CRUX ASSET MANAGEMENT

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This is a Marketing Communication

TM CRUX UK Special Situations Fund

UK companies are trading at significant discounts relative to global peers and 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.

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

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significantly 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.

Fund Performance

The TM CRUX UK Special Situations Fund (I Accumulation GBP) returned 2.0% 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. 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.1.6% 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.0.9% 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.

Bellway was another strong performer during the quarter, up c.23% and contributing c.0.8% to Fund performance. A trading update at the beginning of August was slightly better than consensus expectations with FY24 completions and average selling prices both ahead of previous guidance. Bellway also walked away from the deal to acquire Crest Nicholson during the month. Bellway remains well placed without the deal given its good land bank and the positive tone around recent trading and outlook. Market sentiment towards the housebuilders also improved generally following the first interest rate cut from the Bank of England and ambitious housing targets set out by the new government.

BP was the largest detractor over the quarter, down c.16% and detracting c.0.6% from Fund performance. The shares have largely tracked the declining oil price which accelerated towards the end of the quarter amidst fears of oversupply partly due to members of OPEC apparently not sticking to agreed-upon production limits. Towards the end of the quarter it was also reported that Saudi Arabia are set to abandon their $100 per barrel target and increase supply further to reclaim market share. We believe the shares are undervalued and serve a role to hedge against rising tensions in the Middle East, where escalating conflict would likely push the oil price higher.

Another detractor from performance during the quarter was Arecor, down c.45% and detracting c.0.5% from Fund performance. Arecor announced a fundraise which would provide the company with a two-year cash runway with working

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capital to drive commercial sales of Ogluo, a two-step glucagon emergency pen for treating severe hypoglycaemia, and continued development of the internal pipeline, including the GLP-1. Notwithstanding further funding requirements which could be resolved through partnership/co-development, we believe Arecor's ultra-concentrated ultra-rapid acting novel formulation of insulin has the potential to be a significant driver of future share price performance.

Trufin was down c.26% and detracted c.0.5% from Fund performance. Trufin announced that Lloyds Bank had decided to terminate its contract with one of its portfolio companies, Satago. The termination will result in reduced revenues for Satago, but cost savings combined with improved trading at another Trufin portfolio company, Playstack, is expected to offset most or all of the Satago shortfall. The contract termination appears not to be related to performance or quality of technology and we understand that the remaining Satago clients continue to be very positive and there is a strong pipeline of potential business. Although the Satago news is disappointing, the momentum in the Playstack business is strong with star game Balatro recently released on mobile and immediately taking the number one spot for the 'Top Paid Games' on the Apple app store.

Transactions

A small position in small-cap Mincon was also added to the Fund during the quarter. Mincon specialises in the design, development, manufacture, and service of hard-rock drilling solutions for applications around the world. Mincon has the competitive benefit of a strong balance sheet combined with widely recognised superior product characteristics and high-quality customer servicing. The shares were impacted significantly over the past c.3 years by contraction in construction activity in the US and Europe, reflecting the higher interest rate environment. We initiated a position in the Fund following signs of order books recovering in construction and large mining customers returning to a more regular ordering pattern.

Molten Ventures was sold following a period of strong performance. Similarly, Barclays, JD Sports and Zegona Communications were all trimmed during the period, taking some profit following rapid share price appreciation. TP ICAP and TI Fluid Systems were also exited during the period, focusing the portfolio on our preferred opportunities. Molten Ventures and SSP Group were also added to the portfolio during the quarter. Molten Ventures issued strong results for FY2024 noting average core portfolio revenue growth was in excess of 50% with 85% of the core portfolio having at least 18 months of cash runway as of the end of March. Realisation visibility of £100m and a 10% share buyback provided further reassurance on the strength of the balance sheet.

SSP Group was added following what we believed to be an overly pessimistic market reaction to the half year results announced in May. Top line growth has been impressive, but it has not translated into positive earnings momentum, possibly due to FX headwinds, heightened seasonality, post-Covid capex catch-up and train strikes. We believe these factors should abate over the next 12 months and with the shares trading at record low valuation multiples, we view this as an attractive opportunity.

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.

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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.

Fund's managed by Richard Penny have historically outperformed during economic recoveries with the L&G UK Alpha Trust returning c.173% trough to peak following the Global Financial Crisis in 2008/2009, outperforming the IA UK All Companies Sector by c.88% and the TM CRUX UK Special Situations Fund returning c.151% trough to peak following the COVID-19 pandemic, outperforming the IA UK All Companies Sector by c.75%, with a significant portion of performance coming from small-caps.

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