LIONTRUST UK SMALLER COMPANIES FUND

MANAGER'S SHORT INTERIM REPORT
FOR THE PERIOD ENDED 31ST OCTOBER 2013

Managed by Anthony Cross & Julian Fosh in accordance with **The Liontrust Economic Advantage**

THE LIONTRUST ECONOMIC ADVANTAGE

LIONTRUST UK SMALLER COMPANIES FUND IS MANAGED BY **ANTHONY CROSS** AND **JULIAN FOSH** IN ACCORDANCE WITH THEIR INVESTMENT PROCESS FOR UK SMALLER COMPANIES, **THE LIONTRUST ECONOMIC ADVANTAGE.**

The Fund aims to produce long-term capital growth. With over 2,000 smaller companies quoted on the London Stock exchange, investing in smaller companies requires a disciplined investment approach to identify companies with good long-term potential and avoid the remainder. The Fund's investment approach is to invest exclusively in companies demonstrating two criteria which we believe are the key to what makes some companies successful and others less so. These are: the strength, sustainability and exploitation of a company's Economic Advantage (its intangible strengths), and how key employees (who create this Economic Advantage) are motivated and retained, preferably through direct ownership of the company's equity. The Fund will only invest in those smaller companies that can demonstrate that they have met these two criteria.

MARKET REVIEW

The Market

The FTSE Small-cap ex investment trusts (ITs) index rose 24.1% over the six months to 31 October 2013. An environment of positive sentiment was fuelled by the ongoing provision of supportive monetary conditions by central banks – most notably the US Federal Reserve through its quantitative easing (QE) programme.

The impact of rising risk appetite was greater for smaller companies, which significantly outperformed the 7.7% return from the FTSE 100 index of large capitalisation companies. Smaller companies, as well as typically representing less mature businesses, also tend to be characterised by a greater focus on the domestic UK economy than the largely international companies that make up the FTSE100. During this period the UK economy showed some tentative signs of early recovery at a time when growth in emerging markets appeared to be moderating, although from a much higher level. Even during the temporary bouts of investor nervousness which were prompted by fears that the Fed's QE programme would be scaled back, the FTSE Small-cap ex ITs index showed significant resilience by outperforming the wider equity market.

The Fund

The Fund returned 15.4% over the period, underperforming the index return and the 17.8% average return from the IMA UK Smaller Companies sector.

The value rally to which we referred in our last report persisted in the first half of the new financial year, contributing to the relative underperformance of the Fund. We have designed our investment process with the purpose of identifying higher-quality companies with long-term growth potential. These companies tend to be less sensitive to swings in investor sentiment and therefore have less propensity to participate in value-led market rallies.

Many of the companies that contributed the most to the index gain could be described as cyclical value stocks in consumer-facing or industrial sectors, as opposed to the secular growth businesses we include in the Fund. These sectors often experience the greatest negative impact during a downturn and therefore stand to gain the most from supportive monetary policy (through, for example, cheaper credit costs) and signs of economic recovery. The top five index contributors over the period were: Xaar (a supplier of industrial inkjet printheads, now promoted to the FTSE250), Darty (the former owner of Comet which is now focused on French electrical retailing), Pendragon (a network of car dealerships), Northgate (a commercial vehicle hire company) and Stobart Group (the freight and logistics specialist). The underperformance of the IMA sector peer group relative to the index (17.8% v 24.1%) suggests that some of these stocks are not widely owned by the peer group.

The operational performance of companies within the Fund over the period was – with a few exceptions – good and the majority saw strong share price gains. The positive:negative share price return split was 41:14. If, however, we compare the individual stock performance to the 24.1% rise in the FTSE Small Cap ex IT index, we see that 23 rose by more than this amount, but 32 underperformed it.

Stand-out positive performers included Pressure Technologies (+120.8%), Intercede (+94.0%) and UK Mail (+41.0%). Shares in Pressure Technologies – a manufacturer of engineering systems and components for high-pressure applications – rose after its alternative energy division received two orders to supply biogas upgraders with a combined sales value of £4.6m. It also issued an update stating that trading in the second half of its financial year was strong in both the Cylinders and Engineered Products divisions, and that results for the year to end-September would be ahead of investors' expectations. Intercede provides identity management systems and the company issued an AGM statement which included the announcement of two contract wins – one with a 'major European aerospace and defence contractor' and the other with 'one of Europe's largest urban police forces'. Shares in UK Mail – the parcels, mail and logistics company – performed well over the six months after issuing results in May (for the year to end-March) which showed 11% growth in revenues and an 18% rise in adjusted profit before tax. The period also saw the successful privatisation of its largest competitor – Royal Mail.

The biggest detractors from Fund performance included Bango (-35.6%), Next Fifteen Communications (-24.3%) and Concurrent Technologies (-22.1%). Bango is a provider of web payments whose interim results disappointed slightly relative to high expectations despite the company reporting a 74% rise in end user spend and making upbeat outlook comments. Shares in Next Fifteen Communications had a rough ride over the half-year. The company provides digital marketing services and in interim results in April 2013 had indicated that 'some isolated trading challenges' would impact profits in the second half of its year. As it transpired, it was forced to issue a profit warning in October ahead of its full year results – a particular disappointment given that it had only a month earlier issued a trading update relating to the same period. While revenue was expected to be in-line with market consensus forecasts, its audit process revealed that the impact of restructuring at its Bite division would be greater than management had previously anticipated, and that profits would fall 'materially short' of market expectations. As a consequence the company's finance director resigned. Although the company has clearly experienced difficulties in its communication with investors recently, we believe that the business strengths which first attracted us are intact, while the share price valuation has been de-rated to a level which reflects the need to rebuild the market's confidence in management guidance. Concurrent Technologies (-21.9%) issued a profit warning citing UK government export controls as hampering exports of its products – which contain encryption technology – to emerging markets. It subsequently released interim results which showed growth in turnover in the first half, but warned that 2013 results would be negatively affected by the export issue, although it could not quantify the likely financial impact.

The Fund had a higher average cash position over the period than we target, reflecting a combination of fund inflows and the timing difference between the receipt and reinvestment of proceeds from stock sales. During a period of strong equity market returns this had the effect of diluting the Fund's participation in the rally. In the latter half of the previous financial year the Fund received takeover offers for two of the companies it owned. The nature of such takeovers is that cash receipts are realised fairly rapidly whereas we tend to build up our positions in new holdings slowly to be mindful of the market impact of our investment. There are a number of stocks where this investment process is ongoing and we would expect the cash level to therefore tend towards a more typical level over time in the second half of this financial year.

Portfolio Changes

The only position to be sold out of the Fund in the period was Dialight, after its board director equity ownership fell below 3%, the threshold level for inclusion within the UK Smaller Companies Fund.

We added a new holding to the Fund in the form of Omega Diagnostics, which focuses on in-vitro diagnostics for allergies, food intolerance and infectious diseases. The company has expanded both organically and through acquisition, and now owns a product portfolio containing significant pharmaceutical IP which we believe it can successfully monetise. We also initiated positions in Delcam, a supplier of CADCAM (computer-aided design, computer-aided manufacturing) software to a number of industries including aerospace and medical, and Keyword Studios, which provides linguistics and testing services to the video game industry.

Outlook

We have viewed the scale of the rally in the UK stockmarket in 2013 with some reservations, due to the apparent divergence from the more modest improvement in trading conditions companies are experiencing. If we see the investment environment shift as policy stimulus – such as QE – is removed, we would expect this to provide a better backdrop for the Fund. At the time of writing, there is substantial speculation regarding the 'tapering' of QE. While we are not in the business of predicting the timing of monetary policy changes, when these stimulus measures are inevitably phased out we believe that our emphasis on companies capable of delivering high-quality growth will be beneficial as valuations revert to fundamentals.

MARKET REVIEW CONTINUED

We aim to select companies whose strengths enable them to prosper even in poor economic conditions and who we believe are capable of delivering superior shareholder returns across the cycle. Those stocks which have benefited the most from the benign environment of last 18 months may struggle to justify their valuations. If equity markets weaken in the absence of supportive policy, we would expect the stocks in the Fund to prove more resilient than the market; equally, if economic recovery proves capable of transitioning to a steady state of growth we would also expect our companies to perform well.

Anthony Cross & Julian Fosh

Fund Managers
December 2013

Past performance is not a guide to future performance. The value of investments and the income from them can fall as well as rise.

FUND PROFILE

Investment Objective and Policy

The investment objective of Liontrust UK Smaller Companies Fund is to provide long-term capital growth by investing primarily in smaller UK companies displaying a high degree of Intellectual Capital and employee motivation through equity ownership in their business model. To achieve this aim, the Fund will invest in a portfolio of UK smaller companies' shares, the majority of which are contained within the FTSE Small Cap., the FTSE Fledgling and the AIM indices. Companies within the Fund that graduate into the FTSE 250 Index will be held until a suitable replacement company is found. The Fund may also invest in transferable securities, money market instruments, warrants, cash and near cash and deposits. The Fund may also invest up to 10% of its property in units or shares in collective investment schemes. The Fund is permitted to use derivatives for the purposes of efficient portfolio management and for investment purposes.

Investment Approach

With over 2,000 smaller companies quoted on the London Stock Exchange, investing in smaller companies requires a disciplined investment approach to identify companies with good long-term potential and avoid the remainder. The Fund's investment approach is to invest exclusively in companies demonstrating two criteria which we believe are the key to what makes some companies successful and others less so. These are: the strength, sustainability and exploitation of a company's Economic Advantage (its intangible strengths), and how key employees (who create this Economic Advantage) are motivated and retained, preferably through direct ownership of the company's equity. The Fund will only invest in those smaller companies that can demonstrate that they have met these two criteria.

Risk Profile

The Fund is invested exclusively in UK securities. It invests exclusively in smaller companies, which may be less liquid than larger companies. The price swings may therefore be greater than in those portfolios comprising shares of larger companies. Furthermore, the Fund has a significant proportion of its assets in companies which are traded on the Alternative Investment Market (AIM). The nature of AIM investments is such that prices can be volatile and realisations may not achieve current book value, especially when such sales represent a significant proportion of that company's market capital.

FUND PROFILE CONTINUED

Risk and Reward Profile

The Risk disclosures are in accordance with CESR guidelines and are consistent with rating disclosed in the KIID.

Lower Risk Typically lower rewards						**Higher Risk** Typically higher rewards
1	2	3	4	5	6	7

- The indicator is based upon historical data and may not be relied upon to gauge the future risk profile of the Fund.
- The risk and reward indicator shown is not guaranteed and may shift over time.
- The lowest category (1) does not mean 'risk free'.
- The Fund's risk and reward category has been calculated using the methodology set by the European Commission. It is based upon the rate by which the Fund's value has moved up and down in the past.
- The Fund is categorised 6 primarily for its exposure to securities (equity) of smaller UK companies.

The risk and reward indicator does not take into account the following Fund risks:

- That a company may fail thus reducing its value within the Fund.
- Any company which has high overseas earnings may carry a higher currency risk as for valuation purposes, local receipts may require conversion into the currency of the Fund, which is pounds sterling.
- The Fund will comprise both growth and value companies as appropriate.
- Because the Fund is primarily exposed to smaller companies there may be liquidity constraints from time to time.
- The Fund may, under certain circumstances, make use of derivative instruments but it is not intended that their use will materially affect volatility.

FUND PROFILE CONTINUED

Ongoing Charges Figure

	31st October 2013	30th April 2013
Class R income units	1.66%	1.67%
Class I income units*	1.41%	1.44%

* I class launched 28th January 2013.

Fund Calendar	
Ex-dividend date	1st May
Income payment date	30th June
Accounting period ends	31st October (interim) 30th April (final)

PERFORMANCE

Net Asset Values pence per unit*			
	31st October 2013	30th April 2013	% Change
Class R income units	677.79	587.66	15.34%
Class I income units	680.75	589.04	15.57%

Distributions pence per unit*	
	30th April 2013
Class R income units	2.05
Class I income units	2.57

The Fund distributes income once per annum, on 30th June. The ex-dividend date is 1st May each year. Income can be reinvested to purchase units at no initial charge.

* I class launched 28th January 2013.

PERFORMANCE CONTINUED

Total Return	6 months	1 year	3 years	5 years	Since launch*
Liontrust UK Smaller Companies Fund	15.4	23.5	71.4	186.7	517.3
FTSE Small Cap. Total Return Index (excluding investment trusts)	24.1	47.8	68.4	173.3	160.1
Quartile Ranking	4	4	2	2	1

Discrete Years' Performance To previous quarter, 12 months ending:	Sep-09	Sep-10	Sep-11	Sep-12	Sep-13
Liontrust UK Smaller Companies Fund	13.3	24.8	10.9	27.6	27.5
FTSE Small Cap. Total Return Index (excluding investment trusts)	25.5	-0.6	-4.5	21.4	44.9

* Launched 8th January 1998.

Up-to-date past performance information may be obtained from the Fund's most recent factsheet, available on our website (**www.liontrust.co.uk**) or by calling our Administration and Dealing team on **0844 892 1007**.

Past performance is not a guide to future performance. The value of investments and the income from them can fall as well as rise and are not guaranteed. Investors may not get back the amount originally subscribed. Some smaller companies may be less liquid than larger companies and the price swings in smaller company funds may therefore be greater than in larger company funds. The issue of units in the Fund may be subject to an initial charge, which is likely to have an impact on the realisable value of the investment, particularly in the short term. Equity investment should always be considered as long term.

Performance data source: Financial Express, bid-to-bid, total return as at 31.10.2013 (based on retail units).

PORTFOLIO

Top 10 Holdings			
31st October 2013	**%**	**30th April 2013**	**%**
Wilmington	3.83	Charles Stanley	4.17
Charles Stanley	3.72	iomart	3.75
PayPoint	3.56	Dechra Pharmaceuticals	3.72
NCC	3.48	PayPoint	3.57
UK Mail	3.41	Brooks MacDonald	3.37
iomart	3.30	Craneware	3.22
Craneware	3.17	UK Mail	3.11
Advanced Computer Software	3.05	Wilmington	3.07
RWS	2.77	RWS	2.99
Brooks MacDonald	2.69	Abbey Protection	2.91
Total	**32.98**		**33.88**

Sector Weightings	FTSE Small Cap. Index	Liontrust UK Smaller Companies Fund	
	31st October 2013 %	**31st October 2013 %**	**30th April 2013 %**
Basic Materials	4.67	0.00	0.00
Consumer Goods	7.09	0.00	0.00
Consumer Services	18.60	10.57	9.63
Financials	16.87	12.73	12.92
Healthcare	2.58	4.67	7.02
Industrials	36.32	22.57	24.33
Oil & Gas	7.64	1.70	1.65
Technology	6.23	36.36	33.85
		88.60	**89.40**
Cash (including SSgA* cash deposits)		**11.40**	**10.60**
Net Assets		**100.00**	**100.00**

* State Street Global Advisors.

FURTHER INFORMATION

Liontrust Asset Management Plc:

Liontrust, which was founded in 1994, is an independent fund management group whose shares are quoted on the London Stock Exchange. We manage £3.6 billion (as of 11 November 2013) in UK, European, Asian and Global equities, Global Credit and Multi-Asset. We take pride in having a distinct culture and approach to asset management. This comes through the following factors:

- Liontrust is an independent business with no corporate parent.
- We use rigorous investment processes that are robust and scaleable to ensure they are capable of delivering superior long-term performance. Investment processes ensure the way we manage money is predictable and repeatable.
- We provide a culture that gives all fund managers the freedom to manage their portfolios according to their own investment processes and market views without being distracted by other day-to-day aspects of running a fund management business.
- We aim to treat clients, investors, members, employees and suppliers fairly and with respect. Therefore, we are committed to the principles of Treating Customers Fairly (TCF) and they are central to how we conduct business across all our functions.

Further Information, Report & Financial Statements

Further information on the Fund and its portfolio, the Manager's Long Final and Interim Reports & Financial Statements and the Prospectus and Key Investor Information Document (KIID) are available free of charge from the Manager upon request, and from www.liontrust.co.uk.

The Manager

Liontrust Fund Partners LLP, 2 Savoy Court, London WC2R 0EZ.

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Authorised and regulated by the Financial Conduct Authority.

LIONTRUST

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