During the year to 30 September 2019, the Fund (VT Cape Wrath Focus Fund A-shares, GBP) lost 10.1%, while the Benchmark (MSCI UK IMI net dividends reinvested, GBP) gained 2.2%. This poor performance occurred largely during the first half of the year, when the Fund underperformed the Benchmark by 12.2%. Performance improved steadily through the final quarter of the financial year, and this momentum has continued into the first quarter of the new financial year. For reasons discussed later in this review, we believe that recent outperformance reflects more than just the volatility that has characterised the Fund's trajectory over much of the three years since launch.

The Fund's best performer was CVS Group (CVSG), the veterinary service provider, which delivered a 43.8% return on our average purchase price during the period. CVSG's main business is operating a network of 491 veterinary surgeries, including small animal, farm and equine, across the UK, Ireland the Netherlands. The largest positive attribution was from EI Group (EIGE, formerly Enterprise Inns). EIGE was the Fund's largest position at the start of the period, with an 8.0% weighting, and delivered a positive impact of around 180 basis points on the Fund NAV. For a discussion of our investments in CVSG and EIGE, please see the Interim report.

Another strong performer during the year was NCC Group (NCC), the escrow and cyber security business, which delivered a 40.9% return on our average purchase price during our 3-month holding period, equivalent to around 170 basis points on the Fund NAV. The catalyst for our purchase was a profit warning at the interim results, which sent the shares down around 36%. The principal cause of the profit warning was recruitment and retention challenges in cyber security, which is predominantly a people-based consulting business. Revenue decline in the mature escrow business also fed investors' concerns about structural decline in that market. Investors were also nervous about the turnaround that was underway at NCC. We knew the business well, having previously held NCC in 2017, and our valuation model showed an updated Approximate Value of 174p. While this was a 13% decline from our previous valuation, it implied over 50% upside to the new share price, prompting us to buy two tranches in the week following the profit warning.

Our worst performing stock during the period was Flybe (FLYB), which we exited on 24 October 2018 at 13.1p. Our total holding period for FLYB was 15-months, but during period under review we held the stock for three weeks, during which time the shares fell by 65.5%, resulting in a negative impact of around 400 basis points on the Fund NAV. FLYB was subsequently sold to the 'Connect Airways' consortium for 1p. For a more detailed look at this investment, please see the Broadside 'Snog Marry Avoid'.

While FLYB was the worst performing stock, the largest negative attribution was from Carclo (CAR), the small industrial group. We held shares in CAR throughout the period, during which time they fell by 61.3%, resulting in a negative impact of around 600 basis points on the Fund NAV. CAR operates through three independent divisions: a technical plastics business that produces moulded plastic components used primarily in medical products; a business producing exterior LED lights for low-volume car manufacturers, including Aston Martin; and an aerospace business producing metal components such as control rods.

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We took an initial tranche in CAR on 6 July 2018 at 112p, based on our Approximate Value of 150p. Our analysis showed that cash generation had suffered from a build-up in receivables and inventory, with total working capital expanding over the previous six years from 47 to 93 days of sales. At 2x EBITDA, net debt seemed manageable, and with the first pillar of management's strategy being to improve cash generation, we estimated that £15m of cash could be squeezed from working capital. Meanwhile, a turnaround strategy in the technical plastics division would improve Group profitability in the short-term, and expansion at the LED business into the medium-volume car market would provide longer-term earnings growth. Three months after our initial investment, CAR reported disappointing interims due to delayed new programme launches in the technical plastics divisions, and too many simultaneous new programme launches in the LED business. It soon became apparent that the LED business had overcommitted to new programmes which it did not have the manufacturing capacity or management bandwidth to deliver. As cash flowed out of the business and profitability declined, the balance sheet came under pressure. By the end of the period, CAR shares were suspended at 10.7p, while our Approximate Value had fallen to 31p. Following the period end, CAR completed the sale of the LED business and the shares recovered to around 19p.

We are always looking for incremental improvements in our investment process, but the extent of our underperformance in the early part of 2019 prompted us to think more fundamentally about how we were delivering on our deep value mandate. One outcome of this soul searching has been the development of the 'Red Flag Evaluation' (RFE) template, which is designed to ensure that we invest in fewer CARs and FLYBs. The largest negative contributors to performance typically had balance sheet issues and broken business models. Our valuation-based approach takes a linear view of risk, but some investment risks are non-linear. With our strategy of adding tranches on price weakness, we learned that buying non-linear risk could cause significant pain. The shift has been from a position where we would buy any risk, given sufficient upside, to one where we will now avoid some risks entirely, no matter how attractive the perceived value.

Although there is only eight months of data, we believe that the RFE is having a positive impact on our returns. The following table shows that over the 8-months to 31 December 2019, the Benchmark returned 5.1%, the Fund returned 13.0%, and the new ideas introduced under the RFE returned an average of 23.7%. At 31 December 2019, these new ideas represented 36.4% of the Fund (adjusting for cash, this equates to 46.0% of the Fund's equity holdings). As we come to populate the whole Portfolio with ideas from the RFE, the performance of the Fund will tend towards the performance of the RFE ideas. Given that the average holding period of RFE ideas has thus far been 3.6 months, we may be able to recycle our capital through more than one idea each year, thus compounding these average returns.

31-Dec-19	Entry date	Exit date	Capital return	Holding (months)
M&C Saatchi	04/12/2019	--	49.4%	0.9
Galliford Try	30/04/2019	18/10/2019	42.6%	5.6
Somero Enterprises	22/10/2019	--	38.4%	2.3
RPS Group	10/10/2019	--	35.4%	2.7
Babcock International	24/06/2019	--	30.9%	6.2
Hammerson	23/07/2019	--	30.8%	5.3
Lookers	05/07/2019	11/10/2019	25.2%	3.2
Photo-me International	14/06/2019	--	7.6%	6.6
Superdry	14/05/2019	12/07/2019	1.7%	1.9
Costain	09/09/2019	--	0.4%	3.7
Micro Focus	05/12/2019	--	-2.0%	0.9
Average capital return			**23.7%**	**3.6**
Fund (A-share) total return (30-04-19 to 31-12-19)			**13.0%**	
MSCI UK IMI total return (30-04-19 to 31-12-19)			**5.1%**	

Our deep-value investment style looks for alpha in Mr Market's changing narratives and behavioural mis-steps. We look for a target level of return on each investment, and achieving this return more quickly enables higher compounding. If implemented successfully, this approach leads to high portfolio turnover, requiring a large number of new ideas. This contrasts with the 'Buffett-style' of investing. For example, Nick Train added PZ Cussons to his funds in December 2019. It was the first UK-listed idea that he had bought in nine years. We would look to trade around 200 ideas over that timeframe.

The way we think about and evolve our investment process is our most powerful tool for delivering exceptional performance over the long-term. But we are also aware of the limitations of formal processes (for more on this, please see the Broadside 'We Are Not Odysseus'). In the words of George Box, 'All models are wrong, but some are useful'.

Adam Rackley

Investment Director

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