![EDISON]

# abrdn UK Smaller Companies Growth Trust

## Sticking to the successful long-term strategy

Investment trusts
UK smaller companies

**abrdn UK Smaller Companies Growth Trust (AUSC) is managed by two of abrdn's small-cap specialists: Harry Nimmo (since September 2003) and Abby Glennie (since November 2020). The trust has a long-term record of outperformance versus its reference index, with the managers following a clearly defined focus on quality, growth and momentum stocks, which means they consider that it is likely to underperform when cyclical/value stocks lead the market. There is a high level of economic uncertainty in the UK due to inflation, rising interest rates and the war in Ukraine. However, the managers are confident that if there is a recession, the trust will outperform as the fund contains high-quality businesses and 'the strong get stronger in difficult times'. They say historical data show that when stock markets weaken it is a good time to consider an investment in AUSC.**

**Long-term NAV outperformance versus the reference index**


Source: Refinitiv, Edison Investment Research

## The analyst's view

Despite a recent period of underperformance where investors focused on the macroeconomic backdrop rather than company fundamentals, the managers have a commendable long-term performance record over multiple market cycles. AUSC is ahead of its reference index over the last three, five and 10 years and over the last decade has delivered absolute NAV and share price total returns of 13.7% pa and 13.2% pa respectively. According to the managers, six of AUSC's top 10 holdings are trading below a 20x forward P/E, which is very unusual. Hence, investors now have the opportunity to consider a portfolio of high-quality businesses at a comparatively modest valuation. The managers rigidly adhere to the investment process, which uses the Matrix, a proprietary quantitative screening tool to identify companies with favourable quality, growth and momentum attributes; valuation is a secondary consideration.

## Defined discount control mechanism

AUSC's shares are trading at a 9.5% discount to cum-income NAV, which compares with the 5.2% to 7.3% range of historical averages over the last one, three, five and 10 years. There is scope for a narrower discount given the trust's long-term record of outperformance. The board repurchases shares, targeting a maximum 8.0% discount in normal market conditions.

**NOT INTENDED FOR PERSONS IN THE EEA**

**3 May 2022**

| | | |
|---|---|---|
| **Price** | | **569p** |
| **Market cap** | | **£540m** |
| **AUM** | | **£632m** |

| | | |
|---|---|---|
| NAV* | | 628.5p |
| Discount to NAV | | 9.5% |
| *Including income. At 28 April 2022. | | |
| Yield | | 1.4% |
| Ordinary shares in issue | | 94.9m |
| Code/ISIN | | AUSC/GB0002959582 |
| Primary exchange | | LSE |
| AIC sector | | UK Smaller Companies |
| 52-week high/low | 784.0p | 529.0p |
| NAV* high/low | 842.5p | 590.3p |
| *Including income. | | |
| Net gearing* | | 5.1% |
| *At 22 April 2022. | | |

### Fund objective

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

### Bull points

- Long-term record of strong absolute and relative performance.
- Proprietary investment process driven by the Matrix.
- Shares of smaller companies tend to perform relatively better than those of larger businesses.

### Bear points

- AUSC's relative performance struggles during the early stage of an economic cycle.
- Modest dividend yield, given focus on capital growth rather than income.
- UK market may remain out of favour with global investors.


### Analysts

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Edison profile page

# Market outlook: Opportunity following recent weakness

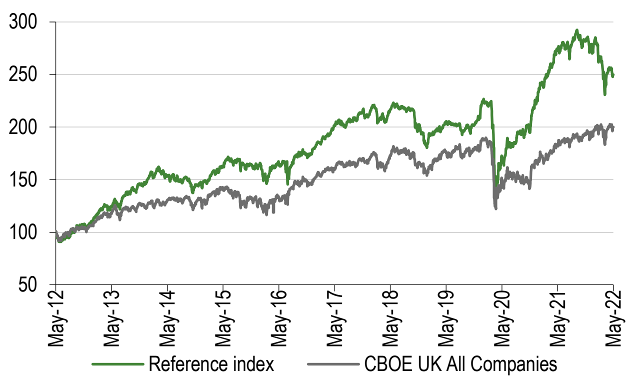
As shown in Exhibit 1 (left-hand side), while UK small-cap equities have outperformed their large-cap brethren over the long term, the recent sell-off has been significantly larger for the shares in smaller rather than larger companies. This may be providing an opportunity for long-term investors to move down the capitalisation spectrum. Economic uncertainty due to rising costs, the prospect of further interest rate hikes and the war in Ukraine has led to elevated stock market volatility; also, there has been a rotation out of growth and into value stocks as higher interest rates reduce the present value of companies' future cash flows.

While small-cap growth stocks are currently out of favour, the fundamentals of high-quality businesses remain robust and companies with pricing power are in a relatively better position to navigate an environment of rising input costs. In general, smaller businesses have superior growth prospects compared with their larger peers and the UK market in aggregate remains attractively valued compared with other regions.

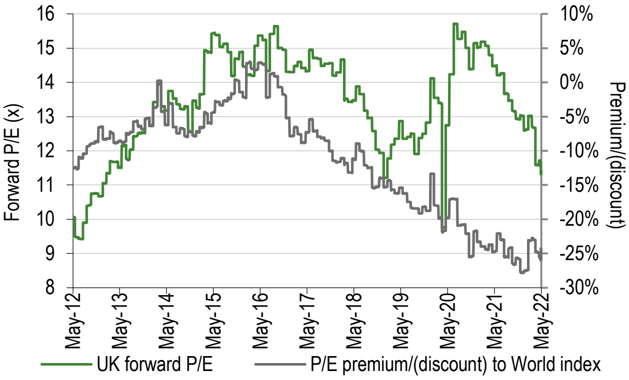
The Datastream UK index is trading on a forward P/E multiple of 11.4x, which is a 25.8% discount to the Datastream World index and is considerably wider than the 17.6% and 11.3% average discounts over the last five and 10 years respectively. Despite the current economic uncertainty, investors who take a selective approach to long-term investment may find interesting opportunities in the shares of high-quality small-cap UK companies that have been oversold in a 'risk-off' market environment.

**Exhibit 1: Market performance and valuation**

**Performance of UK indices (last 10 years)**




**Valuation of UK equities (Datastream indices, last 10 years)**




Source: Refinitiv, Edison Investment Research. Note: AUSC's reference index is the Numis Smaller Companies plus AIM ex-Investment Companies Index (Numis Smaller Companies ex-Investment Companies Index to 31 December 2017). Data as at 29 April 2022.

# The fund managers: Harry Nimmo and Abby Glennie

## The managers' view: Portfolio fundamentals holding up well

Glennie explains we have seen periods before when the stock market is driven by macroeconomic factors, although she considers that now is different as volatility has increased due to a geopolitical event, namely Russia's invasion of Ukraine. The managers take comfort from the fact that following bear markets, stocks can rebound relatively quickly; data from abrdn show that UK stock prices have typically taken from a few months to a couple of years to recover, although timing a bounce is difficult.

Nimmo reports that portfolio companies are generally trading quite well, although there are some areas of the market experiencing estimate downgrades as not all companies are immune to rising costs. He notes that earnings strength within the portfolio as a whole is proving to be resilient and that the strong growth drivers are continuing. There is cost inflation, such as higher energy prices and wages, but many of the companies within the portfolio have pricing power, so are not as exposed to higher costs; these include Kainos (software), Watches of Switzerland (luxury retail) and Safestore (storage warehouses).

The managers provided more information about the UK stock market, as this year share prices have come under pressure. Glennie explains that from the start of 2022 until the Russian invasion of Ukraine on 24 February, there was a strong rotation from growth into value stocks; however, recent weeks have been more settled for AUSC's style of investing with its focus on quality, growth and momentum. Nimmo reports that in a normal recession, the trust's relative performance tends to hold up well as portfolio companies have pricing power, strong management teams and robust balance sheets. The managers say that as oil prices have risen, investors have focused on macroeconomic factors and risks of stagflation, and energy stocks have outperformed (AUSC has no exposure to this sector). They note that the Q421 reporting season was pretty good, and they hope investors will concentrate more on company fundamentals rather than energy prices and rising inflation.

Nimmo suggests there is a two-way pull between fundamentals and macroeconomic factors. He reports that for most of the time, company fundamentals count, but with rising inflation and the prospects of higher interest rates, macroeconomic factors are leading the market. The managers expect AUSC's portfolio will outperform if there is a recession, as strong companies get even stronger. They say that while a few firms in the fund are experiencing higher wage inflation, such as those in the technology and financial sectors, portfolio companies have quite low energy intensity, so higher energy costs are not that problematic. The fund also has modest retail exposure, a sector that is having to deal with transportation dislocations.

Glennie highlights AUSC's exposure to food producers, such as Cranswick and Hilton Foods, which have defensive characteristics; she explains that compared with 10 years ago, these companies have much stronger relationships with their customers, which helps protect their margins. The manager says there has been a high level of investment in automation at Cranswick, so wages as a percentage of total costs have declined.

AUSC has a position in Telecom Plus, which is a multi-utility supplier operating under the Utility Warehouse name. Nimmo says it has a unique business model and is the lowest-cost provider of energy. Many of its competitors have collapsed, so Telecom Plus is in a good position to increase its market share. Investee company Marshalls (block paving) is experiencing cost inflation, but this is being passed through via higher prices, and the company is experiencing very high levels of demand for its products, according to the manager. Nimmo also highlights global recruiter Robert Walters, which he says is experiencing the perfect operating environment. Companies are looking to recruit and employees want to move jobs for potentially higher wages, which benefits Robert Walters, whose fees are based on the recruits' salaries. The firm is taking on higher numbers of recruitment consultants, although the level is below prior peaks, so there is potential for future operating efficiencies.

## Current portfolio positioning

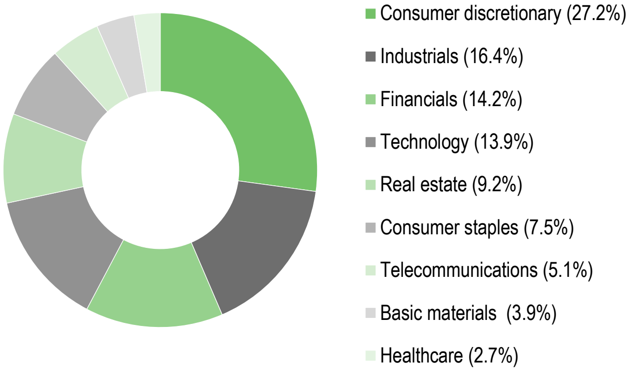
At end-March 2022, AUSC's top 10 positions made up 31.1% of the fund, which was broadly in line with 31.4% a year earlier; four positions were common to both periods. The trust's breakdown by sector and market cap is shown below in Exhibit 3, we are unable to provide a year-on-year comparison of AUSC's sector exposure as the classifications have changed within the last 12 months.

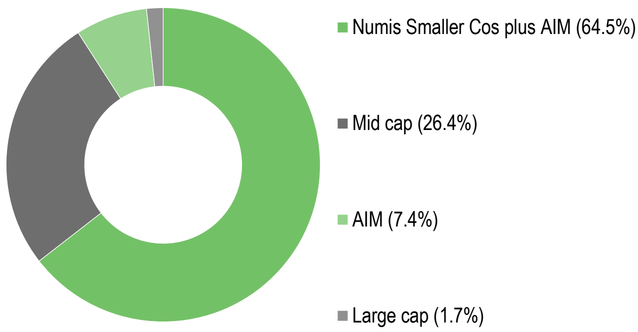
**Exhibit 2: Top 10 holdings (at 31 March 2022)**

| Company | Sector | Portfolio weight % | |
|---|---|---|---|
| | | 31 March 2022 | 31 March 2021* |
| Safestore Holdings | Real estate investment trust | 4.0 | N/A |
| Kainos Group | Software and computer services | 3.7 | 4.6 |
| Hilton Food Group | Food producers | 3.5 | 2.7 |
| Future | Media | 3.3 | 4.0 |
| Next Fifteen Communications | Media | 3.2 | N/A |
| Watches of Switzerland | Personal goods | 3.0 | N/A |
| Gamma Communications | Telecom service provider | 2.6 | 3.9 |
| Focusrite | Leisure goods | 2.6 | N/A |
| Mortgage Advice Bureau | Finance and credit services | 2.6 | N/A |
| Ergomed | Pharmaceuticals and biotechnology | 2.6 | N/A |
| **Top 10 (% of portfolio)** | | **31.1** | **31.4** |

Source: AUSC, Edison Investment Research. Note *N/A where not in end-March 2021 top 10.

**Exhibit 3: Portfolio sector (left) and market cap (right) exposure (at 31 March 2022)**




Source: UEM, Edison Investment Research. Note: Excludes cash.

The managers highlight recent changes in the portfolio starting with the new holdings:

- **LBG Media** is a UK-based multi-brand, multi-channel digital youth publisher. It has a portfolio of brands that it monetises in three ways: working directly with brands in its own studios (the British Army is one of its largest clients); paying a small fee to host amusing clips in the style of 'You've been Framed'; and working with social influencers. LBG's content is posted on its own website and on media platforms. It was founded by two men while they were still at university and the business was self-funded, so became cash generative early in its life cycle. The managers say that on the basis that 'content is king', LBG has significant growth potential from the monetisation of its content.
- **Tatton Asset Management** is a discretionary fund manager. The managers explain the firm has been gathering assets under its attractive low-fee model, a structure that had been lacking in the market. It invests in a broad array of assets via funds rather than directly.
- **Marlowe** offers a group of business-to-business services around regulation and requirements such as online compliance learning programmes and monitoring water quality. It describes itself as a 'leader in business-critical services and software' and has two divisions: governance risk and compliance, and testing, inspection and certification. The company's software enables its clients to track and report their compliance records. Marlowe's model is a mixture of organic and acquired growth as scale really matters in its business, according to the managers. They participated in a modestly discounted secondary offering to initiate a position in this company, where the proceeds were used to fund the acquisition of Optima Health, which is one of the leading providers of health and wellbeing services; the deal has made Marlowe the market leader in this field.

The following positions were sold:

- **Clipper Logistics** received a takeover bid by a US-listed company and the consideration is a mixture of cash and shares in a US business; hence, the holding was sold. Clipper Logistics' share price has rallied by more than 38% since its end-January year-to-date low point.
- **AO World** and **Victorian Plumbing** – these online retailers have suffered from logistical issues. Although the investment rational was unsuccessful, it was the correct decision to sell these shares as subsequent to exiting AUSC's portfolio they have declined further.

## Performance: Ahead of the reference index

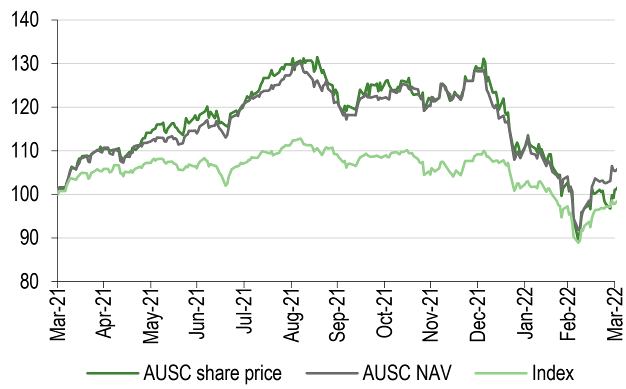
**Exhibit 4: Five-year discrete performance data**

| 12 months ending | Share price (%) | NAV (%) | Index* (%) | Numis Smaller Cos plus AIM ex-ICs (%) | CBOE UK Smaller Cos (%) | CBOE UK All Companies (%) |
|---|---|---|---|---|---|---|
| 31/03/18 | 28.3 | 18.3 | 6.1 | 7.0 | 7.0 | 1.2 |
| 31/03/19 | (7.8) | 0.5 | (4.1) | (4.1) | (3.1) | 6.2 |
| 31/03/20 | (1.1) | (9.2) | (23.2) | (23.2) | (25.3) | (19.1) |
| 31/03/21 | 38.9 | 48.6 | 71.3 | 71.3 | 75.0 | 26.6 |
| 31/03/22 | 1.0 | 5.4 | (2.1) | (2.1) | 13.0 | 13.2 |

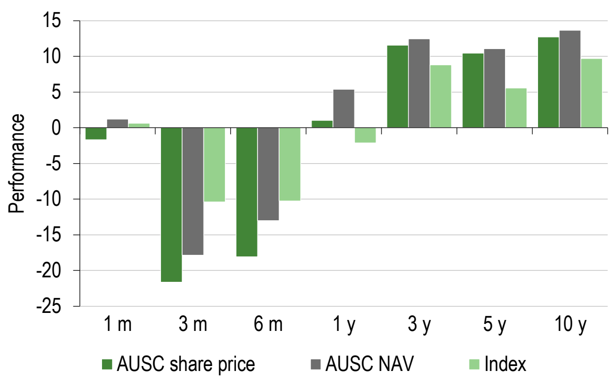
Source: Refinitiv. Note: All % on a total return basis in pounds sterling. *Index is Numis Smaller Cos plus AIM ex-Investment Companies (Numis Smaller Cos ex-Investment Companies to 31 December 2017).

**Exhibit 5: Investment trust performance to 31 March 2022**

Price, NAV and index total return performance, one-year rebased




Price, NAV and index total return performance (%)




Source: Refinitiv, Edison Investment Research. Note: Three-, five- and 10-year performance figures annualised.

AUSC has underperformed the reference index in recent months as investors have favoured more cyclical areas of the market. Nimmo explains that difficult areas for the trust include its overweight exposure to financials, where its asset management names had performed well before the latest market sell-off. Impax Asset Management Group, Liontrust Asset Management and Molten Ventures combined have declined from c 6.5% of the fund to c 4.5% due to some profit taking and market weakness. Platform companies such as AUSC's holding in AJ Bell have sold off as they are market sensitive and the manager reports there are signs that the business is becoming more competitive (the position has recently been reduced). The trust has no exposure to the energy and basic materials sectors, which have performed well and make up c 8% of the reference index. The managers believe that small-cap oil and gas companies are too risky and consume a lot of cash, so do not satisfy their quality, growth and momentum requirements. The valuation of AUSC's portfolio is higher than the reference index and those of some of its competitors' funds. Some companies have derated, such as Gamma Communications, whose share price declined by 7% on the day it posted positive results. Other stocks that performed well during the pandemic including Focusrite, Games Workshop, Team17 and Gear4music have been relative underperformers.

Positive contributors to the trust's performance in recent months include the fund's overweight exposure to real estate. This is a result of positive stock selection such as the holdings in storage warehouses Safestore Holdings and Big Yellow Group. These companies have traded well through the pandemic and beyond. Safestore is continuing its expansion into Europe helped by a successful sales and marketing operation that attracts new business. AUSC has a position in Sirius Real Estate, which owns secondary industrial units and is benefiting from the ongoing trend to nearshoring. Previously manufacturers had just-in-time inventory models shipping inputs from the Far East. As this is now problematic, companies are seeking local suppliers. Most of Sirius's business was in Germany but it made a large acquisition of BizSpace in the UK.

Outside of real estate, Next Fifteen Communications has performed well. It is a digital communications and marketing company and offers business transformation advice. Its customers include the large US tech companies and consumer businesses, which were attracted by the firm's small agency speciality capabilities and the relationships have grown over time. Although the share prices of large-cap US technology companies have come under pressure they are still generating strong earnings and investing for future growth. Next Fifteen's CEO is extremely well connected according to the manager, and the company acquired Engine in the UK, which is earnings accretive. Nimmo says that Jet2 struggled during the COVID-19 pandemic; however, reopening of economies and the relaxation of COVID testing in Europe has been very helpful for its business. There is a big market share opportunity following the collapse of Thomas Cook and Jet2 has been investing in additional capacity to service its leisure customers. According to the manager, Jet2 is a high-quality business and is ranked number nine in Tripadvisor's list of best airlines in the world; it is the only British or Irish airline to make the top 100 list. The firm is managed by its founder and generates a large amount of repeat holiday business because it offers a good service and treated its customers fairly during the COVID mayhem. While there are concerns about inflationary pressure negatively affecting consumer spending, Nimmo says savings were built up during the pandemic and holidays are a high priority for many people.

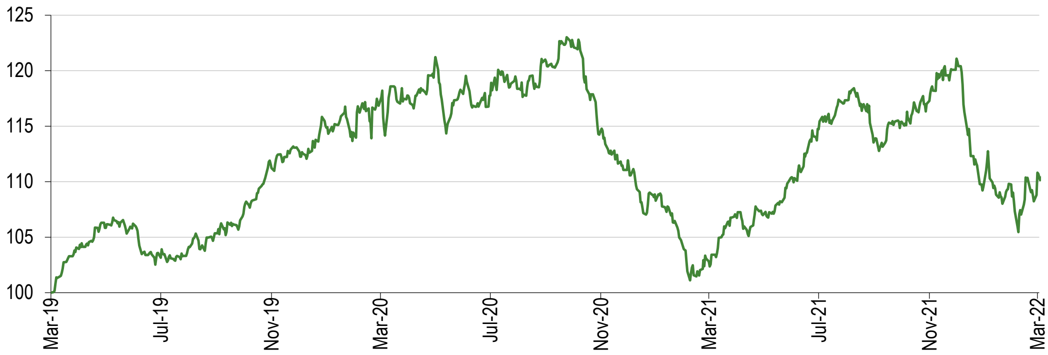
**Exhibit 6: Share price and NAV total return performance, relative to indices (%)**

| | One month | Three months | Six months | One year | Three years | Five years | 10 years |
|---|---|---|---|---|---|---|---|
| Price relative to index* | (2.3) | (12.6) | (8.7) | 3.2 | 7.8 | 25.4 | 31.7 |
| NAV relative to index* | 0.6 | (8.3) | (3.1) | 7.7 | 10.4 | 29.1 | 42.8 |
| Price relative to Numis Smaller Cos plus AIM ex-ICs | (2.3) | (12.6) | (8.7) | 3.2 | 7.8 | 24.3 | 46.9 |
| NAV relative to Numis Smaller Cos plus AIM ex-ICs | 0.6 | (8.3) | (3.1) | 7.7 | 10.4 | 28.0 | 59.4 |
| Price relative to CBOE UK Smaller Companies | (5.3) | (22.5) | (17.4) | (10.6) | (6.1) | 7.2 | 5.8 |
| NAV relative to CBOE UK Smaller Companies | (2.5) | (18.7) | (12.3) | (6.7) | (3.8) | 10.3 | 14.8 |
| Price relative to CBOE UK All Companies | (3.0) | (22.4) | (22.0) | (10.8) | 19.7 | 31.8 | 66.2 |
| NAV relative to CBOE UK All Companies | (0.1) | (18.7) | (17.2) | (6.9) | 22.6 | 35.6 | 80.3 |

Source: Refinitiv, Edison Investment Research. Note: Data to end-March 2022. Geometric calculation. *Index is Numis Smaller Cos plus AIM ex-Investment Companies (Numis Smaller Cos ex-Investment Companies to 31 December 2017).

AUSC's relative performance is shown in Exhibit 6. Its NAV and share price are ahead of the reference index over one, three, five and 10 years, while lagging over most of the shorter periods shown. The trust's outperformance compared with the broad UK market is even more pronounced over the last three, five and 10 years.

**Exhibit 7: NAV total return performance relative to index over three years**




Source: Refinitiv, Edison Investment Research

## Peer group comparison

AUSC is a member of the AIC UK Smaller Companies sector; in Exhibit 8, we show the 18 largest funds with market caps above £50m. The peers employ a variety of investment processes and AUSC is unique with its intense focus on stocks that fulfil its quality, growth and momentum criteria and use of the Matrix proprietary screening tool. Unsurprisingly, the trust's relative performance has been negatively affected by the stock market rotation towards value/cyclical stocks. AUSC's NAV total returns are above average over five and 10 years, ranking fourth out of 16 funds over the last five years and eighth out of 14 funds over the last decade. AUSC's discount is currently below the mean and the board employs a discount control mechanism, repurchasing shares when the trust's discount exceeds 8% in normal market conditions. It has a competitive ongoing charge, a below-average level of gearing and, unsurprisingly given its focus on capital growth rather than income, a dividend yield that is 0.9pp below the peer group mean.

**Exhibit 8: Selected peer group at 29 April 2022***

| % unless stated | Market cap £m | NAV TR 1 year | NAV TR 3 year | NAV TR 5 year | NAV TR 10 year | Discount (cum-fair) | Ongoing charge | Perf. fee | Net gearing | Dividend yield (%) |
|---|---|---|---|---|---|---|---|---|---|---|
| abrdn UK Smaller Cos Growth | 539.8 | (11.1) | 22.7 | 48.9 | 223.2 | (10.0) | 0.8 | No | 105 | 1.4 |
| Aberforth Smaller Companies | 1,173.9 | (2.6) | 18.0 | 20.7 | 163.9 | (13.4) | 0.8 | No | 106 | 2.6 |
| Aberforth Split Level Income | 141.7 | (6.2) | 6.2 | | | (11.5) | 1.2 | No | 134 | 4.9 |
| abrdn Smaller Companies Inc | 65.9 | (10.4) | 13.7 | 34.7 | 204.1 | (15.3) | 1.2 | No | 104 | 3.2 |
| BlackRock Smaller Companies | 757.8 | (11.8) | 23.9 | 42.3 | 235.4 | (13.7) | 0.8 | No | 105 | 2.3 |
| BlackRock Throgmorton Trust | 675.0 | (19.2) | 28.9 | 49.9 | 244.2 | (6.6) | 0.6 | Yes | 128 | 1.6 |
| Crystal Amber | 99.5 | 40.5 | (17.3) | (19.2) | 90.2 | (27.7) | 2.1 | Yes | 100 | 4.2 |
| Henderson Smaller Companies | 702.9 | (15.1) | 19.4 | 35.0 | 226.2 | (13.7) | 0.4 | Yes | 115 | 2.5 |
| Invesco Perpetual UK Smaller | 173.9 | (6.4) | 21.3 | 41.3 | 219.5 | (14.5) | 0.9 | No | 100 | 1.7 |
| JPMorgan UK Smaller Companies | 245.9 | (13.2) | 47.2 | 73.0 | 239.1 | (13.1) | 0.9 | No | 109 | 1.8 |
| Marwyn Value Investors | 64.9 | (0.3) | 2.1 | (13.5) | 13.0 | (33.1) | 2.4 | No | 100 | 7.7 |
| Miton UK Microcap | 94.5 | (13.6) | 62.7 | 44.3 | | (4.7) | 1.5 | No | 100 | 0.0 |
| Montanaro UK Smaller Companies | 200.9 | (16.4) | 5.6 | 17.7 | 90.1 | (6.6) | 0.8 | No | 104 | 5.4 |
| Odyssean Investment Trust | 152.6 | 6.5 | 59.3 | | | (2.3) | 1.4 | Yes | 100 | 0.0 |
| Oryx International Growth | 184.8 | (11.1) | 64.6 | 86.6 | 415.1 | (17.4) | 1.6 | No | 100 | 0.0 |
| Rights & Issues Investment Trust | 173.3 | 1.4 | 23.4 | 30.1 | 287.7 | (11.1) | 0.4 | No | 100 | 1.4 |
| River and Mercantile UK Micro Cap | 72.5 | (19.3) | 26.2 | 48.3 | | (13.1) | 1.2 | Yes | 100 | 0.0 |
| Strategic Equity Capital | 168.1 | (0.7) | 30.1 | 37.2 | 238.4 | (12.5) | 1.1 | Yes | 100 | 0.5 |
| **Simple average** | **316.0** | **(6.1)** | **25.4** | **36.1** | **206.4** | **(13.4)** | **1.1** | | **106** | **2.3** |
| **Rank (out of 18 funds)** | **5** | **11** | **10** | **4** | **8** | **5** | **6** | | **6** | **13** |

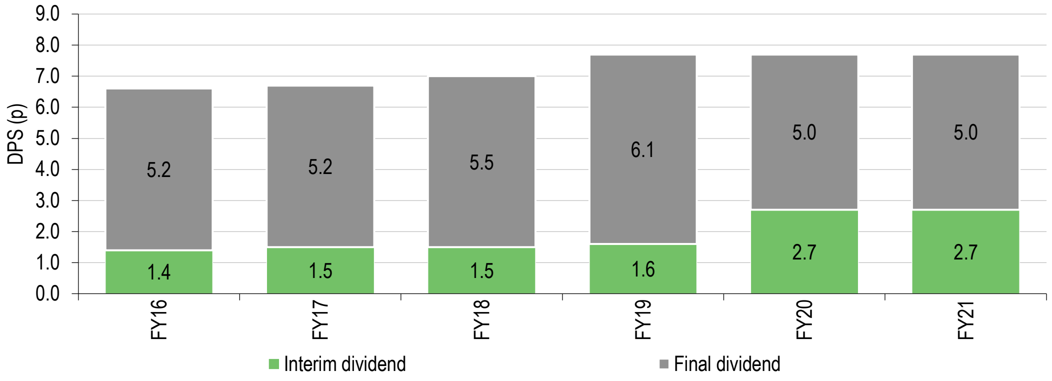
Source: Morningstar, Edison Investment Research. Note: *Performance as at 29 April 2022 based on ex-par NAV. TR = total return. Net gearing is total assets less cash and equivalents as a percentage of net assets.

## Dividends

In H122, AUSC's revenue return was 4.26p per share, which was 24.9% higher than 3.41p per share in H121, as portfolio companies' businesses are recovering following the pandemic-induced slowdown. The percentage of the portfolio made up of non-dividend paying companies has increased to 19%, partly due to investments in IPOs. Nimmo reports that Watches of Switzerland is the only top 10 holding not to pay a dividend as it is investing for growth. The manager cautions that while portfolio companies' earnings are resilient, if there are earnings downgrades, there is a risk that dividend cuts will follow. However, some investee firms are now paying higher dividends than in 2019, such as Kainos, Safestore and Impax Asset Management.

At the end of H122, AUSC had £6.8m in revenue reserves, which is c 0.9x the last annual dividend. The manager expects the trust's income in FY22 will exceed the FY21 dividend payment, but conservatively, the board held the latest interim dividend steady at 2.70p per share. Barring unforeseen circumstances, the board expects to maintain the full-year dividend at the same level as FY21 and to start replenishing revenue reserves, which have been depleted over the last two years. AUSC pays semi-annual dividends in April and October. The board aims to pay out around a third of the total annual distribution as the interim dividend with around two-thirds as the final dividend. Based on its current share price, the trust offers a 1.4% dividend yield.

**Exhibit 9: Dividend history since FY16**



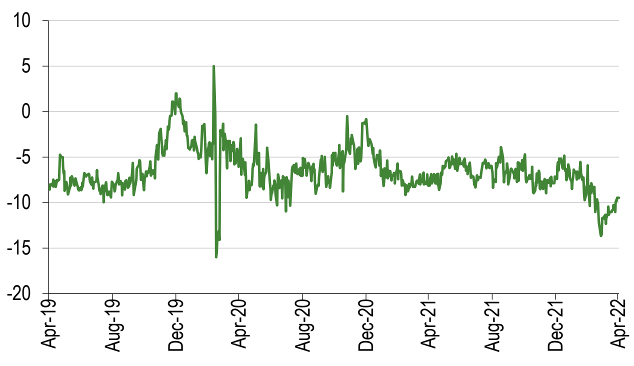

Source: Bloomberg, Edison Investment Research

## Discount: Wider than historical averages

AUSC is currently trading at a 9.5% discount to cum-income NAV, which is towards the wider end of the 3.9% to 13.7% range of discounts over the last 12 months. It is wider than the 7.3%, 6.5%, 6.1% and 5.2% average discounts over the last one, three, five and 10 years respectively.

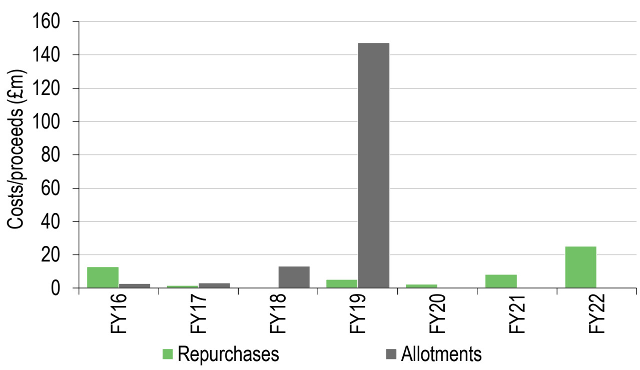
The board employs a discount control mechanism, targeting a maximum 8.0% share price discount to cum-income NAV in normal market conditions. Renewed annually, it has the authority to repurchase up to 14.99% of AUSC's share capital. During H122, c 1.9m shares (c 1.9% of the share base) were bought back at an average discount of 6.4%. The trust also has a discretionary tender mechanism in place, although none have been undertaken since June 2015, as the board says share buybacks are the primary method to manage AUSC's discount.

**Exhibit 10: Discount over three years (%)**




Source: Refinitiv, Edison Investment Research

**Exhibit 11: Buybacks and issuance**




Source: Morningstar, Edison Investment Research

## Fund profile: High-conviction UK small-cap equities

Launched in August 1993, AUSC is quoted on the Main Market of the London Stock Exchange. Since 1 September 2003, the trust has been managed by Harry Nimmo at abrdn. He aims to generate long-term capital growth from a diversified portfolio of UK smaller companies. On 17 November 2020, it was announced that Nimmo's colleague Abby Glennie was appointed as AUSC's co-manager with immediate effect.

The fund is comprised of 50–60 of the managers' highest-conviction investment ideas. AUSC's performance is measured against the Numis Smaller Companies plus AIM ex-Investment Companies Index (the Numis Smaller Companies ex-Investment Companies Index before 1 January 2018). To mitigate risk, at the time of purchase AUSC may hold no more than 5% of total assets in a single position, no more than 5% in companies with a market cap below £50m and the managers tend not to invest in 'blue sky' (not yet profitable) companies, although up to 5% is permitted. Up to 50% of the portfolio may be invested in companies that are constituents of the broad AIM index. The managers may vary the trust's level of gearing between a net cash position of 5% and net gearing of 25% of NAV (at the time of drawdown). At 22 April 2022, net gearing was 5.1%. To provide some context, over the last decade, the financial year-end position has ranged from 4.6% net cash to 8.8% net gearing.

AUSC started life as Edinburgh Smaller Companies in 1993, with Standard Life Investments (now abrdn) assuming management in 2003. The trust merged with Gartmore Smaller Companies Trust in 2009 and with Dunedin Smaller Companies Investment Trust in October 2018. With effect from 25 October 2021, the trust's name was changed, following shareholder approval, from Standard Life UK Smaller Companies Trust (ticker: SLS) to abrdn UK Smaller Companies Growth Trust. The board deemed that the addition of 'growth' better reflects what the trust is seeking to achieve.

## Investment process: Using the proprietary Matrix

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

- **Focus on quality to enhance return and reduce risk** – factors include the strength of a company's relationship with its customers, the existence of long-term contracts and an element of pricing power. Firms with high or unsustainable levels of debt are generally avoided.
- **Look for sustainable growth** – portfolio companies often provide niche products or services.
- **Momentum** – run your winners and cut losers.
- **Concentrate your efforts** – use of the proprietary screening tool known as the Matrix helps identify suitable candidates for inclusion in the portfolio and reduces the risk that time is spent 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** – this is a secondary consideration.

Nimmo and Glennie aim to generate long-term capital growth from a diversified portfolio of smaller-cap UK equities. They use the Matrix, which is a screening tool based on a series of 12 quality, growth, momentum and valuation factors including forecast earnings and dividend growth, earnings revisions, share price momentum, balance sheet strength and the level of directors' dealing, to whittle down the investible universe of around 500 stocks to around 100 that are deemed worthy of further consideration. The most important factor, at 35% of the Matrix weighting, is earnings revision momentum because back-testing shows this is the most predictive measure of future share price performance. Stocks are assigned a Matrix score between +40 and -40, with those between +10 and +40 deemed potential buy candidates and those between -10 and -40 potential sells. Companies considered for inclusion in AUSC's portfolio are subject to further in-depth analysis and meeting company managements is an integral part of the research process. In keeping with other abrdn investment teams, the managers have a strong focus on a company's ESG credentials.

Given the managers' long-term perspective, the average holding period for AUSC's investments is around six years, implying an average annual portfolio turnover of around 15%; although some names have been in the fund for more than a decade. Positions may be trimmed or sold if there is a deterioration in the Matrix score, the original investment thesis no longer holds true, they have grown to more than 5% of the portfolio, or there is a higher-conviction name identified. The disciplined investment process has been employed since abrdn took over management of the fund in 2003 and has delivered creditable performance through economic and market cycles.

### AUSC's approach to ESG

abrdn has more than 800 investment professionals, including c 50 ESG specialists around the world. It encourages companies in which it invests to adhere to best practice in the areas of ESG stewardship. abrdn believes this can be achieved by entering into a dialogue with company management to encourage them, where necessary, to improve their corporate standards, transparency and accountability. By making ESG central to its investment capabilities, abrdn seeks to deliver robust outcomes as well as actively contributing to a fairer, more sustainable world. It considers ESG factors are financially material and affect corporate performance; companies that have higher standards tend to outperform those that do not.

The managers explain that for AUSC, ESG is really embedded at the core of the research process and is an important aspect of the focus on quality and the lower risk approach. There is an ESG specialist on abrdn's small-cap desk, and the managers also work closely with abrdn's large and knowledgeable central ESG investment team. Nimmo and Glennie regularly engage with company management teams, including on ESG aspects. They say that it is important to highlight a couple of nuances for smaller companies. While external ESG data are used, it is not an ideal process because many of the companies are not covered at all, or are covered badly, providing a real opportunity for the managers to add value by conducting ESG fundamental research themselves. Also, smaller companies often have limited internal resources to focus on ESG, so many are keen to engage with the managers, who are able to help advise them and encourage them towards those ESG aspects required by shareholders.

Nimmo highlights a couple of AUSC's portfolio companies that are working to improve their ESG credentials. Focusrite provides hardware and software for audio content creation and has been focusing on the carbon footprint of its production and increasing the ability to recycle its products. The manager says while Focusrite is a small company it is forward thinking on ESG issues. According to Glennie, XP Power's next annual report will contain a greater amount of ESG information and a sustainability report. The company is increasing its exposure to green products that are more environmentally friendly and investing in factories taking energy usage into account; its next facility will be in Malaysia due to favourable ESG factors in the country.

## Gearing

AUSC has a £65m unsecured loan agreement with Royal Bank of Scotland International, maturing on 31 October 2022, made up of a five-year, fixed-rate term loan of £25m at 2.349% and a £40m revolving credit facility (currently £15m is drawn), which was converted to be priced off Sonia in May 2021. The total £65m debt facility expires on 31 October 2022; the board is considering refinancing options. At 22 April 2022, AUSC had net gearing of 5.1%.

## Fees and charges

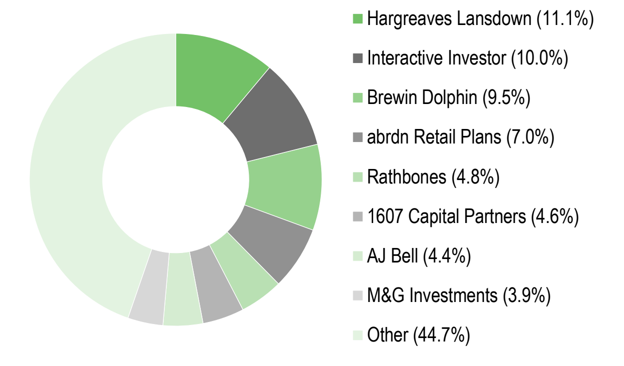
The trust has a tiered management fee structure: 0.85% pa up to £250m of AUSC's NAV; 0.65% pa between £250m and £550m; and 0.55% pa above £550m. Along with the investment management fee, abrdn also receives a fixed secretarial and administration fee of £75k pa plus VAT (capped at £150k pa plus VAT before 2021) and a separate fee for the provision of promotional activities for

AUSC (£150k in FY21). The trust's ongoing charges ratio (OCR) of 0.88% in FY21 was the lowest in the company's lifetime. In H122, the OCR was lower once again at 0.81%, which includes a forecast of costs, charges and net assets for H222, ending 30 June 2022.

## Capital structure

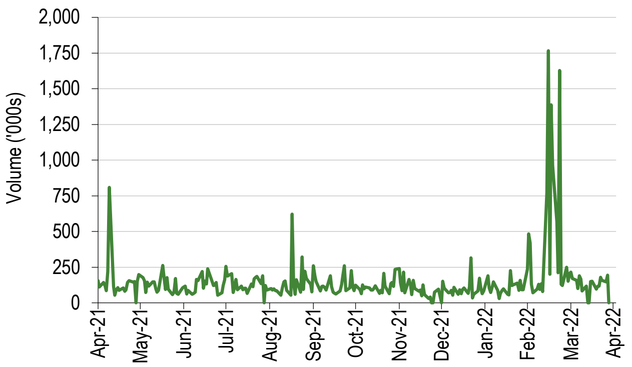
AUSC is a conventional investment trust with one class of share; there are 94.9m ordinary shares in issue, with 9.3m held in treasury. Its average daily trading volume over the last 12 months is c 155k shares.

**Exhibit 12: Major shareholders**




Source: abrdn, at 28 February 2022

**Exhibit 13: Average daily volume**




Source: Refinitiv. Note: 12 months to 29 April 2022.

## The board

**Exhibit 14: AUSC's board of directors**

| Board member | Date of appointment | Remuneration in FY21 | Shareholdings at end-FY21 |
|---|---|---|---|
| Liz Airey (chairman since 1 April 2020) | 21 August 2019 | £35,000 | 40,000 |
| Caroline Ramsay | 22 August 2016 | £27,800 | 4,545 |
| Tim Scholefield | 20 February 2017 | £25,200 | 5,964 |
| Ashton Bradbury | 2 July 2018 | £23,700 | 10,000 |
| Alexa Henderson | 8 October 2018 | £23,700 | 4,391 |

Source: AUSC

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