Gresham House
Specialist asset management

Strategic Equity Capital plc

Factsheet Commentary - Q1 2022

Overview

The quarter was dominated by an increasing level of market volatility driven by negative sentiment surrounding inflationary pressures, expectations of ongoing interest rate rises, and an impending cost of living squeeze in the UK all of which weighed on UK equities. Russia's invasion of Ukraine has resulted in an ongoing broader correction across global equity markets, being particularly pronounced in UK and European equities. There have also been sharply rising commodity prices, notably across key Russian and Ukrainian exports such as oil, natural gas and wheat as well as a rush to safe haven assets.

Despite some easing of the supply constraints over the quarter, we have seen historically low interest rates driving consumer spending and persistently high energy costs, further exacerbated by the Ukraine-Russia crisis and the new energy price cap, all conspiring to drive inflation[1] to record highs. UK CPI reached a 30-year high of 7% in in the UK during the first quarter of 2022. We previously highlighted the Bank of England having raised interest rates in December, albeit incrementally to 0.25%, the first major central bank to do so.

We have been anticipating increasing market and stock level volatility for some time and believe our portfolio is set up to deliver long-term resilient value, growth opportunities. This is due to our rigorous investment process focusing on high quality fundamentals-based businesses that are largely insulated from wider macro factors and are trading at reasonable valuations.

Despite the increased volatility and weaker sentiment, we continue to believe that the longer-term opportunity across the market cap spectrum of UK equities remains material. This is underpinned by the continuing discounted valuations applied both to the overall UK equity market and, in particular to the smaller companies segment providing some downside protection in more challenging market conditions.

Notwithstanding the fast-moving geopolitical situation, we believe market conditions are increasingly supportive of finding attractive investment opportunities for those prepared to take a longer-term view. We remain selective and disciplined in our approach, seeking high-quality companies with attractive long-term sustainable income and capital growth characteristics at sensible valuations.

Performance[2]

The Fund NAV Total Return decreased by 5.6% over the quarter, outperforming the FTSE Small Cap Index (excluding Investment Companies) which decreased by 6.5% and the UK Smaller Companies Investment Trust sector which declined by 9.3%. We believe the outperformance is notable given the Fund's lack of exposure (by design) to the more cyclical sectors which, by and large drove the market during the period.

Key contributors to returns in the quarter came from: Wilmington (+21%), a professional media and training provider that delivered results ahead of expectations and forecast upgrades; Hostelworld (+12%), an online travel agent on positive sentiment around the easing of global travel restrictions; and Ten Entertainment (+7%), a leading operator of ten pin bowling centres, which reported strong FY21 results and continued positive trading momentum.

The main detractors in the period were: Hyve Group (-32%), a global events operator with material exposure to Russia which was forced to exit its Russian operations; Tyman (-20%), a building products

[1] *Sources:*
Bank Rate increased to 0.25% - December 2021 | Bank of England | https://www.reuters.com/world/uk/uk-inflation-jumps-30-year-high-70-march-2022-04-13/
[2] *Where holdings' returns are stated, please note these are Total Returns, including dividends, for each of those stocks over the quarter.*

supplier which saw share price weakness due to deteriorating sentiment around input cost inflation despite reporting results in line with market expectations and demonstrating it had successfully passed on cost increases through price rises; and Inspired (-14%), an energy procurement and management consultancy, which de-rated due to quantifying its exposure to Gazprom in the UK energy market amid concerns it may be forced to cease trading – to date Inspired has had no negative financial impact and sees potential opportunities arising from the market disruption.

Portfolio activity

Realisations totalled £18.7m in the quarter of which £14m related to a material reduction in the Trust's position in Clinigen as the shares traded above the takeover offer price in the aftermath of an approach by Triton.

Triton completed its acquisition of Clinigen on 5 April realising our remaining holding in Clinigen and an IRR of 18.9% over the holding period.

Corporate activity

On 23 December 2021 the Trust announced that it had received an unsolicited approach to explore a potential combination with Odyssean Investment Trust ("OIT"), a UK Smaller Companies focused investment trust peer. On 9 February 2022 the Trust announced the Board's intention to reject the OIT approach and to introduce a number of additional measures designed to assist in reducing the share price discount to NAV and support shareholder value creation. These measures included (1) an accelerated tender offer for up to 10% of the issued share capital at NAV; (2) a commitment to commence a share buyback programme of up to 9% of the issued share capital at up to a 5% discount to NAV; (3) a commitment from the Trust's investment manager Gresham House to purchase shares up to a value of £5mn at up to a 5% discount to NAV in the secondary market; and (4) an ongoing commitment by Gresham House Asset Management to reinvest up to 50% of its ongoing management charge into SEC shares in the secondary market on the same basis.

On 21 March 2022 SEC announced that shareholders had approved the proposed tender offer and this was subsequently completed on 24 March 2022.

Outlook

Aftershocks from the pandemic that emerged towards the end of last year, such as elevated inflation across a number of areas and global and domestic supply chain disruption, have been exacerbated by the Russia / Ukraine crisis. This caused acute dislocations in asset classes globally and deteriorating equity market sentiment towards the end of March.

Taken in aggregate we believe this is an attractive environment to invest. Whilst ongoing uncertainty can be challenging, it also provides the opportunity to unearth good long-term investments at attractive valuations. At a portfolio level, we have limited exposure to companies that are directly impacted by the issues noted; a direct output of our highly selective, quality-focused investment approach. Second and third order effects – of both the pandemic, and of an inflationary and uncertain geopolitical environment – can be difficult to predict. However, we believe agile smaller businesses with strong management teams will have the opportunity to take market share and build strong long-term franchises.

The elevated levels of corporate activity within the UK equity space continue to play out. We believe our investment process and private equity lens across public markets position us well to identify investment opportunities with potential strategic value that could be attractive acquisitions for both corporate and financial buyers.

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 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. Capital at risk.

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