

Downing Strategic Micro-Cap Investment Trust



August 2021 Commentary

In August, the Company's NAV increased by 5.7% and the share price increased by 7.4%. While the discount narrowed modestly, it is still close to 20% which we believe is at odds with the prospects of the Company and its holdings. The managers continued to buy shares in the month.

There were no results in August but we saw material news flow from a handful of companies. **Volet** (+24.1%) announced the acquisition of Irvine Electronics which continues the buy and build strategy, with now seven acquisitions since 2018. This adds printed circuit board assembly capability in the US, lengthening the value chain offering of Volet to clients, whilst also marking the beginning of a move into the defence electronics sector. We expect more acquisitions before the end of the financial year which ought to act as a further catalyst to earnings and the share price, alongside the potential for underlying earnings beat which we outlined in last month's investor letter. **Tactus** (na) completed an up round of financing with a new investor, Chrysalis Investments, to provide capital to continue consolidating the PC gaming space. There is an exciting organic and inorganic growth story evolving here across three main verticals: entry level computing, gaming, and education. DSM retains the Tactus investment at a significant discount to the recently completed round which we hope to release into the NAV as we gain more visibility on full year results. To facilitate the transaction, DSM sold around 15% of its equity stake, realising just over 50% of its cost of equity investment, alongside a redemption of its £759k 10% loan notes which repaid £798k in total. **Duke Royalty** (+10.7%) made several announcements in the month. A new royalty agreement with Creo-Tech to fund acquisitions of engineering, procurement and construction businesses in Canada. Duke committed CA\$20 million and will earn an initial cash yield of 13.2% alongside taking an 18.75% equity stake in the business. Duke also exited its investment in BHPC Limited, an Irish insurance brokerage. Duke invested £4.3 million and returned £6.9 million, generating a 29.4% IRR.

Synectics (-11.1%) reported a new contract win worth around £1 million to supply safety monitoring and safety equipment for a refinery in South-Eastern Mexico. The contract leverages Synectics' expertise in hazardous-area applications. Management have been active realigning the cost base through Covid and have generated £2.4 million of annualised cost savings. We remain optimistic of the recovery here as we exit Covid, and with the business potentially trading on over 20% free cash flow yield there is extreme value on offer. **Venture Life** (-23.6%) issued a disappointing trading update which indicated that hand sanitiser was significantly underperforming and the Chinese Dentyl distribution partner was also underperforming. Naturally, we are disappointed by these updates and will investigate thoroughly at the interim results. Pleasingly, Venture Life also completed a further acquisition which will be immediately earnings enhancing. Helsinn generated £1.3 million of gross profit last year. Since this is an asset purchase only, all of this ought to drop through to the group's earnings. We still think Venture Life presents good value on a worst-case basis – taking pro-forma earnings from the recent M&A and writing down China Dentyl and hand sanitiser to zero, this is still a £10 million EBITDA business, with facility headroom and an operationally geared and capital light platform from which to continue consolidating.

We added a new toehold in the month where we are continuing diligence but see near term potential for earnings upgrades and likely corporate activity in due course.

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 39.15% (31/08/2020-31/08/2021)		
	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					21.84	
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 31 August 2021

Top five holdings

Holding	Sector	% of Company
Volex Plc Ordinary 25p	Electrical Equipment	17.14
Hargreaves Services Plc	Support Services	11.70
Real Good Food Company Plc (including loan notes)	Food Producers	9.10
Flowtech Fluidpower Plc	Industrials	7.26
Ramsdens Holdings Plc	Financial Services	7.17

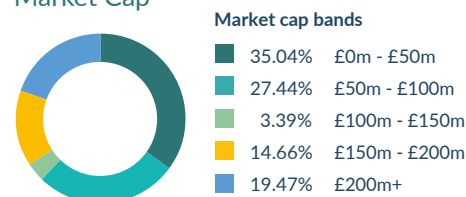
*Holding includes a 9.26% loan note and 0.34% equity split

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 31 August 2021

Launch date

9 May 2017

Morningstar sector

UK Small Cap Equity

Total market value

£39,040,699.16

Total net assets

£48,151,508.01

No of Ordinary Shares in issue

51,369,341

NAV incl. income (starting NAV 98.04p)

93.74p

Market Price of Ordinary Shares

76.00p

Premium (Discount)

-18.92%

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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