

Downing Strategic Micro-Cap Investment Trust



June 2022 Commentary

In June, the Company's NAV declined by 6.4%. This was disappointing given the relatively upbeat reporting from our companies. It was significantly ahead of the index, which declined by around 10%. The macroeconomic environment is becoming increasingly uncertain and long duration assets continue to sell off precipitously. The portfolio EV/EBITDA sits at 8x and thus we feel that it ought to be relatively well insulated from further multiple compression. However, this cannot be guaranteed as markets become less rational and overlook fundamentals, balance sheet strength, and longer-term prospects for growth. Conversely, this presents an opportunity for the Company's 10% cash balance to be deployed at depressed valuations.

Volex (-8.2%) reported full year results which, as previously flagged, were ahead of expectations. While revenues were higher, margins were slightly softer due to business mix in lower margin products combined with a lag in passing on cost inflation. Net debt was higher, with significant investment in working capital to support the revenue growth, capex to support future growth, and acquisitions completed earlier in the year. While the global economic outlook is challenging, we think that Volex has some attractive exposures. Medical should continue to grow as hospitals exit Covid and projects restart, now with larger backlogs to clear. EV should continue to grow given its relatively low base and increasing pump prices, and Volex has a cost and quality leading proposition here. While data was weak, Volex is coming to market with new products, and we expect the data centre replacement cycle to generate dependable revenues and growth going forwards. We think that an earnings yield of around 10% significantly undervalues the long-term growth prospects of the business. **Ramsdens (-0.5%)** also reported a robust set of interim results which demonstrated further recovery post-Covid. Gross revenues grew by 51%, with all divisions performing well. Looking forwards, we expect that the diversified business model will continue to prove resilient through macro headwinds. The business has a strong balance sheet with significant precious metal inventories and net cash approaching £10 million. Forecasts were upgraded at the interims and we still see a pathway towards £9 million of profit before tax in the medium term. With a market cap around £60 million, this presents good value.

Several other holdings reported trading updates in the period. **Synectics (-4.8%)** reported good progress in the Systems division which, in our view, is the key driver of intrinsic value. **Hargreaves Services (-13.4%)** announced a pre-close trading update and a further earnings upgrade for the year, with profit before tax increasing by £3.5 million. The balance sheet is strong with net cash of £14 million and with a short-term loan of £15 million which we expect to be repaid imminently. Separately, we noted the acquisition of R&G Fluid Power by Diploma for £100 million on £65 million of revenue. R&G is a smaller peer of Flowtech Fluidpower, with both having executed similar buy and build strategies in the fluid power market.

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 -11.66% (30/06/2021 to 30/06/2022)												
	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Year
2022	4.83	-3.90	2.61	2.15	-5.57	-6.43							-6.69
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 30 June 2022

Top five holdings

Holding	Sector	% of Company
Real Good Food Company Plc (including loan notes)	Food Producers	13.31
Hargreaves Services Plc	Support Services	9.50
Ramsdens Holdings Plc	Financial Services	8.53
Flowtech Fluidpower Plc	Industrials	8.14
Centaur Media Plc	Consumer Discretionary	7.35

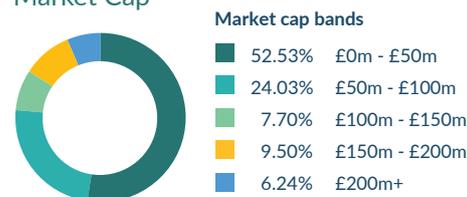
*Holding includes a 12.89% loan note and 0.42% equity split

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 June 2022

Launch date

9 May 2017

Morningstar sector

UK Small Cap Equity

Total market value

£30,949,926.25

Total net assets

£39,182,230.24

No of Ordinary Shares in issue

49,519,882

NAV incl. income (starting NAV 98.04p)

79.12p

Market Price of Ordinary Shares

62.50p

Premium (Discount)

-21.01%

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 2022 were 1.75%.

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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