Liontrust UK Smaller Companies Fund

March 2023 review

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The Liontrust UK Smaller Companies Fund returned -3.9%* in March. The FTSE Small Cap (excluding investment trusts) Index comparator benchmark returned -7.0% and the average return of funds in the IA UK Smaller Companies sector, also a comparator benchmark, was -5.7%.

The month began with strong economic data which lifted expectations for the number of central bank hikes still to come. As news of Silicon Valley Bank's (SVB) demise fed through, the market narrative quickly shifted to one of financial sector resilience, which in turn seemed to reduce the chances of substantial further monetary tightening.

With investors fretting over banks' exposure to a combination of a negative yield curve (meaning more expensive short-term deposit finance and mark-to-market losses on long-term assets) and the risk of deposit flight, the sector took a broad-based hit. Credit Suisse was the highest profile casualty, forced into a government-brokered sale to UBS that wiped out bondholders and the majority of its share price.

Unsurprisingly, the financials sector was the weakest in the FTSE All-Share Index in March, losing 7.5% with the banks sub-segment down by 12%. The Fund is overweight in financials, but this is mainly via asset managers and financial services providers. As a group, they ended March slightly lower but ahead of the market average.

At the small cap end of the market, companies' liquidity became a focal point. Although based in the US, SVB had strong ties with the technology sector globally, including companies in the UK. As its balance sheet unravelled and regulators stepped in, many companies – particularly small caps – chose to issue stockmarket updates in order to reassure over their exposure to SVB and liquidity position. Several portfolio stocks were among this number. The common theme was that where SVB exposure existed via deposits or borrowing facilities, it was an insignificant proportion of overall liquidity.

For example, among those companies that updated the market, **Team17 Group** (-20%) stated that SVB represented less than 1% of its current cash reserves and is immaterial to its liquidity position. Investors were reassured by this short update and would have found pleasing evidence of the company's rapid growth in 2022 results released later in the month. But the unexpected resignation of CEO Debbie Bestwick caused some concern after it was announced on the same day as the results. Bestwick will stay on until a successor is found, at which point it is intended she will transition to a non-executive role on the board of directors.

The Fund's top performer was **Mortgage Advice Bureau** (+26%). It reported solid growth in many of its key metrics over 2022: adviser numbers rose 20% to 2,254; gross mortgage completions were 20% higher at £27.3bn; and its market share of new mortgage lending rose from 6.4% to 7.5%. Liz Truss and Kwasi Kwarteng's September mini-budget had a large negative effect on the mortgage market, a headwind Mortgage Advice Bureau has described in detail through two subsequent trading updates. This negative development now looks to be priced into the shares, which have recovered around half the tumble they took in September. As expected, adviser numbers have reduced in the first quarter of 2023 to stand at 2,129 on 24 March. The company expects this metric to stabilise in Q2 and then build in the second half of the year alongside business volumes.

Shares in **Big Technologies** (+14%) have been soft since January, even though a trading statement released at the time stated that 2022 revenue and earnings would be ahead of analyst consensus. It subsequently rallied in March on the release of results that confirmed 2022 revenue of £50m, up 33%, and adjusted EBITDA (earnings before interest, tax, depreciation and amortisation) of £31m, an increase of 50%. The provider of integrated hardware/software solutions for the electronic monitoring of criminal offenders also commented that trading so far in the new financial year has been in line with its expectations.

Although **Fevertree's** (+21%) adjusted EBITDA declined by a third in 2022, the fall had already been flagged to investors due to supply chain disruption and inflation headwinds and the final figure of £39.7m was marginally ahead of consensus expectations. The company's largest market is the UK, accounting for around a third of sales. This segment already has very high market penetration with 45% market share of the mixer category, and it saw a 2% decline in revenues last year. However, sales in the company's international operations increased 18%, pulling the group total growth to 11% (to £344m). This year the company expects total growth of 13% - 18% year-on-year, with the UK returning to growth and momentum maintained elsewhere.

EKF Diagnostics (+11%) staged a partial recovery from the falls suffered after last month's profit warning. Its contract manufacturing and laboratory testing divisions have been affected by a drop in demand for Covid testing, while there have been supply chain delays in the life science division regarding fermentation capacity build out in the South Bend Indiana plant. During March the company announced the disposal of ADL Health, its laboratory testing business, and full-year results revealed that it will discontinue its UK contract manufacturing operations. EKF Diagnostics will now focus on point-of-care, central laboratory and life sciences divisions.

Turning to the detractors, **Craneware** (-17%) experienced a tough month. It had warned in January that full-year group sales for the period to 30 June would fall short of market expectations. Investors also noted that cash generation was disappointing, with cash reserves falling to $38.7m from $41.7m a year ago. Although interim results released in March commented that headwinds in the US healthcare market look to be abating, they failed to alleviate these cash flow concerns. Its cash conversion ratio over the six months dropped to 77% of EBITDA as some hospitals face financial pressures, although its not yet suffered any significant bad debts.

Echoing the key messages of its February AGM update, a March interim trading statement from **Focusrite** (-18%) maintained profit expectations for the year to 31 October 2023, with gross margins improving as freight costs and supply chains normalise, but noted industry-wide demand weakness in Asian markets. It also commented that the timing of new product launches will mean a financial weighting towards the upcoming second half of the year. Focusrite develops hardware and software for the high-quality production of recorded and live sound.

Mobile payments company **Bango** (-17%) had outperformed the market so far this year, helped along by an upbeat trading update issued in January. It gave back most of this relative performance in March despite issuing solid looking 2022 results. Revenue rose 38% to $28.5m and adjusted EBITDA of $5.0m was ahead of market expectations albeit down 17% on last year due to the short-term impact of its DOCOMO Digital acquisition. End user spend rose from $4.1bn in 2021 to $5.6bn in 2022 and finished the year at an annual run-rate of $8.6bn. Bango also provided upbeat comments on trading so far in 2023 and the outlook for the rest of the year.

Positive contributors included:
Mortgage Advice Bureau (+26%), Fevertree (+21%), Kitwave Group (+15%), Big Technologies (+14%) and EKF Diagnostics (+11%).

Negative contributors included:
Team17 Group (-20%), Next Fifteen Communications (-19%), Focusrite (-18%), Bango (-17%) and Craneware (-17%)

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

	Mar-23	Mar-22	Mar-21	Mar-20	Mar-19
Liontrust UK Smaller Companies I Inc	-14.7%	2.6%	56.7%	-5.8%	1.9%
FTSE Small Cap ex ITs	-12.9%	5.5%	74.9%	-24.4%	-3.1%
IA UK Smaller Companies	-16.6%	-1.7%	65.7%	-17.9%	-2.6%
Quartile	2	1	3	1	1

*Source: Financial Express, as at 31.03.23, total return (net of fees and income reinvested), bid-to-bid, institutional class.
**Source: Financial Express, as at 31.03.23, 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/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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