



Liontrust Special Situations Fund

May 2023 review

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The Liontrust Special Situations Fund returned -3.2%* in May. The FTSE All-Share Index comparator benchmark returned -4.6% and the average return in the IA UK All Companies sector, also a comparator benchmark, was -2.8%.

The UK market's negative monthly return followed a sharp drop over the final week as negotiations on extending the US debt limit came very close to the wire, before ultimately being resolved at the start of June, avoiding a painful default process.

Interest rate uncertainty remained a feature of markets, with expectations at the start of the month tempered by the contractionary impact of this year's banking crisis, before more strong economic data and evidence of inflation persistence led to additional rate hikes being priced back in for later this year. UK, European and US base rates were all raised by a 25 basis point margin in May, with the US Federal Reserve indicating that rates would now pause at the 5.0 – 5.25% level.

Energy sector weakness was another feature of the UK market. The Brent crude oil benchmark only slid 9% in May but is now down 40% compared with a year ago when it had spiked in the aftermath of Russia's invasion of Ukraine. Between them, **BP** (-14%) and **Shell** (-8.6%) knocked 1.3% off the FTSE All-Share index during May, despite both reporting huge Q1 profits that appeared at least in-line with analysts' forecasts. BP was penalised more than Shell after a cut to the planned pace of share buybacks was a source of some disappointment.

BP and Shell are held within the Fund due to their possession of significant intellectual property and global distribution networks, both of which are intangible barriers to competition of the type sought out by the Economic Advantage investment process. Neither is owned as a directional bet on energy or wider commodity prices and both, in fact, are in possession of a degree of internal energy price hedging due to their integrated ownership of upstream and downstream assets, and profitable energy trading operations.

The Fund's poor energy sector return in May was exacerbated by private equity group Apollo's withdrawal of bid interest in **John Wood Group** (-38%). The provider of consulting and engineering services to the energy and materials sectors gave up all of its prior 2023 share price gains. It had received five takeover proposals from Apollo this year, rejecting the first four but agreeing to enter discussions following the final cash proposal of 240p.

Newsflow from other Fund holdings was largely typical of the year-to-date experience outlined in last month's review: very encouraging on the whole but also including one or two inevitable instances of companies disappointing on short-term earnings.

To coincide with a day of investor presentations, **YouGov** (+17%) unveiled its third long-term growth plan which includes medium-term targets of £500m revenue and an adjusted operating profit margin of 25%. While no time frame is specified, investors welcomed the ambitious goals, which represent a near doubling of the c.£265m revenue expected this financial year (to 31 July) and an eight percentage point improvement in profit margins from its recent half-year results.

TI Fluid Systems (+16%) announced a 15% year-on-year increase in Q1 revenues to €870m, well ahead of 5.7% growth in the wider light vehicle production market. The specialist in highly engineered automotive fluid systems

saw growth in all of its regions, which was boosted by efforts to increase prices to recover cost inflation. Having cut its 2022 growth expectations late in the day, this update gave promising signs that trends have improved.

Sage Group (+6.4%) and **Compass Group** (+5.0%) both edged higher after nudging up full-year profits guidance when announcing results for the six months to 31 March.

Sage Group, the provider of SME-focused online accountancy, payroll and HR tools, reported a 12% increase in underlying recurring revenue, driven by 29% growth in its Sage Business Cloud product to £787m. As a result, it has upgraded its full-year recurring revenue growth target to 11%, which compares with analyst consensus of about 10%, and also expects operating margins to improve this year and in future periods; for the first six months, operating margins expanded by 1.6 percentage points to 19%.

Global catering group **Compass** (+5.0%) recorded 25% organic revenue growth to £15.8bn as balanced growth in demand for outsourced services fed through in all its regions, more than offsetting the impact of some pockets of macroeconomic weakness. It upgraded its full-year outlook, with the organic revenue growth target raised from 15% to 18% and operating margins expected to be 6.7% - 6.8% (versus 6.5% previously). As a result, operating profit growth is now expected to be 30% rather than 20%.

Industrial thread and footwear component manufacturer **Coats Group** (-11%) revealed an organic constant currency decline of 20% in the first four months of the year as customers destocked in reflection of subdued consumer demand and high inventory levels. The group commented that the decline was in line with its expectations against a strong prior-year comparator. Coats has maintained its full-year targets but it will need a large weighting of activity towards the second half of the year in order to achieve them.

Keywords Studios (-28%), the support services provider to the video games industry, slid on read-across from some evidence of weaker trading from sector peers as well as general concern over the impact of AI developments on the industry.

Aside from John Wood Group, the portfolio's poorest performer was **Future** (-36%). Future is a multi-platform media company owning a number of content brands in specialist consumer and B2B sector which it is seeking to digitise. Its shares tumbled as it warned that results for the year to 30 September would be at the bottom end of current market expectations. Future commented that challenging market conditions had persisted, including a wider market slowdown in audience numbers, and that it is increasing its investments in pursuing growth in the US market.

Future is a good example of the extremity of de-rating experienced by some of the mid and small cap companies in the market (in particular) over the past year. Having always been noteworthy as a capital-light, cash generative business, Future is currently trading on a free cash flow yield of over 20% based on forecasts for the next 12 months – meaning, simplistically, that investors can pick up shares today at a price which is discounting fewer than five years of annual cash flows. While Future is unquestionably beset by short term macroeconomic headwinds – and potentially by longer term challenges brought about by the rise of generative AI as well – we think it remarkable that the market appears to be pricing in an existential decline of the business over a very short time frame, and entirely discounting the competitive advantage of Future's premium content, market leadership positions and attractive business model generating prodigious amounts of cash. Of course, we may be proved wrong – such is the nature of a 'market' – but it is opportunities such as this, thrown up by the market turmoil of the past few years, which have prompted us to selectively top up our positions with our focus on long term alpha generation.

Positive contributors included:

YouGov (+17%), TI Fluid Systems (+16%), Renishaw (+12%), Sage Group (+6.4%) and GlobalData (+5.9%).

Negative contributors included:

John Wood Group (-38%), Future (-36%), Keywords Studios (-28%), BP (-14%) and Coats Group (-11%).

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

Past performance does not predict future returns

	Mar-23	Mar-22	Mar-21	Mar-20	Mar-19
Liontrust Special Situations I Inc	0.1%	5.1%	31.1%	-11.0%	8.9%
FTSE All Share	2.9%	13.0%	26.7%	-18.5%	6.4%
IA UK All Companies	-1.9%	5.4%	38.0%	-19.2%	2.9%
Quartile	3	3	3	1	1

*Source: Financial Express, as at 31.05.23, 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.

A proportion of the portfolio is 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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