

## Tellworth Insights

Q1 2019

### Why UK Smaller Companies?

Last week I managed to sit through a conference call for 2 h and 13 mins until someone mentioned Brexit, it was incredibly refreshing and suddenly rather depressing in equal measure. However, it made me think what else are we missing while we are pre-occupied with the politics, how about the UK economy? One of the perpetual surprises of this recent stasis is how resilient the UK economy has been. Maybe the worst is yet to come, but to some extent one assumes this is testament to its breadth, flexibility and the inherent ‘keep calm and carry on’ nature of the average Briton. The UK stock market has broadly been dancing to a different tune, particularly down the cap scale where Small and Mid-Cap indices saw c15% declines last calendar year.

There were definitely pockets of overvaluation that needed correcting, growth stocks stand out as having run too far particularly on the AIM market. At the start of October last year, the top 10 AIM shares were trading on 38x forward earnings, at the same time the FTSE Small-Cap market as a whole was trading on barely 11x the same period. The perception is that UK smaller companies are domestic, backward and generally not as good as everywhere else in the world. To some extent this is the typical British self-deprecating view. However, look at our fund and we have a broad geographical exposure by end market across the long and short books. We can find lots of domestic stories we like, often good quality businesses with a value bias and plenty we don’t like – perhaps growth stories that we think are slowing faster than the market is forecasting.

**Figure 1. Revenue by geography of the long and short books**

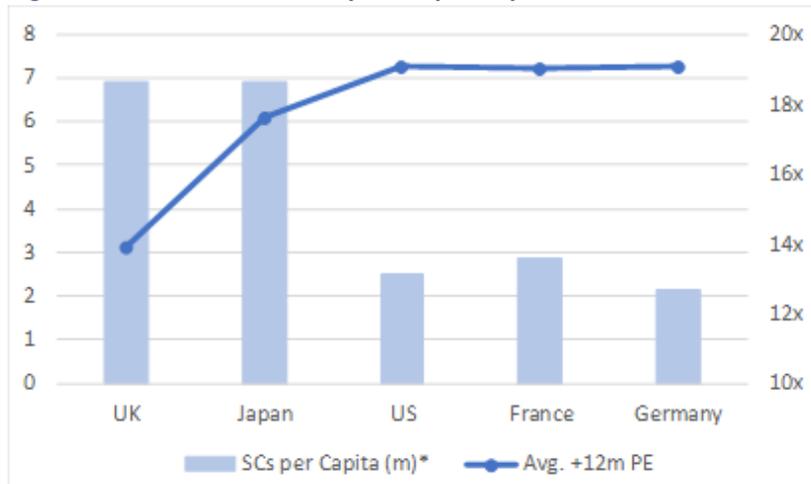
	UK	US	Europe	RoW
Longs	54.3%	12.3%	16.5%	11.7%
Shorts	50.2%	17.6%	12.6%	18.9%

Source: Bloomberg and Tellworth Investments

If you focus on the cohort of smaller cap winners that drive our long term performance you see a much less domestic picture. AB Dynamics is a good example, this company is the world leader in systems for testing autonomous cars. Globally from Detroit to Nagoya, via Silicon Valley and Stuttgart, the industry turns to AB Dynamics for the latest technology. This company is based in the distinctly non industrial Wiltshire town of Bradford-on-Avon and has just completed a new state of the art head office campus – little could be further from the popular image of UK industrial decline. They have also developed a virtual reality driving simulator and have opened a new facility to make and sell

this in Germany – overall sales into the UK account for less than 5% of their total. Why bother with this detail? It’s a perception thing, the reality is that the UK market is populated with companies like this. In fact the UK has 1.5x as many listed smaller companies per capita worth less than \$1bn than the US and 2.5x more listed smaller companies than Germany or France.

**Figure 2. Listed smaller companies per capita worth less than \$1bn**



Source: Bloomberg

The culture for founders and families to list small businesses in the UK is much more entrenched, over the years we have invested in many very successful businesses with large family or founder stakes like VP (UK plant hire) or Fever Tree (soft drinks). There are c.£5bn of specialist smaller companies assets from dozens of institutions investing in this efficient, well-regulated and well governed equity sub sector.

So what are we trying to say here? UK smaller companies are not solely domestic, and constitute one of the cheapest geographies in global small cap while being one of the most well established and well covered by analysts and investors alike. Therefore when we are seeking out the long term winners of tomorrow we need to look no further than the industrial estates and office parks of the UK; when we get there what we find has become no less attractive since the Brexit process began, just quite a bit cheaper.

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