Results analysis: Miton UK MicroCap

MINI's share price discount could offer a good long-term entry opportunity...

Update
21 July 2022

- **Miton UK Microcap Trust (MINI) has released its financial results for the year ending 30 April 2022. After appreciating very substantially since March 2020, the NAV total return declined by -13.1% which compares to -5.8% for the Numis 1000 Index and the average return of -7.0% for the AIC UK Smaller Companies sector.**

- **MINI has an annual redemption facility, which is designed to ensure that the share price does not deviate too far from the underlying NAV. At the 6 June 2022 redemption point 14,614,999 ordinary shares were requested to be redeemed, or 13.38% of the issued share capital at that date.**

- **Whilst the trust's discount has widened from 0.31% to 5.0% and in the subsequent period it has widened further to 7.1%, the redemption mechanism means it often trades at a narrower discount than the peer group's simple average which is currently 15.2%.**

- **Like others in the peer group, the trust's share price total returns over the reporting period were worsened by the share price discount resulting in a -17.2% fall over the year. Although the manager's outlook statement outlines why they believe the strategy has major upside potential; with the ongoing political uncertainty, the NAV total return and share price total return have fallen a further 20.7% and 22.3% respectively since the year end in April.**

- **Ongoing charges have fallen to 1.41% from 1.60% in the previous period. As the trust starts to demonstrate its potential to deliver premium returns in the absence of global growth (as it did in 2020 and 2021) this is anticipated to reduce ongoing charges further, especially if renewed investor demand leads to an increased level of assets.**

- **The newly appointed chairman, Ashe Windham, commented "Your directors are pleased with MINI's long-term performance as it is handsomely matching its objective ... MINI is well positioned as its portfolio of investments is largely composed of companies which not only generate profits, but also have robust balance sheets."**

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Kepler View

As with most other small and microcap trusts, **Miton UK MicroCap (MINI)** results reported a decline in NAV over this most recent reporting period. With persistent inflation, and the steady appreciation of the US Dollar, micro-cap strategies haven't held up as well as the large caps within the FTSE100 Index for example. It is worth noting that there is some variation amongst competitors in the AIC UK Smaller Companies peer group which includes trusts that have not performed well over the long term but have up to 25% in individual holdings that have driven much of the performance this year, and others which we find it hard to label as true small-cap strategies. Whilst many of the share prices of MINI's portfolio holdings declined with the market trend, there were specific detractors over the year. One such example is the toilet roll supplier, Accrol Group, which produced the greatest detraction to returns over the year with a share price fall of 65%, reducing portfolio returns by 1.4%. Although demand remained consistent, Covid-related staff absences led to unreliable delivery schedules and a decline in service levels, resulting in the customers' refusal to fund additional energy costs of their factories. However, subsequently as service levels have recovered, Accrol have highlighted that these price rises have now been achieved.

Despite the short-term underperformance, MINI has a lot to offer the long-term investor. Gervais and Martin remain upbeat about the trust's future prospects and have long held a view that the reversal of multi-decade trends of globalisation, declining interest rates and the expansion of cheap credit will alter the dynamics of equity markets. In recent years their views seem to have been borne out by events. They expect the new trends to result in the outperformance of cash generative, small-cap value companies against the highly rated large and mega-caps that have dominated the market for many years. Since the trust's inception in April 2015, they have demonstrated relatively strong performance over the longer term with NAV total returns of 89.1% versus 63.2% from their performance comparator the Numis 1000 Index.

In addition, the return on small and micro-cap strategies and associated volatility tends to be less correlated with UK mainstream stocks, and that has been a marked feature over the year. Gervais and Martin believe their portfolio has some advantages however, which may be of help should the global economy remain troubled. First, the trust's portfolio diversifies risk across sector and industry, secondly, the managers select companies with low levels of debt and high levels of imminent cash generation. These are features that would become more important if shortfalls of cash became more endemic due to interest rate increases. Additionally, whilst the FTSE 100 Put option hasn't risen as global stock markets have declined as it did during the pandemic setback, the differential in returns between the two parts of the UK stock market merely underline the scale of the trust's recovery potential.

With the risk that interest rate rises and a global recession lead to customers shopping around for lower prices, Gervais and Martin have focussed on allocating to companies that aspire to deliver outstanding customer service, which they believe is an area that corporate presentations routinely overlook. It appears to help them identify potential winners and avoid investing in highly speculative stocks. They believe management teams that encourage excellent customer service can better manage margin pressures and enhance customer loyalty. In a persistently high inflationary environment, where input cost pressures are particularly prevalent and corporate profit margins are squeezed, this may provide a far less risky source of returns than more highly geared regions.

We think MINI offers investors an attractive source of potential returns in a strategy that isn't necessarily correlated with various high-beta strategies that have been so popular during the latest period of globalisation. In the current uncertain environment and following this bout of share price weakness in the small-cap space, the ability for fundamentally strong micro-cap companies to grow exponentially over the long term, may provide a useful source of returns in an otherwise flat growth environment. In the past, when the MINI NAV has recovered, it has recovered very strongly, and at the current discounted levels this may provide a good entry opportunity.

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