

Downing Strategic Micro-Cap Investment Trust



September 2021 Commentary

In September, the Company's NAV declined by 1.6% which, whilst disappointing on an absolute basis, was relatively strong when compared to the wider market which declined by around 3.80%. The month was characterised by extreme risk-off, with fears around Evergrande contagion, gas prices, fuel shortages and supply chain issues. We don't expect that any of these issues will affect the intrinsic value of our portfolio companies over the long term and the sell-off has generated some attractive mispricing opportunities. It is a good time to have over £7 million in cash.

Digitalbox (+32%) delivered an ahead of expectations performance following a successful turnaround of the Tab acquisition and strength in Entertainment Daily, offsetting weakness in the Daily Mash. Happily, management are beginning to see signs of recovery in Daily Mash traffic following the algorithmic problems from late last year. We think that the Digitalbox story is interesting, with an experienced management who can strip cost out of underperforming digital assets which they monetise through their proprietary ad-stack, Graphene. The business is highly operationally geared with a largely fixed cost base and 80+% gross margins. It is capital light and is expected to finish this year with over 25% of its market cap in cash from which management will continue buying and improving underperforming digital assets. EBITDA for this full year has been upgraded from £0.51m to £0.75m, and we think that there could be further scope for upgrades as the business moves into the busiest part of the year. An acquisition would likely drive further upgrades. **Flowtech Fluidpower** (+6.6%) delivered a reassuring set of interim results which demonstrate a recovery in trading post widespread lockdowns. We remain of the view that guidance is set conservatively and the business ought to upgrade earnings. Longer term, the prospect of an e-commerce platform to generate customer synergies and scale is attractive and could drive a more premium rating than the business has achieved historically. **FireAngel Safety Technology Group** (-2.9%) continues to make progress against its strategic priorities with pleasing improvements in gross margin. However, the business is experiencing supply chain constraints which will continue into the second half, albeit, we thought that management's tone was quietly confident so long as the situation doesn't deteriorate markedly. This view was bolstered by management buying shares in the month. **Venture Life** (-25.9%) was the standout disappointment in the month, with management disclosing further margin headwinds despite only releasing a trading statement the prior month. As the business grows organically and with the additions of the recent acquisitions and a relatively fixed manufacturing overhead, margins and earnings should improve.

Real Good Food announced its intention to de-list which we are supportive of. This will allow the company to maximise the residual value for equity holders. Prior to the announcement, Real Good Food equity was less than 0.3% of NAV with the majority of DSM's investment in loan notes.

Elsewhere in the portfolio, we continue to be active on WIP and have continued to add to the toehold which we announced last month, whilst also adding a new toehold, which, subject to liquidity, we hope to scale into a core position in due course. As above, we have a significant amount of cash which puts us in a strong position as the market becomes increasingly nervous going into the fourth quarter.

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.



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 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).

Fund discrete performance (%)	Rolling 12-month period 39.80% (30/09/2020-30/09/2021)												
	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Year
2021	1.63	3.80	2.46	7.64	-0.62	0.69	-1.02	5.73	-1.63				19.85
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

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

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

Portfolio summary

As at 30 September 2021

Top five holdings

Holding	Sector	% of Company
Volex Plc	Electrical Equipment	17.44
Hargreaves Services Plc	Support Services	9.42
Real Good Food (including loan notes)*	Food Producers	9.21
Flowtech Fluidpower Plc	Industrials	7.94
Adept Technology Group Plc	Telecommunications	7.30

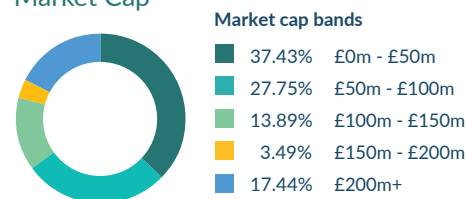
*Holding includes a 9.05% loan note and 0.17% equity split

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 30 September 2021

Launch date

9 May 2017

Morningstar sector

UK Small Cap Equity

Total market value

£40,309,232.69

Total net assets

£47,347,106.84

No of Ordinary Shares in issue

51,349,341

NAV incl. income (starting NAV 98.04p)

92.21p

Market Price of Ordinary Shares

78.50p

Premium (Discount)

-14.86%

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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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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