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Strategic Equity Capital plc

Factsheet Commentary – Q1 2021

Overview

The market performed well over the quarter, building on the exceptional trajectory of the latter part of 2020. Improving sentiment around the UK economic recovery and the speed of the vaccination programme helped to drive some flows back into UK equity funds and drove strong performance in more domestically focused smaller company shares and started to narrow the small cap valuation discount relative to larger UK listed companies. The total return on the FTSE Small Cap ex Investment Trusts Index ("the Small Cap Index") has now increased by more than 50% over the six months to the end of March 2021, and over 17% higher than at the end of 2019. This could be viewed as a strong move even before taking into account the catastrophic impact of the global pandemic on parts of the economy in the intervening period.

Despite this recent outperformance, the UK equity market remains at a material valuation discount to other developed markets and the small cap discount to larger companies remains material. This relative valuation opportunity continues to underpin increasing M&A activity which has started to recover to pre-Covid elevated levels driven by overseas trade and well-funded private equity buyers. This was demonstrated after the end of the period, when portfolio holding Equiniti received a non-binding bid from previously rumoured suitor Siris Capital Group, a US private equity firm. We suspect Equiniti will not be the last UK plc to attract international interest and expect this to be an ongoing theme for the remainder of 2021.

Performance[1]

The fund delivered a NAV Total Return of 12.4% over the quarter, compared to the Small Cap Index which increased by 16.3%. The market was driven by similar factors to those experienced in the previous quarter, namely a strong rebound in cyclicals, resources and financial stocks - all areas where the fund strategy, by design, has limited exposure.

Key contributors to returns came from: **Tribal** (+22%), an educational software and services provider, which finished 2020 with a flurry of strategically significant contract wins, leading to a positive trading update and upgrades early in the period; **Medica Group** (+25%), a provider of teleradiology services, which was a laggard last quarter, recovered well after continued resilient performance and undertaking the accretive acquisition of US clinical trial imaging specialist RadMD; and **Clinigen** (+15%), a specialist pharmaceuticals and pharmaceutical services company, which reported in line half year results and improving cash generation as expected.

The main detractors in the period were: **Benchmark Holdings** (-8%), a provider of genetic, health and nutrition products to the aquaculture industry, which derated slightly, despite a positive update, following a strong share price performance in Q4; **XPS Pensions Group** (-4%), a pensions consultancy, which had no news in the period; and **Proactis** (-9%), a provider of spend control and e-procurement software, which issued an in-line trading update and reported a number of modest contract wins over the period.

Portfolio activity

During the period, we made two small new investments: **LSL Property Services**, a leading UK provider of mortgage broking, estate agency and surveying services, that we believe is well-positioned to benefit from improving market dynamics and an evolution of their strategy under new management; and **Idox**, a provider of software solutions to the public sector, previously owned by the Fund, following the failure

[1] Where holdings' returns are stated, please note these are Total Returns, including dividends, for each of those stocks over the quarter.

of an attempted bid for the company by Canadian peer Dye and Durham. Top up investments were also made in a number of existing holdings, most notably scaling positions in recent investments in **Ten Entertainment Group** and **Fintel** (formerly **SimplyBiz**) and supporting a placing at **Medica Group** to finance the strategic acquisition of RadMD in the US. Further top up investments were made in **XPS Pensions Group** and **Wilmington** which we believe remain attractively valued on a relative and absolute basis.

During the period, we made two full realisations: **Strix Group** (47.6% IRR) and **JTC** (39.6% IRR). Both were sold on valuation grounds following a period of very strong execution and share price performance. We continue to view both companies as well-managed, high quality global enterprises with excellent prospects, however, we see better opportunities within our developing pipeline to redeploy the capital in the near term. These exits build on the full realisations, based on similar rationale, in the preceding quarter of **Ergomed** (72.2% IRR), **4Imprint** (21.8% IRR) and **Numis** (1.8% IRR). We also undertook some top slicing activity during the quarter to reduce our positions in **Alliance Pharma, Tyman, Tribal** and **Harworth Group** on the back of strong share price appreciation in the period.

In aggregate, purchases in the period totalled £18.2m which represented 9% of closing NAV; realisations in the period totalled £11.7m, or 7% of opening NAV. The weighted average market capitalisation of holdings purchased was £220m, compared to £557m for those realised. These data points reflect a period of good progress in evolving the portfolio in line with the strategy, with modestly higher turnover in order to increase our focus on companies at the slightly smaller end of the market cap spectrum (£100-300m market capitalisation at the point of investment). This has also enabled us to increase the average size of our equity stakes across the portfolio in order to provide a more effective platform from which to constrictively engage with our portfolio companies.

Outlook

As lockdown restrictions in the UK begin to ease and progress continues in the penetration of the national vaccine roll-out, there is some cause for optimism that the economy can rebound rapidly as the year progresses. This, in turn, could stimulate asset allocators to re-evaluate the significant discount being applied to the UK, and to UK smaller companies in particular, due to their perceived domestic focus. There are some signs that discounts are starting to narrow and as markets reopen and earnings recover it could provide a strong tailwind for share prices.

Given the residual uncertainty, we still expect periods of sentiment driven market volatility. Lower than average visibility over earnings estimates may drive heightened volatility at the individual stock level, whilst at the macro-economic level the long-term impact of the pandemic, and the monetary and fiscal response to it, remains unclear. However, we believe that volatility, while creating some challenges, will provide an attractive environment in which we can unearth good long term investment opportunities at attractive valuations. We believe we have strong capabilities to leverage our private equity network to help evaluate investment candidates and build high conviction in a select number of opportunities. The economic environment and lingering Covid-19 discontinuity will provide agile smaller businesses with strong management teams with the opportunity to take market share and build strong long-term franchises.

We continue to believe that our fundamentals focused investment style has the potential to outperform over the long term. The Fund will maintain its focus on building a high-conviction portfolio of less cyclical, high quality, niche growth businesses which we believe can deliver strong returns through the market cycle regardless of the performance of the wider economy.

Past performance is not necessarily a guide to future performance. Portfolio investments in smaller companies typically involve a higher degree of risk.