer of 350p per share. As the formal details of the acquisition were laid out in January, the Fund exited its position with the shares trading at the offer level several months ahead of expected completion.

One of the features of the Economic Advantage investment process is the frequency with which its holdings have proven attractive to acquirers.

Positive contributors included:
Bango (+24%), Intercede Group (+21%), Tribal Group (+17%), Churchill China (+13%) and On The Beach Group (+12%).

Negative contributors included:
Totally (-27%), Cropper (-27%), Virgin Wines (-23%), Animalcare Group (-19%) and EKF Diagnostics (-18%).

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

	Dec-22	Dec-21	Dec-20	Dec-19	Dec-18
Liontrust UK Micro Cap I Acc	-17.1%	33.6%	12.1%	29.1%	3.0%
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	1	1	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, 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.