



Liontrust UK Smaller Companies Fund

July 2023 review

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The Liontrust UK Smaller Companies Fund returned 1.6%* in July. The FTSE Small Cap (excluding investment trusts) Index comparator benchmark returned 4.1% and the average return of funds in the IA UK Smaller Companies sector, also a comparator benchmark, was 1.5%.

Market gains were helped by some evidence of an easing in inflation. June data for the US consumer price index showed a retreat to 3.0% annual inflation, down from 4.0% in May and slightly below expectations for a 3.1% rate.

The US Federal Reserve had been on record as saying further interest rate rises should be expected after the pause in its tightening cycle in June, and the 0.25% hike delivered in July had been entirely priced in by markets. The outlook from here is less certain; with the Fed now saying that future rises will be data-dependant, many have taken the easing in inflation data as a sign that rates have already reached their peak at a 5.25% - 5.50% range.

The pattern was the same in the UK, albeit at a higher inflation level. June's data showed a 7.0% annual rise in consumer prices, well below the expected 8.2% rate and down from 8.7% last month. With inflation still well above the Bank of England's 2% target, at least two more quarter-point rises are currently priced into futures markets.

These macroeconomic developments presented a relatively benign backdrop for equity markets, allowing investors to focus on a busy month of company earnings updates.

Starting with the positives, revenue continues to grow rapidly at mobile payments company **Bango** (+16%). A trading update for the first half of 2023 showed an 88% increase to \$20m, driven by its digital vending machine business, which secured two large contracts in the US during the period. This division allows telecoms companies to offer a range of content and service options that can be bundled into subscriptions. Bango now works with three of the top five telecoms operators in the US, covering 60% of consumers.

Last year, Bango acquired the payments business of NTT DOCOMO Digital for €4m, a deal which is expected to significantly enhance earnings in future periods. Despite integration costs pushing Bango to a small loss in the first half of this year, it expects synergies and its typical second-half weighting to help it to hit forecasts of £12m EBITDA for the full-year.

Investors also welcomed interim results from **Arbuthnot Banking Group** (+14%) which showed a jump in profit before tax to £26m over the first half of 2023, up from £3.4m a year earlier as it benefited from an environment of higher interest rates. Although credit appetite has tightened due to a weak economic backdrop, Arbuthnot grew customer loans by 7% year-on-year to £2.3bn, with customer deposits also growing year-on-year by 16% to £3.3bn.

Ergomed (+11%) released an encouraging interim trading update, with 10% year-on-year revenue growth to £77m in the first six months of 2023 and a 9% rise in the order book to £310m. The company is a global contract research organisation providing fully outsourced drug trials to speciality pharma and biotech clients, with specialisms in oncology and rare diseases. Ergomed also boasts one of the largest qualified teams of pharmacovigilance professionals globally, helping clients manage the risks around portfolios of approved drugs.

Turning to the detractors in July, property fintech platform operator **Lendinvest** (-31%) was a large faller. The hybrid alternative asset manager, platform and lender matches retail and institutional investors with property finance opportunities by packaging up loans, enabling this process via an automated technology platform, and investing its own balance sheet capital to help seed new opportunities alongside its investors.

LendInvest has been affected by the slowdown in the UK mortgage market brought about by interest rate rises and disruption from last September's mini-budget. In July, it extended its platform model of managing external assets by announcing a £500m investment from Chetwood Financial to mortgage originations in buy-to-let and residential. Full-year results released later in the month showed strong growth in assets on platform and funds under its own management, but also noted that the outlook for the UK property market is not constructive due to rising interest rates.

EKF Diagnostics (-15%) is in a transitional period, divesting of underperforming units, implementing cost-cutting measures and dealing with a decline in revenues after a drop-off in demand for Covid testing. Following the disposal of its laboratory testing business and closure of its UK contract manufacturing earlier this year, the company is now focused on the "core" point-of-care, central laboratory and life sciences divisions. An interim trading update in July detailed revenues from continuing operations in the first half of 2023 of £26m, down from £34m a year earlier. EKF expects to boost profit margins in 2024 through its recent cost reductions as well as the addition and utilisation of new fermentation capacity in its life science division. However, the near-term outlook is uncertain. The extent to which it can improve margins to achieve its 2023 earnings relies on a significant second-half weighting to trading and the timing of new life sciences contracts currently under discussion.

Nexpeq (-13%) fell on an interim trading update which detailed 6% revenue growth in the first half of the year but predicted full-year revenues only broadly in line 2022 levels due to customers unwinding their stock positions. However, Nexpeq has "materially enhanced" operating margins, which it expects to help it meet market expectations for adjusted profit before tax. **Nexpeq** changed its name from Quixant earlier this year to reflect the growth of its software and hardware solutions into industries outside of its initial core gaming market.

Last month we once again highlighted the frequency with which Economic Advantage fund holdings – and the intangible barriers to competition the investment process seeks out – have proven attractive to acquirers. In June, **Alfa Financial Software** (-20%) disclosed that Swedish private equity investor EQT had proposed several takeover offers, the most recent at 208p – prompting a 20% rally in the shares. But the shares retraced their gains in July as EQT formally withdrew its bid interest. However, July also saw a bid for another fund holding: **Gresham House** (+56%). The board of the specialist alternative asset management company agreed to a 1105p/share takeover offer from private equity group Searchlight Capital Partners, a level which represents a 63% premium to its prior share price and 10% higher than the shares' all-time high reached in 2022.

Positive contributors included:

Gresham House (+56%), Focusrite (+33%), Bango (+16%), Arbutnot Banking Group (+14%) and Ergomed (+11%).

Negative contributors included:

Lendinvest (-31%), Alfa Financial Software (-20%), EKF Diagnostics (-15%), Nexpeq (-13%) and Team17 (-12%).

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

Past performance does not predict future return

	Jun-23	Jun-22	Jun-21	Jun-20	Jun-19
Liontrust UK Smaller Companies I Inc	-5.3%	-18.4%	46.7%	1.9%	2.3%
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	2	3	1	1

*Source: Financial Express, as at 31.07.23, 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, 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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