

Downing Strategic Micro-Cap Investment Trust



November 2021 Commentary

In November, the Company's NAV per share declined by 7.3%. It was a tricky month for the market generally, with Omicron and inflation concerns causing a widespread sell off, particularly at month end. NAV performance was particularly disappointing, especially considering reasonable company reporting, with companies selling off on sentiment rather than fundamentals.

Volex (-18.8%) contributed around half of the Company's decline in NAV in the month. Volex issued a robust set of interim results generating almost 45% revenue growth in the half year. This growth came at the expense of operating margin, which declined to 9.3%, but with absolute operating profit growth of over 30%. We believe that it was a strategic decision to prioritise profit growth over margin and we remain confident that the business will return to its 10% operating margin target over the short term. Significant investment in working capital was required to ensure the business could meet increasing customer demand, but this will normalise in due course. We remain optimistic for the second half of this year and think that guidance looks conservatively set, conscious also of management's long track record of beating expectations. The core structural growth drivers remain in place: in EV, two new Tier 1s and a new OEM have been signed. There is a 25% capacity expansion underway at DEKA. Strengthening medical markets, and a significant growth runway in higher contribution data cables should all generate meaningful growth from here. Finally, there remain two acquisitions to complete this financial year which do not form part of analyst guidance. **AdEPT (-23.5%)** also issued interim results in the period with respectable organic growth in the targeted Cloud and Managed Services segments of 6% and 4% respectively, offset by ongoing (and expected) decline in traditional telephony revenues. Profitability and cash conversion was strong, with EBITDA of £5.7 million and underlying free cash flow of £4.3 million generated in the half year. As has been the case with AdEPT, fixed line decline masks the underlying growth and quality of earnings and cash flow of Cloud and Managed Services, but at 13% of sales and declining, it is not long until this becomes an immaterial part of the business and a significant re-rating catalyst ought to emerge. Given the recent share price decline, there is a significant valuation anomaly with the shares trading on less than 7x EV/ EBITDA and P/E and approaching a 15% free cash flow yield for this year.

Other news flow came from **Synectics (+2.3%)** who reported winning two new major casino projects in North America where they will provide the Synergy software platform followed by a five year support contract. Gaming reopening in the US and Asia post Covid will be a significant catalyst for Synectics' earnings. We see a pathway to over 20% free cash flow yield upon widespread reopening, thus Synectics remains amongst the deepest value opportunities in the portfolio.

At the end of the month, the Company made a new equity investment. Given the illiquidity and our desire to continue building the position, we have not disclosed it at this time. It is a company we have owned in other Downing funds in the past, going through a turnaround but with a recently installed, high calibre and heavily invested (in equity terms) management team who have form in significantly value accretive trade exits in the sector.

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 15.11% (30/11/2020-30/11/2021)												
	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	-1.51	-7.27		9.45
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 November 2021

Top five holdings

Holding	Sector	% of Company
Volex Plc	Electrical Equipment	15.47
Real Good Food (including loan notes)*	Food Producers	10.47
Hargreaves Services Plc	Support Services	10.23
Flowtech Fluidpower Plc	Industrials	8.39
Centaur Media Plc	Consumer Discretionary	7.95

*Holding includes a 10.09% loan note and 0.38% 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 November 2021

Launch date

9 May 2017

Morningstar sector

UK Small Cap Equity

Total market value

£38,554,589.16

Total net assets

£43,000,514.30

No of Ordinary Shares in issue

51,065,681

NAV incl. income (starting NAV 98.04p)

84.21p

Market Price of Ordinary Shares

75.50p

Premium (Discount)

-10.34%

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

Registered Office

St Magnus House
3 Lower Thames Street
London
EC3R 6HD
Telephone: +44 (0) 207 416 7780
Email: customer@downing.co.uk

Source of data: Downing LLP.

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.

Important notice: This document has been approved and issued by Downing LLP ("Downing"), St Magnus House, 3 Lower Thames Street, London EC3R 6HD. This document is for information only and does not form part of a direct offer or invitation to purchase, subscribe for or dispose of securities and no reliance should be placed on it. 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. You should only invest based on the information contained in the relevant product literature available from Downing. Downing does not offer investment or tax advice or make recommendations regarding investments. Please see the relevant product literature for details of charges; your attention is drawn to the risk factors contained therein. Downing is authorised and regulated by the Financial Conduct Authority (Firm Reference No. 545025). Registered in England No. OC341575.

DSM3071_Dec (Nov) 2021