CRUX ASSET MANAGEMENT

Fund Managers: Richard Penny

This is a Marketing Communication

TM CRUX UK Smaller Companies Fund

> "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."

Market Performance

UK mid and small caps outperformed the FTSE 100 over the quarter which lagged due to higher exposure to underperforming energy stocks. The FTSE 250, FTSE Small-cap and FTSE AIM All-Share drifted lower during October before rebounding strongly amid growing confidence that base interest rates may have peaked, potentially paving the way for rate cuts in 2024 if inflation continues to fall

Fund Holdings Q4 2023

Top 5 Holdings (by %)
AdvancedAdvT (6.13)
Kooth (5.42)
IQE (4.78)
First Derivatives (4.73)
Jadestone Energy (4.67)

Source: CRUX as at 31.12.23

Fund Performance

Over the period under review, the TM CRUX UK Smaller Companies Fund (B Accumulation GBP) returned 1.2% against its performance comparator the IA UK Smaller Companies Sector return of 6.8%. Performance against the performance comparator was held back by three notable detractors which reported disappointing trading updates.

CyanConnode detracted c.1% from fund performance during the quarter, after raising capital to support additional investment in the rollout of smart meters in India. The Indian smart metering programme, backed by significant government funding, appears to be on track with c.100 million smart meters already awarded to prime bidders and these orders should soon filter down to competitively well positioned subcontractors such as CyanConnode. We believe the strong growth prospects for the company, driven by the Indian market opportunity for c.250 million smart meters, is not reflected in the current valuation.

FD Technologies shares fell, detracting c.0.9% from performance, following an announcement of a reduction in near-term expected profits. This was partially due to weaker trading in its consulting division which was not wholly unexpected in our view. There was a bigger impact from further investment in the KX division to advance opportunities in Artificial Intelligence, and specifically vector databases. We continue to believe that the sum of the parts is materially undervalued, and we welcome the announcement of a strategic review of the group which could realise some unrecognised value. The shares have recovered strongly since the trading update. Small-cap Sondrel was a poor performer over the quarter after announcing the delay of projects as clients delayed spending amidst the challenging macroeconomic environment. 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.

Domino's Pizza Poland was the strongest performer for the fund during the quarter, contributing c.2.5% to performance. The company issued a strong trading update in November showing that the momentum in the business in H1 continued into H2. The trading update reinforced the positive direction of travel under the new management team where there has been relentless focus on growing average weekly order count to drive store profitability. This will ultimately allow the company to transition to a franchise model in-line with the model that has proven to be of huge success for Domino's globally.

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Creo Medical contributed c.2% to performance with shares ending the quarter at c.46p, c.130% above the fundraising price which the fund participated in during February 2023. During the quarter, the company hosted a capital markets day for a brief update from management, impressive testimonies from customers and product demonstrations. Anticipation remains around further updates on the company's partnership with US goliath Intuitive Surgical.

Transactions

In terms of transactions, Inspired, Incanthera and Zegona Communications were added to the portfolio.

Inspired has reported excellent operating and strategic progress recently across its divisions. We expect strong organic progress to continue, especially in the rapidly developing Optimisation, ESG and Software divisions.

The fund participated in a fundraise by Incanthera to support the initial launch of Skin + CELL which is Incanthera's new luxury skincare brand. A commercial deal has been secured with Marionnaud which is part of the A.S. Watson Group, the world's largest health and beauty retailer. Skin + CELL will be available in Marionnaud's stores in Switzerland and Austria from Q2 2024 with the roll out into the remaining 1,100 stores across European markets expected to follow thereafter in 2024. Manufacturing, quality control and packaging has been subcontracted to Switzerland's leading skincare manufacturer, Frike Cosmetic. The Marionnaud deal is truly transformational for the company and is not suitably reflected in the current valuation.

The fund participated in a fundraise by Zegona Communications which is in the process of acquiring Vodafone Spain for €5bn. The acquisition is synonymous with a private equity style deal, with the acquisition predominantly funded with debt and €300m equity raised. The impressive management team of Zegona are highly experienced and have a history of value creation, having generated a shareholder return of c.87% at Euskaltel in 2 years, a c.42% return at Telecable in less than 2 years and a 6x return in c.8 years at Jazztel.

We believe that Zegona have acquired Vodafone Spain at a highly attractive price and due to management's experience in the sector, we believe in their ability to execute a major cost reduction plan and deliver significant cashflow upside. We believe there is a further opportunity for Zegona to realise value from the deal extremely quickly through monetising Vodafone Spain's fixed network via a sale to an infrastructure investor. There is also scope to combine the fixed network with other major operators in Spain to form an even more attractive monetizable fixed network asset. Similar transactions are taking place in the market currently with smaller competitor Digi in talks to sell its Spanish fibre network.

Outlook

The UK stock market is trading at a 30-year high discount relative to the global market, the FTSE 250 is pricing in c.30% earnings cuts (close to that experienced during the global financial crisis of 2008/2009) and small-caps have experienced 2 of the worst 6 years on record since c.1955 in succession. Although past performance is no guide to future returns, periods of weak returns have historically been followed by periods of very strong performance, particularly in small caps. The economic outlook remains uncertain but financial crisis levels of pessimism are already priced into shares despite signs of economic resilience. 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 funds managed by Richard Penny on the way out of the pandemic, and during the 1998, 2003 and 2008 recoveries. We believe current depressed conditions offer a strong opportunity to buy well-run sensibly financed businesses for the long term.

