CRUX
ASSET MANAGEMENT

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This is a Marketing Communication

TM CRUX UK Core Fund

The TM CRUX UK Core Fund (B Inc GBP) returned 3.7% against its performance comparator the IA UK All Companies Sector return of 2.4% over the quarter.

Market Conditions

The third quarter ended with reasonable returns across global markets, despite several bouts of volatility. Concerns that economic data was pointing to a weakening US economy, a surprise interest rate hike from the Bank of Japan leading to a rapid unwinding of the now infamous 'Yen carry trade' and thin summer liquidity all contributed to equities selling off quite significantly at the beginning of August. As these concerns eased and major central banks commenced the rate cutting cycle, markets finished the quarter strongly.

In the UK, mid-caps outperformed as sentiment towards cyclical stocks improved following the first interest rate cut from the Bank of England. Small-caps underperformed amidst overly gloomy rhetoric from Rachel Reeves in the lead up to the October budget. Having recognised that disorderly communications are self-defeating, Reeves' has sought to recalibrate the overly negative messaging and is now outlining plans for higher levels of public spending through more permissive fiscal rules. Although economic growth remains modest, H1 performance leaves the UK tied for the top spot amongst the G7, whilst valuations remain low versus Europe and the US.

There were 11 meaningful M&A bids in Q3, taking the total to 40 for the year as a whole, with a total value of c.£47bn. The average premium so far this year has been c.40% with some bids exceeding a 100% premium. Last year, the majority (c.56%) of offers were from financial buyers such as Private Equity, whereas corporate buyers (c.68%) have dominated so far this year as the rate environment and economic outlook have become clearer, demonstrating the value of UK companies. Over half of bids have come from overseas buyers, further illustrating the relative value compared to global markets.

We are excited by the opportunities available across the UK market, however the opportunity is most pronounced in smaller companies in our view, and c.1/3rd of the Fund is allocated to small-caps. We believe that UK small-caps should benefit significantly from an economic recovery and falling UK interest rates which should lead

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to a positive backdrop of attractive valuations and momentum and a reversal of the outperformance of large-cap defensives experienced over the past 2-3 years.

Fund Performance

The TM CRUX UK Core Fund (B Inc GBP) returned 3.7% against its performance comparator the IA UK All Companies Sector return of 2.4% over the quarter. Performance was led by the Fund's mid-cap companies which benefitted from improving sentiment towards cyclical stocks and the market beginning to look through to an economic recovery. The Fund's large-caps also performed strongly during the quarter, outperforming the FTSE 100 by c.7%. Thin summer liquidity and uncertainty ahead of the October budget contributed to a weaker quarter for small-caps.

At a stock level, Zegona Communications was the largest contributor to performance during the quarter, up c.38% and contributing c.1.7% to Fund performance. The Fund participated in an equity raise that enabled Zegona to acquire Vodafone Spain in November 2023 at 150p and the shares ended the quarter at c.364p. During the quarter Zegona announced two separate agreements to monetise Vodafone Spain's fixed network infrastructure. The deals will be opened to external financial investors which will allow Zegona to extract upfront cash while still retaining equity stakes to participate in any future value uplift. Although subject to regulatory approval, we believe the market is materially underappreciating the potential value creation from these deals. Separately, the impressive Zegona management team are embarking on a transformation plan to improve the underlying Vodafone Spain business and have a strong track record of creating significant value for investors. Despite the strong share price performance so far, we believe there is significantly more to come.

JD Sports Fashion was the second strongest performed during the quarter, up c.29% and contributing c.1.1% to Fund performance. The company announced a positive trading update with improvements in all geographies and winning market share. Although trading conditions remain difficult, JD Sports is performing better than the competition and we believe the valuation does not reflect the medium-term potential of the business.

IQE was the largest detractor from performance during the quarter, down c.46% and detracting c.1.5% from Fund performance. The interim trading update saw revenue expectations lowered to the bottom end of the range previously guided by management, as some markets remain in recovery. Cashflow was quite weak during the period as they built up inventory however this should, in our view, unwind somewhat in the second half. The potential Taiwan IPO, potential CHIPS act funding and ongoing market recovery should all help the balance sheet over the short-term. IQE has under-utilised capacity with a primarily fixed cost base, meaning that as underlying markets recover and revenues grow, profitability should improve quickly.

Victrex also performed poorly during the quarter, down c.15% and detracting c.0.4% from Fund performance. Several end-markets showed improvement in the July trading update which is encouraging, however destocking in the medical division has continued and management appear to have little visibility. Medical destocking continues to drag profits down as it is a high-margin division, however we believe we are at or close to the trough, and Victrex is typically a significant early-cycle beneficiary.

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Transactions

Whitbread was added to the portfolio during the quarter. Management outlined that UK accommodation sales strengthened in the first quarter of Whitbread's financial year and we expect trading to continue to improve. Whitbread continues to outperform the market as independents continue to struggle. At the time of purchase we believed the valuation was significantly backed by the group's freehold property estate, as well as the capital invested in Germany which is beginning to bear fruit. The shares have performed well since being added to the Fund.

Domino's Pizza Group was also added to the portfolio during the quarter. New CEO Andrew Rennie has been with the brand for 30 years, with experience throughout the network lifecycle as a franchisee, local, national and international manager. He delivered impressive transformation as CEO of Domino's Pizza Enterprises Europe. Alongside incremental growth from aggregator apps, we believe increased app and marketing personalisation, combined with the group's proposed loyalty scheme will boost order frequency and re-invigorate the dormant customers that app data reveals. We believe a second brand is a compelling proposition, backed by some of the UK's most successful franchisee entrepreneurs and facilitated by the scale of the company. In the absence of deals, in addition to the dividend, we would expect further buybacks.

Capita was also another addition to the portfolio during the quarter. With the sale of Capita One realising cash proceeds of more than £200m, Capita's funding needs for the immediate future appear to have been resolved. New management is seeking to make the company more efficient, implementing change largely around digitisation and removing the too many manual processes across the business. Management have already taken decisive action in cutting costs with more to come in 2025. Capita is now focusing on working with technology hyperscalers, which will allow the group to minimise its capex yet improve efficiencies and widen the groups offering and quality, improving customer experience. We see scope for margin improvement starting from a low valuation.

BATM Advanced Communications was also added to the Fund during the quarter. BATM is a leading provider of real-time technologies for networking, cyber security and bio-medical diagnostics. A strategic review of the group was completed in 2023 and management are now seeking to manage and dispose of non-core activities to focus on growth areas within the business which have high potential. BATM is supported by a strong balance sheet with net cash of c.$30m. In July, BATM signed an agreement with a major technology provider to take the Group's cyber technology into commercial markets worldwide. The Group's cyber technology is already used by some of the world's most advanced militaries. Also in July, BATM announced that its edge computing platform, Edgility, had become a qualified software partner on Amazon Web Services, forming a new and extremely efficient route to market.

Legal & General, Tesco, Smith & Nephew and H&T Group were all exited during the quarter. Smith & Nephew and Tesco were sold on valuation grounds following a strong run in the share prices. Legal & General was sold due to trading in-line with peers but offering fewer catalysts and limited scope to beat targets. We also believe the dividend may come under pressure. H&T group was sold to prioritise better small-cap opportunities. Barclays was also trimmed during the quarter following a strong period of performance.

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Outlook

The recent gloomy narrative surrounding the UK economy is, we believe, at odds with the prevailing economic backdrop. Private sector balance sheets are healthy, labour markets are strong, and UK economic growth in the first half of the year was the strongest in the G7. Reacting to the improving economic situation, consumer and business expectations are recovering and inflation appears to be under control, leaving the door open to further interest rate cuts.

Simultaneously, UK companies are trading at discounts relative to global peers and from what we have seen M&A activity has shown no signs of abating. An average premium of c.40% and buyers dominated by overseas and corporate entities is illustrative of value and improving economic conditions.

We are excited by the opportunities available across the UK market, however the opportunity is most pronounced in smaller companies in our view, and c.1/3rd of the Fund is allocated to small-caps. We believe that UK small-caps should benefit from an economic recovery and falling UK interest rates which should lead to a positive backdrop of attractive valuations and momentum and a reversal of the outperformance of large-cap defensives experienced over the past 2-3 years. The underperformance of small vs large-caps over this period is twice as bad as that experienced during the Global Financial Crisis and therefore the recovery opportunity is potentially significant.

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