Rockwood Strategic (RKW)

RKW's strong performance continues, with the manager also exercising good portfolio discipline...

Update
29 May 2025

Overview

Rockwood Strategic (RKW) has one of the best **Performance** track records amongst its UK smaller companies peer group over the past five years, with NAV returns of over 170%. This has been primarily driven by manager Richard Staveley's focus on bottom-up stock selection, looking to identify overlooked and therefore undervalued companies from the lowest end of the UK market-cap spectrum.

Richard takes an activist approach to management, often engaging with his holdings to instigate a turnaround plan that can help unlock the value that is being dismissed by other investors, usually due to concerns over other, temporary factors. Due to the high level of involvement required, Richard often takes sizeable stakes in these companies, and this has resulted in a highly concentrated **Portfolio**, currently at only 24 stocks.

The number of stocks has increased slightly over the past year, as Richard has looked to take advantage of several new opportunities, as well as adding to a number of existing holdings at good valuations. This has been funded through a combination of share issuance, undertaken to manage the trust's rating (see **Discount**), as well as from disposals. Some of this again comes from M&A activity, which has been a significant contributor to returns for several years, although Richard has also sold a significant stake in one of his best-performing holdings as part of a prudent profit-taking and risk management approach in the past few months.

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Analyst's View

In our opinion, RKW has provided an excellent example of how a manager can produce significant alpha through a differentiated and active approach. **Performance** over the past few years has been very impressive, especially relative to the numerous smaller companies indices, one of which has endured negative returns in the same time that Richard has nearly trebled NAV.

The primary driver behind this performance has been stock selection, and the manager's strong involvement in his holdings to help instigate a share price recovery. One of Richard's most common exit plans is M&A and whilst this featured in the past year, it has been less pronounced than previously. Despite this, Richard has, in our view, shown good pragmatism by selling down one of his best-performing stocks in order to capture some profits and recycling cash to use elsewhere. We believe this demonstrates that the manager will exercise discipline when necessary to rotate capital and that returns can come from more than one outlet.

Furthermore, these returns have come despite a challenging economic backdrop. We believe this continues to demonstrate how uncorrelated micro-cap performance can be, as the fortunes of companies at this end of the market-cap spectrum are considerably less exposed to global events. As such, we believe RKW could be seen as a potential diversifier as part of a wider portfolio and a way of delivering very differentiated returns.

BULL
Exceptional performance track record, driven by manager involvement and stock selection
Highly differentiated portfolio can provide portfolio diversification
A long-awaiting recovery in the asset class could further drive returns

BEAR
Shares are trading at a premium to NAV, versus a peer group mostly at a discount
Trust levies a performance fee which may be off-putting to some investors and has a high OCF versus peers
Concentrated portfolio means downside contribution of individual holdings could be high

Portfolio

The portfolio of Rockwood Strategic (RKW) is likely to look significantly different to comparators in the UK smaller companies sector. This is due to manager Richard Staveley's focus on companies below £250m, that are overlooked by the market and therefore undervalued, but with the potential to recover.

When Richard finds an idea, it is backed with conviction, with the trust often taking a substantial stake in the company, leading to positions in the portfolio often going into double-digit percentages. By taking sizeable positions, it gives Richard the opportunity to instigate a turnaround through engagement, looking to work with the company to understand where their challenges are, and finding solutions to them. Recent examples included selling loss-making divisions, cutting costs to improve margins, and even changing management teams or board members. This work is often done in collaboration with investors of the wider Harwood Group (see **Management**). We understand there are Chinese walls in place between different strategies, though the similar approaches within the group, and the overlap in their investable universes often means companies can appear in multiple portfolios of the Harwood group, which can therefore have a sizeable ownership stake.

As this approach is quite time intensive, Richard has a very concentrated portfolio, currently only at 24 names, enabling him to focus on a few companies rather than a large portfolio where he cannot dedicate the resources required to support a recovery. Positions are divided into core and springboard categories, depending on the size of the position, and how immediately the recovery can be delivered.

As of April 2025, about 35% of the portfolio consisted of core positions, which are targeted to be at least 5% of the portfolio each and where the outcome of their engagement work is expected to be the catalyst for improvement. This overall allocation is likely to be larger in future as a number of core holdings established a few years ago have not been able to grow alongside the significant growth in the fund. For example, the Harwood Group (see **Management**) owns a combined 29.9% of the equity and is unable to buy more without itself making a takeover bid. The remaining springboard positions are considered starting positions that Richard believes could become core stocks in the future, or could even recover without his involvement, should other investors recognise the value on offer. As a result of this, the top ten holdings are often a significant portion of the portfolio—currently 63.1%, though we note this is down notably on the 67.5% at the beginning of the year.

One factor that has contributed to the falling concentration in the top-ten has been the addition of four new holdings, as well as the topping up of some smaller existing names.

Top-Ten Holdings

COMPANY	SECTOR	PORTFOLIO %
RM	Education services	13.9
Filtronic	Technology	9.4
Trifast	Industrials	6.5
Vanquis Banking Group	Financial Services	6.0
M&C Saatchi	Media	5.2
James Fisher & Sons	Industrials	4.8
Restore	Business Services	4.8
Funding Circle	Financial Services	4.6
Capita	Business Services	4.0
Mercia Asset Management	Financial Services	3.9
Total		**63.1**

Source: Rockwood, as of 31/03/2025

This has diluted the top-ten holdings, especially as assets have grown through issuance (see **Discount**).

One notable new holding is Vanquis Banking Group, a specialist sub-prime lender. This was previously known as Provident Financial, and operated as a door-step lender, before being hit by a regulatory crack-down. The company subsequently rebranded and focussed on Vanquis' business, offering responsible credit to those needing to rebuild their credit scores, through credit cards and car loans. Whilst at its peak, the firm was a constituent of the FTSE100, its market cap is now just £150m, despite having over £2bn in customer deposits, and trading at a price/book ratio of 0.3x. Richard believes the new chairman and CFO understand the company's challenges and are making good strides in improving the outlook which, if executed well, could see a strong recovery for the shares.

Another new holding is Kooth, which provides mental health services, including the NHS' counselling service for young people. Richard initially purchased shares in late summer 2024, although the price soon fell away following concerns over the firm's Californian contract following an investigation. Despite this, the company has since won a new contract in New Jersey and has indicated positivity on further contract wins. Richard is particularly encouraged by the firm's attractive margins, net cash position, and valuation, which he calculates to be just 3x forward earnings.

Alongside these new positions, Richard has also topped up some existing holdings. A notable one is the engineering firm, Capital Ltd, which has seen Richard increase his shareholding by at least 50% over the past year and is a 3.5% position (as of 31/03/2025). This means the stock is still considered a springboard position, although towards the higher end of the range. Other recently added-to springboard positions include STV Group and James Fisher & Sons, with an addition to core holding Van Elle, an engineering firm, completing the purchases.

To fund this, the manager has used a combination of capital raised through share issuance (see **Discount**) as well as the proceeds of disposals. In March 2024, the takeover of portfolio holding, City Pub Group by Youngs was completed, generating a 2.5x return for RKW's investment. This capital was used to fund the new purchases. Since then, one portfolio holding has been bid for; National World. As mentioned in a **previous note**, this was Richard's first returning holding, the manager having initially sold the stock in 2022 before repurchasing for less than half the sale price in 2024. Despite the short holding period, the stock was soon bid for. Richard initially resisted this, believing the bid undervalued the company, leading to a secondary, higher bid which was accepted. We understand he will wait for the deal's conclusion, having signed an irrevocable undertaking to receive the cash.

The manager also partly sold down his Funding Circle position. The shares have had a remarkable run, having more than trebled in 2024 alone, leading to the position becoming very sizeable at c. 14% of the trust. As such, Richard decided to take some profit and reduce the risk. He remains positive about the outlook, though pragmatic about the risk; reducing the position size to c. 4%. We believe this is a good example of Richard's flexibility, and whilst M&A is a key part of the exit strategy for many holdings, he will be pragmatic and disciplined if a holding's upside is recognised through share price appreciation.

Richard has a notable allocation to defence through two stocks, which is supported by the broader macro situation. Firstly, there is the holding formerly known as Pressure Technology—although following the disposal of a division, enabling the firm to repay the loan RKW issued to them— which is now known as Chesterfield Cylinders. This more streamlined firm has recently won a contract for the US submarine programme, marking the first time a UK company has entered the sector. Furthermore, the portfolio has a holding in Pennant Group. This provides software for the defence industry, although is very small. The market cap is just £11m, meaning RKW holds 13% of the shares. The manager has used this position to influence a restructuring, including a board change. With the defence theme in demand at the moment, but the number of firms quite scarce, Richard is optimistic about the potential for these two holdings.

Gearing

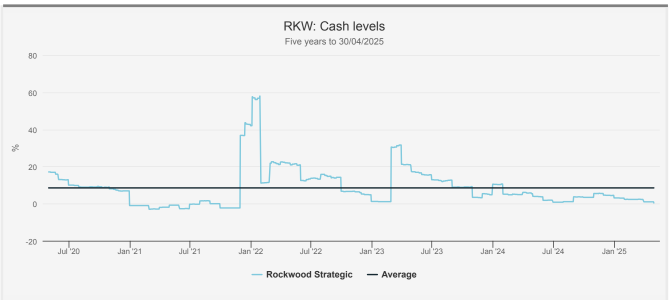
Whilst the trust's investment policy allows the manager to take gearing up to 20% of gross assets, Richard is unlikely to use this capability, and in fact, has no facility in place to do so.

Richard does not use gearing as he believes there is already sufficient risk in the portfolio due to its highly concentrated nature consisting of micro-cap companies.

As a result, the trust has been run with varying levels of net cash for much of the past five years. The cash level has been as high as 30% in the past couple of years following the takeover of a large portfolio holding, and higher, following some corporate activity, as we discussed in a **previous note**.

In the past few months, the level of cash has notably decreased as the manager has added to a number of opportunities, falling from c. 10% at the beginning of 2024, to low single figures for much of the period since. Whilst the trust has continued to issue shares (see **Discount**), the proceeds have been deployed in the portfolio. However, the concentrated positions and the goal of using M&A as an exit route for holdings means that cash levels can quickly increase. We understand that Richard is currently awaiting the proceeds of one M&A deal which would mean that cash is likely to pick up again in the near future and provide Richard with some more cash to deploy should he find new opportunities.

Fig.1: Gearing

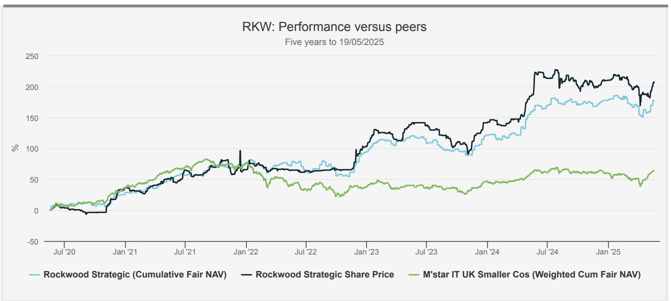


Source: Morningstar , Kepler

Performance

Richard has delivered an impressive return profile for RKW over numerous time periods, especially so since he resumed management duties in 2022 after a brief hiatus, having initially taken on the trust in 2019. Cumulative NAV total returns over the past five years were 177.2% (to 19/05/2025), nearly double the trust's closest comparator albeit not the formal benchmark, the FTSE Small Cap ex-IT Index, which returned 92%. Furthermore, Richard has significantly outperformed other comparators, with the average of the UK smaller companies peer group returning 63.5%, the Deutsche Numis Smaller Companies plus AIM ex-IT (a common benchmark for peers) returning 43.4% and the FTSE AIM All Share Index falling 4.5%. The AIM Index includes a number of RKW's holdings and therefore we believe this comparison demonstrates the extent to which Richard's stock selection has helped drive performance, having generated significant returns from a universe that on aggregate, has fallen.

Fig.2: Five-Year Performance



Source: Morningstar

Past performance is not a reliable indicator of future results.

As mentioned in a **previous note**, this five-year period does include a time when the trust had high cash levels during a falling market following some corporate activity. Despite this, the discrete outperformance over the past three calendar years demonstrates how much of this performance has come since Richard resumed actively managing the trust, with returns (and percentage points of outperformance) of 10.1% (27.4), 13.9% (3.6), and 25.7% (11.9) from 2022 to 2024 respectively.

Over the course of the past year, the market has gone through some more challenging moments, although Richard has still managed to deliver strong performance regardless. Much of this has been driven by stock selection, which is to be expected considering the highly concentrated nature of the portfolio.

The stock with the biggest impact on the portfolio was space engineering firm, Filtronic, following the extension of its strategic agreement with SpaceX, as well as the announcement of a new contract with another firm. This includes supplying parts for both ground stations and satellites which Richard believes demonstrates the strength and depth of the product suite. As such, Richard believes the firm continues to look attractive with a strong order book. Therefore, the stock remains a large position, the second largest in the portfolio at c. 9% although some of this size is a result of Filtronic's share price more than doubling over the past year (to 21/05/2025).

The portfolio's largest position is educational technology firm, RM which, whilst broadly flat over the past year, has rallied in the past six months by c. 27%. This is a result of an encouraging management update reflecting good results across the business, a significant contract win with the International Baccalaureate (IB) and a new strategy to refocus the group which should lead to the sell-off of a division to reduce the firm's debt burden; something Richard has helped influence. Richard believes the firm has an encouraging future, with the potential to benefit from an increase in digitisation of their core examination market, as well as further collaboration with the likes of the IB exam board. He also notes that the current market cap of £82m is significantly below his estimate of the sum-of-the-parts valuation of the business, and as such, has not sold down his holding yet, despite the near-term rally.

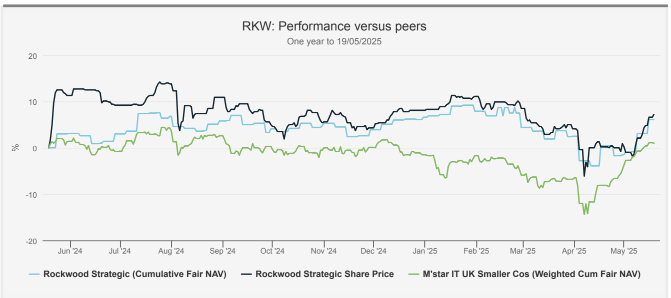
The trust also again benefitted from M&A in National World. As previously mentioned, this was Richard's first repurchase, having initially bought at 10p per share in 2021 before later selling on at 29p after a turnaround. For technical factors, he was able to buy back into the shares again at an average price of 13.5p in 2024, though, by the year-end, the share price was back above 22p following a takeover approach. Richard was instrumental in driving the takeover price up, which was initially lower than this, which we believe demonstrates the value of his engagement approach. We understand he is awaiting the completion of the deal before recycling the capital elsewhere.

The past year has seen a couple of notable detractors to performance though, most recently, Argentex. This financial firm provides currency risk management services and had initially had a strong start to 2025, with the new management team announcing earnings had come in ahead of expectations, whilst also demonstrating good cash levels. However, following the market turmoil around President Trump's tariff announcements, the company revealed it had failed to have adequate corporate liquidity to cover the additional margin calls on its clients' FX trades. Argentex management had allowed clients to transfer their margin liabilities to the company itself, a significant change and increase in business risks which had not been communicated to shareholders. This effectively bankrupted the firm, with the share price falling over 90% in the year-to-date, despite being up more than 60% coming into April.

Back in September 2024, the trust was also impacted by the closure of Hostmore, the operator of the UK's TGI Friday group of restaurants. This also resulted in RKW having its position wiped out. However, in the cases of both Hostmore and Argentex, Richard has kept the position sizes low, at below 2%, meaning despite their impact, they haven't offset the strong performance seen elsewhere in the portfolio. As a result, RKW's performance over the past year is broadly in line with the FTSE Small Cap ex-IT Index, having returned 6.1% to 19/05/2025 versus 5.2% for the index. RKW's performance was again notable ahead of the peer group average (1%), the Deutsche Numis Index (1%), and the AIM Index (-5.8%) in the same period.

Looking forward, Richard is relatively encouraged by the outlook. The UK has fared relatively better than other major economies and has signed a trade deal with the US that keeps tariffs low. Additionally, Richard's portfolio has very limited exposure to companies that export significant amounts of goods to the US, being more exposed to the domestic economy and the rest of the world and services businesses. We believe this positions the trust well as US tariffs focus on goods. However, there may be some issues of second-order effects from some of the more macro-exposed names such as industrial holdings, although Richard notes these are very attractively valued which provides a margin of safety. In all, he believes the UK micro-cap asset class is well sheltered from current macro challenges.

Fig.3: One-Year Performance



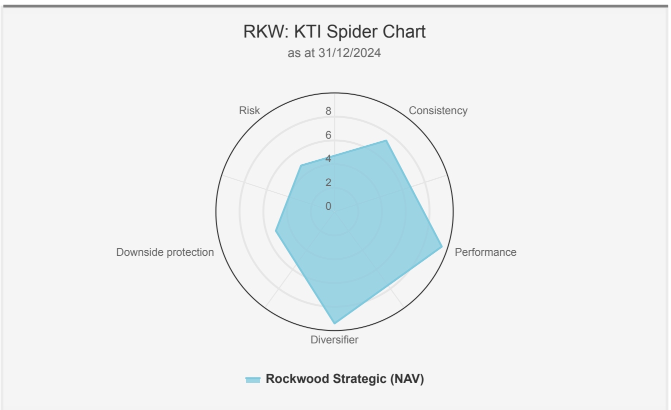
Source: Morningstar
Past performance is not a reliable indicator of future results.

In addition, Richard believes there are some early indications that professional investors are beginning to reallocate to the UK-listed equities sector, potentially anticipating future rule changes or minimum holding requirements. This has contributed to the UK market performing relatively well versus the S&P in 2025 so far. Market inflows have not trickled down the market-cap spectrum yet, although Richard notes that as interest rates fall, the investment case for the asset class only increases.

Our proprietary KTI Spider Chart is shown below. This shows how RKW has performed versus a wider peer group of 21 investment trusts over the past five years, in some key categories. Each category is scored out of ten and scores are normalised to the peer group, with a higher score indicating a superior characteristic.

RKW scores very highly for performance as a result of its strong alpha generation over numerous time periods. The score as a diversifier is also significantly above average, something we'd expect from the trust's micro-cap portfolio, as the asset class often behaves very differently to wider markets. RKW's scores for risk and downside protection are closer to the average though, however, whilst the volatility score is below average, this has been offset by a strong risk-adjusted score, demonstrating the additional risk Richard has taken has delivered additional performance. We note this five-year period includes some months when the portfolio had a high cash allocation in a falling market, which will likely have affected the downside protection score relative to peers.

Fig.4: KTI Spider Chart



Source: Morningstar
Past performance is not a reliable indicator of future results.

Dividend

As a result of the micro-cap focus, dividends are unlikely to feature. This is because these firms are typically in their growth phase, and therefore likely use additional capital to reinvest in growth rather than pay out to shareholders. Furthermore, Richard typically targets firms undergoing a challenging period, which often means they are not in a strong enough financial position to pay out to shareholders. Furthermore, Richard spends time considering the likelihood and potential for various exit plans when initially buying stocks, typically M&A, rather than running positions as they mature and grow, meaning dividends are rarely paid in his ownership tenure.

That being said, an annual dividend of 0.6p per share was paid in the past year which offers a historic yield of just 0.2% as of 20/05/2025, although the share price has risen significantly since this dividend was paid in September 2024.

Regardless, we believe RKW should primarily be viewed for its capital growth prospects, rather than as a potential income generator.

Management

Richard Staveley is the lead fund manager of RKW, with Nicholas Mills as assistant fund manager. Richard has over 25 years of experience in smaller companies investing, having previously started at PwC where he became a chartered accountant. He then had a stint at Société Générale managing their UK Small Companies fund, before going on to co-found River and Mercantile where he launched and managed the R&M UK Small Companies fund. This preceded a move to Majedie, before in September 2019, taking on lead manager duties of Gresham House Strategic (GHS), the predecessor to RKW. RKW is now the only vehicle Richard manages.

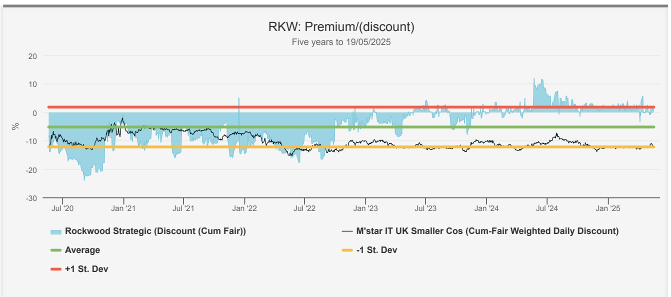
GHS was originally launched in 1999 but, despite a change of strategy to UK smaller companies in 2015, began a wind-down procedure in December 2021 when Gresham House used its position as largest shareholder to instigate, following Richard's departure as fund manager in May of the same year. The shares were eventually bought by Harwood Capital in April 2022, which then saw Richard reinstated as manager under the Rockwood moniker and him implementing the current strategy.

Rockwood is part of the Harwood Capital Management Group, which was founded by Christopher Mills in 2011. It has a range of interests across private equity, real estate, and business services, and specialises in smaller companies. This includes other investment trusts in the UK smaller company sector, like Odyssean (OIT) as well as North Atlantic Smaller Companies (NAS) run by Christopher Mills. Christopher founded Harwood and is also head of the investment advisory group that provides input to Richard for stocks in RKW. We understand there are strict Chinese walls in place between the internal Harwood divisions. There remains a high level of ownership of RKW shares by members of the Harwood group and company of c. 22% as of 06/02/2025, from a maximum allowance of 29.9%, which they argue indicates a fully aligned and focussed fund management team.

Discount

After Richard returned as manager in 2022, the discount of RKW narrowed markedly, with the trust trading close to NAV, or at a small premium from around May 2023 onwards. This has happened in the wake of strong NAV returns that Richard has generated (see **Performance section**) and therefore, we would attribute the premium rating to this performance, especially when comparing returns to the peer group, and the discount many of them are trading at.

Fig.5: Discount



Source: Morningstar

The board has attempted to keep the premium close to NAV through share issuance. The premium did widen notably in the second quarter of 2024 as the trust had maximised its issuance capabilities, though since this was renewed, the premium has come down and remained narrow. We understand the board will continue to use share issuance to keep the premium in check. Richard has used the proceeds of this to add to both new and existing holdings (see **Portfolio section**). We understand the strategy still has considerable capacity to keep issuing shares, despite being a concentrated portfolio of micro-cap companies.

Charges

RKW has a flat management fee that charges 1% of net assets. In addition, there is a performance fee of 10% for any NAV returns above 6% per annum, although this is subject to a high-water mark. The performance fee is also subject to a cap of 3% although any amount earned above this will be deferred into the following performance fee period. This amount rolled over is again capped at 3%, which includes that year's management fee. We note that the trust has accrued a performance fee in its interim results (to 30/09/2024). We calculate the amount is likely to meet or exceed the 3% level, although the final amount will be declared in the end-of-year results when the full performance figure is known.

The most recent OCF is 1.83%, which we understand does not include the performance fee, and compares to the weighted average of the peer group of 0.80%. Whilst these charges may appear higher than peers, underlying we note they have come down significantly in the past few years, as the management fee and performance fee rates have been reduced. In the past year a new prospectus was produced to support increased issuance, which was overwhelmingly supported by shareholders though did add cost during the year. We understand one-off costs such as this and the move from the FTSE AIM Index to the main market in the prior year should now be in the rear-view mirror (helped by the changing rules on issuance limits) and the growing trust's asset base should provide scale cost benefits to all shareholders. Overall, all fund NAV performance is stated net of costs and the higher fees reflecting a specialist, hands-on, capacity-constrained fund.

ESG

Richard takes a pragmatic approach to the consideration of ESG factors in his process. With the level of engagement he has with the management teams of his portfolio companies, governance tends to be the standout element. When Richard builds the investment case for a company, his confidence in the ability of a management team to be able to execute the plan will be critical. Therefore, only those with high corporate governance characteristics will be suitable for the portfolio.

For environmental and social issues, Richard takes a common-sense approach. He will consider these issues based on qualitative inputs, rather than using methods such as scorecards, which are likely to be labour-intensive, especially in smaller companies due to the lower level of disclosure. Examples of the social issues that Richard will consider, include a company's treatment of its key stakeholders, such as customers, employees, and suppliers, as this will affect the firm's future fortunes and the ability to perform a turnaround. Any risks Richard identifies will be used to engage with the firm to encourage them to work on improving any issues. These are also monitored post-investment.

As a result of the low coverage in the small-cap market, Morningstar does not have a formal ESG score for RKW.

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