Results analysis: Miton UK MicroCap

MINI's unique investment process may uncover some good value in an otherwise uncertain environment...

Update
16 December 2022

- **Miton UK Microcap (MINI) has released its interim results for the half year ending 31/10/2022. Over the period the trust has seen its NAV total return decline by 29% compared to total returns of -19.5% for the Numis 1000 Index and the average total return of -16.1% for the AIC UK Smaller Companies sector. MINI's share price declined by 31.8% on a total return basis.**

- **Micro-caps have underperformed larger companies in the small cap universe, which has detracted from MINI's relative returns. The managers report that the prospects for most of the trust's holdings have not deteriorated, but nonetheless some have sold off thanks to even modest profit taking. There have also been a handful of cases where the prospects for their holdings have deteriorated and detracted from portfolio returns.**

- **MINI offers a voluntary annual redemption facility, which is designed to ensure that the share price does not deviate too far from the underlying NAV. At the 06/06/2022 redemption point, 14,614,999 ordinary shares were requested to be redeemed or 13.38% of the issued share capital at that date. The Redemption Point will change to 2 November in 2023.**

- **Over the six months to 31/10/2022, the trust's discount widened from 5.0% to 8.6%, however in recent weeks it has again narrowed to 6.3%. The redemption mechanism means the trust often trades at a narrower discount than the peer group's simple average which is currently 14.0%.**

- **Chairman Ashe Windham commented "... it is a source of some comfort to see glimmers of life in our microcap stocks." He continued by noting that "Microcaps... now stand at significantly attractive valuations". Furthermore, "With the constraint on capital that comes with inflation, the relative strength of UK quoted company balance sheets should be a considerable advantage, especially compared to those with substantial debt burdens."**

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Kepler View

The last six months have been a particularly challenging period for many equity strategies. Inflation has proven to be stickier than perhaps initially expected, with the rapid increases in interest rates seemingly having little effect on the data. This has had a disproportionate impact on smaller and micro-cap strategies compared to their large cap counterparts and is reflected in **Miton UK Microcap's (MINI)** most recent reporting period as the trust's NAV total returns declined in absolute and relative terms compared to the benchmark and peer group average. Despite the underlying prospects for most of the trust holdings remaining strong, a number of the trust's holdings have experienced significant share price pressures and have been subject to the inherent volatility associated with the microcap sector. For example, the UK-based global engineering company Saietta Group was able to raise £23m of new capital in August to fund a major contract with a US business to accelerate its transition to a fully integrated e-drive supplier. Following significant demand from institutional investors, a modest amount of profit taking drove down the share price by 47.8% and detracted 1.1% from returns.

Despite MINI's underperformance the managers, Gervais Williams and Martin Turner, believe it has led to a significant longer-term opportunity. The ongoing caution enveloping the UK has stemmed from the political gridlock associated with the Brexit referendum, the global pandemic and more recently, the unsuccessful mini budget. Combined with global market uncertainties, they note that the aggregate price-to-book valuation of the portfolio, which is a company's share price divided by its asset value per share, reached an unusually low level of 0.8x by the period end – almost half that of the UK market as a whole.

Moreover, Gervais and Martin believe that as we enter a structurally different environment to the multi-decade period of globalisation, which includes persistent levels of inflation and higher interest rates, this presents opportunities for the underlying companies they invest in. As monetary authorities act to suppress demand, this will present challenges to many businesses as price wars begin to drive down prices and impact companies' profit margins. They expect this to result in the outperformance of companies that can demonstrate high levels of customer service (leading to customer loyalty), high levels of near-term cash generation and low levels of debt – particularly given these companies' seemingly overlooked valuations. We note since the trust's inception in April 2015, MINI has been able to demonstrate outperformance over the longer term with NAV total returns of 34.3% versus 33.4% from the trust's performance comparator, the Numis 1000 Index, as at 31/10/2022. We note that between the March 2020 stock market low and May's 2021 peak, MINI's NAV rose 191%, indicating the strong return potential in the strategy when the market moves in its favour.

There is no escaping the fact that global equity markets have been negatively impacted by the persistent challenges of macroeconomic data and geopolitical uncertainty. Micro- and smallcap strategies have suffered disproportionately, with MINI at the more volatile end of the spectrum. However, we believe the sell-off in share prices seen this year is a significant overshoot. Although market sentiment may not improve immediately, MINI's track record suggests it may generate strong returns when it does so. At the current discount of 6.3%, this may prove an attractive entry opportunity, particularly given the trust's annual redemption facility.

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