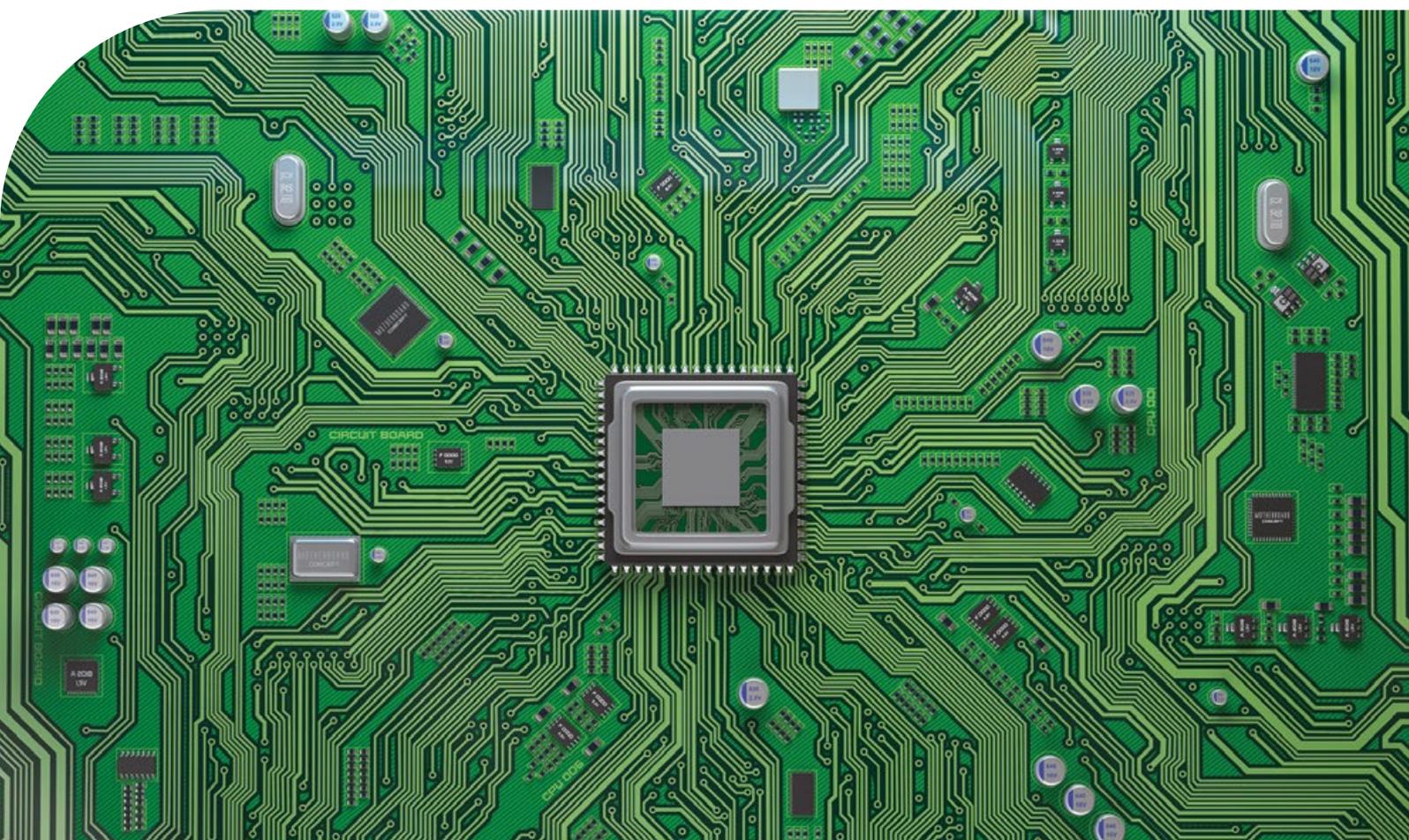


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For professional investors only

UK SMALLER COMPANIES: TRANSFORMATIVE TRENDS

Dan Green is tapping into four key long-term investment themes where pioneering goods and services are an emerging trend: The Digital Economy, Consumer Brands, Decarbonisation and Content/IP Creation. The first of a four-part series, he decomposes some of the most exciting opportunities within the first theme, the **UK Digital Economy**.





Dan Green

Portfolio Manager
& Research Analyst

UK smaller Companies are some of the most exciting and dynamic businesses listed on the London Stock Exchange. The observed long-term outperformance of UK smaller Companies is supported by some unique characteristics across the universe. Prevalent owner/operator structures align the interests of management and shareholders, reduced analyst coverage compromises pricing efficiency, and enhanced M&A activity bolsters the attractiveness of smaller companies. However, in our view the competitive advantage for smaller companies lies in the propensity to emerge, adapt and disrupt their way to established industry-leading positions. To this end, we have identified four distinct investment themes where we believe structural growth and enhanced returns will persist for the long-term.



The Digital
Economy



Decarbonisation



Consumer
Brands



Content and
IP Creation

The Digital Economy

The world as we know it is continuously evolving. The emergence of FinTech, the structural shift to e-commerce and enhanced demand for robust cyber security infrastructure - technological innovation is disrupting industries the world over. The key driver of all this change is digital transformation.

With the rapid expansion of the internet, traditional and digital economies have been on a path of conflation for many years. The culmination of this enhanced consumer connectivity is the Digital Economy. Based on technological infrastructure, increasingly intuitive devices and interfaces, and vast audience networks, this dynamic ecosystem offers a whole new medium for e-business. First coined in 1995 by Don Tapscott, today's Digital Economy can be defined as a collective term for all economic transactions reliant on the use of digital inputs, including digital technologies, digital infrastructure, digital services and data.

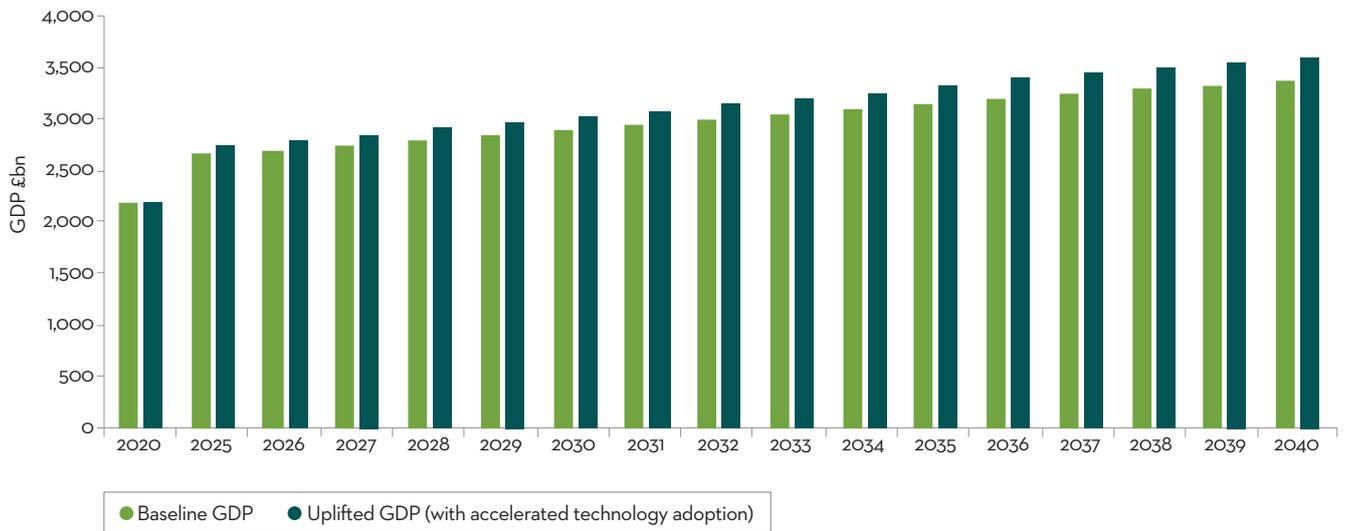
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The Digital Economy is a significant driver of UK GDP growth

Forecasted data suggests that by 2026, internet user penetration will increase to 94% of the UK population (Statista). Whilst the onward trajectory of this curve is unknown, the prevailing demographic suggests that the Digital Economy will be a significant driver of UK GDP over the coming years. The evolution of the Digital Economy has accelerated both as a result of the Covid-19 pandemic, and the UK government continuing to invest to build trust in the technology of tomorrow. It is estimated that by 2040, UK GDP will be nearly 7% higher than baseline GDP if increased investment in digital technology persists.

GDP growth from investment in digital technology in the UK 2020-2040



Source: Statista, Virgin Media; CEBR; ID 1295712, as at 31/05/2022

Online retail in the UK has gained significant momentum in the last decade. Since 2012, UK online retail spend has increased nearly 260% reaching £120bn in 2021¹. As a result, the UK is now recognised as one of the most developed e-commerce markets in the world accounting for nearly 5% of total worldwide retail ecommerce². Despite this leading global footprint, the UK market is widely considered a play on the ‘old economy’ with investors herding to international markets to obtain exposure to exciting growth opportunities. Within UK smaller companies, we believe that investors can gain exposure to progressive and disruptive businesses delivering global revenue streams without leaving the shores of the UK.

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¹Source: Statista, CRR; VoucherCodes.co.uk as at 31/12/2021.

²Source: eMarketer as at 31/05/2021.

Digital economy: the opportunities

Digital evolution of the auction industry

The auction industry has been subjected to its own evolution in recent years. A large and growing market opportunity with positive tailwinds, we are witnessing a structural shift from physical to online auctions along with a growing circular economy supportive of the onward sale of second-hand goods. Auction Technology Group (ATG) operates six marketplaces that enable independent auction houses to connect with bidders worldwide, and is the world leader in transforming the global auction industry.

Growth is largely driven by the structural shift of physical auctions to online, and ancillary services improving ATG's end-to-end offering as well as its take rate. We like the network effects of the business model where the dominant platform attracts the most bidders and therefore the most auction houses and vice versa. ATG has a leading market position in Arts & Antiques and Industrial & Commercial markets in the UK, USA and Germany. The adoption of online auctions was accelerated by the Covid-19 pandemic with many auction houses unable to run in person events looking for an alternative. This has proven out the benefits of the ATG proposition with access to a global pool of bidders, often increasing the price for the seller, and thus commission for the auctioneer. We believe that the market is still in the early development phase of the online transition. Therefore structural growth should underpin earnings over many years with ATG also able to expand its value-added services through offering payments, logistics or insurance. The business may also prove resilient in a downturn as we observe that the use of auction houses increases during challenging economic environments.

Increased e-commerce requires physical, logistical infrastructure

Elsewhere, the structural shift from brick-and-mortar stores to e-commerce platforms has transformed the demand for efficient and reliable order fulfilment infrastructure. Urban Logistics is a Real Estate Investment Trust which invests in the logistics sector, giving our portfolio 'picks and shovel' exposure to the transition to and growth in online shopping. The company purchases and develops 'last mile' logistic properties, where its tenants are typically third-party logistics companies and UK businesses who deliver staple domestic products and require last mile or e-fulfilment services. We are observing favourable demand and supply characteristics in this area of the property market that was intensified during the COVID-19 pandemic, where lockdowns and restrictions have forced the already-growing online retail sector into overdrive, driving further demand ahead of supply for 'last mile' properties. Property agent Cushman & Wakefield recently warned that the UK could run out of warehouse space and we believe the demand for properties to facilitate the shift to online shopping habits will remain elevated for several years, benefitting Urban Logistics through higher rental and capital values.

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Increased cybersecurity vital to the digital transition

NCC Group is a provider of Software Escrow and Cybersecurity Consultancy services to a wide range of customers across the UK, Europe and USA. With the acceleration and shift of economic activity to digital, the need for NCC's services has only heightened and there is a continuing trend for political and regulatory pressures to drive up attention to and spending on cybersecurity. We believe that cybersecurity services will continue to grow over 15% per annum for the foreseeable future driven by the growth of the connected environment, increasing dependence of cloud services, rising threat levels from individuals and state actors alongside continued increases in regulation.

Some of the other portfolio companies which are exposed to the Digital Economy include Alpha FX which uses technology to deliver financial management solutions, Tracsis a leader in software and remote monitoring for the rail network, Kin & Carta a global digital transformation consultancy, dotDigital a digital marketing software provider and Big Technologies which provides market leading innovation in remote monitoring solutions.

The structural shift to a digital economy underpins our conviction in these names. Offering unique exposure to exciting and emerging businesses, we believe that UK smaller companies are becoming an increasingly attractive option for investors searching for globally exposed disruptors.

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