Liontrust UK Smaller Companies Fund

February 2023 review

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The Liontrust UK Smaller Companies Fund returned -0.8%* in February. The FTSE Small Cap (excluding investment trusts) Index comparator benchmark returned 0.6% and the average return of funds in the IA UK Smaller Companies sector, also a comparator benchmark, was -0.2%.

This year's investor excitement over the prospect of an imminent interest rate 'pivot' failed to extend throughout February. Rate hikes from key central banks – 50 basis point increments from the European Central Bank and Bank of England, and a slowdown to 25 basis points by the US Federal Reserve – were as expected, but several US macro releases later in the month pointed to unexpected economic strength and inflation persistence.

As markets priced in roughly an extra 50 basis points of US hikes this year – with a peak above 5.0% - equities lost momentum and bond yields moved higher. The S&P 500 and MSCI World Index of developed markets both dropped 0.8% in sterling terms in February. The UK stockmarket was able to buck this trend, helped by its sector constitution as energy alone accounted for 0.9% percentage points of the FTSE All-Share Index's 1.5% gain. This sizeable contribution reflects the sector's 12% index weighting coupled with a bumper quarterly reporting season for oil & gas giants BP and Shell.

Large-caps drove the UK market's positive monthly return, with the FTSE 100 index recording a 1.8% gain. Returns were weaker further down the market cap scale, with the FTSE 250 mid-cap index gaining 0.4%, the FTSE Small Cap (ex-IT) index rising 0.6%, and the FTSE AIM All-Share returning -0.9%.

There was plenty of newsflow to digest from portfolio holdings in February. Full-year results from **Kitwave Group** (+29%) provided one of the easier reads, as it outlined a year of very strong growth in revenues and profits, in-line with the upgraded guidance issued at the half-year stage. The independent wholesale delivery business grew revenue 32% to £503m while adjusted operating profit trebled to £21.5m. Much of the company's growth has been acquisitive, as it seeks to consolidate what it sees as a fragmented UK wholesale market. Since the end of its financial year on 31 October 2022, it has completed the £29m cash purchase of WestCountry Food Holdings and is on the look out for more bolt-on acquisitions.

There was further positive news in the form of a handful of companies upgrading their financial guidance. Platform law firm **Keystone Law Group** (+23%) commented in a trading update that revenues and profits for the year to 31 January had marginally exceeded market expectations as client demand remained robust. **Microlise Group** (+14%), the telematics software provider for fleet operators, also stated that 2022 adjusted EBITDA will be slightly ahead of market expectations. Although 2022 sales were constrained by global microchip supply issues, Microlise still managed to grow revenues by 5% to £63.2m. In a broadly positive trading update, Microlise noted that customer churn was very low at 0.4%, over 250 new customers were added, and its order book sits at a record level. It expects supply chain headwinds to persist into 2023 but improve during the second half.

In a similar vein, construction materials distributor **Brickability** (+14%) announced that adjusted EBITDA (earnings before interest, tax, depreciation and amortisation) was on track to be at least £47.0m in the year to 31 March, ahead of market consensus expectations of £44.7m.

Of those that provided disappointing updates in February, a trading update from **EKF Diagnostics** (-32%) gave investors most cause for concern, prompting a large share price fall which accounted for around half the Fund's negative monthly return. Although 2022 revenues were in line with expectations, earnings were slightly below the anticipated level due to falling profitability at two of its units: Contract Manufacturing and Laboratory Testing. A trading update revealed that both divisions have been affected by a drop in demand for Covid testing and have struggled to successfully transition to alternative revenue streams. This combined with supply chain delays in the life science division regarding fermentation capacity build out in the South Bend Indiana plant. Cumulatively, these setbacks prompted downgrades to brokers' medium-to-longer term forecasts, triggering EKF's share price fall

FRP Advisory Group (-13%) notified the market that its results for the year to 30 April are on track to be only "broadly in line" with consensus sales and earnings expectations, with the possibility of a wider miss if several corporate finance transactions fail to complete by year end. FRP has seen an increase in the number of liquidation mandates as company insolvencies rise, but it is yet to see higher-value restructuring and administration work recover to pre-Covid levels.

In December, **Tribal Group** (-15%) issued a profit warning due to an underperforming contract with Nanyang Technology University. This month, the software provider to the education sector commented that 2022 results would be in line with the lower guidance issued in December, but also warned that the contract dispute is ongoing with no resolution likely in the short term. Nevertheless, Tribal commented that good momentum in the rest of its business should return it to profitable growth this year.

Focusrite's (-8.6%) AGM statement provided investors with a mixed bag. On the one hand, full-year expectations remain unchanged after the first four month's trading, and gross margins are improving as freight costs normalise and component shortages ease. Offsetting these positive notes was a observation of recent demand weakness in Asian markets.

Wealth manager **Mattioli Woods** (-8.7%) saw adjusted EBITDA drop 5% year-on-year to £15.0m in the six months to 30 November 2022 as total client assets fell 2% to £14.6bn. It has maintained its expectations for the full year.

Positive contributors included:
Kitwave Group (+29%), Keystone Law Group (+23%), Brickability (+14.2%), Microlise Group (+14%) and Judges Scientific (+13.4%).

Negative contributors included:
EKF Diagnostics (-32%), FRP Advisory Group (-13%), Tribal Group (-15%), Integrafin Holdings (-9.4%) and Mattioli Woods (-8.7%).

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 28.02.23, 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.

Disclaimer

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