Results analysis: BlackRock Smaller Companies

BRSC's historically wide discount may offer an attractive entry point for long term investors...

Update
17 May 2023

- **BlackRock Smaller Companies (BRSC) has released its financial results for the year ending 28/02/2023. Over the period the trust has seen its NAV total return decline by 13.0% (debt at fair value) compared to total returns of -7.5% for the Numis Smaller Companies plus AIM (excl. Investment Companies) Index.**

- **BRSC's total share price return for the period was -15.9%, which compared to the FTSE 250 Index decline of 2.8% and FTSE 100 Index gain of 9.6% in a period of heightened volatility and increased market uncertainty. This period included a sharp rise in inflation, with the UK CPI growth peaking at 11.1%, thanks to the impact of the pandemic and Russia's invasion of Ukraine in early 2022.**

- **Total dividends increased to 40p per share over the year, representing a 14.3% increase on the previous financial year. This represents an annualised increase of 11.2% since the 2003 financial year resulting in BRSC now gaining the accolade of "Dividend Hero" for this consistent 20-year growth in dividends.**

- **Revenue return per share rose to 40.92p, a 16% increase on 2022, a reflection of the robust rebound in the portfolio companies' dividend paying ability.**

- **Over the period BRSC's shares traded on a 13.9% average discount to NAV, compared to the AIC UK Smaller Companies sector average discount of 10.9% for the same period. The board bought back 220,000 shares during FY 2023 and BRSC's discount has narrowed slightly since to 12.8%.**

- **Board Chairman Ronald Gould said: "[The] Company's portfolio is weighted towards companies with well capitalized balance sheets and entrepreneurial management teams that are able to rapidly adjust their businesses to the shifting market dynamics. As such we believe your Company is well positioned and prepared to take advantage of the investment opportunities that lie ahead despite the uncertain market conditions."**

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Kepler View

Over the long term **BlackRock Smaller Companies (BRSC)** has had an excellent track record of generating alpha. However, the growth style fell out of favour last year, and was unhelpful to returns in the light of rising interest rates. Nevertheless, despite some disappointing performance from some individual holdings, Roland reports that his focus on identifying high-quality companies that are cash generative, with strong balance sheets and competitive advantages has led to the delivery of generally inline or better-than-expected trading updates. For example, the marketer of promotional merchandise, 4imprint, remained the top contributor for the financial year. The company continues to upgrade forecasts and accelerate gains in market share, having announced record revenue levels. However, Roland believes their low single digit percentage market share leaves room for future growth.

As a result of this sell-off, Roland argues that UK growth stocks are at extremely attractive valuations. Moreover, he has recently found a number of what he believes to be good companies trading at attractive entry prices. For example, he has bought Essentra, which is now a pure play components business following its simplification of operations through the disposal of pharma and tobacco filter assets. He has also bought the builders merchants

Grafton, which similarly sold off assets which has generated a significant cash pile, and US infrastructure play Hill and Smith. Furthermore, Roland believes that regardless of the economic outlook, the attractiveness of UK small and mid-sized companies valuations is higher than it has been for some time. Therefore, he believes it is reasonable to expect a pick-up in M&A activity later in the year, building on the bids received for holdings Ideagen and Clipper Logistics.

In response to the holdings' generally positive trading updates, combined with the expected gradual reduction in inflationary pressures over the course of this financial year, Roland has tentatively started to utilise more of BRSC's gearing facilities. We note that BRSC's gearing has at times exaggerated its volatility, however, this reflects the high beta nature of the strategy which has proven to enhance volatility both on the downside and on the upside. In our view, his focus on identifying companies that offer the potential to deliver multi-year options for growth, combined with the current discount of 12.8%, which is significantly wider than its five-year average of 7.2%, could prove to be an attractive entry opportunity for long-term investors, especially once fundamentals resume as the dominant driver of equity market returns.

Finally, given the dramatic selloff across the equity markets and the discount that has opened up, BRSC has seen its dividend yield increase to c. 3.0%. In our view this adds to the attractions at the current juncture, especially considering the strong growth in dividends that has resulted in the trust being awarded the coveted AIC Dividend Hero status in recognition of its 20 years of uninterrupted dividend growth. Currently BRSC is one of only 19 trusts to achieve this status.

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