ARTEMIS
The PROFIT Hunter

Mark Niznik – UK Smaller Companies Fund

Dick Turpin: Ladies and gentlemen good morning; thank you for finding the time to join us and welcome to the continuing series of Artemis webcasts. Also now I thank those of you who've been waiting while we've got everybody hooked up either online or through their telephones.

First, before I introduce Mark, if we could just pick up on a couple of housekeeping points and I apologise to those of you who are regular listeners to our webcasts, and have been through this before. For those of you who haven't, you should in front of you have a screen with a picture of Mark to the top left and the cover slide for the discussion and presentation. Just to the right of Mark's picture you see a line of tabs and the second one in from the left is a question tab. If you'd like to ask a question - and please we encourage you to do so - just click the question tab and a new screen will appear in front of you and you'll see a box where you can submit your questions and just below that if you'd like to type in your name that would be most welcome, and then at the very bottom just click the "submit" button. We'll receive the question and I'll take every opportunity to make sure that your questions are answered.

It now gives me great pleasure to welcome Mark to his first webcast on the Artemis UK Smaller Companies Fund. As many of you know, Mark joined us last year from Standard Life where he was a highly regarded AAA-rated manager by Citywire and had a most impressive track record managing the UK Opportunities Fund at Standard Life. Mark joined not just Artemis, but specifically joined us to be part of our small-cap team working alongside John Dodd, and is now the Co-manager with John on the Artemis UK Smaller Companies Fund.

The Fund has just recently passed its ten-year mark as it was launched back in April of 1998, so it seems an appropriate time for Mark to reflect on the Fund and now that he's got his feet firmly under the desk, his thoughts on where we're going and small-cap in general. Mark welcome, thank you very much for finding the time to be with us, and how are things?

Mark Niznik: Thanks very much Dick; first of all thanks for dialling in everyone and apologies for you having to sit with my ugly face on your screens. What I wanted to do today was just cover off a few points, mainly talk for 10-15 minutes with a few questions in between. I was just going to cover the recent performance of the Fund; our current thinking on small-caps; then maybe talk about some of the winners and losers so far this year in the Fund; what we've been doing dealing wise; and then maybe finish off on the outlook as we sit here today.

First of all performance wise: you can see the Fund has performed pretty well over pretty much the last couple of years and in the long-term too, and this has been really due to our overweight stance in the resources sector of the economy. You should have the pretty cartoon in front of you; we used this earlier in the year at our road shows and I think it still holds true today. We see in the current equity storm - evidenced by those big waves - our ship is still firmly tethered to the side of the shore with oil and gold indicating our overweight stance in the mining areas, the exploration and production areas of the economy.

We still see it too early to start sailing over to the right hand side of the screen in maybe some of the more regular growth, or AIM shares, or property, other areas of the stock market. What we're hoping to do is to time that move - shown by those barometers at the top - with the relative valuation of small-caps after the sell-off last autumn time coming much more in our favour. And also with an eye on what the people that are running the companies are actually doing with their own money, so the level of Director buying involved.

Just turning to the Fund performance so far in 2008: as you saw from the performance slide where the Fund has preserved investors' capital so far this year in rather a tricky market.
And you can see the winners there are all resource related, and it's really with Aquarius Platinum, it's their 500,000 ounces of production of platinum each year and the cash flow at $2,000 an ounce of platinum that that entails. Similarly with Energy21 it's their 26,000 barrels of oil per day, oil equivalent per day, and the cash flow that generates at a $130 plus oil. With Lamprell it's their near monopoly position in the Arabian Gulf with rig refurbishment and the business that the high commodity prices add to their group.

To balance it off on the losers' front, I've put in the worst three performing stocks this year: Corin, which is a new hip replacement implant company that was hit with delays in their US partner – Stryker - providing training for the surgeons in the US, so they'll be going to put these hips in place. Imperial Energy was probably quite a good example of a company being hit by the liquidity crisis as they had quite huge expansion plans in the former Soviet Union for developing their oil and gas fields and they had difficulty funding that via the banks and turned to equity markets to do that but at a low price.

Then finally, International Greetings; although we've been very underweight in the consumer side of the economy this is one of the few consumer related shares we own and it has suffered with many of the other retailers, housebuilders and property companies around the market.

Dick Turpin: You mentioned - if I can interject - I've got a question here, the sender hasn't put his name, but basically talking about rising inflation and I know you're not a great fan of looking at the macro economic and are more sort of a bottom-up stock-picker. But you mentioned the oil price there and obviously the feed through to those energy stocks that you're holding, but this question really says: 'Do you see rising inflation as a major threat to ongoing Fund performance, and how long do you think that current inflationary pressure might last?' A difficult one to judge really.

Mark Niznik: I would say inflation is normally, I would have thought, pretty good for stock markets relative to bonds. I'm not a big macro economist so I don't like answering those kinds of questions; I'm just a simple stock-picker so I'll leave that to global strategists and economists, which I'm not.

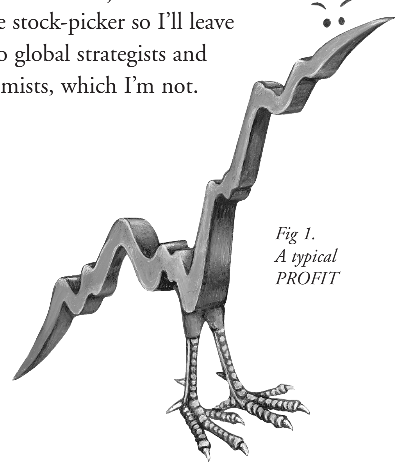

Fig 1.
A typical
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Dick Turpin: Super, thanks for that.

Mark Niznik: Hopefully you've got a slide of recent dealings in front of you - we haven't changed the Fund much over the last year, as we showed you in that cartoon slide, but the big overweight in resources remains. But these are the largest of the purchases and sales that we've done over recent months; I wasn't going to talk about all of them, but I'll just highlight a few. You can see on the sales we've been taking profits in some of the best performing companies in the Fund; both Lamprell and Aquarius Platinum as you saw from the previous chart were the best performing shares in the Fund and were very large holdings, and we didn't want the Fund getting too reliant on any single investment so we took a bit of profit in those two. Similarly with the Imperial Energy that emergency rights issue spooked us a bit at a time when their production was lower than expected and we thought that that was too much risk going forward for us to take. The last sale there was just one of our stocks, Codait, received a cash takeover bid which I would hope would be maybe some indication if share prices continue to fall that corporate activity would pick up as companies see value in acquiring the equity of competitors.

On the new holdings front, lets talk about one or two of these: H&T is an interesting one - that's a new holding we've taken in the UK's largest pawnbroking business - interesting I think because my perception is that it should be a counter-cyclical business. In times of global liquidity crisis and banks not wanting to lend, it was funny to me to see H&T shares underperforming over the last nine months despite the prospects of that company improving. Just to outline what they do, they basically provide a six-month loan at 8% a month interest, backed against the smelt value of any gold, or very occasionally diamond jewellery that a punter might bring to the shop. You can imagine these are people who are desperate for the money and can't get it from any other place. The banks have told them to go away and they don't qualify under any other loan institution rules.

What I like about this is the fact that after the six months, on average two-thirds of the customers come back and redeem the jewellery that they've pledged as collateral against that loan, because my perception is that they are pawning the family gold or something that has an inherently greater worth sentimentally to them than the actual value of the metal. You can see that an 8% a month margin is a hugely valuable and profitable book of business and H&T is the biggest in a very fragmented market. We bought it on something like a single digit multiple of current year profits when this company has grown its profitability every year for the last decade, and at a time when the Directors of the company were also buying shares alongside us as a comfort factor. That's an example of one that, despite the tough times and gloom and doom around us, we think is good value.

Another which is a slightly different company, is that second one down: Abcam; this is a fascinating company which was started by a pharmaceutical researcher who was looking for cancer cures and in order to test the cures that he was working on you need to react your product against antibodies. And he found it very difficult ten years ago to find sufficient quality of antibodies with sufficient data attached outlining the properties of those antibodies for him to do his experiments and tests on. What he did was come up with a company, Abcam, and if you look on the internet at abcam.com you'll see that this is a 100% online manufacturer and distribution company of antibodies. It has grown every year since its inception and it's very, very high margin business; very simple with an Amazon like concept in that once the customers get sent their antibodies they then report back on the Abcam website as to what they thought of it and that provides reassurance to the next purchaser of the same product; so that's a free self-reinforcing online business model.

Shares have done very well, admittedly are relatively dear at about twenty times earnings, but my perception is that there's a very good chance of it continuing to grow at well over 20% a year for the foreseeable future. That's quite an interesting one, again non-cyclical.

Dick Turpin: I've a couple of questions if I could just pick up on; the gentleman here, Dave Venn from Jones Sheridan, mentions that there are clearly a lot of articles at the moment about commodities in terms of the valuation and considering what you've just said in terms of the strong performance that has come through from the mining sector, 'do you do feel that there's a point coming quite soon where you might start to reduce that weighting and if you do, where might you be heading in terms of repositioning the portfolio?'

Mark Niznik: I think - if you go back to that cartoon slide - we're certainly still at port and the chain's still there tethered to the harbour wall, and that's holding us in very good stead. The way that we, John and I, divvy out responsibility is that John is responsible for the resources side of the portfolio - for the mining and oil and gas shares - and I'm looking after everything else. John has great experience over many, many years; he's probably the country's leading small-cap expert in resources and made that very prescient move overweight several years ago, which is what the Fund has benefited from over the last few years, and is currently doing. We see that massive overweight that we have as likely to reverse at some stage in the future; and what I tried to get across with that cartoon was, it will be the relative valuation of other shares in the economy and maybe a bit of Director buying and maybe some corporate activity in these areas that would give us the confidence to start switching - now that we've made the greater bulk of the returns that we see in this area. At the moment we don't see it yet; I think it's too early to make that wholesale change. We've certainly been taking a few profits along the way, but as the share prices of these investments have been rising, we've been taking a bit of profit in some of the areas like we showed you with Lamprell and Aquarius Platinum.

Dick Turpin: While we're just taking a couple of questions, if I may, there's one from John Wallis here about liquidity. 'Has it been reflecting the smaller company sector, certainly over the last year or so, and looking into the second half of 2008 whether you feel that liquidity will be an issue going forward?'

Mark Niznik: I'm not sure whether that's liquidity with regards to liquidity in the shares themselves, or liquidity available to finance?

Dick Turpin: I get the feeling, just looking at the question again, its referring to liquidity in terms of moving in and out of the stocks.

Mark Niznik: That's part and parcel with running a small-cap Fund and there are always problems with buying and selling smaller company shares. One of the ways that we counter that - there are a couple of ways - the first one is that we are long-term investors; whenever we buy a share, we're buying it on a 3-5 year time horizon. When we say that we definitely mean it; there are a lot of people that say they're long-term, but when you look at their underlying portfolio turnover of the fund that they run it tells a different story.
The underlying portfolio turnover of this Fund has been about 25% a year over the last few years, which coincidentally was very similar to the underlying portfolio turnover of the fund I was running at Standard Life for the last five years. On average we're holding the shares for between three and five years as we said.

If you're buying for the long-term you can afford to wait for a bad day in the stock market and pick up the shares slowly but surely.
The other thing which guards against the liquidity is being a contrarian or being an anti-share-price-momentum investor. A bit like the example of H&T; that share has been falling, or was falling until we bought the holding recently and when share prices are falling people generally want out and they just want to have

an embarrassing loss off their books. I take a different view in that if you have done your homework properly, and the value of the asset as you perceive it in the long-term is attractive, then surely it is better to buy the shares at a lower price than a higher price - I like to deal at lower prices. If you're an anti-share-price-momentum investor it helps with liquidity, but there's no denying liquidity is an issue with small-caps; it's part and parcel of the business.

Dick Turpin: I've another question from Paul Davies at King Furness on Kenmare; just wondered if you had any thoughts on that stock; the stock clearly has been in the Fund for a long time…

Mark Niznik: Yes, Kenmare has been in the Fund for a long time and to be honest it's been a relative disappointing holding for the Fund given where commodity prices have gone in the last year. For those of you who don't know, Kenmare is a one project company; they operate Moma ilmenite project in Northern Mozambique, which produces a titanium dioxide which is what ilmenite is - it goes into a paint pigment, it's the main use for it. Kenmare has suffered from start-up delays as they ramp-up production to 800,000 tons of ilmenite per annum, which is their expectation for the run rate at the end of the current year. It remains a large holding in the Fund. I went down to Mozambique to kick the tyres earlier in the year and came back very impressed. They're got the world's largest deposit of ilmenite and it's probably the world's cheapest source of supply and it clicks into the huge demand from China and the Far East. Ilmenite prices have been rising over the last year and even more recently than that. Although it is a relatively risky investment - because it's just one project - it's a potentially very, very lucrative mine. I think it has intrinsic value being the world's lowest cost titanium sand mine - so that's Kenmare.

Just to finish off, if you click on the last slide entitled value emerging: just our thoughts on the future for small-caps. As I sit here today there's no doubt that the economy is slowing and I think many investors are expecting a recession, and you've seen smaller companies underperform after the three or four cracking years we've had up until last summer. What's happened since last summer is obviously share prices have fallen and they've fallen pretty substantially. Small-caps are off maybe 35% in the last nine months or so, which is why I've put in there that we see values starting to emerge. Certainly Directors are increasingly buying shares of their own companies and corporate activity has also picked up.

There's been an increasing level of takeovers of companies in the small-cap arena and P/E ratios are relatively low. If you look at that barometer on the cartoon chart that I showed earlier, P/Es are looking relatively low and Director buying is picking up. Although we're not saying now is the time to be putting all of your money in small-caps, it is certainly getting near the point and we're becoming increasingly more excited that we are near a time when people are going to make some pretty decent returns from investing in smaller companies in the UK. That's all I had to say really; I'd just like to thank everyone for listening and if you've got any further questions just get in touch with the broker support desk, or you can email them, I think it's brokersupport@artemisfunds.com. Thanks very much and good-bye.

Risk warning: