EDISON

Rockwood Strategic

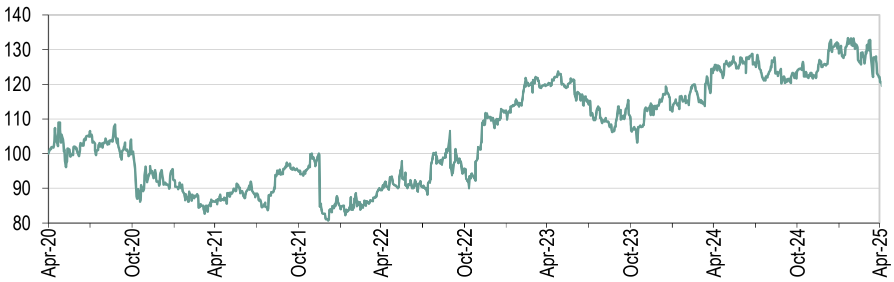
Different approach has favourable outcomes

Investment companies
UK small-cap equities

28 May 2025

Rockwood Strategic (RKW) is managed by Richard Staveley at Harwood Capital. He has a differentiated approach, aiming to generate a 15% annual internal rate of return (IRR) over a rolling five-year period from a concentrated portfolio of UK small-cap stocks. The manager employs a value-based strategy seeking companies with a sub-£250m market cap that are trading at a significant discount to their estimated intrinsic value. The lower end of the UK market is inefficient, which could provide a valuable source of mispriced investment opportunities. Staveley's approach has proved successful as RKW has meaningfully outpaced the performance of the UK market and its small-cap peers over the long term.

NAV outperformance versus UK small caps, last five years



Source: LSEG Data & Analytics, Edison Investment Research. Note: UK index is Small Cap ex Investment Trusts.

Why consider RKW?

Staveley's investment universe is the smaller-cap end of the UK market, which tends to be inefficient due to liquidity and regulatory concerns, and a lack of sell-side research on these companies. He aims for at least 100% upside in each investment and has a 15% annual IRR hurdle rather than measurement against a traditional index benchmark.

The manager employs a disciplined, repeatable investment strategy, which includes the use of an investment advisory group (IAG). The IAG is made up of seven highly experienced investment professionals who bring their insights, networking opportunities and any concerns to the stock selection process.

As Christopher Mills, the owner of Harwood Capital, holds 22.7% of the trust, all shareholder interests are aligned, with the manager and his family owning a further 1.0%. Since the end of 2023, RKW has regularly traded at a premium, which has led to regular share issuance and a significant increase in the company's size (its market cap is now above £100m).

There are reasons to be optimistic about the UK market, which has been out of favour with investors for a very long time. Valuations are attractive in both absolute and relative terms. Importantly, having been the 'only game in town', there are now question marks around investing in the US given the uncertainty resulting from President Trump's policies and his inconsistent approach. So far this year, while UK outperformance versus the US has been led by large-cap stocks, there is potential for a trickle-down effect into smaller-cap companies if there are further fund flows into the UK market.

Price		**261.50p**
Market cap		**£104m**
Total assets		**£102m**
NAV		256.6p
[1]At 23 May 2025.		
Discount to NAV		(1.9)%
[1]Trading at a premium.		
Shares in issue		39.8m
Code/ISIN		RKW/GB00BRRD5L66
Primary exchange		LSE
AIC sector		UK Smaller Companies
Financial year end		31 Mar
52-week high/low	278.0p	228.0p
NAV high/low	265.0p	233.1p
Net gearing		0.0%
[1]At 30 April 2025.		

Fund objective

Rockwood Strategic seeks investments capable of delivering a 15% internal rate of return over a three- to five-year horizon in publicly listed UK small companies.

Bull points

- The trust has a strong record of outperformance versus both its peers and the UK stock market.
- Disciplined, repeatable, bottom-up stock selection approach.
- Tentative signs of improved investor sentiment towards attractively valued UK market.

Bear points

- Concentrated portfolio brings higher performance risk.
- Key person risk – RKW's manager is not part of a large investment team.
- Lack of regular dividends.

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RKW: Disciplined approach drives long-term outperformance

Long-term returns from UK small-cap stocks have been very strong, where 'time in the market' rather than 'timing the market' has delivered superior results. Staveley employs a disciplined, value-based approach to stock selection. RKW's portfolio is concentrated, with just 24 positions, but is actively managed. The manager is able to draw on the resources of Harwood Capital, including its private market experience. Staveley invests in proven businesses that are trading at a meaningful discount to their estimated intrinsic value, where value can be realised via strategic, management or operational changes. A typical holding period is three to five years. Up to 15% of NAV at the time of investment may be held in unlisted companies.

Summary investment process

There is a five-step investment process. Step one is **idea generation**, which utilises the manager's extensive network and quantitative screening. Step two is **due diligence**, which involves deep analysis; a successful result is a 2–4% of NAV 'springboard' investment, or analysis continues into the third stage. **Expanded due diligence** includes the involvement of the IAG (including recent joiner Richard Pease, who founded Crux Asset Management). Staveley takes the IAG's recommendations on board before investing; a successful result is a 5–15% 'core' investment. Step four is **engagement**, which is with a company's board and management and other stakeholders, and structuring and execution of the core investment via a block trade or a refinancing. The final step is **portfolio management**, which involves monitoring the investment thesis, including industry and company engagement and analysis of corporate results. Stocks are primarily sold through corporate activity, or in the secondary market following a corporate recovery or if an investment thesis no longer holds true.

RKW's key differentiating features

- **Value and recovery style** – the majority of investment trusts have a growth or growth at a reasonable price rather than a value bias. A recovery strategy requires considerable patience.
- **Concentration** – the portfolio has a much lower number of holdings than most trusts.
- **Absolute performance mindset** – most trust managers' performance is measured relative to an index; aiming to generate positive returns in any market environment requires a different way of thinking.
- **Added-value 'engagement' activities** – the manager believes that this enables a deep understanding of a company's dynamics, while a constructive relationship with the management teams leads to better shareholder outcomes.

The UK investment backdrop

The UK market has been out of favour with both domestic and global investors for a very long time, which has resulted in attractive UK absolute and relative valuations. Higher interest rates over the last two to three years have also led to a de-rating of growth stocks. In addition, open-ended funds dominate the UK market and tend to avoid micro-cap stocks, tax relief for investing in the AIM market has been reduced, while a lack of share issuance is shrinking the UK investment universe. However, there are reasons to be optimistic about the prospects for the UK market. Pension fund allocations to UK equities are so low (c 4%) that it seems unlikely they will fall further. While inflation is proving sticky, interest rates are in a downward trend. There could be changes to the individual savings accounts rules favouring investments in UK shares rather than cash, and private equity companies are lining up businesses to be sold. Importantly, following a multi-year period when the US market outperformed, there are now question marks around US exceptionalism; a small asset allocation shift from the US to the UK could have a significant positive effect on the UK market. As it currently stands, the UK is relatively well positioned under President Trump's tariff regime.

The portfolio

There are four relatively recent additions to the portfolio. Kooth, which is a mental health services provider, is trading on a very low valuation; the manager suggests the company's stock price could rise multiple times. Vanquis Banking Group was formerly called Provident Financial and is a lender to the large part of the UK population with poor credit scores; the lending model is highly profitable and is well capitalised. Mercia Asset Management invests in equities, venture capital, private equity and private credit. Its differentiating feature is its non-London focus, with 12 regional offices, which could be an attractive target for a larger firm seeking private equity exposure. Capita provides public and private sector outsourcing services such as student loans. It is seen as a beneficiary of the growth in AI, and has an increased focus on cost reduction and operational efficiencies, under a new senior management team.

RKW's top 10 holdings, which are spread across a broad range of industries, are shown in Exhibit 1. At the end of Q1 CY25, they made up 63.1% of NAV, which was a modestly lower percentage compared with 64.4% 12 months earlier; five names were common to both periods. Most of the top 10 investments have been made within the last two years.

RM, the largest holding, was one of the biggest positive contributors to RTW's performance in 2024. Within the educational services sector, it supplies resources to 90% of UK primary schools (c 40% of sales, including some overseas). Assessment services (c 22% of sales) marks exams internationally; the manager considers this high-margin business the 'jewel in the crown'. RM has a business providing schools with IT services (c 30% of sales). The company is recovering from a period of excessive cash outflows resulting from the roll-out of a new enterprise resource planning system and a warehouse consolidation project, operational issues and elevated debt levels. It is addressing a large pension obligation and has a new senior management team including the CEO and CFO. Harwood Capital has a 15.7% stake in the company and its proposed non-executive director is now senior independent director on RM's board. Staveley believes that the company could be afforded a higher rating from lower financial risk, a profit recovery and the sale of non-core assets. The manager's £150m sum-of-the-parts valuation is considerably higher than the current c £80m market cap.

Exhibit 1: Top 10 holdings as % of NAV

Company	Sector	End of Q1 CY25	End of Q1 CY24
RM	Education services	13.9	9.5
Filtronic	Technology	9.4	6.7
Trifast	Industrials	6.5	8.4
Vanquis Banking Group	Financial services	6.0	N/A
M&C Saatchi	Media & entertainment	5.2	8.1
Fisher (James) & Sons	Industrials	4.8	N/A
Restore	Business services	4.8	N/A
Funding Circle	Financial services	4.6	6.8
Capita	Business services	4.0	N/A
Mercia Asset Management	Financial services	3.9	N/A
Top 10		**63.1**	**64.4**

Source: RKW, Edison Investment Research. Note: N/A where not in end Q1 CY24 top 10.

Performance: Ahead of the peers and the UK market over the long term

RKW is one of 22 funds in the AIC UK Smaller Companies sector. In Exhibit 2, we highlight the trust along with its five closest peers. RKW's NAV total returns are notable, ranking second out of six over the last year and first out of five over the last three and five years, with 38.4pp and 105.1pp above-average returns, respectively. At 26 May 2025, RKW was the only fund trading at a premium. It has the third-largest ongoing charge and a performance fee is payable. In line with its peers, it has no gearing and, due to the focus on capital return, RKW does not pay regular dividends.

The trust's performance also stacks up well against the whole AIC UK Smaller Companies sector with its NAV total return ranking fifth out of 21 funds over the last year, second out of 20 funds over the last three years and first out 20 funds over the last five years.

Exhibit 2: Analysis of the UK Smaller Companies sector at 26 May 2025

% unless stated	Market cap (£m)	NAV TR 1Y	NAV TR 3Y	NAV TR 5Y	NAV TR 10Y	Premium/discount	Ongoing charge	Performance fee	Net gearing	Dividend yield
Rockwood Strategic	104.0	3.5	47.4	177.6		1.5	1.7	Yes	100	0.0
Odyssean Investment Trust	188.0	(16.9)	(12.1)	49.7		(2.3)	1.5	Yes	100	0.0
Onward Opportunities	26.2	12.3				(3.3)	6.4	Yes	100	0.0
Rights & Issues Inv Trust	99.7	(5.3)	3.1	53.9	115.0	(17.8)	1.0	No	100	2.1
River UK Micro Cap	60.8	1.7	(5.1)	21.0	106.5	(17.2)	1.7	Yes	100	0.0
Strategic Equity Capital	147.9	(6.6)	11.8	60.4	76.7	(8.5)	1.2	Yes	100	1.1
Average of selected funds	**104.4**	**(1.9)**	**9.0**	**72.5**	**99.4**	**(7.9)**	**2.2**		**100**	**0.5**
Rank	**3**	**2**	**1**	**1**	**0**	**1**	**3**		**6**	**3**
Number of funds	**6**	**6**	**5**	**5**	**3**	**6**	**6**		**6**	**6**
Average of whole sector	**217.8**	**(0.6)**	**5.9**	**48.9**	**66.8**	**(15.5)**	**1.9**		**104**	**2.5**
Rank	**12**	**5**	**2**	**1**	**0**	**1**	**8**		**22**	**15**
Number of funds	**22**	**21**	**20**	**20**	**18**	**22**	**21**		**22**	**22**

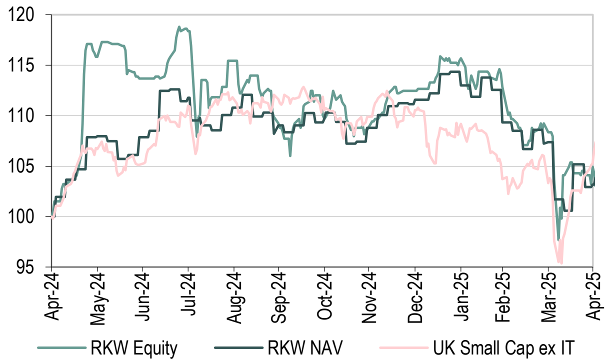
Source: Morningstar, Edison Investment Research. Note: TR, total return. Performance at 26 May 2025.

Exhibit 3: Five-year discrete total returns

12 months ending	Total share price return (%)	Total NAV return (%)	UK Small Cap ex IT (%)	UK Aim All-Share (%)	UK All-Share (%)
30/04/21	42.1	46.1	69.5	59.8	25.9
30/04/22	(6.0)	2.3	(1.5)	(19.6)	8.7
30/04/23	39.4	22.0	(8.9)	(17.5)	6.0
30/04/24	19.1	15.7	11.3	(6.6)	7.5
30/04/25	5.0	3.2	5.3	(7.5)	7.5

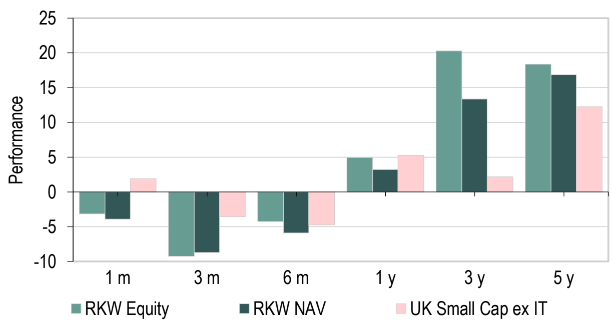
Source: LSEG Data & Analytics

Exhibit 4: Rebased one-year total return performance to end April 2025



Source: LSEG Data & Analytics, Edison Investment Research

Exhibit 5: Price, NAV and index total return performance to end April 2025 (%)



Source: LSEG Data & Analytics, Edison Investment Research. Note: Three- and five-year figures annualised.

RKW's relative returns are shown in Exhibit 6. While there has been modest NAV underperformance versus the UK small-cap and broader UK market over the last 12 months, this has been dwarfed by the significant outperformance over the last three and five years. The trust has significantly outperformed the AIM market over the last one, three and five years in NAV and share price terms.

Exhibit 6: Share price and NAV total returns relative to indices (%)

	1 month	3 months	6 months	1 year	3 years	5 years
Price relative to UK Small Cap ex IT	(5.0)	(5.9)	0.5	(0.3)	63.1	30.4
NAV relative to UK Small Cap ex IT	(5.7)	(5.3)	(1.2)	(2.0)	36.4	22.1
Price relative to UK Aim All-Share	(4.6)	(6.1)	1.3	13.4	144.1	153.8
NAV relative to UK Aim All-Share	(5.3)	(5.5)	(0.5)	11.5	104.2	137.6
Price relative to UK All-Share	(2.9)	(8.1)	(9.4)	(2.4)	42.1	38.6
NAV relative to UK All-Share	(3.7)	(7.6)	(10.9)	(4.0)	18.8	29.7

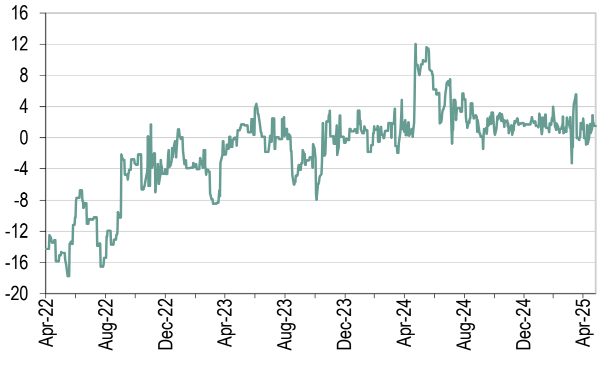
Source: LSEG Data & Analytics, Edison Investment Research. Note: Data to end April 2025. Geometric calculation.

Valuation: Premium rating allows significant share issuance

RKW's current 1.9% premium to NAV compares with a range of a 17.8% discount to a 12.0% premium over the last three years. Over the last one, three and five years, the average valuations were a 2.9% premium, a 1.4% discount and a 5.2% discount respectively.

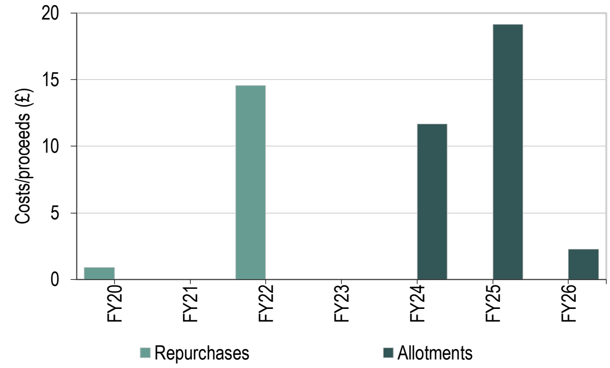
Since the end of 2023, the trust has regularly traded at a premium, which has enabled significant share issuance to satisfy investor demand and has been an important driver for increasing the size of the company. In FY25, c 7.5m shares (c 24.1% of the end-FY24 share base) were issued, raising c £19.0m. This compares to a c 5.8m share issuance in FY24 (c 22.7% of the end-FY23 share base), which raised c £11.5m.

Exhibit 7: Discount, last three years (%)



Source: LSEG Data & Analytics, Edison Investment Research

Exhibit 8: Share buybacks and issuance



Source: Morningstar, Edison Investment Research

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