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[INTRODUCTION]
James Yardley (JY): Hello and welcome to the Investing on the go podcast. Today I'm joined by Paul Marriage, the Elite Rated manager of the Tellworth UK Smaller Companies fund. Paul, thank you very much for joining us today.

Paul Marriage (PM): Hi, Morning James, good to see you this morning.

[INTERVIEW]
[0:18]

JY: And you. Paul, you were recently quoted as saying that the companies you meet remain on the front foot - they're doing deals, recovering revenue and learning a lot from last year. Could you perhaps give us some examples of this?

PM: Yeah, absolutely. I think it's one of the really interesting themes of last year, which was where if you go back a year, we entered 2020 and you know, almost reluctant to say it, but we were pretty optimistic about life, you know, it felt like the political landscape in the UK had changed, it was getting a bit more permanency, whether we liked that a lot, but political certainty. Most companies we were talking to had fantastic January, February times in trading, you know, economically we were in quite a good place.

Then, you know, we all had a big COVID hit and then we're not talking about COVID too much. We hear so much about COVID. But clearly that was a massive shock to all companies to go from a hundred percent of revenue down to and revenue that was really flying and going really well down to 10% or 20% or zero in some cases. So a massive shock for us all clearly, but you know, a shock for anyone running a business and actually, how did companies respond to that. I think it was one of the, you know, it's actually quite a credit to the UK economy and you can argue, you know, commerce globally, but companies adapted really, really fast I think, that made big and rapid changes to the businesses, the way they work. You know, we all moved to online very quickly didn't we and that's generally seemed to work for most people.

So, once we went through that shock phase of March, April companies adjusted pretty quickly. And I think we were quite surprised really when we came back into August and September, when companies were coming back to see us. They were saying, actually guys, yeah, horrible shock but revenues are recovering. In fact, revenues are recovering quicker than we expected them to. And actually, that means that we can get ourselves back into a sort of 19/20 mindset of trying to grow these businesses. And you know, looking for acquisitions, if you're an acquisitive business, developing new products, launching new products, finding new customers, doing all that sort of good stuff you want small companies to be doing. So that was very much the message from companies starting from the back end of the summer. And we saw that come through to the year end.

Now remember a lot of these companies that perhaps looked a bit stressed in terms of their financials back in March, had raised money, had made themselves stronger, so they were coming into this kind of reinvigoration phase in a slightly better condition. So, it was great to see some companies move that little bit step further you know, making acquisitions. So, a couple of ones maybe worth mentioning, Inspecs.

[2:45]

Inspecs is an interesting story we think. It is a spectacle frame manufacturer. The spectacle frame industry globally is dominated by a couple of massive European players. And then there's lots of smaller ones. But one of the smaller ones, in fact, the biggest of the small is a UK listed business called Inspecs, based in Bath. Great website, if you're interested in it and really informative. And Inspecs bought their number one German competitor called Eschenbach in November last year and the deal was completed in December. And that was a great example of using an equity that had gone through a tricky time. You know, you think that the spectacle frame maker's supply chain is very much Asia into Europe, bit of manufacturing in the UK, but it's a global supply chain, customers everywhere. So, you know, all the typical things you'd expect from the pandemic impacts there, but the company managing that quickly, working out how they can manufacture specs in a safe environment in their facilities globally. And then saying, right, we're ready to do another deal and probably taking advantage of maybe lower valuations, global uncertainty to do that. That was a good one.

[3:50]

Another interesting one, a different sort of business entirely, something called Accrol. Sort of a business that makes tissue papers, loo roll, that kind of stuff in Accrington, Accrol. And they were a business that floated, had a bit of a mess, had a bit of a corporate governance disaster two or three years ago. New management came in, rebuilt the business in terms of the way it was presented to the city, the way things like HSE - it had a few health and safety issues - sorting those out, getting back on the front foot. That was COVID it was probably pretty good for them. We'll read about those queues of people looking for loo roll at the supermarkets. UK manufacturer in a good place. So used the strength they had from the COVID environment, so the boost they got from a challenge they weren't expecting, to acquire another tissue manufacturer, you know, consolidating their position in the UK. So that's Accrol. So a couple of examples of companies with very different COVID experiences reacting.

[4:43]

Maybe one more interesting one, which not acquisition-based is a business realising that their end market's changing and they need to adjust their products. So that would be Vitec. So Vitec is everything about image capture. So, you know, tripods is where the business started, they're still massive in tripods. But a lot of the communications you have around a studio between the camera man and the editors' and you can imagine a big Hollywood film environment or, you know, Netflix blockbuster-type productions, hundreds of people running around with cameras and messages and all the sort of stuff, you can't do that in a COVID environment. So much less people on set, much more technology. And actually, Vitec's technology is all about capturing the image, sending it to editing, and reducing the number of people scurrying about. So COVID suddenly created a really good opportunity for them to accelerate really their kind of next generation products, which were coming anyway, but, you know, giving them a great boost.

[5:38]

JY: Very interesting. And you own a couple of companies in the portfolio have been hit particularly hard. I think you've got Gym Group and Hollywood Bowl, for example. Do you still own these and what do you like about them?

PM: Yeah, absolutely still own them. So yeah, any consumer-facing business, particularly anything in the hospitality and leisure industry, as we well know, totally taken out by this and remains in a really horrible place, and if you remember, when most of these companies when they came to see us in April, May, June, that kind of Q2, what do we need to do secure our balance sheet until things get normal again? So yeah, these businesses not only faced a shock then, but face a continuing period of uncertainty, so raise capital, secure the balance sheet, both those companies have raised enough capital to secure their balance sheet, you know, well into to this year. So wouldn't expect a second raise. You never seen another never do you, but you wouldn't expect a second raise. So they raised enough, good thing. And then I think one of the key things there, and we have talked about a little bit is what we call supply-side winners.

So if you think of a supply side of pubs or restaurants, gyms, cinemas, bowling alleys, all these things that you know, up until March last year, we used to enjoy spending our leisure time and money doing. So those industries quite diverse ownership basis. We've got lots of private operators. We've got lots of really large private equity businesses. So we think that Hollywood Bowl, ten pin bowling, and Gym Group, discount gyms, are great supply-side winner examples because within their industry, they're in a tough industry, they're relatively the strongest player. So they should come out of this with market share gain, ability to get the best sites and the best balance sheets…

JY: And when you say supply-side winner, what you mean is a lot of supply, the industry is going to be taken out as all their competitors go bust…

PM: Yeah absolutely, yeah. So the demand-side is me and you going to the gym, I'm going to do 10 pin bowling, whatever. And the supply-side is the number of gyms and 10 pin bowling places we can go to. If there's way too many gyms, we can choose our gyms and we're the price leader, we will force the price down. If there aren't enough gyms, those people who've got the best gyms will be able to generate the best profits now.

So the gym sector is a really interesting one actually, because in probably 1980/1990, there were too many gyms in the UK. And we were beginning to see pre-COVID a real crunch on gym capacity because there's a lot of competition out there, probably too many low cost gyms for number of people who wanted to go to them. So there's two big national players, Pure Gym and the Gym Group. Pure Gym, private equity-owned, pretty dicey balance sheet, probably got less flexibility than the Gym Group that can come back to its shareholders like us and say, look, guys, we can see the future here in terms of where things might go. We know about all the uncertainties, give us a bit of cash now at a sensible price and we could be a supply-side winner on the other side. So I think two examples of companies, yes, massively hit, but that have fixed their balance sheets and that we think will come out the other side, stronger for longer.

[8:36]

JY: Is there not a lot of hope built into the future though, because it feels like there's a bit of a disconnect between the stock market and the real world at the moment. I mean the UK, yes the stock market is down a bit, but it feels like it's not done nearly as badly as what's the reality of the situation is for a lot of businesses and a lot of people.

PM: I think that's a really, really fair point, James. Something we talk about it an awful lot. So stock market versus reality. So UK reality is currently we're all locked down, a decent proportion of the population who aren't working are effectively having their wages supported by government. And when that ends, you know, where will we be? Will we see a big surge in unemployment that everyone's forecasted, but it keeps getting delayed? And if that happens, presumably we'll have a big consumer recession. And will there be anybody who wants to go to a gym or a bowling alley? Yeah, I think that's a really valid concern and something we definitely manage in our portfolios and something where our international focus, not just, you know, we've got gyms and bowls and but we've got, you know, international Future [inaudible] and Inspecs and businesses that are very international, which we think play a slightly wider frame.

I think stock market versus reality is a very interesting story because if we look at the UK stock market, we've got extremes in the UK. I mean AIM was an exceptional market last year, up 20% in aggregate against the FTSE 100 down 14%, you know, rough numbers. So 35% divergence between two indices in the same stock market. Well, AIM was driven by a very narrow group of sort of computer gaming stocks, COVID winners, e-commerce, and ESG. And anything that was kind of slightly green-tingy, growthy, batteries, hydrogen that kind of stuff, has gone absolutely bonkers, and it's not difficult to find a bubbly looking share-price chart on AIM, you know, a stock that was in the doldrums for decades or years into this year, into the final quarter of last year, so 2020, suddenly doubled and tripled, maybe even been a 10-bagger on not very much. So I think there's still a little bit we need to be concerned about that is this a bit of a retail bubble, particularly in small caps in AIM, particularly hope companies without a lot of revenue, but where they could change the world, they might have the next fantastic you know, hydrogen energy thing. They may have a great COVID drug, whatever it is. And we need to be careful though, we've seen that before, we've seen it in the tech boom.

I've been running money over 20 years and I've seen these kinds and that does worry me a bit. And, I think it's something, you know, we don't invest in many of those things, but it would be bad news if retail investors got caught up in a lot of these things where a valuation of several hundreds of millions for a business, which is maybe worth 25 or 50 million, it's not good news because generally bubbles get burst. You know, you can see a bubble, you might be able to smell a bubble, but when it pops, I'm afraid you've heard about it after it's popped. So you know, gotta be really careful about some of that stuff.

[11:34]

JY: Thank you, very interesting. And we've got a Brexit deal now. Is this going to be a big help to UK smaller companies? What are they saying to you about the reality of not being in the EU now?

PM: Okay. Yeah. So we've got Brexit deal that's… getting a Brexit deal, I don't want to talk about any politics here, but the thing about getting a Brexit deal was good in that it created an element of certainty about trading and that lingering uncertainty and lots of fund managers said 'we were always going to do the deal. It was always going to be long UK, it was always going to do a deal.' Well, actually, you know, sitting there, I think we all thought we were, but actually sitting there with no deal so late, was a nervy place to be as an investor and you could see some gyrations in December.

So that is a good thing for the UK market in general. And it helps to tick that sort of box ticking process we need to do to get back on the global kind of no longer underweight list, which is really important to the UK, is to be at least an equal weight market, if not overweight, because the UK's pretty cheap.

So, you know, we have the Brexit referendum and became a sort of market 'persona non grata' for a long time. Other markets did well. We did badly very much last year, generally up the cap scale, particularly. And then the Brexit deal has sort of said, well, okay, maybe the UK has got an established relationship with the EU. We can look at it like Sweden, Norway, Switzerland, whatever, any other European country that's outside the EuroZone. And, you know, look at its attributes. And, of course, its attributes are, and always have been, a big and mature stock market, an open and flexible economy, quite big knowledge, pharma, high-tech education and all the sort of things that have made the UK a pretty good place to invest. You know, for most of the kind of post-war era. So we're not reliant on commodity industries, et cetera, et cetera. So that's all good news in terms of just making us investible again. And that…

JY: And overseas money, which is hopefully is going to come back to the UK market. Does that filter down to smaller companies or is most of that just going into the FTSE 100?

PM: No, I think, I mean the FTSE 100 has had a surge at the beginning of the year, hasn't it particularly? You know, I think anybody running money down the cap scale is going, 'Oh God, this is a pain isn't it, the market's racing away.' And calm down a bit. They're still looking at a pretty strong start. So, you know, I think logically larger investors go for liquidity FTSE 100 there, you know, lots of the things that were going up there were kind of global things as well, like mining oil type, you know, the classic FTSE 100 plays. So what we would normally see would be a sort of larger cap led growth as people put money in the market. And they'll go, oh, actually, you know, that's performed well, mid-caps, what do I like in mid cap? Well I like UK domestics, there's a lot of those in mid-cap. And then inwardly domestic investors in the UK, are saying actually where's the value in the UK now? Well suddenly my house bills have just gone up 40% to overseas investors and actually value in the UK is probably down the cap scale UK small caps potentially.

So yes, money coming in the top is good for the hopper. But those, you know, if we read a global wealth manager, you know, one of the big global names is saying, 'we're going to close our underweight UK'. We're not suddenly going to simply see a load of money coming into UK small cap, but it's interesting that the institutional investors and the wealth managers that make up our funds alongside retail investors have also been phoning us up and saying, yeah, actually, we think it's probably time to be adding to our UK small cap weighting. So a lot more incoming, which would suggest that trickle down is actually happening at a small cap level.

So I think you can look at small cap this year and think, well, bearing in mind what we said about some bubbly parts of the markets, you can say that, you know, the UK smaller end of the market is relatively modestly valued. So, you know, small caps are trading on low to mid-teens P/Es, their forecast earnings growth over 20%, obviously a lot of recovery in there, but, you know, if that 20% is true and there's a reasonable chance this time around, it could be, then these aren't racy multiples. You're not a monster recovery multiple at the bottom of the market. And we've got a massive range of companies to invest in. We don't just have to buy you know, reopening plays or retailers that have been bombed out. We can buy high quality businesses with international earnings on low multiples. So, I think that in that respect, the UK does look quite attractive. So your combination of interesting things to own that are pretty cheap relative to global markets.

[15:57]

Just going back to the bit about are UK companies feeding back to us yet on Brexit? On the deal, you know, the actual Brexit deal, you know, to be honest it's too early to have any companies come back to us and say, don't like the look at the deal. It's going to be very difficult for us. But you know, we are on recording this on the 18th of Jan so quite early days for people to pipe up.

To be honest, apart from a shortage of food in M&S in Paris, we've not seen as many headlines as we thought, have we, so far? I thought we'd see a lot more in the first couple of weeks in terms of, you know, all it needed was a telegenic spokeswoman for some niche industry to, or man, to pipe up about an issue they'd gotten and BBC camera and ITV camera guys, you know, to be on the port side, watching these sacks stuck up. We've not really seen that actually, which is interesting.

JY: Can probably do without the Percy Pigs, I think or whatever...

PM: Yeah, yeah, you're right. I mean so I think really, we're probably seeing two things. We're seeing the fact that a lot of companies did a lot more prep for this they really wanted to fess up to. We saw this last time round that companies were doing a lot of no deal Brexit prep18 months ago, and that I think that work has stead pretty well for them. And I think there's a lot of companies who've done a bit of restructuring and stuff internally to help them out. They've got stock in the right places. So I do you think companies would prepare for this. And to some extent, if companies were making a genuine no deal focus on their preparations, which I think it was probably higher than people went public on, then a deal is kind of like a soft result for them. So I don't think we're going to see a lot of companies coming back to us saying, actually, this is a bit of a nightmare, this new relationship with the EU, I think most companies are going to be getting used to it pretty quickly.

I mean, to some extent, getting used to this new EU deal versus getting used to a whole new COVID environment, you know, they've had to face quite a few challenges and relatively the new EU relationship might not be as big a challenge as it would have been on its own.

JY: Yeah. When you put it like that I guess it puts it in perspective.

PM: Yeah, a little bit, yeah.

[18:00]

JY: So Paul, your company just recently celebrated this third anniversary.

PM: Yeah, what a party!

JY: How's it been managing a new business in this environment?

PM: Yeah, well, it's, I guess if you'd asked me three years ago, where do I want to be in three years' time? I think we've doubled our assets. You know, we've launched a couple new products, we've taken on a new process, kind of biz-dev [business development] wise and all that kind of cheesy MBA land. We've done a really good job.

If you actually look at what it's been like, it's been pretty hard work. I mean, you know, when you start up a new business, having been in a high quality long-term businesses, like Schroder's, you know, you know you shouldn't underestimate the challenge, but it's almost impossible to know what it's going to be like. So you know, I think that our third anniversary was a sort of sense of relief that we probably got through the worst of COVID, that our assets have remained pretty solid. Our clients have been very loyal, which is great. And you know, that we're in a market, which has been, you know, through the mill and we're still intacy and we've got some good products, you know, we've got a decent performance story for people. So yeah, it's been, it's been a massive challenge. But I think it'd be fair to say that most of the time I've enjoyed it. And I think, you know, we, we've had fantastic client support, which has been great, and that's kind of what you need.

You know, would I have done anything differently? I'm not sure I would've had the levers to pull to do much differently really. You know, we could have perhaps taken a less small cap risk three years ago, to be honest we've been running a small cap focus and smaller end of small cap portfolio in a period when that part of small cap market has been pretty grim. We had a bit of payback on that, I guess, more recently, which is good.

Yeah, I'm enjoying it. It'll be interesting to see what I think about you know in five years. If we continue to be kind of front foot doing all the sort of stuff that we want, our management teams to be doing. That's often the way I think about it, actually. How would you perceive us as a business if we were the other side of the desk and you were an investor?

JY: Yeah. Well, thank you very much for talking to us today. It's been very interesting and best of luck for 2021.

PM: That's very much James, thanks so much for your time. And hopefully you found it useful.

JY: And if you'd like to learn more about the Tellworth UK Smaller Companies fund please visit our website fundcalibre.com and please also remember to subscribe to the Investing on the go podcast.