

abrdn UK Smaller Companies Growth Trust

Confirmation that trust is back to winning ways

abrdn UK Smaller Companies Growth Trust (AUSC) is managed by Abby Glennie and Amanda Yeaman, who are encouraged by the trust's relative performance versus both the reference index, which bottomed in Q423, and its larger-cap peers in the AIC UK Smaller Companies sector. During CY24, value stocks outperformed growth strategies, which was a style headwind for AUSC. However, successful stock selection and ensuring portfolio positions were sized appropriately, while avoiding companies that failed to meet consensus expectations, was a winning formula. By the end of 2024, growth versus value was in neutral territory, which should provide a more level playing field, enabling the managers to build on their long-term record of outperformance.

NAV versus the reference index (last three years)



Source: LSEG Data & Analytics, Edison Investment Research

Why consider AUSC?

Glennie and Yeaman employ a well-defined, repeatable investment process using the Matrix, which is a proprietary screen that identifies companies with quality, growth and momentum attributes worthy of further investigation. The Matrix is also used to highlight portfolio companies with deteriorating fundamentals, which may need to be sold.

Despite a tough UK economic backdrop, according to the managers, the UK small company space has many thriving businesses. They believe that the UK market could benefit from a shift in sentiment away from the US, which in recent years has been the 'go-to' country for global investors. However, Glennie and Yeaman remain mindful of short-term stock market volatility due to overseas developments, including President Trump's widespread introduction of tariffs and the ongoing war in Ukraine.

Over the last 20 years, AUSC has traded at a forward P/E multiple premium to the reference index, ranging from two points during the global financial crisis to 14 points during the global pandemic. It is currently towards the lower end of the historical range, meaning that investors are only paying a modest premium to gain exposure to high-quality UK small-cap growth stocks despite a difficult, low-growth economic environment. The managers believe that a reduction in interest rates should be a positive catalyst for the UK market, particularly for small-cap stocks. Company valuations are undemanding, but even if stocks do not re-rate, shareholders could generate an attractive total return from investee companies' earnings growth and the trust's growing dividend.

Investment companies
UK smaller companies

19 March 2025

Price 484.00p
Market cap £317m
Total assets £380m

NAV 528.4p

¹At 17 March 2025.

Discount to NAV 8.4%

Current yield 2.5%

Shares in issue 65.5m

Code/ISIN AUSC/GB0002959582

Primary exchange LSE

AIC sector UK Smaller Companies

52-week high/low 534.0p 437.5p

NAV high/low 598.8p 508.4p

Net gearing 9.7%

¹At 14 March 2025.

Fund objective

abrdn UK Smaller Companies Growth Trust aims to achieve long-term capital growth through investment in a diversified portfolio consisting of UK-quoted smaller companies. Performance is measured against the Deutsche Numis Smaller Companies plus AIM ex-Investment Companies Index (the reference index).

Bull points

- Long-term record of strong absolute and relative performance.
- Consistent proprietary investment process driven by the Matrix.
- Over the long term, shares of smaller companies tend to perform relatively better than those of larger businesses.

Bear points

- Relative performance tends to struggle when investor focus is on macroeconomic events rather than on company fundamentals.
- Less appetite for small-cap stocks during periods of elevated investor risk aversion.
- In general, the operations of UK small-cap companies are more leveraged to the domestic economy.

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AUSC: Now could be an opportune time for this high-quality fund

AUSC's fundamental investment approach is based on quality, growth and momentum factors and has proved successful for more than 25 years through multiple economic cycles. The trust tends to perform better when share prices respond to company fundamentals, when stock markets are challenged or during periods of low growth.

As a reminder, the Matrix, which is an integral part of the investment process, is a proprietary screening tool that focuses the managers' research efforts and stock selection. The Matrix has 12 performance indicators including: earnings revisions (the most important factor), earnings growth, valuation and dividend yield, share price momentum, the level of directors' dealings and Altman Z-scores (to measure balance sheet strength). It can identify a shortlist of companies that warrant further analysis, either as initiations/top-ups or as reductions/disposals.

The managers follow seven principles for successful small-cap investing:

- Focus on quality to enhance return and reduce risk – factors include strong financials, the strength of a company's relationship with its customers and pricing power.
- Look for sustainable growth – companies that can deliver consistent year-on-year earnings growth.
- Momentum – run your winners and cut losers.
- Concentrate your efforts – use of the Matrix helps identify suitable portfolio companies and reduces the risk of spending time on stocks that do not meet the required criteria.
- Invest for the long term – identify the great companies of tomorrow and hold them for the long term, which helps to maximise returns and reduce trading costs.
- Management quality – high ownership and involvement by founders and CEOs with long tenures are viewed positively.
- Valuation aware – company valuations are embedded within the Matrix and the decision-making process but are not a primary focus.

Highlights of AUSC's H125 (ending 31 December)

- Performance: NAV and share price total returns of +1.9% and +4.9%, respectively, were ahead of the reference index's +0.8% total return.
- Revenue and dividends: AUSC's net revenue declined by 15.3% y-o-y to £4.3m. This was partly due to a trend of companies preferring to return cash to shareholders in the form of buybacks rather than dividends. Due to the trust's regular share repurchases, earnings per share was 5.93p, which was just 1.2% lower than 6.00p in H124. AUSC's interim dividend was held steady at 3.70p per share.
- Share repurchases: buybacks were undertaken on most trading days. During H125, c 4.7m shares (c 6.3% of the share base) were repurchased at a cost of c £23.5m and an average 11.1% discount, which added 0.7% per share to NAV. The board targets a maximum 8% discount in normal market conditions.

Perspectives from AUSC's managers

Glennie and Yeaman note that although the UK market is performing relatively well so far this year, money has not yet trickled down into UK small-cap stocks. However, history suggests that fund flows into the UK would benefit share prices across the market cap spectrum. The managers say that regulatory changes could increase demand for UK equities, such as the removal of stamp duty, requiring domestic pension funds to increase their allocation to UK equities or changing the ISA rules to encourage retail investors to consider shares rather than cash.

While around 50% of UK small-cap company revenues are generated overseas, Glennie and Yeaman are encouraged by robust expectations for AUSC's aggregate portfolio earnings growth given very modest UK GDP forecasts. They believe equity markets are likely to be volatile due to the uncertainty following President Trump's re-election, although non-US regions could benefit from a shift in sentiment away from the US, which has been the 'go-to' market for global investors in recent years.

Following their quality, growth and momentum approach, the managers focus on companies that are in control of their own destinies, rather than those that are dependent on the macroeconomic environment. They highlight food companies Cranswick and Premier Foods, which have strong relationships with retailers, so are able to pass through higher costs and are benefiting from the trend of increased dining at home. Glennie and Yeaman contrast these businesses with those that are negatively affected by decision-making and project delays, including recruitment companies and firms with government contracts. They note that most of AUSC's top 10 holdings are beating or meeting estimates, and acknowledge the importance of avoiding companies that disappoint as their share prices are being duly punished. As an aside, the managers report that a few portfolio companies featured in the recent plc awards: XPS Pensions Group as growth business of the year; John Morgan at Morgan Sindall as CEO of the year; and Games Workshop Group as company of the year.

Interestingly, Glennie and Yeaman comment that although UK M&A activity is lower than a year ago, portfolio companies appear to be more confident about doing deals, including Breedon, Cranswick and XPS Pensions Group. AIM shares were under pressure ahead of the 2024 UK autumn budget as there were concerns about changes to their 100% inheritance tax relief. Halving the tax relief has negatively affected flows into inheritance portfolios and added to AIM market volatility. Also, there is a series of companies moving from AIM to the Main Market, including portfolio companies Alpha Group International, Gamma Communications, GlobalData, Johnson Service Group and Mortgage Advice Bureau.

Current portfolio positioning

At the end of January 2025, there were 49 names in the portfolio, which was two lower than a year before and just below the typical 50–60 range. The top 10 concentration was 3.0pp lower year-on-year and five companies were common to both periods. AUSC's active share at the end of January 2025 was 80.6%, which was modestly lower than 82.0 a year earlier – this is a measure of how the trust's portfolio differs from the reference index, with 0% representing full index replication and 100% no commonality. In terms of market cap, at the end of 2024, AUSC was broadly split 2% large cap (£5–10bn), 57% mid-cap (£1–5bn) and 41% small cap (< £1bn), which compared with the reference index's broad 40:60 split between mid- and small-cap stocks respectively.

Exhibit 1: AUSC's top 10 holdings

Company	Industry	Portfolio weight 31 January 2025 (%)	Portfolio weight 31 January 2024 (%)
Morgan Sindall Group	Construction & materials	4.1	3.6
XPS Pensions	Investment banking & brokerage services	4.0	N/A
Cranswick	Food producers	3.7	3.7
Cairn Homes	Household goods & home construction	3.1	N/A
Paragon Banking Group	Finance & credit services	3.1	3.2
JTC	Investment banking & brokerage services	3.0	3.3
Coats Group	General industrials	3.0	N/A
AJ Bell	Investment banking & brokerage services	2.9	N/A
Alpha Financial Markets	Investment banking & brokerage services	2.8	N/A
Hilton Food Group	Food producers	2.8	3.0
Total:		32.5	35.5

Source: AUSC, Edison Investment Research. Note *N/A where not in end-January 2024 top 10 but may be held elsewhere in the portfolio.

Exhibit 2: Portfolio sector exposure (ex-cash and gearing, % unless stated)

	Portfolio end January 2025	Portfolio end January 2024	Change (pp)
Industrials	24.1	25.2	(1.2)
Financials	20.8	18.0	2.8
Consumer discretionary	20.2	18.4	1.7
Consumer staples	10.7	7.8	2.9
Technology	6.8	7.4	(0.7)
Energy	5.1	6.7	(1.6)
Telecommunications	4.0	4.4	(0.4)
Basic materials	3.6	5.5	(1.9)
Real estate	3.4	4.8	(1.5)
Healthcare	1.4	1.6	(0.2)
Utilities	0.0	0.0	0.0
	100.0	100.0	

Source: AUSC, Edison Investment Research

There were modest differences in AUSC's sector exposure over the 12 months to the end of January 2025. The largest changes were higher weightings in consumer staples (+2.9pp), financials (+2.8pp) and consumer discretionary (+1.7pp) with lower allocations to materials (-1.9pp), energy (-1.6pp) and real estate (-1.5pp).

The managers highlight a couple of AUSC's holdings to give some more colour to the portfolio. Glennie suggests that ME Group is not the most exciting business but is a great investment. The company designs, manufactures and operates photo booths and communal laundries, which have high barriers to entry, and ME's international business is growing strongly. Photo booths generate high levels of cash, which is funding the international laundry roll-out. In Europe, photo booths are very popular as, unlike in the UK, individuals cannot submit their own photographs for passport applications. The laundry operations generate very high returns and there are scale benefits in cleaning and maintenance for both parts of the business. Overall, ME Group offers very good growth prospects and an attractive dividend yield.

Yeaman provides more information about Premier Foods. She says the company is reinvigorated under a new management team and is clearing its pension deficit, which is freeing up cash for product development and M&A. Premier has a portfolio of leading brands including Ambrosia, Mr Kipling, Oxo and Sharwood's, along with more recent acquisitions such as The Spice Tailor and FUEL10K, a broad geographic exposure and pricing power, so can pass on higher input costs. The company's resilient earnings stream has led to a series of positive estimate revisions.

Recent portfolio transactions

Portfolio activity was higher than normal in H125 as the Matrix identified several companies with positive quality, growth and momentum attributes, across a range of sectors, that were worthy of further consideration. The UK's economic recovery is more drawn out than investors had originally expected; portfolio companies highlighted as having sluggish momentum were sold.

There were seven new holdings: Applied Nutrition (IPO, nutritional products); Avon Technologies (respiratory and head protection products for the military and first responder markets); Bloomsbury Publishing (an independent publisher of both general and academic content); Breedon Group (construction materials); ME Group (automated vending machines in high footfall locations); Savills (a geographically diversified real estate agent); and Trustpilot Group (an online review platform for businesses and consumers).

During H125, there was an equal number of complete disposals: Alpha Financial Markets Consulting (received a takeover bid from private equity firm Bridgepoint); Big Technologies (slowing business momentum); Liontrust Asset Management (difficult operating environment); Marlowe and Midwich Group (both have uncertain future prospects); Robert Walters (the recruitment industry is under pressure); and YouGov (unexpected profit warning).

So far this year, there has been one further disposal. Ricardo is a global engineering and consulting company that had a surprise profit warning, and the managers are unsure when its business will get back on track. The firm is going through a transition, increasing its capital allocation to higher-growth businesses with better returns. However, the process has not been smooth, primarily due to external factors.

Performance: On the right track

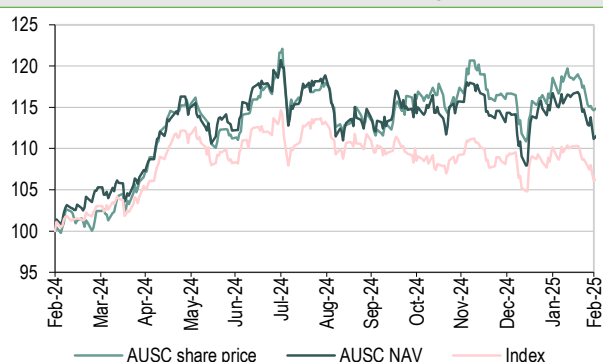
In Exhibit 3, we show 11 of the 22 funds in the AIC UK Smaller Companies sector, with market caps of at least £100m. AUSC's NAV total return ranks first over the last 12 months and is 5.9pp above the selected peer group average. It is also 4.6pp higher than the average over the last decade, ranking fourth out of 10 funds. At 17 March, AUSC had a below-average discount in a group where no funds were trading at a premium. It has an average ongoing charge, an above-average level of gearing and a dividend yield that is modestly above the mean.

While the peers shown employ different investment approaches, Morningstar applies more broad classifications. AUSC is considered to be a small-cap growth fund along with Montanaro UK Smaller Companies Investment Trust (MTU) and Odyssean Investment Trust (ODI). Considering these three funds, AUSC ranks first over one year, third over three years, second over five years and first out of two funds over the last decade. The trust has a modestly higher exposure to defensive (c 14%, anticyclical) sectors than its peers, a similar weighting in cyclical sectors (c 41%, high sensitivity to the business cycle) and a modestly lower weighting in sensitive sectors (c 45%, moderate correlation to the business cycle).

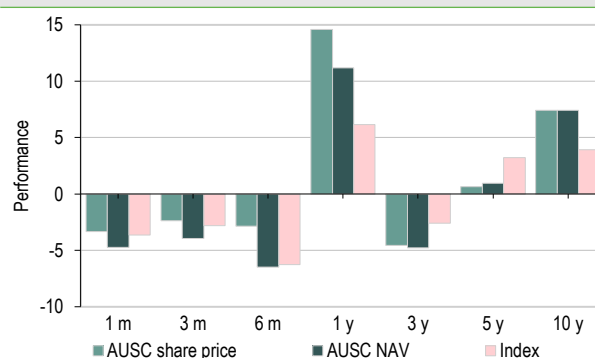
Exhibit 3: Selected peer group at 17 March 2025

% unless stated	Market cap (£m)	NAV TR 1Y	NAV TR 3Y	NAV TR 5Y	NAV TR 10Y	Discount	Ongoing charge	Performance fee	Net gearing	Dividend yield
abrdn UK Small Cos Growth	317.0	4.2	(15.9)	41.3	94.1	(8.4)	0.9	No	110	2.5
Aberforth Smaller Companies	1,126.3	3.4	10.4	111.2	65.6	(10.4)	0.8	No	109	3.6
Artemis UK Future Leaders	105.1	(6.7)	(24.2)	25.3	61.3	(16.2)	1.0	No	100	0.0
BlackRock Smaller Companies	549.9	(4.4)	(20.3)	43.3	76.5	(11.7)	0.8	No	114	3.6
BlackRock Throgmorton Trust	435.1	(3.0)	(13.6)	62.1	109.9	(10.0)	0.6	Yes	122	3.3
Henderson Smaller Companies	569.7	0.7	(16.7)	49.6	60.6	(10.4)	0.4	Yes	112	3.5
JPMorgan UK Small Cap Growth & Inc	375.2	0.3	(2.8)	90.7	117.8	(11.2)	0.6	No	111	3.6
Montanaro UK Smaller Companies	142.9	(1.0)	(7.9)	29.5	34.4	(8.0)	0.9	No	100	4.6
Odyssey Investment Trust	179.7	(7.5)	(11.2)	69.0		(3.9)	1.5	Yes	100	0.0
Oryx International Growth	147.0	(0.5)	3.8	79.6	201.1	(37.2)	1.5	No	100	0.0
Strategic Equity Capital	136.3	(4.5)	2.8	67.6	73.4	(8.8)	1.2	Yes	100	1.2
Average (11 funds)	371.3	(1.7)	(8.7)	60.8	89.5	(12.4)	0.9		107	2.4
Rank	6	1	8	9	4	3	7		5	7

Source: Morningstar, Edison Investment Research. Note: Performance is total return.

Exhibit 4: Rebased one-year price, NAV and index total return performance to 28 February 2025 (%)


Source: LSEG Data & Analytics, Edison Investment Research

Exhibit 5: Share price and NAV total return performance, relative to indices (%)


Source: LSEG Data & Analytics, Edison Investment Research. Note: Three-, five- and 10-year performance figures annualised. Index is Deutsche Numis Smaller Cos plus AIM ex-Inv Cos (Deutsche Numis Smaller Cos ex-Inv Cos to end of 2017).

Exhibit 6: Share price and NAV total return performance, relative to indices (%)

	One month	Three months	Six months	One year	Three years	Five years	10 years
Price relative to index*	0.3	0.5	3.6	8.0	(6.0)	(11.9)	39.2
NAV relative to index*	(1.2)	(1.1)	(0.2)	4.7	(6.6)	(10.4)	39.3
Price relative to Numis Smaller Cos plus AIM ex-ICs	0.3	0.5	3.6	8.0	(6.0)	(11.9)	35.3
NAV relative to Numis Smaller Cos plus AIM ex-ICs	(1.2)	(1.1)	(0.2)	4.7	(6.6)	(10.4)	35.4
Price relative to CBOE UK Smaller Companies	(1.0)	(2.1)	3.1	2.5	(25.7)	(34.9)	(6.5)
NAV relative to CBOE UK Smaller Companies	(2.5)	(3.7)	(0.7)	(0.6)	(26.2)	(33.8)	(6.4)
Price relative to CBOE UK All Companies	(4.6)	(7.6)	(8.0)	(3.4)	(32.8)	(33.4)	11.2
NAV relative to CBOE UK All Companies	(6.0)	(9.1)	(11.5)	(6.3)	(33.2)	(32.4)	11.3

Source: LSEG Data & Analytics, Edison Investment Research. Note: Data to end February 2025. Geometric calculation. *Index is Deutsche Numis Smaller Cos plus AIM ex-Inv Cos (Deutsche Numis Smaller Cos ex-Inv Cos to 31 December 2017).

In H125, the largest positive contributors to NAV were: Morgan Sindall (+1.56pp contribution, strong operational delivery and solid financial performance); Cairn Homes (+0.92pp, ramping up its volumes of new homes in Ireland and has a strong order book); IPO Raspberry Pi (+0.58pp, has made solid commercial and technology progress); XPS Pensions (+0.58pp, strong growth from client demand and a supportive regulatory environment led to earnings estimate upgrades); and Volution Group (+0.56pp, operational strength and announcement of an attractively priced international acquisition).

The largest detractors were: Ashted Technology (-0.91pp, meeting expectations and in line guidance was not sufficient to support a stock price that had rallied strongly over the prior 18 months); Hunting (-0.79pp facing greater than expected headwinds to its US business); Mortgage Advice Bureau (-0.63pp, a more difficult operating environment); Next15 Group (-0.60pp, an earnings downgrade based on a softer macroeconomic backdrop and a contract loss); and Bytes Technology (-0.37pp, concerns about IT spend and exposure to Microsoft).

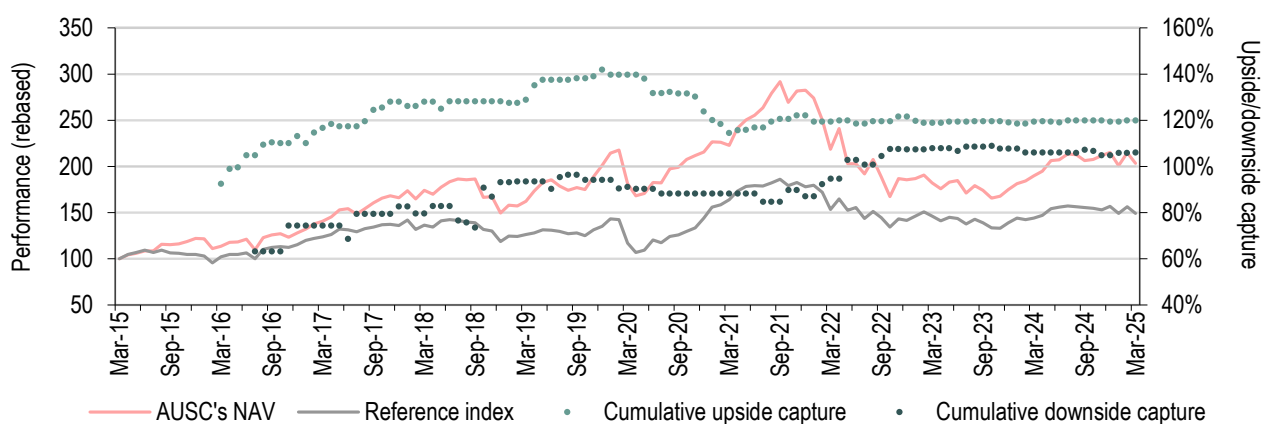
Exhibit 7: Five-year discrete performance data

12 months ending	Share price (%)	NAV (%)	Index* (%)	CBOE UK Smaller Cos (%)	CBOE UK All Cos (%)
28/02/21	14.3	14.3	24.9	17.8	2.8
28/02/22	3.9	6.4	1.5	15.0	16.7
28/02/23	(23.8)	(20.9)	(7.5)	(1.7)	8.2
29/02/24	(0.4)	(1.8)	(5.8)	6.5	0.7
28/02/25	14.6	11.2	6.2	11.8	18.6

Source: LSEG Data & Analytics. Note: All % on a total return basis in pounds sterling. *Index is Deutsche Numis Smaller Companies plus AIM ex Investment Companies.

Upside/downside capture

Exhibit 8 shows AUSC's upside/downside capture rates over the last decade. Its upside capture rate of 120% suggests that during periods when UK small-cap shares are rallying, the trust is likely to outperform by around 20%. The lower 106% downside capture rate implies that AUSC is likely to perform modestly worse than the market during periods of UK small-cap share price weakness.

Exhibit 8: AUSC's upside/downside capture


Source: LSEG Data & Analytics, Edison Investment Research

Note: Cumulative upside/downside capture is calculated as the geometric average NAV total return (TR) of the fund during months with positive/negative reference index TRs, divided by the geometric average reference index TR during these months. A 100% upside/downside indicates that the fund's TR was in line with the reference index's during months with positive/negative returns. Data points for the initial 12 months have been omitted in the exhibit due to the limited number of observations used to calculate the cumulative upside/downside capture ratios.

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