Results analysis: BlackRock Smaller Companies

BRSC trades at a wide discount, despite its successful long-term track record...

Update
09 May 2025

- BlackRock Smaller Companies (BRSC) has released its financial results for the year ending 28/02/2025. Over the year, the trust saw NAV total returns of 0% (debt at fair value), versus the benchmark, Deutsche Numis Smaller Companies plus AIM (excluding Investment Companies) which returned 6.2%. Despite the near-term challenges, long term performance remains significantly ahead of the benchmark, with ten year returns of 89.5% versus the index of 51.3%, to 28/02/2025.

- The underperformance over the latest financial year primarily came in the second half, with BRSC having delivered returns in line with the benchmark at the interim results. Manager Roland Arnold stated that stock selection was again the primary driver of performance. The trust suffered from the likes of TT Electronics delivering a surprise profit warning, and Workspace Group which fell on weak sentiment. Furthermore, underweights to some of the indexes' best performers such as Zegona Communications, also caused a relative headwind.

- There were numerous positives though, such as XPS Pensions which was the best performer on the back of good client growth seeing repeated earnings upgrades. Alfa Financial Software also contributed positively on earnings upgrades, despite also successfully transitioning their business approach. Despite this, they were not enough to offset the headwinds elsewhere.

- The dividend picture continues to be positive. Revenue per share was up 4.5%, allowing for total dividends paid in the year to rise by 4.8% to 44p, offering an historic yield of 3.4% as at 08/05/2025. The increase marks 21 years of growth, reaffirming the trust's AIC Dividend hero status. Revenue was c. 99.5% of the dividend paid, meaning a small fraction came from revenue reserves. These remain sizeable, enough to cover 92% of the previous years' dividend.

- The discount was volatile throughout the year, at an average level of 11%, although ranging from 5.7% to 14.1%. This was slightly narrower than the average of the peer group at 11.5%. The board attributes this slight premium rating to the high level of share buybacks in the year. Over the period, 3.5m shares were repurchased, equivalent to 7.4% of opening share count. This added 0.7% to NAV, with a further 700k bought back since, at an average discount of 12.2%.

- Gearing increased in the year to 13.3% of net assets, up from 11.5% at the beginning of the period and 6.3% the year before. This reflects the manager's positive view on company valuations in the index. The trust continues to have very favourable rates on its long-term facilities.

- In the period, the board entered into an agreement with activist investor and sizeable shareholder Saba Capital Management. This results in Saba agreeing not to undertake a series of actions that could undermine the future of the trust until 2027 at the earliest. There has been no monetary consideration from BRSC to settle these matters.

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- **Chairman Ronald Gould noted the volatile outlook, saying BRSC "is well-positioned and prepared to take advantage of the investment opportunities that lie ahead despite the uncertain market conditions"**

Kepler View

The period covered by **BlackRock Smaller Companies' (BRSC)** annual results includes a particularly challenging one for UK markets, following weakening economic sentiment and a challenging start for the new UK government. However, whilst this has caused a performance headwind, especially in the second half of the year, these results have, rather coincidentally, been published on the eve of a Bank of England interest rate cut, with indications this could go lower still, and the prospect of a UK/US trade deal. As such, we believe the backdrop for the UK, and smaller companies in particular, has improved considerably in the period post results, and could prove a turning point for the trust.

BRSC continues to have very strong long-term numbers, despite the short-term headwinds, which have largely been driven by stock selection. This has been the case for these results too, albeit on this occasion, it has been a drag on performance. This was largely a result of the manager not owning several good performers, rather than poor choices in what he does hold. Despite this, there are some bright spots within the portfolio, with some of the larger holdings, such as XPS Pensions, delivering strong fundamental performance and earnings upgrades. Furthermore, Roland notes that sometimes, strong operational performance of his holdings was not reflected in their share prices. With an improvement in broader sentiment, this anomaly could soon correct, which would have a positive impact on the sector more widely, with Roland having noted UK valuations continue to be depressed versus their own history.

We think the current discount could also prove an opportunity for long-term investors. The discount has fluctuated throughout the year as optimism waxed and waned, though the current level is notably wider than its five-year average, and in line with the sector average, despite BRSC having historically traded at a premium rating to peers. If an improving economic backdrop feeds through to markets, we believe investors could benefit from not only a recovery in UK small cap valuations, but also from this discount tightening.

The dividend was another bright spot in the year. The payout was increased again, reaffirming BRSC's status as an AIC dividend hero with 21 years of continuous growth, and now offering a competitive yield of 3.4%. The dividend was almost entirely covered by revenue, which we believe is a further demonstration of the low valuations of UK equities. As such, we believe BRSC can offer investors a differentiated income stream, from an asset class not usually associated with one, with good prospects for capital growth too should sentiment turn positive on the sector more broadly.

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