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# Strategic Equity Capital plc

## Factsheet Commentary - Q2 2021

### Overview

Market conditions remained positive during the quarter, rounding off a very strong period for UK equities and UK smaller companies in particular throughout the first half of the year. The M&A environment remains extremely active. There continues to be a steady stream of small-cap IPOs and a strong pipeline for the second half, although anecdotal evidence of some flotations failing to get away suggests there may be some deal fatigue setting in due to the sheer volume of equity issuance so far in 2021. There is also ongoing secondary issuance by existing listed companies to support acquisitions and growth initiatives as confidence in the vaccine driven recovery gathers pace.

As we have been flagging for some considerable time, the discounted valuation applied to the UK and to UK smaller companies in particular remains material. This is still the case despite the strong performance during H1 2021. Some sustained positive flows are now being seen into UK Smaller Company funds which is a signal of improving sentiment towards the UK and should be supportive for smaller company share prices.

Large amounts of “dry powder” in private equity funds, combined with still discounted valuations, has triggered a frenzy of takeover activity in the UK equity market ranging from small caps right through to the FTSE100. This represents a double-edged sword for investors who benefit from a short-term share price uplift but then may lose out on the long-term potential of good quality companies that leave the public markets. As an illustration of this point, two holdings, Equiniti and Proactis, were subject to takeover offers from private equity during the period; we think this will be an ongoing theme for the remainder of the year.

The current dynamic market environment continues to offer a number of investment opportunities. We remain selective and disciplined in our approach, seeking high quality companies with attractive long-term capital growth characteristics at sensible valuations.

### Performance[1]

The fund delivered a NAV Total Return of 10.6% over the quarter, in line with the Small Cap Index which also increased by 10.6%. Increasing optimism regarding the economic and trading outlook supported a broad-based strength in share prices both across the market and within the fund. Key contributors to returns came from: Equiniti (+39%), a provider of share registry and related technology-enabled financial services, which, following a prolonged period of speculation, received a recommended offer from US private equity firm Siris Capital Group; Medica Group (+18%), a provider of teleradiology services, which continued to recover as NHS activity began to return to more normal patterns; and Hostelworld (+40%), a hostel focused travel booking platform which benefited from an improving outlook as global travel restrictions began to ease.

The main detractors in the period were: Clinigen (-20%), a specialist pharmaceuticals and pharmaceutical services company, which issued a profit warning driven mainly by weakness in oncology products due to Covid-related delays to cancer diagnoses and treatments; Tribal Group (-6%), an educational software and services provider, with some profit taking following a very strong period of share price performance despite ongoing positive trading momentum; and Idox (-1%), a provider of software solutions to the public sector, which issued an in-line trading update and made a strategically sensible bolt-on acquisition during the period.

Although Clinigen’s profit warning was disappointing and a drag on performance, we believe the company remains a valuable asset that is well-positioned in the specialty pharmaceuticals services

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

space. With the company trading near historic lows in terms of valuation, and market expectations at a low ebb despite multiple potential medium-term drivers of value, the company is looking increasingly vulnerable to private equity suitors in our view. We also note that the Chairman is stepping down at the AGM, which could provide a catalyst for fresh talent to be added to the Board.

## Portfolio activity

Portfolio activity returned to more normalised levels in the quarter. No new investments or full realisations were made during the period, although a toehold position was established in **Nexus Infrastructure** post-period end. Nexus is a leading UK provider of infrastructure and engineering services to the housebuilding, transport, and commercial sectors. We believe the company is well positioned to benefit from recovering activity levels in these sectors in the medium term. The company also provides electric vehicle charging infrastructure installation services; whilst nascent, this is an area that we think could support material growth opportunities (and catalysts for rerating) for the company over the long term.

There was moderate portfolio activity in the quarter as profits were taken on strong performing investments and capital redeploying into companies where we see stronger relative medium-term potential. Realisations totalled £13.3m in the quarter, with profit-taking in Equiniti, Tyman, Tribal, and Harworth Group, all of which performed strongly during the period. This was redeployed into Inspired Energy, LSL Property, Fintel, XPS Pensions and Clinigen (post-profit warning), with aggregate purchases in the period totalling £14.8m. The period ended with a relatively low cash balance of 2.6%, although we expect this to increase in the subsequent period following the completion of the Equiniti and Proactis takeovers discussed earlier.

In aggregate, since September 2020 the fund has made purchases totalling £52.4m, which represented 24% of closing NAV; and similarly, realisations in the period totalled £41.6m, or 27% of opening NAV. The weighted average market capitalisation of holdings purchased was £292m, compared to £639m for those realised. The average market capitalisation of the fund’s current holdings is £367m at the period end; on a like for like basis (i.e. using June 2021 share prices) this compares to £481m at the end of September 2020. These data points reflect another 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

We continue to expect a strong economic recovery in the UK during the second half of 2021, driven by vaccine penetration and restrictions being removed later this month. Nevertheless, the extreme uncertainty that has hung over many sectors and companies is still limiting short-term visibility. In turn, this will drive elevated profit warnings, both positive and negative as the year progresses.

In this context we anticipate heightened volatility at the individual stock level. 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. The economic environment and lingering COVID-19 discontinuity will provide agile smaller businesses with strong management teams the opportunity to take market share and build strong long-term franchises.

We continue to believe that our fundamental 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 the Manager believes 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.***