



## Montanaro UK Smaller Companies

Investment companies | Update | 16 April 2021

### Long COVID effect requires a focus on corporate health

In absolute terms, Montanaro UK Smaller Companies Trust (MTU) has been generating healthy returns for its shareholders; both the share price and the NAV are close to all-time highs. However, recently MTU has given up some of its earlier outperformance.

As vaccines are rolled out, the end of lockdowns is finally in sight and we are all eager to get back to 'normal'. Last November, the news that a number of vaccines were effective triggered a surge in stock markets and a sharp rotation from high quality and growth stocks into riskier and/or 'value-style' stocks. This did not suit MTU's investment approach.

MTU's manager, Charles Montanaro, is convinced that this is likely to be a short-term setback. He believes that the long-term economic effects of COVID will put a severe strain on companies with unsustainable business models and some may fail. MTU will stick with its quality and growth focus.

### UK small cap with a bias to quality

MTU aims to achieve capital appreciation through investing in small quoted companies listed on the London Stock Exchange or traded on AIM and to outperform its benchmark, the Numis Smaller Companies Index (excluding investment companies).

Sector	UK smaller companies
Ticker	MTU LN
Base currency	GBP
Price	154.7p
NAV	158.2p
Premium/(discount)	(2.2%)
Yield	3.6%



MTU's dividend is another source of comfort for investors. It is one of the highest in the peer group and it is growing



Sustainability is embedded within the culture of the management company



The manager's outlook is positive overall but Charles cautions investors that the economic effects of the virus will be long-lasting.





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<b>Domicile</b>	<b>England &amp; Wales</b>
<b>Inception date</b>	<b>16 March 1995</b>
<b>Manager</b>	<b>Charles Montanaro</b>
<b>Market cap</b>	<b>259.0m</b>
<b>Shares outstanding</b>	<b>167.4m</b>
<b>Daily vol. (1-yr. avg.)</b>	<b>263,633 shares</b>
<b>Net gearing (26/02/21)</b>	<b>9.7%</b>

[Click here for our initiation note](#)



[Click here for an updated MTU factsheet](#)



[Click here for MTU's peer group analysis](#)



[Click here for links to share trading platforms](#)



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## At a glance

### Share price and premium/(discount)

Over the year ended 31 March 2021, MTU's shares traded in a range from a discount of 17.7% (when markets were panicky back in April 2020) to a premium of 1.4% and an average of a 9.4% discount. MTU's supportive shareholder base has helped keep its discount under control, perhaps suggesting that investors agree with Charles that the relative underperformance will prove temporary.

### 31 March 2016 to 14 April 2021

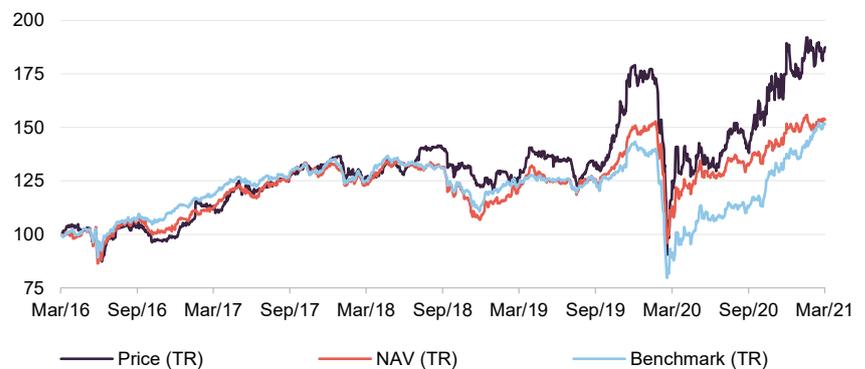


Source: Morningstar, Marten & Co

### Performance over five years

MTU's outperformance of the Numis Smaller Companies Index accelerated in the spring of 2020, as investors became more unnerved about the likely effects of COVID and sought safety in the high-quality and growth stocks that are the focus of MTU's portfolio. However, the good news on vaccines last November triggered a sharp rotation into riskier, value stocks and, against that backdrop, MTU lagged the benchmark index.

### 31 March 2016 to 31 March 2021



Source: Morningstar, Marten & Co

12 months ended	Share price total return (%)	NAV total return (%)	Numis SC ex Inv Co.s TR (%)	MSCI UK total return (%)
31/03/2017	13.3	12.8	18.8	23.5
31/03/2018	12.0	9.3	5.2	(0.2)
31/03/2019	(1.1)	(1.4)	(1.2)	7.6
31/03/2020	(0.3)	(6.9)	(25.9)	(19.1)
31/03/2021	50.0	35.9	65.6	20.0

Source: Morningstar, Marten & Co

## Fund profile

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More information is available at the manager's website [www.montanaro.co.uk/muscit](http://www.montanaro.co.uk/muscit)

Readers may wish to refer to [our initiation note](#), which was published on 5 March 2020

MTU is a UK smaller companies trust with a focus on capital growth. Montanaro Asset Management Limited (MAML) is the trust's AIFM. Charles Montanaro established MAML in 1991, and MTU was launched in March 1995 with Charles as its lead manager. He has been the trust's named manager for about 70% of its life, most recently returning in 2016. The trust raised £25m at launch and topped that up with a £30m C share issue the following year. Today the trust has a market cap of £259m.

More of the history of the trust was set out in our initiation note – see page 3 of that note, which can be accessed via the link on the left or by visiting the QuotedData website.

MAML has one of the largest teams in Europe focused on researching and investing in quoted small- and mid-cap companies. In spite of the pandemic, MAML has been growing its team since we last published and it is now 35-strong altogether, including an investment team of 13. The team is experienced, multi-lingual and multi-national (10 different nationalities). All but two of the fund managers also have research responsibilities. At the end of December 2020, MAML had assets under management of almost £4.0bn. Charles Montanaro and his family together own 95% of the business, but staff have options over about half of that.

The trust is benchmarked against the Numis Smaller Companies Index (excluding investment companies) and we have also used the MSCI UK Index as a performance comparator in this report. The benchmark plays no part in determining which stocks are selected for the portfolio, or how large positions are as a percentage of net assets.

MAML's interests are aligned with those of MTU's shareholders. MAML owns around 5% of the trust and Charles added to his own holding by buying 850,000 shares in December 2020.

Shareholders are offered regular continuation votes. The next of these is scheduled for this year's Annual General Meeting.

As we discuss on page 18, MTU's discount has narrowed over the past year and, at times, the shares have traded at a premium to asset value. A better appreciation of the quality of the portfolio, and the trust's strong environmental, social and governance (ESG) credentials (see page 7) will have played a part in that, but the enhanced yield offered by the trust (see page 17) is likely to have been another important factor.

## Navigating 2020

Globally, the UK market was one of the worst-performing over 2020 – as Figure 1 illustrates, the total return on the MSCI UK Index lagged the MSCI World Index by 22.7% over the year.

**Figure 1: MSCI UK relative to MSCI World**



Source: Morningstar, Marten & Co

**Figure 2: GBP trade weighted**



Source: Bloomberg

This was not a one-off, however. Until relatively recently, the UK market had been underperforming other major markets since the Brexit referendum was announced. As Figure 2, which is a graph of the pound relative to a basket of major currencies shows, a significant component of that initial underperformance can be attributed to a weak currency.

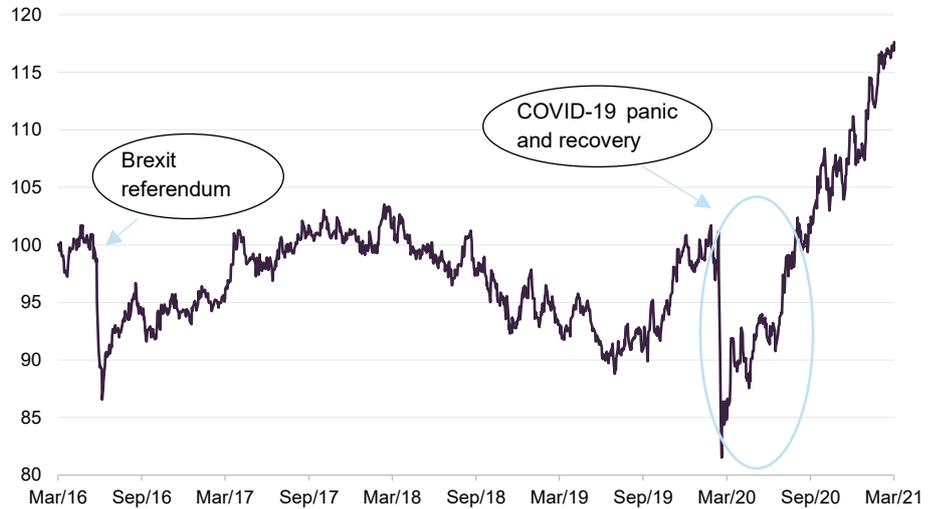
The final quarter of 2020 was marked by a string of good news on the vaccine front and a last-minute agreement on the terms of trading with the EU post-Brexit. The UK may have a poor record of controlling the coronavirus, and has suffered a significant economic hit, but the pace of the vaccination programme has injected a note of optimism. There are tentative signs that both domestic and overseas investors may be looking at the UK once again.

## Smaller stocks doing better

Over 2020, smaller UK stocks outperformed larger ones on average, with a pretty strong inverse correlation between market cap and returns. The pandemic panic of March 2020 saw the usual flight to the perceived safety of large cap stocks. However, smaller stocks quickly regained their footing, helped by the substantial financial support package provided by the government.

Figure 3 shows the performance of the Numis Smaller Companies (excluding investment companies) Index relative to the MSCI United Kingdom Index.

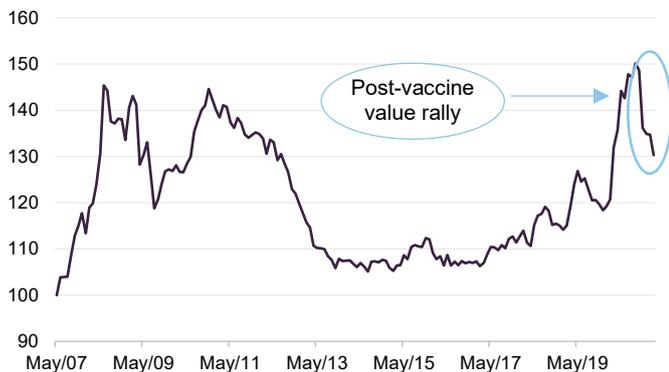
**Figure 3: Numis Smaller Companies ex IC relative to MSCI UK**



Source: Morningstar, Marten & Co

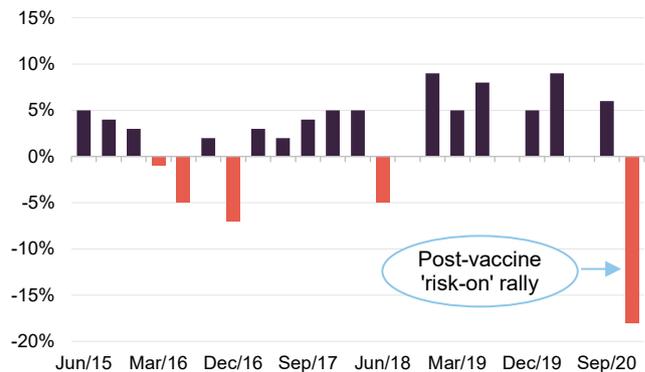
This trend was accentuated by good news on vaccines and the promise of an end to lockdowns. However, that was accompanied by a rotation into 'value' and lower-quality stocks. This has triggered a short-term setback in the relative performance of MTU's quality and growth-focused portfolio. We have illustrated this with the charts in Figures 4 and 5. Figure 4 shows the performance of the MSCI UK small cap growth index relative to the value index. Figure 5 is based on analysis carried out by MAML and shows how high quality stocks perform relative to low quality ones.

**Figure 4: MSCI UK small-cap growth relative to value**



Source: Morningstar, Marten & Co

**Figure 5: UK small-cap high-quality versus low-quality (quarterly change)**



Source: MAML

The manager's outlook is positive overall but Charles cautions investors that the economic effects of the virus will be long-lasting. Government finances have been stretched by fiscal stimulus. Measures are already being taken to recoup some of this, with corporation tax rises planned and tax allowances frozen (which will restrict consumer spending).

COVID-related lockdowns accelerated many trends that were already underway, such as the shift to online retail, education and healthcare, and increased working from home. A reopening of shops and offices may provide some relief, but many companies have borrowed significant sums to tide them over and will be struggling with this debt burden for years to come. MAML is also concerned that consumers may have been unnerved by recent events and may fear for their job security. Any initial consumer boom that occurs after the lifting of lockdowns may prove short-lived.

We are not quite out of the woods yet

We must also acknowledge that the virus has not yet been defeated and new variants may complicate the situation. Even in the UK, where the vaccination programme has been a notable success story, obstacles are emerging to delay its completion.

## Long-term quality growth focus

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Our initiation note set out MAML's approach to managing MTU in some detail. However, it might be worth a reminder that MAML invests in:

- simple businesses that it can understand;
- profitable companies trading at sensible valuations;
- niche businesses in growth markets (non-cyclical companies, growing organically);
- market leaders (strong, defensible market positions and pricing power);
- companies with high operating margins and high returns on capital (barriers to entry/a sustainable competitive advantage);
- good management that it trusts (aligned to shareholders and demonstrating sound ESG practices); and
- companies that can deliver self-funded organic growth and remain focused on their core areas of expertise, rather than businesses that spend a lot of time on acquisitions.

This could be summed up as investing in high quality businesses at sensible prices.

MAML places great emphasis on conducting its own research on potential investments rather than relying on third parties such as brokers. Meeting companies is an important part of this. The team conducted almost 500 meetings over 2020, albeit mostly virtually, and will return to making site visits when this is permitted. An evaluation of ESG aspects is integral to the analytical process. High quality companies have sustainable businesses.

## Sustainability

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Sustainability is embedded within the culture of the firm

ESG analysis has been part of MAML's investment process for 20 years and sustainability is embedded within the culture of the firm. MAML has been a **B Corporation** since June 2019. Certified B Corporations are legally required to consider the impact of their decisions on their workers, customers, suppliers, community, and the environment. MAML has committed to achieving net zero emissions by 2030, offsets its business travel in conjunction with **ClimateCare**,

supports a number of charities and promotes diversity, equality and wellness within the team.

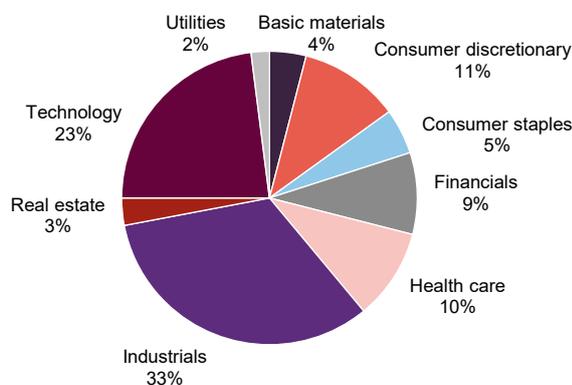
Within its portfolios, including MTU's, MAML will not invest in tobacco companies; companies manufacturing weapons, those facilitating gambling or manufacturing alcohol; companies engaged in oil and coal-related exploration and production; companies involved with pornography; and those making high-interest-rate loans. MAML's corporate governance checks include an assessment of a company's remuneration policy.

MAML has an internal sustainability committee that meets quarterly and oversees MAML's efforts in this area. MAML also has its own handbook, policies and checklists. It votes the shares it controls, and engages with companies. MAML expects the companies that it invests in to improve their ESG awareness and it monitors their progress.

## Asset allocation

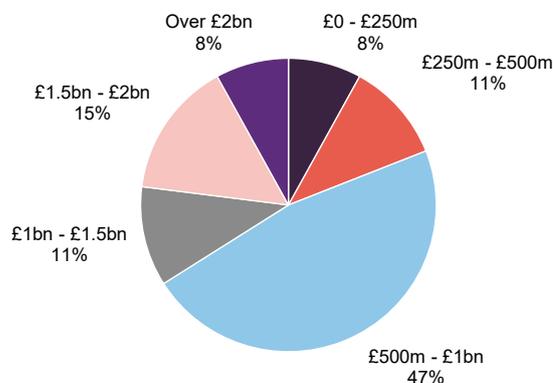
At the end of February 2021, MTU had 53 holdings and the median market cap of the companies it was invested in was £702m. The sector split is driven by MAML's stock selection decisions.

**Figure 6: MTU sector split at 31 March 2021**



Source: MAML, Marten & Co

**Figure 7: MTU split by market cap at 31 March 2021**



Source: MAML, Marten & Co

MTU's bias to quality is evidenced in Figure 8, which shows average measures for a range of metrics (all based on current year forecasts) for MTU's portfolio and compares these to the equivalent figure for the benchmark. That quality comes at a price, but it is clear that MTU's companies have, on average, stronger balance sheets, faster sales and earnings growth and higher returns on equity than the average stock in the benchmark index.

**Figure 8: MTU portfolio structure versus benchmark, as at 31 March 2021**

	MTU	Numis Smaller Companies Index
Price/earnings ratio, 12 months forward	27.3x	14.3x
Earnings before interest and tax margin, 12 months forward	17%	12%
Return on equity, 12 months forward	18%	10%
% of companies with net cash, 12 months forward	52%	24%
Sales growth	13%	7%
Earnings per share growth, 12 months forward	21%	14%

Source: MAML, Factset

At the end of 2020, MAML estimated that around half the portfolio's sales were to the UK domestic market.

## Top 10 holdings

**Figure 9: MTU top 10 equity holdings at 31 March 2021**

	Sector	% as at 31 March 2021	% as at 31 March 2020	Change (%)
NCC Group	Software and computer services	3.9	2.8	1.1
Discoverie Group	Electronic and electrical equipment	3.8	3.5	0.3
Kainos	Software and computer services	3.7	n/a	n/a
Treatt	Flavourings and fragrances	3.6	n/a	n/a
XP Power	Electronic and electrical equipment	3.6	2.7	0.9
Marshalls	Construction and materials	3.5	3.7	(0.2)
Ideagen	Software and computer services	3.3	3.7	(0.4)
4Imprint Group	Promotional material	3.2	3.2	-
Dechra Pharmaceuticals	Veterinary pharmaceuticals	3.2	2.4	0.8
Liontrust Asset Management	Financials	3.2	n/a	n/a
<b>Total</b>		<b>35.1</b>		

Source: MAML, Marten & Co

The underlying turnover within the portfolio has remained relatively low (21% in 2020 as compared to 29% in 2019, and an average of 24.4% over the past seven years).

**Figure 10: Top 10 holdings – size, profitability, yield and valuation as at 15 April 2021**

	Market cap (£m)	Earnings before interest and tax margin (%)	Dividend yield (%)	Price/earnings ratio, 12m forward	Price/earnings to growth ratio
<b>NCC Group</b>	<b>791.5</b>	<b>7.7</b>	<b>1.6</b>	<b>33.6</b>	<b>n/a</b>
<b>Discoverie Group</b>	<b>661.1</b>	<b>4.6</b>	<b>0.4</b>	<b>31.7</b>	<b>2.6</b>
<b>Kainos</b>	<b>2068.9</b>	<b>17.6</b>	<b>0.8</b>	<b>46.3</b>	<b>n/a</b>
<b>Treatt</b>	<b>659.1</b>	<b>13.8</b>	<b>0.5</b>	<b>45.1</b>	<b>n/a</b>
<b>XP Power</b>	<b>995.5</b>	<b>16.0</b>	<b>1.5</b>	<b>26.8</b>	<b>2.8</b>
<b>Marshalls</b>	<b>1444.4</b>	<b>2.0</b>	<b>n/a</b>	<b>28.2</b>	<b>3.2</b>
<b>Ideagen</b>	<b>725.3</b>	<b>3.3</b>	<b>0.1</b>	<b>47.9</b>	<b>n/a</b>
<b>4Imprint Group</b>	<b>692.3</b>	<b>0.7</b>	<b>n/a</b>	<b>50.6</b>	<b>1.3</b>
<b>Dechra Pharmaceuticals</b>	<b>4071.5</b>	<b>12.2</b>	<b>0.9</b>	<b>36.6</b>	<b>n/a</b>
<b>Liontrust Asset Management</b>	<b>952.5</b>	<b>9.7</b>	<b>2.2</b>	<b>23.1</b>	<b>n/a</b>

Source: Bloomberg, Marten & Co

Since we published our initiation note (using data as at 31 January 2020), new entrants into the list of the 10-largest holdings are NCC Group, Kainos, Treatt, Dechra Pharmaceuticals and Liontrust Asset Management. Most of those were pre-existing holdings that performed well.

We discussed Kainos in the last note as MTU had been building a position in this software company. Kainos's share price has more or less doubled since that note was published. A trading update, released on 22 January 2021, revealed that the company expected that its results for the year ending 31 March 2021 would be ahead of market consensus expectations. Amongst other things, it has been working with the NHS as part of the UK Government's digital transformation programme.

Looking at some of the others:

**Figure 11: NCC Group**



Source: Bloomberg

## NCC Group

NCC Group ([nccgroup.com](http://nccgroup.com)) is a global cybersecurity and risk mitigation specialist. Despite some deferral of projects by firms as a result of COVID-19, NCC's revenue grew over 2020 and the company continued to generate strong cash flows from its operations. In its interim results presentation, it drew investors' attention to the Solarwinds hack and the impetus that this might bring to its business. The shift to the cloud is requiring customers to rethink their approach to cybersecurity. NCC's escrow-as-a-service (EaaS) business – which allows customers to access or replicate their cloud environment in the event of a service disruption – is proving increasingly popular. Market consensus is for a near doubling of earnings per share in its 2021 financial year and 20% growth for the 2022 financial year.

**Figure 12: Treatt**



Source: Bloomberg

## Treatt

Treatt ([treatt.com](http://treatt.com)) has made it into the list of largest holdings by virtue of its strong price performance. The company is a market leader in flavourings for non-alcoholic drinks. It has a strong history of margin and profits growth. In a trading update released in January 2021, the company said that it was performing particularly well in its citrus, health & wellness, fruit & vegetables and tea categories, had achieved some material new business wins, and was cautiously optimistic that its profit before tax and exceptional items for its 2021 financial year would materially exceed the then-market consensus expectations.

**Figure 13: Dechra**



Source: Bloomberg

## Dechra Pharmaceuticals

Global veterinary healthcare business Dechra Pharmaceuticals ([dechra.com](http://dechra.com)) is upbeat, helped by the trend towards greater pet ownership. In its half-year presentation, covering the six months ended 31 December 2020, it said that each of its product categories was delivering double-digit growth. Revenue growth for the business as a whole was 22% higher year-on-year and undiluted earnings per share 24.7% higher.

The company is growing both organically and by acquisition. In 2020 it bought dermatology products business Osurnia from Elanco Animal Health for \$135m and global rights to Mirataz for \$43m. Mirataz products are aimed at tackling weight loss in cats. Chiming with MTU's strong focus on ESG, Dechra recently appointed a global sustainability director.

## Other recent portfolio changes

The manager reports that it has been buying AB Dynamics, Focusrite, Avon Rubber and Strix, while reducing Brewin Dolphin, IntegraFin and Gooch & Housego.

**Figure 14: AB Dynamics**



Source: Bloomberg

## AB Dynamics

AB Dynamics ([abdplc.com](http://abdplc.com)) is a global automotive testing business, working with automotive manufacturers on both real-world and virtual testing. COVID-19 impacted revenue in 2020, particularly in areas such as track testing and motorsport. Advanced driver assistance systems are a growth area for the business as is autonomous driving. The company has been making bolt-on acquisitions to broaden its product range and strengthen its market position. The most recent of these was the €26m purchase of Vadotech, a supplier of testing services in the Asia Pacific region.

**Figure 15: Focusrite**

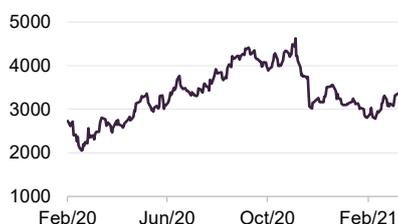


Source: Bloomberg

## Focusrite

Focusrite ([focusriteplc.com](http://focusriteplc.com)) is a global music and audio products group making a range of products from speakers to synthesisers. Despite the effect of lockdowns on its Martin Audio division (which makes loudspeakers and associated equipment), Focusrite's sales have been very strong recently. A trading update released in February suggested that sales for the six months to the end of February 2021 might be more than 80% ahead of the equivalent period in 2020. There is a potential constraint on growth in the form of a global shortage of semiconductors.

**Figure 16: Avon Rubber**

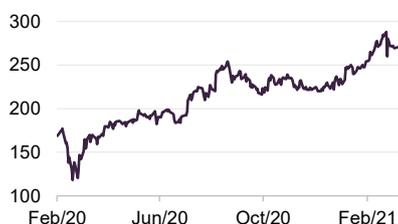


Source: Bloomberg

## Avon Rubber

Avon Rubber ([avon-rubber.com](http://avon-rubber.com)) sold its milking machine operations in September 2020 to focus on its defence business (making helmets and ballistic protection equipment). In December 2020, the company announced that there were problems with the approval process for certain US defence business and a protest had been lodged against its US Army Next Generation Integrated Head Protection System sole source contract announced on 24 September 2020. The protest was upheld and the contract is to be re-tendered. This has knocked Avon Rubber's share price, but the company believes that it can continue to meet financial estimates for 2021 and 2022.

**Figure 17: Strix**



Source: Bloomberg

## Strix

Strix ([strix.com](http://strix.com)) makes controls for kettles and water filters. A new production facility in China should come onstream in August 2021 and is designed to support the company's ambition of doubling its revenue over the next five years. COVID-19 had a temporary adverse effect on kettle manufacturing in the first six months of 2020 but Strix offset that by growing its market share to 55% from 54% and aims to take this to around 57% over the medium term. The purchase of Laica in 2020 boosted Strix's water filtration and small domestic appliance business and this should be the major growth driver in coming years.

## Performance

Charles Montanaro's return as MTU's lead manager in the summer of 2016 was the catalyst for improved returns for the trust. Its outperformance of the Numis Smaller Companies Index accelerated in the spring of 2020, as investors became more unnerved about the likely effects of COVID and sought safety in the high-quality and growth stocks that are the focus of MTU's portfolio. However, the good news on vaccines last November triggered a sharp rotation into riskier, value stocks and, against that backdrop, MTU lagged the benchmark index.

**Figure 18: MTU NAV relative to Numis Smaller Companies ex Investment Companies Index in total return terms**



Source: Morningstar, Marten & Co

**Figure 19: Total return performance over periods ending 31 March 2021**

	1 month (%)	3 months (%)	6 months (%)	1 year (%)	3 years (%)	5 years (%)
<b>MTU share price</b>	<b>0.9</b>	<b>1.1</b>	<b>35.9</b>	<b>50.0</b>	<b>47.8</b>	<b>87.5</b>
<b>MTU NAV</b>	<b>3.2</b>	<b>2.8</b>	<b>16.1</b>	<b>35.9</b>	<b>24.6</b>	<b>53.6</b>
<b>Numis Smaller Companies ex IC</b>	<b>5.1</b>	<b>11.3</b>	<b>33.6</b>	<b>65.6</b>	<b>21.2</b>	<b>51.4</b>
<b>Peer group median NAV<sup>1</sup></b>	<b>4.0</b>	<b>7.7</b>	<b>30.8</b>	<b>56.5</b>	<b>35.2</b>	<b>87.0</b>
<b>MSCI UK</b>	<b>4.1</b>	<b>5.2</b>	<b>16.4</b>	<b>20.0</b>	<b>4.5</b>	<b>28.8</b>

Source: Morningstar, Marten & Co. Note 1) peer group is defined on page 15.

The short-term reversal in MTU's fortunes has clouded its record versus its benchmark and its peer group (see page 15). However, the manager is convinced that the realities of life post-COVID will soon reassert themselves in investors' thinking and quality and growth will be back in demand, to MTU's benefit.

## Attribution

Figure 20 shows the stocks that had the greatest impact on MTU's returns over 2020.

**Figure 20: MTU relative performance attribution over 2020**

Positive	(%)	Negative	(%)
Ideagen	1.5	Avon Rubber	-1.2
XP Power	1.5	RPS	-1.2
Treatt	1.4	Cineworld	-1.2
YouGov	1.1	James Fisher & Sons	-1.0
IntegraFin	1.1	Restore	-0.9

Source: MAML

Looking at some of these in more detail:

**Figure 21: Ideagen**



Source: Bloomberg

### Ideagen

Ideagen ([www.ideagen.com](http://www.ideagen.com)) is a regulatory and compliance software business. It has been delivering organic growth and expanding through acquisition – most recently with the purchase of Qualtrax (a Blacksburg, Virginia-based business with around 340 clients and about \$5m of revenue). That acquisition and the earlier £28m purchase of Huddle (a SaaS-based secure content collaboration and workflow solution with customers across highly-regulated sectors such as accountancy and government) were funded from a £48.7m fundraise that Ideagen carried out last December. Its half-year results, announced in January, came with an upbeat trading statement.

**Figure 22: XP Power**

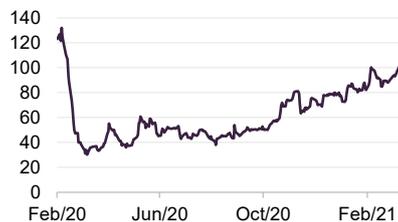


Source: Bloomberg

### XP Power

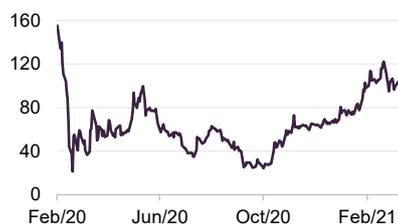
XP Power ([xppower.com](http://xppower.com)) provides a comprehensive range of power supply and power converters to a wide range of industries. Results for 2020 were released in March 2021. These showed revenue growth of 17%, which when coupled with margin growth translated into a 40% increase in adjusted earnings per share. Strong cash flow helped slash net debt by 57%. A new facility in Vietnam helped offset the temporary COVID-19-related shutdown of the group's Chinese manufacturing facility. The restoration of dividends (which were suspended on COVID uncertainty) and a strong order book for 2021 have helped improve investors' confidence in the company.

**Figure 23: RPS**



Source: Bloomberg

**Figure 24: Cineworld**



Source: Bloomberg

## RPS

Professional services firm RPS ([rpsgroup.com](http://rpsgroup.com)), a global engineering consultancy, saw its share price fall sharply as concerns built about the potential effects of COVID-19 on its business, particularly with respect to its exposure to the energy sector. Its balance sheet looked stretched in this context. The manager sold the position.

Results for 2020, published on 9 March 2021, showed that fee revenue for each quarter of 2020 was impacted by COVID-19 but was on an improving trend. Strong cash conversion and a small placing of stock dramatically reduced the group's outstanding debt, which fell from £103m to £17m over the year.

## Cineworld

Cineworld ([cineworldplc.com](http://cineworldplc.com)) is the second-largest cinema chain in the world by number of screens (9,311 screens across 767 sites at 31 December 2020). COVID-19 has hit the business hard, with all sites closed since March 2020 (barring a brief re-opening in the summer). The effect was an 80% fall in revenue for 2020, net cash outflow of \$691m and significant losses – 66.5 cents adjusted earnings per share loss versus earnings per share of 21.3c for 2019.

The company raised \$811m of debt over 2020 and deferred \$350m of rental payments. A US tax credit of \$200m should be received shortly and a \$213m convertible bond issue increases liquidity further. Nevertheless, the business may be operating with capacity restrictions for some time yet. MTU's position was sold in 2020.

## Peer group

The peer group that we have used in this note is a subset of funds within the AIC's UK smaller companies sector. We have omitted split-capital companies, trusts with a small market capitalisation, and those with an exclusive focus on micro-cap companies.

MTU's portfolio held up well in the falling markets of a year ago, but the gyrations in markets around that time mean that the one-year figures in Figure 25 provide little useful information, in our view.

The impact of MTU's focus on quality and growth on its returns is best illustrated by comparing its recent returns with those of Aberforth Smaller Companies, a value-focused trust.

The sharp deterioration of MTU's relative returns since the vaccine announcements of early November 2020 has pushed it towards the bottom-end of the peer group performance tables over most short/medium-term time periods. If Charles is right, and quality starts to reassert itself, MTU could move swiftly back up the rankings.

Up-to-date information on MTU and its peer group is available on the [QuotedData website](http://QuotedData.com)

**Figure 25: Listed UK smaller companies peer group NAV total return performance over periods ending 31 March 2021**

	1 month (%)	3 months (%)	6 months (%)	1 year (%)	3 years (%)	5 years (%)
<b>MTU</b>	<b>3.2</b>	<b>2.8</b>	<b>16.1</b>	<b>35.9</b>	<b>24.6</b>	<b>53.6</b>
Aberforth Smaller Companies	8.7	21.3	63.6	82.6	15.0	50.1
BlackRock Smaller Companies	4.5	7.9	35.7	64.9	33.5	99.8
BlackRock Throgmorton	4.0	6.7	31.2	76.1	50.4	125.0
Crystal Amber	6.5	4.8	25.7	50.8	(31.5)	(4.7)
Gresham House Strategic	3.3	5.5	26.0	45.6	35.2	n/a
Henderson Smaller Companies	6.3	8.4	36.8	71.7	35.9	86.7
Invesco Perpetual UK Smaller	4.0	10.8	32.6	54.2	35.5	87.4
JPMorgan Smaller Companies	5.4	7.4	29.7	81.3	54.7	106.8
Odyssean Investment Trust	2.5	6.3	30.3	53.0	n/a	n/a
Oryx International Growth	1.5	9.9	29.5	80.2	74.4	130.1
Rights & Issues Investment Trust	5.2	11.6	32.7	58.9	13.0	78.9
Standard Life UK Smaller Co.	2.3	1.9	14.3	48.9	36.2	95.0
Strategic Equity Capital	4.1	12.4	32.3	48.6	23.8	54.8
<b>Peer group median</b>	<b>4.0</b>	<b>7.7</b>	<b>30.8</b>	<b>56.5</b>	<b>35.2</b>	<b>87.0</b>
<b>MTU rank</b>	<b>11/14</b>	<b>13/14</b>	<b>13/14</b>	<b>14/14</b>	<b>9/14</b>	<b>10/14</b>

Source: Morningstar, Marten & Co

Comparing MTU on other measures, it is a reasonable size – about middle of the pack for this peer group. MTU’s supportive shareholder base has helped keep its discount under control, perhaps suggesting that investors agree with Charles that the relative underperformance will prove temporary.

MTU’s dividend, which we discuss overleaf, is another source of comfort for investors. It is one of the highest in the peer group and it is growing.

Lastly, we would highlight MTU’s **ongoing charges ratio**, which is towards the lower end of those in the peer group, especially given its size.

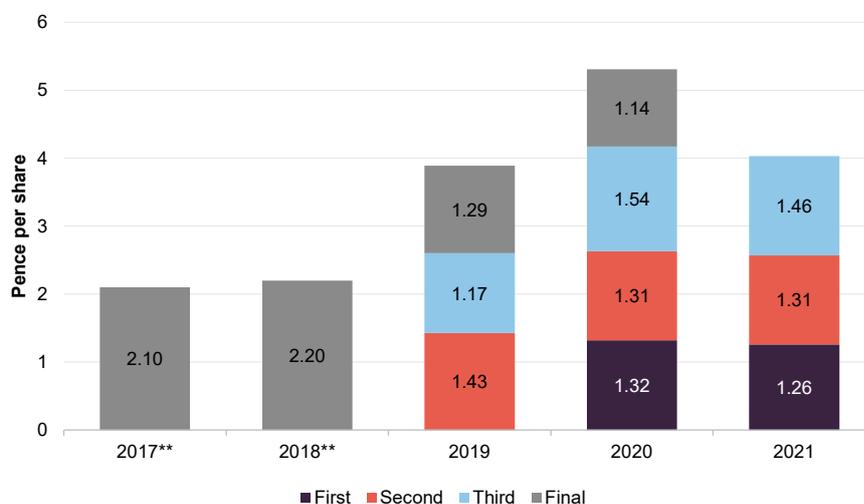
**Figure 26: Listed UK smaller companies funds, comparison as at 14 April 2021**

	Market cap (£m)	Discount (%)	Dividend yield (%)	Ongoing charge (%)
<b>MTU</b>	<b>259</b>	<b>(2.2)</b>	<b>3.6</b>	<b>0.81</b>
Aberforth Smaller Companies	1,373	(3.8)	2.2	0.81
BlackRock Smaller Companies	920	(4.2)	1.7	0.74
BlackRock Throgmorton	787	0.8	1.2	0.60
Crystal Amber	88	(20.8)	4.8	2.08
Gresham House Strategic	50	(7.5)	1.9	2.94
Henderson Smaller Companies	929	(2.1)	1.9	0.42
Invesco Perpetual UK Smaller	199	(9.1)	1.7	0.97
JPMorgan Smaller Companies	310	(0.9)	1.4	1.01
Odyssean Investment Trust	121	(4.3)	0.0	1.51
Oryx International Growth	213	(9.4)	0.0	1.62
Rights & Issues Investment Trust	174	(11.8)	1.4	0.51
Standard Life UK Smaller Co.	639	(6.9)	1.2	0.88
Strategic Equity Capital	182	(12.3)	0.4	1.11
<b>Peer group median</b>	<b>236</b>	<b>(5.6)</b>	<b>1.6</b>	<b>0.92</b>
<b>MTU rank</b>	<b>7/15</b>	<b>4/15</b>	<b>2/15</b>	<b>5/15</b>

Source: Morningstar, Marten & Co

## Dividend

**Figure 27: MTU ordinary dividends (pence per share), 2017-2021\***



Source: MAML, Marten & Co. \*Note: 31 March financial year-ends. \*\*Note: 2017-2018 figures re-stated to reflect the subsequent five for one share split.

In accordance with a policy introduced in July 2018, MTU pays out 1% of its NAV each quarter as a dividend – a level it considers to be meaningful for investors. Dividends are now paid quarterly; they are declared in July, October, January and April and paid in August, November, February and May. At 31 March 2020, MTU had distributable reserves of £114m equivalent to about 13 years of dividends.

The enhanced dividend policy has had no impact on the way in which the fund is managed or the yield on the underlying portfolio. MTU's primary objective is to generate capital growth with the income generation of the underlying portfolio considered to be a by-product of the stock selection process.

## Premium/(discount)

Over the year ended 31 March 2021, MTU's shares traded in a range from a discount of 17.7% (when markets were panicky back in April 2020) to a premium of 1.4% and an average of a 9.4% discount. At 14 April 2021, MTU's shares were trading at a discount of 2.2%.

**Figure 28: MTU premium/(discount) over five years ending 31 March 2021**



Source: Morningstar, Marten & Co

## Previous publications

Our initiation note – [Reputation restored](#) – was published on 5 March 2020 and is available on the QuotedData website or by clicking the link above.



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