PORTFOLIO MANAGER'S REPORT

The portfolio manager of the Company is George Ensor. George graduated from Bristol University with an Upper Second Class degree in Chemistry in 2008, before joining Smith & Williamson Investment Management as a graduate trainee where he worked for five years as an analyst and Private Client Investment Manager. George joined River and Mercantile Asset Management LLP in March 2014 as a UK equity analyst. George is a CFA charter holder.

This Portfolio Manager Report is compiled with reference to the investment portfolio. Therefore, all positions are calculated by reference to their official closing prices (as opposed to the closing bid prices basis within the condensed financial statements). The estimated unaudited NAV referenced below is calculated on a daily basis utilising closing bid prices and is inclusive of all estimated charges and accruals.

REVIEW OF PERFORMANCE

We have, following a period of strong performance since the market low in March 2020, had a challenging six-month period for performance. The NAV per share has declined from 328.3p, which was close to the peak NAV per share of 332p in August 2021, to 251.1p at the end of March 2022. The 23.5% decline compares poorly to the 10.3% decline in our benchmark, the Numis Smaller Companies plus AIM ex Investment Companies, which is the bottom 10% of UK listed companies by marker capitalisation.

Using the end of March 2020 as a proxy for the market low (19th March 2020), the NAV has gained 72% over the last two years, which includes two capital returns, and leaves the Company's performance a little ahead of the 67.6% gain in the benchmark.

As illustrated in the table below, the longer term performance remains compelling.

Period	NAV	Benchmark	Active return
6 months	-23.5%	-10.3%	-13.2%
12 months	-12.4%	-2.1%	-10.3%
3 years p.a.	9.4%	8.8%	0.6%
5 years p.a.	10.1%	5.7%	4.4%
Since inception p.a.	13.7%	7.9%	5.8%

Source: River and Mercantile Asset Management LLP, BNP Paribas, Bloomberg performance to 31 March 2022. Inception date is 02 December 2014. *Benchmark is Numis Smaller Companies plus AIM (excluding Investment Companies).

MARKET BACKDROP

An obvious place to start is the prevailing investor sentiment towards micro-caps. There are multiple signs of depressed investor sentiment – a lack of IPOs, failed equity placings and the asymmetry between how good and bad news is 'priced' into stocks. The breadth of underperformance in the portfolio is informative; of the 42 holdings we owned at the end of March, 35 of them have delivered a negative relative contribution over the last six months leaving just 7, or one in six, delivering positive relative performance.

Smaller companies typically outperform; data from the Numis Indices 2022 Annual Review demonstrates that the average annual premium in returns from UK smaller companies since 2000 is 4.3% per annum, longer term data going back to 1955 provides further support. This is one of the key justifications for this Company to focus on investing in micro-caps. However, this outperformance is not consistent – it is, like so many things, impacted by investor behaviour. In the last six months we have experienced, as measured by the performance of our benchmark when compared to the MSCI UK Investable Markets index (IMI0), a substantial underperformance of smaller companies. Our benchmark has underperformed the wider UK equity market by 16.4% in the six-month period. At the time of writing (19th April), the peak smaller companies' drawdown (for which we look to the maximum relative underperformance and so start from the 17th of September) is 19.6%. This compares to the previous period of smaller companies' underperformance, when our relative performance was also poor, from March 2018 to August 2019 of 16.3%. We need to go back to the financial crisis to find a more severe period of underperformance (c26% for the 17 months to the end of 2008).

The obvious question then, are investors right to be this cautious? Is this negative sentiment well placed? After all, the extremely accommodative monetary and fiscal regimes of the last two years are being unwound, interest rate expectations are ratcheting up and excess liquidity is being removed. Perhaps, although we know that sentiment tends to swing the pendulum too far one way and then too far the other.

SUSTAINABILITY

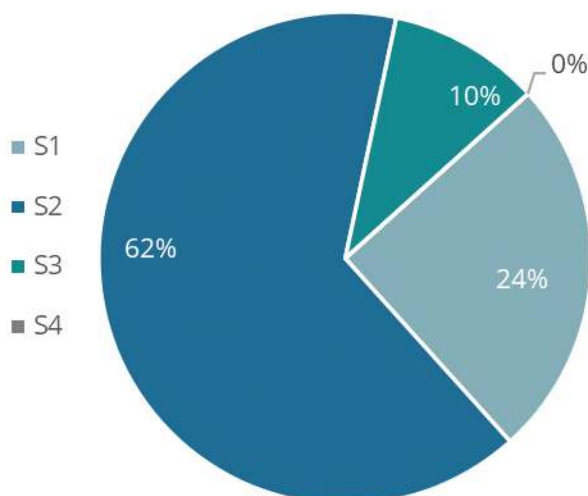
*"A sustainable business compounds value for all stakeholders over the long term.
It is a responsible steward of capital with a culture of longevity.*

We evaluate sustainability through the pillars of People, Innovation and the Environment, including companies undergoing change leading to positive long-term outcomes."

We believe that our inclusion of a broader, stakeholder focused analysis will deliver better risk adjusted returns. We think that it is critical that we treat this analysis in the same way that we do our fundamental research; namely using third party data and opinion where it is additive but never outsourcing the analysis.

We rate companies with one of four sustainability scores. S1 rated stocks are beneficiaries of sustainability trends – a good example being **Strip Tinning** which was purchased in the period and is set to benefit from the growing penetration of EVs (electric vehicles). Companies that have neither material sustainability concerns or opportunities are rated S2 and include each of the other new additions (**Renold** and **1Spatial**). We strongly believe that we can and should invest in businesses where we identify sustainability challenges and look to benefit as these businesses improve (S3 rated stocks). This is one of the areas where we focus our engagement. Finally, there are businesses for which sustainability concerns are too great a risk and so we will not invest in S4 rated companies.

The chart below demonstrates the value of the portfolio invested in each category.



Source: River and Mercantile Asset Management LLP. Data to 31 March 2022.

New Positions:

Strip Tinning (ST): S1 rated given electric vehicle opportunity where ST's capabilities in flexible printed circuit boards and their application, validated by a major German OEM (original equipment manufacturer), in connecting battery cells in EVs appears an exciting growth opportunity.

Renold: Whilst we believe that an increasingly environmentally aware marketplace is a commercial tailwind, we rate the business with a neutral S2 rating. Renold's product is typically longer lasting than that of the competition with a lower environmental footprint as it is more energy efficient (less friction) and has lower or no lubrication requirements. Although there are only a few components to a chain, the group has a lot of innovation and intellectual property tied up in the complex manufacturing process that gives its chains unique properties in certain

applications and is at the crux of its sustainable competitive advantage. The group is reviewing its energy usage with a view to identifying short and long-term energy reduction opportunities and setting long-term targets.

OneSpatial: an early-stage software business whose solutions enable better decision-making based on accurate location data. Primarily serving companies and government agencies associated with maintaining the global critical infrastructure, demand is supported by environmental and social drivers. For example, its products aid engineers in understanding the ecological impacts of the UK's High Speed 2 project; and better mapping of sewage networks enabling prioritisation of works to prevent leaks. 1Spatial is committed to reducing its carbon footprint and is in the process of establishing its ESG strategy and sustainability roadmap. With no material barriers to value creation identified, it is S2 rated.

Rating Changes:

Capital: S3 to S2. As mentioned, one of the areas we focus engagement is in our S3 rated holdings. We have engaged with Capital several times and attempted to improve disclosure around GHG (green house gas) emissions and the board composition. The company announced the appointment of a new NED (non-executive director) who is heading up the newly formed sustainability committee. The recent annual report includes, for the first time, GHG emissions and the company has committed to announce an emissions target this year.

Diversified Energy: S1 to S2. We believe that natural gas, which has half the GHG intensity of coal, is a critical fuel in the transition to a less carbon intensive planet. We cannot just turn off our reliance on fossil fuels. And Diversified Energy's approach of acquiring operational assets and running them more efficiently strikes us as a sensible approach. We reviewed the rating in the period and decided, given the carbon intensity of the business, which at 19Kg CO_2e/boe is similar to the average for UK North Sea gas businesses (22kg CO_2e/boe), that a neutral rating was more appropriate.

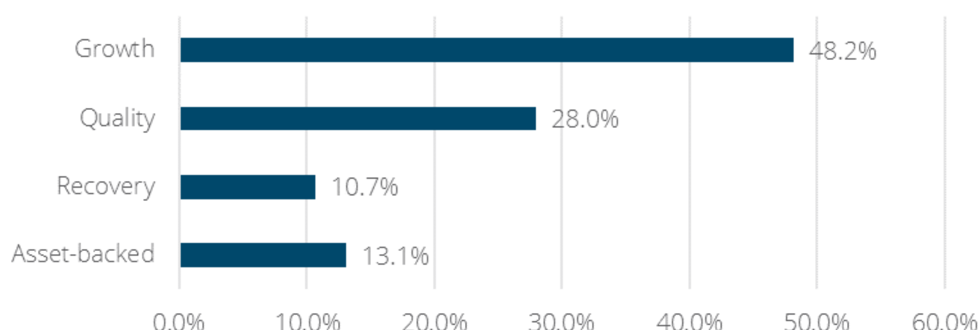
PORTFOLIO POSITIONING

In line with our philosophy, we will continue to construct a portfolio of companies that have the **P**otential to create shareholder value at attractive **V**aluations with supportive **T**iming ("PVT"). Our PVT philosophy has delivered the Company's strong performance since inception and will continue to be at the heart of everything we do.

Investors will be aware that within our PVT Philosophy there are four forms of Potential: Growth, Quality, Recovery and Asset-backed. The portfolio continues to have a bias to Growth; that is investing in companies that have the potential to grow revenues, profits, and cash flows at a higher rate than average. Quality, companies that have high and improving return on capital, remains the second largest category.

Recovery and Asset-backed opportunities make up the balance of the portfolio. When we invest in Recovery stocks, we are looking to buy into companies where margins are depressed compared to history but have begun to improve. And with Asset-backing, confidence in the value of the assets is key and we look for changes in the asset scarcity (e.g. supply-side consolidation), driving asset value upgrades and share price performance.

The exposure to different categories at the end of the period, which is broadly unchanged from prior periods, is shown below.



Source: River and Mercantile Asset Management LLP.

The allocation to each of the categories of Potential is similar to March 2021. When compared to September 2021, the allocation to Growth is a little lower at 48% versus 53%, with the Recovery and Asset-backed categories benefitting – up from c.10% each at the start of the period. This is despite the three new investments being Growth investments. Having previously moved the investment case for **Joules** from Recovery to Growth, we moved the holding back to a Recovery which explains part of the move.

From a performance attribution perspective, at a category level, our Quality and Asset-backed investments outperformed the wider portfolio whilst the Growth and Recovery investments were a drag on performance.

PORTFOLIO ATTRIBUTION

Further to previous comments on the breadth of underperformance within the portfolio, there was only one holding that made a significant positive contribution. **Capital**, a provider of drilling and mining services to gold miners in Africa, gained 32% on the back of continued strong trading. The financial performance of the Quality investment case is geared to the utilisation of their fleet which continues to increase as gold exploration companies commit, given the ongoing strength of the gold price, to new exploration and development activity. The company made a 1.2 percentage point (ppt) contribution to relative performance.

Unfortunately, there is a long list of companies that significantly underperformed in the period – a review of the most expensive names from a performance perspective follows:

Joules was a holding we acquired as a Recovery thesis at the start of the pandemic in 2020. The investment case was premised on margins being rebuilt as the eCommerce revenues grew and given the opportunity to rebase rents for their store portfolio. Whilst supply chain challenges have been a headwind for many businesses, Joules seems to have fared worse. A combination of the increased cost of freight and labour shortages in their distribution centre has been a massive headwind to profits and the company has reduced expectations twice in the period. This resulted in the shares losing 73%; a negative 2ppt impact on performance. However, these headwinds should not, in the main, be permanent. Price increases will be put through to offset the higher costs. Despite this, the company is currently trading at a discount to the price at which they raised capital in April 2020 and – having reported no disappointments in terms of demand – trade on a depressed EV/Sales multiple of approximately a quarter of the average multiple they have traded on since IPO.

Allergy Therapeutics is a specialty pharmaceutical company focused on research and development of allergy treatments that deal with the underlying cause and not just the symptoms of allergies. Its vaccine technology provides the only ultra-short course treatment for grass, tree and ragweed allergies free of toxic aluminium in the European market. It offers convenience with far fewer injections than the market average supporting increased patient adherence, and this is the foundation of the group’s well established commercial position in Europe which continues to grow through a combination of market share gains and new product registrations. The cash cow core European business coupled with a strong balance sheet supports R&D investment in a rich pipeline of both near market and early-stage opportunities. A successful US market entry, where Allergy has the potential to be the first player to launch an ultra-short course allergy vaccine in the largest allergy market offers significant upside optionality. Another lever of upside optionality is the ability to leverage Allergy’s vaccine technology in other allergy areas such as food (peanut). At 1.8x EV/sales FY22E, the shares are currently trading below the fair value of the core European business with nil value attributed to the potentially significant pipeline opportunities, presenting a compelling risk/reward opportunity.

Allergy shares dropped 31% over the period, impacting relative performance by 1ppt, reflecting weaker than expected 1H sales, a function of product phasing and pandemic related demand disruption in some markets, both temporary factors in our view that should not materially change the value of the business. AGY is a long duration asset with a lot of potential value sitting in its R&D pipeline and we suspect the rising rate environment was a key driver behind the valuation de-rating over the period.

Brand Architekts is a beauty business with a portfolio of 13 challenger brands. The company has previously delivered attractive margins from a portfolio of digital brands. Since the disposal of the Swallowfield manufacturing business, the company has been broadly breakeven due not only to the depressed profitability but also the small scale of the business. A new management team arrived to drive the turnaround and they have recently announced the acquisition of a similar business, InnovaDerma Plc. The current valuation is fairly exceptional with the company trading at a discount to the cash on the balance sheet, albeit this doesn’t account for the acquisitions spend (which I would argue is value accretive).

The shares lost 52% in the period, impacting performance by 0.9ppts, on the back of a delay to revenue growth and margin pressure given higher freight costs.

RA International is a support services business providing construction and facilities management services in remote locations. These services are often provided to IGOs/NGOs but also include commercial customers; Total's Cabo Delgado LNG project in Mozambique was due to be a major project. The company's financials are depressed with revenues 20% below pre-pandemic levels and margins, which have historically been in excess of 20%, dropping to mid-teens. Assuming a normalised level of earnings, the company trades on approximately 4x earnings. The shares dropped 55% in the period as both the realised profits for 2021 and closing order book were lower than expected. The impact on performance was 0.8ppts.

Ince Group, a legal services business which was acquired on a Recovery investment case with the view that the company could re-rate from depressed earnings multiples as the company delivered margin improvement and cash generation on a stable revenue base. The development in the last six months has been the acquisition of Arden Plc – a business that has recently reported a profit of c.£1m with £2.1m of net cash plus £2.7m of equity trading inventory. At the time of the deal, given Ince's 53p share price, the deal valued Arden at £10m with a plan to deliver £1m of synergies. The 50% decline in Ince's share price (0.75ppt impact on performance) implies a valuation of more like £5m – broadly equivalent to the cash and equity inventory value. Needless to say, the deal has not been taken well by investors but I expect the profit warning at Knights has also had an impact alongside the caveated outlook statement that Ince made at the interim results.

Cake Box shares fell 40% (0.5ppts) as a blog highlighted several issues including the resignation of the prior auditor, the delayed reporting of the website breach and inaccuracies between the preliminary statement and the annual report. Most of these issues have been previously disclosed and the company has already taken steps to address them through investment in internal functions, which includes the appointment of BDO to assist with implementing improved internal audit practices. We cannot see any manipulation of revenue, profits or cash generation in the inaccuracies which points to poor reporting as opposed to anything more sinister.

There are four additional holdings that contributed to a negative performance of more than 0.5 percentage points but, in the main, the companies have done little to justify their share price moves.

ActiveOps, a business that enables back-office operations to be optimised, lost 46% (1ppt impact) despite outperforming IPO expectations. The company flagged that the pandemic has extended the sales cycle in the US but, ultimately, the opportunity remains as it was at the time of the highly oversubscribed IPO in March 2021, only with shares 45% cheaper.

Science in Sport delivered another year of strong organic growth and gross margin improvement despite a material headwind from higher whey prices. The company is embarking on another investment cycle which should drive further gross margin gains. The EV/Sales multiple continues to look very depressed given the transaction multiples we have seen for similar businesses. The shares fell 26%, impacting performance by 0.8ppts.

Mind Gym, a provider of behavioral science solutions to corporates, declined 29% as a caveated outlook statement at the interim results highlighted risks to short term expectations. The impact on performance was 0.7ppts. The company is investing in a digital transformation programme which should, alongside the strong thematic tailwinds as ESG issues are high on management agendas, support long term growth but does come at a cost to short term profitability. The shares trade at an EV/sales multiple of 2x March 2023 which is well below historic levels and at a significant discount to private market transaction multiples for learning and development peers.

Finally, shares in **Kooth** fell 38%, impacting performance by 0.6ppts. The valuation rating of the business, as measured by the EV/Sales multiple has fallen from a peak of 6.6x in September 2021 to 3.3x. The company provides digital mental health services to, predominantly, children and young people in the UK and has a very clear leadership position in this market. Prior year growth was supplemented by some exceptional, pandemic related, government mental health funding which has begun to unwind and impacted churn and revenue growth.

PORTFOLIO ACTIVITY – NEW POSITIONS AND EXITS

New Positions – in order of position size at the end of the period:

Strip Tinning – 1.7%: A tier two auto supplier with leading market share in specialist automotive electrical glazing connectors. There is a compelling growth opportunity in both its core glazing business and as an enabler of electric vehicle growth which is key to decarbonising the auto sector. High revenue cover and strong gross margins are underpinned by patented manufacturing related IP and a +65-year heritage of reliably supplying leading auto OEMs. Glazing growth potential is augmented by entry into the rear glazing connector market catalysed by regulatory change, with Strip Tinning providing a differentiated lead-free solution and the ongoing trend towards increasing functionality being embedded in auto glazing (e.g. autonomous driving sensors). EV connector growth potential is substantial with a fast-growing sales pipeline and product validation from a high-end German OEM. We believe execution risk is low given that the manufacturing process for Glazing is relevant to the EV opportunity. The IPO valuation was attractive at < 11x P/E offering in our view, an asymmetric pay-off.

Renold – 1%: A manufacturer of highly engineered industrial chains typically used in demanding environments and high-tech applications (e.g. automated warehousing systems, power stations, rollercoaster rides) in a broad range of end-markets. It provides a low cost but critical product that affords it pricing power through the cycle. Sustainability trends are a commercial opportunity as Renold's product is typically longer lasting than that of the competition and has a lower environmental footprint as it is more energy efficient (less friction) and has lower or no lubrication requirements. Management has resolved historic under-investment, previously a restraint on recovery potential, positioning the business for higher growth, margins, and cash flow generation. There is evidence of underlying improvement in operating efficiency that should underpin strong operational leverage as end markets recover. Balance sheet strength underpins scope for value accretive bolt-on M&A which is key to growth in a market where customers are sticky. We identified significant upside risk to consensus short and mid-term forecasts and the stock trades on a depressed valuation presenting a compelling risk/reward opportunity.

1Spatial – 0.75%: We initiated a holding in 1Spatial, which provides software solutions for managing location and geospatial data into the Government, Utilities and Transport sectors. Through the automatic cleansing of complex data inputs into a usable output, its products improve the accuracy and reliability of the data relied upon by the agencies responsible for maintaining the global critical infrastructure (such as the US' 911 Emergency Services). Combined with cost and time savings, this generates a high return on customer investment whilst enabling them to achieve their sustainability goals. Product standardisation drives Growth Potential, with an improved growth outlook, margin accretion and improving cash generation. Trading on 1.5x EV/Sales, we believe the current share price offers asymmetric risk/reward and attractive upside if management can execute on their turnaround strategy. Momentum in new contract wins supports growing conviction in their ability to deliver to a conservative expectation set.

Exits: There were no exits in the six-month period. We took profits in some of our longer duration holdings, **Alpha FX** and **Keystone Law**, as well as **Litigation Capital Management** and **Flowtech Fluidpower** which has been delivering to its Recovery investment case.

PORTFOLIO STATISTICS

Top 10 Holdings

	Weight
Instem	5.4%
Science In Sport	5.3%
Capital Limited	4.8%
Allergy Therapeutics	4.6%
Litigation Capital Mgmt	3.6%
Supreme	3.6%
LendInvest	3.4%
Mind Gym	3.4%
Keystone Law	3.3%
DF Capital	3.3%

Source: River and Mercantile Asset Management LLP

OUTLOOK

Despite the recent bounce in equities, investor sentiment remains poor. The hit to consumer income from higher inflation now being realised is evident in consumer confidence which is close to the low of March 2020. The exceptional fiscal and monetary response of the last two years is being unwound through higher rates, excess liquidity withdrawal and higher taxes - measures that are likely to weigh on growth. We should therefore be prepared for ongoing volatility in equity returns, style leadership and investor sentiment. However, given the underperformance of smaller companies over the last six months, we caution against becoming too bearish 'after the event' and note that current levels of consumer confidence have historically been coincident with troughs in its relative performance.

In the short term, we believe we are likely to avoid a recession owing to the strong consumer balance sheet coupled with the positive seasonal effect (i.e. lower prices) in the energy market. We are presumably somewhere near peak disruption to supply chains which means that businesses with reasonable pricing power should sooner or later be able to recover the hit to profitability that supply chain challenges have caused, and robust consumer businesses represent bargain basement – we are selectively finding cases of March 2020 valuation levels on through-cycle metrics, even if aggregate markets are perhaps surprisingly within 10% of all-time highs.

We remain dedicated to our strategy of building a high conviction portfolio exploiting investment opportunities in a part of the market that, in general, has greater scope for growth and is often overlooked by larger funds and the stockbroking community.

Thank you for your ongoing support.

George Ensor
Portfolio Manager
16 June 2022