

WS Gresham House UK Micro Cap Fund

Quarterly commentary – Q1 2025

Past performance is not necessarily a guide to future performance. Portfolio investments in smaller companies typically involve a higher degree of risk. Capital at risk. Extracted portfolio performance is not necessarily indicative of the performance of the fund. Not to be construed as investment advice or recommendation. Views expressed by the investment team are correct at the time of writing but are subject to change.

Overview – Q1 2025

UK equity market performance was mixed in the first quarter of 2025 as smaller company stocks generally underperformed their larger peers. The Deutsche Numis Smaller Companies plus AIM ex Investment Trusts Index, FTSE AIM All Share, and FTSE 250 Index declined by **5.9%**, **4.9%** and **5.0%** respectively. In contrast, the FTSE 100 Index rose by **6.1%**.

During the quarter, several dynamics negatively impacted on the performance of the UK smaller companies sector, however we have observed strong fundamental business performance across the portfolio. There were 43 company trading updates or results announcements during the period, of which 84% were in-line with or ahead of market expectations (37% ahead). Based on the degree of positive earnings upgrades across the portfolio, we would have expected low single-digit aggregate Fund performance had valuations remained static during the period.¹ In reality, a broad de-rating across the portfolio more than offset positive fundamental progress in terms of earnings growth and cash generation.

A variety of factors have contributed to this de-rating in our view. Domestically, the national insurance (NIC) and minimum wage changes announced in the government's Autumn Budget have continued to reverberate across the UK economy as consumers and companies prepared for implementation of new measures. We have seen a sharp and relatively broad-based slowdown in consumer footfall, particularly concentrated among low-earning consumers, as uncertainty regarding the employment outlook in that cohort has driven lower spending. While the majority of portfolio companies were insulated from these adverse dynamics, UK consumer and business sentiment has weakened since the Autumn Budget, driving risk-off investor attitudes towards UK smaller companies. Moreover, the change in government policy towards inheritance tax relief available on AIM-listed equity investments has caused a handful of larger AIM-listed companies to seek main market listings, leaving an overhang of inheritance tax (IHT)-focused investors who are expected to become forced sellers in the short term, albeit we expect to see those IHT funds redeployed into other AIM companies in due course.

UK equity markets also remain out of favour compared to other international markets. The first two months of 2025 saw accelerating outflows from UK focused equity funds of £1.1bn and £1.2bn respectively, with most of the money rotating into US or global equity funds. Net outflows have exerted downward pressure on UK smaller company valuations across the board, and we believe the subsequent de-rating explains all of the negative performance given in-line and positive earnings revisions on aggregate during the period. Moreover, the initial rhetoric and policies of the new US administration has fueled geopolitical and

¹ Weighted average (using daily average NAV) earnings growth based on forecast earnings per share at the start and end of the period.

macroeconomic uncertainty, causing multiple developed equity markets to sell off, particularly in anticipation of widespread trade tariffs.

Evidently, domestic and global circumstances are currently headwinds to equity market performance generally. Nevertheless, we take comfort from the strong operating performance and outlooks of our portfolio companies, whose earnings profiles and value creation potential are largely insulated from external factors.

Our bias towards defensive fundamental characteristics such as structural growth drivers, high margins, and strong cash generation has led to a high proportion of companies delivering results in-line with or ahead of market expectations. We continue to see the dislocation between portfolio company fundamentals and valuations – which has widened during the first quarter – as a compelling medium-term opportunity.

Performance – Q1 2025

Performance in the WS Gresham House UK Micro Cap Fund decreased by **5.6%** during the quarter, outperforming the IA UK Smaller Companies sector which decreased by **7.4%**.

Key positive contributions came from **Staffline (+0.9% CTR)** following a full-year trading update which showed profit delivery materially ahead of market expectations driven by market share gains as well as a disposal of the non-core PeoplePlus business and launch of a share buyback programme; **Inspired (+0.8% CTR)** following full-year results in-line with expectations and announced confidence in Full Year 2025 earnings prospects following the completion of previously delayed contracts and removal of a covenant risk overhang due to a significantly strengthened balance sheet following an equity placing; and **Argentex (+0.7% CTR)** following a full-year trading update ahead of market expectations.

The largest detractors to performance were **Ricardo (-1.4% CTR)** following a significant profit warning in late January driven by order delays in the high-value Energy and Environment segment as well as Rail, however, we have extensively engaged with the management team and board on a value recovery plan; **Iomart (-1.5% CTR)** following a profit warning driven by higher-than-expected customer churn in the legacy self-managed infrastructure segment; and **MPAC Group (-1.0% CTR)** on no specific newsflow.

Portfolio activity

We made one new investment during the period: into **Tribal Group**, an international provider of student administration software with market leading positions in the UK, Australia and New Zealand. Tribal is well known to us, and we believe it provides strong defensive characteristics with high visibility of earnings through its SaaS revenues, and is attractively valued relative to software sector averages for quoted peers and precedent transactions. Since investment, Tribal has reported full year results ahead of consensus expectations with particularly encouraging performance in recurring revenue, EBITDA and cash generation.

We made three full exits during the period: from **Loungers** following the completed takeover by US private equity firm, Fortress Investment Group at a 30% premium to the undistributed prior-day share price; **Windward** following the completed takeover by US growth equity firm, FTV capital, at a 47% premium to the undisturbed prior-day share price and 92% to the volume-weighted average share price over the six months prior to the announcement; and **Belluscura**, a legacy position which had become sub-scale and unsuitable for the Fund's mandate based on market capitalisation.

We made selective follow-on investments during the period into: **Argentex**, a currency risk management and cross-border payments business which we believe offers attractive long-term value driven by structural market tailwinds, an attractive platform-based proposition to drive share gains, and an attractive financial profile; **Inspired**, a tech-enabled energy & ESG services provider which benefits from structural demand

tailwinds for energy procurement optimisation and other ESG solutions and quality financial characteristics. We participated as part of an equity placing which re-capitalised the company following short-term contract delays which have now completed; and **Pinewood Technologies**, via an over-subscribed equity placing undertaken to acquire Seez, an AI and machine-learning driven software-as-a-service platform to the automotive sector.

Outlook – Q2 2025

Looking ahead to Q2, we remain cautious about the short-term macroeconomic and geopolitical outlook given current headwinds, however, our portfolio companies have demonstrated good operational resilience with the majority announcing constructive earnings outlooks in this challenging environment.

While we expect US tariffs and the retaliatory actions of its trading partners to have an influence on the global economy and equity markets during the next quarter, we believe the strong fundamental performance of our portfolio companies reflects our emphasis on defensive, idiosyncratic characteristics, which better insulate overall Fund performance from external headwinds. Circa 88% of equity net asset value is invested in services-focused businesses, while on average, 71% of portfolio company revenues are derived from the domestic UK economy,² protecting investee companies from direct tariff exposure. More importantly, we believe these companies benefit from strong positions in structurally growing markets and quality financial characteristics including very low leverage, high margins, and a high return on capital. These high-quality businesses are managed by capable, experienced, and aligned management teams exercising value creation levers in their direct control. Indeed, recent events highlight the advantages of avoiding sectors in which key investment drivers are beyond management influence.

Over the medium term, we retain conviction that our portfolio companies can consistently drive earnings growth and cash generation, with optionality for selective re-rating as the market gradually reflects positive fundamental progress and prospects in valuations. We therefore see the current dislocation between portfolio company fundamentals and valuations – which has widened since year-end – as a compelling long-term buying opportunity.

While uncertainty has persisted into this year, we see upside potential to Fund performance from elevated takeover activity across UK equity markets. In the first quarter, there was an increase in activity as expected, with 15 companies with a market capitalisation of over £100 million entering bid situations at an average premium of 36% versus the undisturbed prior-day price.³ Corporate and financial buyers are attracted to the discounted valuations available in UK equity markets which do not properly reflect the strategic value or high-quality fundamental characteristics on offer. Ultimately, this bid activity should illustrate the discounted nature of comparable businesses in relevant sectors and demonstrate scope for organic re-rating over time.

We have also seen greenshoots of IPO activity over the first quarter of 2025, with some of the businesses considering or actively pursuing listings being of considerable scale compared to those of the last two years. In this light, we continue to press for government reforms which offer structural support to UK capital markets, both in terms of alleviating downward valuation pressure and preventing ongoing de-equitisation. Part of the solution lies in promoting greater UK pension fund participation in domestic equity markets, where they are materially under-penetrated today at defined contribution, defined benefits, and local government levels compared to other developed western nations.⁴ Should the UK pensions sector increase investment in domestic equities in-line with developed peers, this additional liquidity would help alleviate the valuation issue we describe, revitalise UK capital markets as an attractive listing venue for quality innovative businesses, and promote greater investment in the wider UK economy.

² Weighted average by equity net asset value as of 31 March 2025

³ Charles Hall, 'Pace of M&A quickens', Peel Hunt, 1 April 2025

⁴ Department for Work & Pensions, 'Pension fund investment and the UK economy.'

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