Quarterly Commentary
Q3 2023

CRUX ASSET MANAGEMENT

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This is a Marketing Communication

TM CRUX UK Special Situations Fund

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Market Performance

The FTSE 100 rose over the quarter. The large UK-quoted diversified energy and basic materials groups outperformed as they rebounded from weakness in the previous three-month period. They benefited from sterling weakness against a strong dollar. A sharp recovery in crude oil prices buoyed the energy groups in particular.

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Attribution Stock Level Q3 2023

Top 3 Contributors (%)	Bottom 3 Contributors (%)
Shell +0.7	One Savings Bank (OSB) Group -1.3
Glencore +0.6	Sondrel -1.2
Grafton +0.6	FD Technologies -1.0

Source: Bloomberg as at 30.09.23

Fund Performance

Over the period under review, the TM CRUX UK Special Situations Fund (I Accumulation GBP) returned -6.0% against its performance comparator the IA UK All Companies Sector return of 1.3%.

The fund's 32% allocation to small-caps was particularly unhelpful over the quarter, with the FTSE Small Cap Index underperforming large and mid-cap, and the FTSE AIM All-Share Index down c.3%. The UK stock market is currently at a valuation discount to the rest of the world not seen since 1994. For domestically focussed mid and small caps, there is a double discount as UK focussed funds have now had outflows for 27 months in a row. This widespread outflux of capital has depressed mid and small-sized companies share prices relative to larger UK listed companies.

The largest positive contributors to performance over the quarter were Shell and Glencore, contributing c.0.7% and c.0.6% respectively, rebounding from weakness over the previous quarter and benefitting from sterling weakness against a strong dollar.

Vistry was the best performing position in the fund, up c.38% over the quarter and contributing c.0.5% to fund performance. In-line interim results accompanied a strategy evolution with the group shifting to focus wholly on the capital-light (higher return on capital employed) partnerships business. As a result, Vistry also announced an update to its capital return policy, which sees it commit to c.£1bn of dividends or share buybacks over the next three years.

The largest detractor from performance during the quarter was One Savings Bank (OSB) Group, down c.30% and detracting c.1.3% from fund performance. OSB announced a one-off charge of c.£180m due to buy-to-let landlords refinancing at a faster-than-expected rate. This accounting change impacted net asset value by c.-6% and future EPS by c.6-8% but reduced this year's profits by c.1/3rd. Due to the fickle market that we are currently in, shares fell 30%+, focusing on the short-term and ascribing little value to the fundamental value that remains in the business. Valuing OSB at a 15% discount to peers provides a target price of c.£6.50, almost double the share price at the end of Q3 2023. The CEO also bought c.£100k of shares after the recent announcement, at a level c.20% higher than at the end of the quarter,

“Genus is a world-leading animal genetics company, helping farmers rear the best animals possible. The share price is down c.65% from its peak and earnings are likely near or at the trough. Valuing the core business in line with other businesses delivering similar growth, quality of earnings and high barriers to entry implies a valuation of c.£25 per share, c.20% above the share price at the end of the period.”

Small-cap Sondrel was the second largest detractor during Q3, down c.74% and detracting c.-1.2% from fund performance after announcing the delay of major projects as clients delayed spending amidst the challenging macroeconomic environment. Management remains confident in the business's long-term prospects, but the short-term outlook is uncertain and a small fundraise remains a possibility in our view. Despite the disappointing project delays in Europe, it is encouraging to note that Sondrel is experiencing significant traction in the US market with a growing pipeline. We believe returns above and beyond our entry point remains entirely possible.

FD Technologies was the third largest detractor during the quarter, down c.24% and detracting c.1.0% from fund performance. FD Technologies has built a time series database which is growing strongly and has yet to reap the full benefit of tie-ups with Microsoft, Snowflake and AWS. This application should grow 25-40% within the financial services, defence and industrial sectors. More recently it has become evident that there is additional scope for the company's vector database to be useful in AI applications, for which we believe there is little or nothing in the share price, with the shares off 65% from its highs.

Transactions

In terms of transactions, WH Smith, CAB Payments, Genus and housebuilders Vistry and Bellway were added to the portfolio.

We believe WH Smith's forensic approach to retailing should stand it in good stead to expand successfully in the global travel essential retail segment. Consumer demand for travel remains strong, and WH Smith should be helped by its relatively low basket size in a tougher consumer environment. WH Smith has fairly waterfront coverage in the UK but only a c.2.5% share internationally, and we see an opportunity for it to expand its airport coverage in the US, where it has been winning 50% of tenders. WH Smith continues to deleverage, providing scope for future cash returns. The high street stores are a much more mature business but profitability is supported by cost efficiencies in the form of lower rentals.

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CAB Payments provides FX and payments services between developed markets and emerging markets. By combining an extensive global network with a UK-banking licence and a modern technology platform, it solves for the cross-border payment pain points of speed, cost, transparency and trust. The company floated in July at an offer price of 335p but has since fallen c.30% with most of the fall attributed to insiders that couldn't sell during the IPO realising some long-awaited liquidity. The fund did not participate in the IPO but has been picking up shares in recent weeks as the valuation becomes increasingly attractive. CAB's maiden interim results illustrated significant revenue growth (60%+), high EBITDA margins (c.56%) and impressive cash generation, with shares available for less than 7x P/E. Valuing CAB in-line with slower growing peers with lower margins results in a valuation more than double the prevailing share price.

Outlook

We remain firm believers in the small-cap premium and the potential for small companies' share prices to go up many multiples on the way out of a recessionary environment, as was demonstrated by the fund's outperformance on the way out of the pandemic, and by Richard Penny's previous funds during the 1998, 2003 and 2008 recoveries. Although there has been significant selling of small and mid-cap UK companies by institutions under liquidity pressures, other participants have been buyers. Companies are repurchasing their own shares at substantial levels, which is testimony to the strength of corporate balance sheets. Elsewhere, the level of director purchasing and takeover approaches for UK companies speaks to the long-term value that the "stock market" cannot see.

Notwithstanding general economic headwinds, a focussed special situations fund should be able to find the companies that are overly discounted or can outperform in difficult market conditions. In 2020, distressed market conditions brought about the low prices that facilitated the fund's subsequent significant outperformance from larger cyclical businesses and disruptive small and mid-cap companies. We believe current depressed conditions offer a strong opportunity to buy well-run sensibly financed businesses for the long term.

