

Downing Strategic Micro-Cap Investment Trust



February 2022 Commentary

In February, the Company's NAV declined by 3.9% versus the market which declined by 4.5%. It was an extraordinary month, scarred by the tragic events which continue to unfold in Ukraine. As in all crises, we use the volatility in markets to reflect on our portfolio positions and overall construct, and to think deeply about where we may be exposed to permanent loss of capital. We do not think there is any of this risk in the portfolio and we retain around 8% cash.

Direct revenue exposure to Russia and Ukraine is significantly below 1%. There is also very little supply chain exposure, and our businesses are not currently seeing delays – albeit these are becoming more widespread as reported in the media, and may begin to generate some headwinds. Our companies are well financed, most have a net cash balance sheet, and the remainder are recently refinanced. This will allow them to invest in inventory to meet customer demand in case headwinds do stiffen. We have had feedback around minor labour shortages, in some cases where workers have returned to Ukraine to help their families and their country. Other input cost pressures are a concern – but we take comfort in the underlying quality of our businesses where we know that costs can be passed through (albeit with some lag).

It was a quiet month in terms of results. **Synectics (+24.3%)** reported a much-improved set of numbers aided by significant cost savings which the management team executed through Covid. This paves the way for a business which, we think, will generate improved margins as revenues return on a much leaner cost base. The group structure masks the inherent quality in the Systems division which will generate a normalised 45% gross margin from here. It was breakeven at operating profit level in 2021 on £20.7 million of revenue. In 2019 it generated £40.5 million of revenue, and we think it should return here as the gaming markets recover. That, in our view, presents a very tangible and profitable recovery trade with a pathway to around £5-6 million of operating profit plus a Security division which should cover the group's central costs. With a sub £20 million market cap and a net cash balance sheet, we think this presents exceptional value.

Significant trading updates came from **Real Good Food (no change)** who reported that labour shortages and supply chain issues would result in a lower-than-expected EBITDA outturn. **Hargreaves Services (-1.1%)** announced two key developments within the land division – the exchange of contracts and JV Unity, and a further exchange of contract at Blindwells. The positive momentum in the land business is encouraging and we expect more news flow here this year. **Volox (-10.9%)** announced a refinancing which will provide flexibility to invest in organic and inorganic growth. The group also announced that they are “successfully navigating the current supply chain challenges while demonstrating our ongoing ability to pass through inflationary cost increases.” With 19-20p per share of earnings expected this year, coupled with top quartile returns and ample reinvestment opportunities, we think that the shares are too cheap. We discuss Real Good Food, Hargreaves, and Volox in more detail in our latest investor letter [here](#).

Opinions expressed in this document represent the views of the investment manager at the time of publication, are subject to change, and should not be interpreted as investment advice.

Fund discrete performance	Rolling 12-month period 5.27% (28/02/2021 to 28/02/2022)												
	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Year
2022	4.83	-3.90											0.75
2021	1.63	3.80	2.46	7.64	-0.62	0.69	-1.02	5.73	-1.63	-1.51	-7.27	0.70	10.22
2020	1.26	-10.64	-17.04	8.45	0.64	0.12	-2.09	6.44	-2.09	2.04	8.69	5.17	-2.36
2019	-1.81	-3.59	1.65	4.01	-3.93	-1.20	0.57	-3.75	-2.83	0.72	5.23	5.57	-0.02
2018	-0.98	-1.49	-1.76	-1.15	1.14	-2.24	-1.04	-0.19	-0.51	-7.23	1.07	-4.04	-17.18
2017*					-0.02	-0.12	-0.64	-1.31	-0.16	-1.02	-0.55	0.86	-2.94

Source: Downing LLP. Please note that past performance is not a reliable indicator of future results.

* From inception 09/05/2017 to 31/12/2017



Lead Investment Manager
Judith MacKenzie

Judith is a Partner at Downing, having joined in 2009 and founding Downing Fund Managers.

Previously she was a partner at Acuity Capital managing AIM-quoted VCT and IHT investments and a small-cap activist fund. Prior to Acuity, Judith spent nine years as a senior investment manager with Aberdeen Asset Management Growth Capital as co Fund Manager of the five Aberdeen VCTs, focusing on technology and media investments in both the public and private arenas.



Investment Manager
Nick Hawthorn

Nick began working on the buy side in 2013 and joined Downing in September 2015 from BP Investment Management. Prior to this, he worked for Aberdeen Asset Management. Nick holds an MSc in Finance and Investment from Durham University and a MA in Accounting and Economics from the University of Aberdeen.

Investment rationale

- ▶ The Company aims to generate a return of 15% p.a. compound over the long term. Please note that this is a target only and is not guaranteed.
- ▶ The Manager employs a value approach and seeks to be influential through taking strategic stakes.
- ▶ The Company seeks to hold a concentrated portfolio between 12-18 holdings.
- ▶ The Company will typically hold between 3 – 25% of the equity of investee companies, notwithstanding ability to use debt instruments alongside equity.
- ▶ Long-term investment horizon over three to seven years.
- ▶ Private equity approach to research and engagement seeks to unlock greater shareholder value over the long term
- ▶ We believe a strategic, proactive investment approach can help smaller companies realise their potential
- ▶ Buyback mechanism for up to 14.99% of the equity of the Company seeking to closely control discount (at the Board's ultimate discretion and subject to shareholders' annual approval).

Portfolio summary

As at 28 February 2022

Top five holdings

Holding	Sector	% of Company
Real Good Food Company Plc (including loan notes)	Food Producers	10.67
Hargreaves Services Plc	Support Services	10.09
Volex Plc	Electrical Equipment	9.98
Flowtech Fluidpower Plc	Industrials	7.92
Ramsdens Holdings Plc	Financial Services	7.80

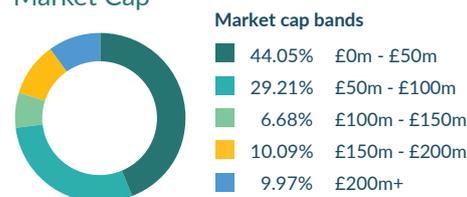
*Holding includes a 10.27% loan note and 0.40% equity split

Portfolio by sector



Source of holding and sector data is Downing LLP.

Market Cap



Source of market cap data is Factset.

Key facts As at 28 February 2022

Launch date

9 May 2017

Morningstar sector

UK Small Cap Equity

Total market value

£36,667,560.49

Total net assets

£43,058,094.12

No of Ordinary Shares in issue

50,402,145

NAV incl. income (starting NAV 98.04p)

85.43p

Market Price of Ordinary Shares

72.75p

Premium (Discount)

-14.84%

Dividends

The company has no stated dividend target.

Codes and fees

Ordinary Share ISIN: GB00BF0SCX52

Ordinary Share SEDOL: BF0SCX5

Ordinary Share Ticker: DSM

AMC on market cap: 1%

Ongoing charges

The ongoing charges represent the company's management fee and all other operating expenses excluding any finance costs, expressed as a percentage of the average daily net assets during the year.

The ongoing charges for the year ending 28 February 2021 were 1.84%.

Managers

Judith MacKenzie & Nick Hawthorn

Directors

- » Hugh Aldous, Chairman
- » Linda Bell, Non-Executive Director
- » Robert Legget, Non-Executive Director
- » William Dawkins, Non-Executive Director

Financial calendar

The company's annual financial statements will be prepared to 28 February in each year and will typically be sent to shareholders within four months of its financial year end.

The company also publishes an unaudited interim report covering the six months to 31 August each year, typically within two months of that date.

Further information

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www.downingstrategic.co.uk

Risk warning: Your capital is at risk. Investments and the income derived from them can fall as well as rise and investors may not get back the full amount invested. Investments in smaller companies will normally involve greater risk or volatility than investments in larger, more established companies. Performance figures are taken from daily valuations provided by Downing LLP. Return is the total return (value of the investments plus cash including income after all expenses and charges), ignoring investor's taxation. Because shares in an investment Trust are listed on the London Stock Exchange their price is affected by supply and demand. This means that the share price may be different from the NAV. The Company's investment strategy may involve the use of leverage, which exposes the Company to risks associated with borrowings. Please note that past performance is not a guide to future performance.

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