Downing Strategic Micro-Cap Investment Trust PLC

Half-Yearly Financial Report

31 August 2019

Company number: 10626295

Downing

Objective of the company

The investment objective of Downing Strategic Micro-Cap Investment Trust PLC ('the company') is to generate capital growth for shareholders over the long term, from a focused portfolio of UK micro-cap companies (those whose market capitalisations are under £150 million at the time of investment) targeting a compound return of 15 percent. per annum over the long term.

Investment policy

The investment policy is available on the company's website. An explanation of the investment strategy is provided in the investment manager's report on page 5.

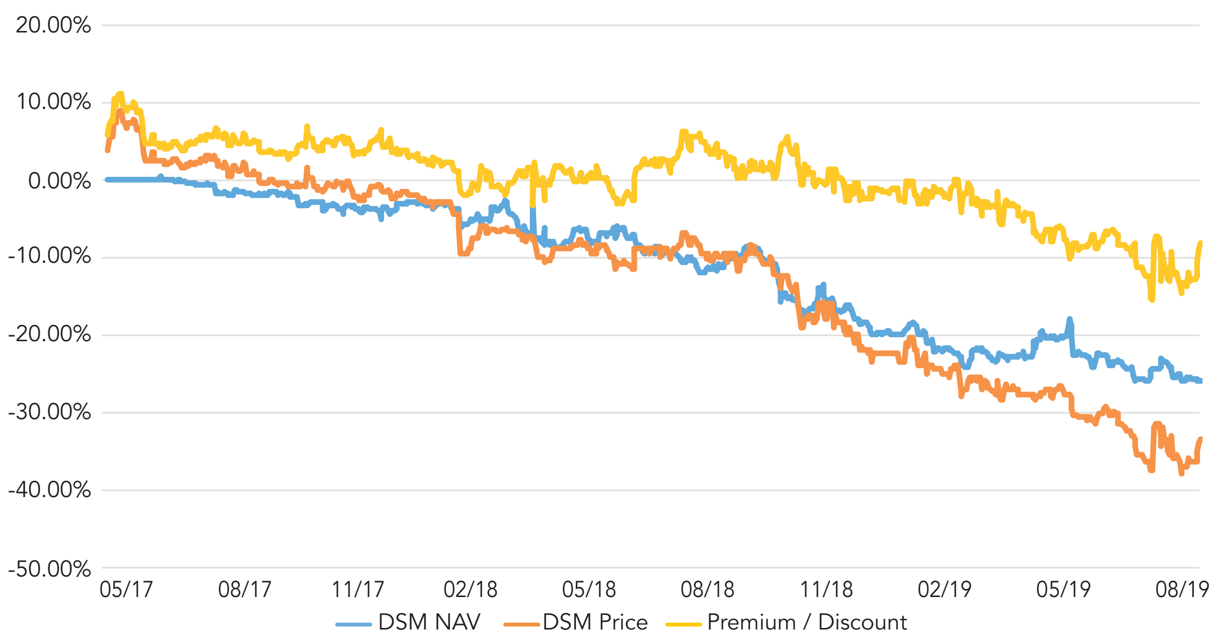
Contents

Financial Summary

	(Unaudited) Six months ended 31 August 2019	(Audited) For the year ended 28 February 2019	% change
Performance			
Net assets (£'000)	**39,771**	41,475	(4.11)
Net asset value (NAV) per Ordinary Share	**72.47p**	74.59p	(2.84)
Mid market price per Ordinary Share	**66.50p**	73.00p	(8.90)
Discount	**(8.24)%**	(2.13)%	–
Revenue return per Ordinary Share	**1.02p**	1.50p	–
Capital return per Ordinary Share	**(1.96)p**	(19.97p)	–
Total return per Ordinary Share	**(0.94)p**	(18.47p)	–
	%	%	
Decrease in NAV since admission[1]	**(27.53)**	(25.41)	–
Decrease in share price since admission[1]	**(33.50)**	(27.00)	–

[1] 9 May 2017

Share Price and NAV Performance from 9 May 2017 to 31 August 2019



Source: Downing

Chairman's Statement

Widespread concern, global and national, a decline in economic sentiment and uncertainty dominating markets, do not make it easy to write to shareholders about a portfolio invested in undervalued micro-caps, however determined and effective their management may be. Standing back from the tide of daily worries, in my view your company and the investment managers have worked hard and productively on the prospects for the portfolio. If we could bring about normal times, the outlook for most of its investments would be back on track. But for now, we and the investment managers tussle through a somewhat destabilised state of affairs. In all that uncertainty, UK micro-caps have had little attention from the stock market; they have been largely ignored by investors and share prices of good investee companies have continued to drift down. In stock market terms, DSM and its peer group of micro-cap investment companies have struggled over the last six months. At your company's year-end last February, its NAV was 74.59p per share and at the half year, 30 August 2019, it was 72.47p. Your company's share price at 30 August 2019 was 66.5p and the discount to NAV was 8.24%. At the time of writing the share price is 64.00p and the discount 9.16%.

In the current climate it may not provide much immediate relief to shareholders to say that the majority of your company's portfolio has improving prospects and is, we believe, increasingly better managed. In statistical terms, the intrinsic value of your company's portfolio has improved, despite the sound prospects for such small companies as these being yet further discounted by the stock markets. At their current market prices, the portfolio as a whole trades at barely more than 8 times earnings per share. That is value; and it is value unrecognised.

Nonetheless, your board does appreciate that in today's market, the value of your company's portfolio will have to be confirmed by events and we can't dictate those, even though the investment managers will be doing their best to encourage catalysts to engender value. I cannot apologise for markets, but, as Chairman, I can assure you that the board, and the investment manager, do appreciate any shareholder frustration. I and my fellow board members share that. The word 'patient' has unfortunate current associations, but I do believe that this portfolio has burgeoning opportunities.

Your company stands 85% invested and the investment manager and board consider the level of cash holdings to be about right, given current market and economic uncertainties. We have undertaken some modest buy-backs when the discount has widened but we have tried to do so, and will do, only when such intervention would be helpful. We do think the shares are good value.

As a backcheck:

Your board does, constantly, consider amongst itself and with the investment manager what we and your company could have done better. What both of us (board and investment manager) have got right, and continue to pursue, is the principle of DSM – investment in under-valued small companies that have good, future prospects. In four cases out of thirteen, hindsight tells us that both of us were wrong-footed on the quality of the boards of the investee company and, in some cases, their senior management. Optimism, perhaps enthusiasm, about the prospects for a company, its products and market, can override the very real difficulty of assessing a public company's governance, given what is available in the public domain; one doesn't have the freedom to investigate in depth as one might in assessing private companies; assurance in public documents may not be what it seems. When it became evident that the board and management of an investee had to change, by and large that has been achieved. Even so one investment, Redhall Group Plc, also suffered such serious delays to its major contracts that deteriorating cash flow pushed it into administration.

In May, in the company's annual report, I set out the extensive changes that had been made to the boards and management of several investments. DSM's investment managers 'stay on the case' with all of the portfolio. That is your company's style. As you will see from the investment manager's report, most of the portfolio is now progressing and most investments are now performing much as expected, or better.

The majority of the company's holdings are now performing ahead of, or in line with, the investment manager's thesis. Those that are behind the investment manager's expectations have undergone significant change, and we are confident that structural and management changes will result in progress going forward.

The Board

At the beginning of August, Robert Legget joined the board. Robert was Managing Director, now Chairman, of Progressive Value Management Limited which was founded 20 years ago to provide institutional investors with a means of realising better value from holdings in illiquid portfolios of UK small companies. Robert has succeeded Stephen Yapp as Audit Committee Chairman and Stephen has stepped down from the board, with every good wish and thanks, in order to seek board and potential Chairman posts amongst the field of small listed companies. Andrew Griffiths caught us (and I think himself!) by surprise on being accepted by the Ministry of Defence to join the Royal Fleet Auxiliary as a mature officer and he resigned from the board and joined the Britannia Naval College at Dartmouth on 12 October. Andy has been a great contributor and we are working through a short list of potential replacements. The board currently consists of Dr Linda Bell, Robert Legget and myself. I would like to thank my board colleagues through this period for being incisive thinkers who consistently push the level of thought at board meetings, at the more relaxed sessions that we tend to hold between boards, and generally as a hands-on, diligent board.

I hope that level of involved concern on behalf of your company will begin to show through in improved performance.

Hugh Aldous
Chairman
1 November 2019

Investment Manager's Report

Evolutionary psychology proves that as humans we are hardwired to some of the most basic instincts. One is that it is always easier to blame someone else, or things apparently out of your control, when things don't go according to plan.

It would be easy to blame markets for the company's lack of performance; the AIM market is down by circa 17% over the last 12 months (at the time of writing), whilst those companies with market capitalisations below £150 million (which is the universe of this company) are down by nearly 21%. The NAV of the company is down by 16.6% (at the time of writing). Markets have not helped us and at a time when our portfolio companies were beginning to step onto the front-foot, they have been knocked by poor market sentiment. Nevertheless, we must admit that our performance since the company's inception has been disappointing.

This is particularly frustrating as a number of our more 'strategic' positions have worked hard to refocus what are good businesses, and others have executed sound strategies well. Unfortunately, right now it is still the case that few investors take enough interest in these businesses and hence the difference between our cautious valuations and how the stock market values these companies has grown wider. One of us will be wrong.

The reality is that our portfolio companies have gone through tremendous change – in the vast majority of instances for the better. Frequently this has been at our instigation to encourage, or even bring about, change for the benefit of all shareholders. Strategic investing isn't a free ride. It requires active engagement and decisiveness from all involved and as investment managers we have been more active than we thought we would have to be.

In the full year accounts to the end of February 2019, I talked about the J-curve of investing. Put simply, private equity and strategic investing tend to find things get worse before they get better; reflecting the changes that are made in the underlying businesses, investing for the future comes before the benefit is felt.

So where are we on that J Curve - are we coming out of the depths?

Certainly, the levels of corporate activity and management change have reduced significantly in the period. At the time of last writing on 2 May 2019, we had gone through 23 board and management changes in the previous 12 months, in the last six months it is 15, including five at Real Good Food Plc and three at Science in Sport Plc. We now believe we largely have the correct people in the driving seats of these businesses, and that largely they are engaged and incentivised in the appropriate way. Reporting has become more reliable. We have been able to stand back, look at the attributes of the companies we have bought, and engage with those teams to execute the next stage of the strategy for value realisation. We are now seeing a noticeable improvement in what we believe is sustainable performance.

The metrics are quite interesting. We have emerged with a portfolio that has attributes similar to a maturing private equity portfolio.

- Average 'insider' or management ownership is 22% of the portfolio
- The running yield on the portfolio is 4.8%
- The weighted average PE is 8.19x
- The weighted average price to book value is 1.45x

This isn't an early stage or speculative portfolio by any means, these are largely mature companies who have gone through some strategic change. We believe that they are good value and overlooked, and now our challenge is to ensure that they are appreciated and valued correctly.

We talk about our investments and their progress against our investment case over the next few pages, however, it is worth highlighting some of the main events over the period.

Starting, frankly, on a down note, the most significant and disappointing development in the period has been the demise of Redhall Group Plc ("Redhall"), which went into administration. At the time of writing all its divisions have nevertheless continued to trade through administration and have found new homes, which secures the future of employees.

The investment case in Redhall was simple, it was in an enviable position as a specialist UK manufacturer to win and deliver high value projects geared to UK infrastructure – at that time predominantly in nuclear and rail. The business had a very attractive forward order book which we believed would deliver cash generation and ultimately a trade exit. The irony has been that the very contracts that made the investment attractive in the first place led to its downfall. Delayed payments to this highly skilled small supplier in a large supply chain led to a working capital crisis that was impossible to unwind.

In fund management you aim to get more right than you get wrong. And Redhall is one we got wrong. There are lessons to be learned; contractors can make attractive investments if the terms are right. They were not in this case. We invested just over £5 million in Redhall via equity and loan notes, both of which have been written down to nil.

Redhall was a mistake that we are adamant will not be repeated.

On the other hand, a company that was giving us major headaches at this time last year, Real Good Food plc, has demonstrated an ability to move up the J curve. Although coming through the latter part of an aggressive turnaround, it is already clear to see where value creation is being derived. The business is now constituted of two divisions, namely Renshaw (a manufacturer and distributor of sugar paste) and Brighter Foods (a manufacturer of healthy snacks). In the last 18 months the company has gone through the following changes;

- Divested £17 million of non-core assets
- De-geared term debt
- Announced a significant improvement in operating profit for the year to end of March 2020
- Announced increased capacity in Brighter Foods (91% increase in the year to end of March 2019), and stated at that time that it can sell whatever it has the capacity to make
- Refinanced a small portion of shareholder loans
- Appointed a new independent NED and executive director, further improving the governance of the company.

Two years ago, Real Good Food was the epitome of poor governance. But we believed the sum of the parts was greater than our entry value. It looked great in a spreadsheet and an investment paper. Governance could be remedied and surely the businesses divested and prioritised? Then reality met with the spreadsheet… What we got wrong - we underestimated the governance issues. We got the mix of potential value of the underlying businesses wrong. What we got right - the structure of our investment, with implied investor rights, allowed us to act quickly when we spotted the governance issues. We were correct in understanding that the businesses as a whole, were undervalued. We put in new management and the principal culprits departed. Under the tenure of Hugh Cawley as turnaround CEO, the fortunes have changed and so has the governance. Although still not perfect, given the number of shareholder directors, the balance is significantly in the hands of strong and capable independent directors, which ensures that the interests of all stakeholders are taken into account. We expect that Real Good Food will reward shareholders for their patience, and us as Investment Managers for our hard work in the short to medium term.

As for the portfolio as a whole, you can see from the portfolio statistics table below that we believe in the significant upside in the portfolio, which is now over 65% from where the market places us now. Our challenges are less to do with the underlying businesses, but more about getting them recognised. Fortunately, with a decent position in these companies, we have the ability to persuade and cajole management teams into adopting best of breed Investor Relationship strategies – if you don't tell people about a company, how can they value it and ultimately buy it?

Performance valuation statistics (as at 30 September 2019)	P/Book	P/earnings[1]	Margin of safety[2]	Upside[3]
Average	1.42	9.27	46.18%	106.66%
Median	1.20	10.22	48.42%	94.21%
Weighted average	1.45	8.19	32.60%	65.28%

[1] Normalised as: (Downing expected EBIT - (cost of debt * debt))* (1 - tax rate)
[2] 1 - (current price/intrinsic value). Intrinsic value = Downing estimate. Price from FactSet
[3] (Intrinsic value/current price). - 1. Intrinsic value = Downing estimate. Price from FactSet

Mifid II and Woodford have made our job harder when it comes to getting recognition for our flock. However, there are some great examples of why shareholder engagement should be adopted. One of the best examples, and an investment to which we would give a gold star, is AdEPT Technology Group ("AdEPT").

The AdEPT management team have embraced shareholder engagement by the heart; here are some of the initiatives they have put in place:

- New branding and website; excellent Investor Relations site
- Producing short video on live content at the time of the full year and interim results
- Engaging with private shareholders at Mello and other private investor events
- Writing a Chairman's Investor Letter
- Holding a Capital Markets Day.

What difference has that made? Well, it helped AdEPT weather the last two years, which saw the relevant FTSE index fall by circa 16%, while AdEPT experienced a 40% increase in its share price (at the time of writing).

We need to work harder and smarter with many of the rest of our existing portfolio to ensure that their Investor Relations strategies all have gold stars.

What do we expect from the next half-year? We cannot plan for how market sentiment will pan out, but we can help our niche, largely profitable and cash generative companies on their journey; supporting the management teams that are now in place and helping to improve governance across the board.

We aim to narrow the gap between our interpretation of the value of these businesses and that of the market. There may be some modest portfolio reshaping. However, our focus is on delivering returns to our shareholders from what we believe is a very attractive portfolio of quality and cheap positions. We believe there is over 65% upside in the portfolio. It will be (another) busy six months. Thank you for your patience.

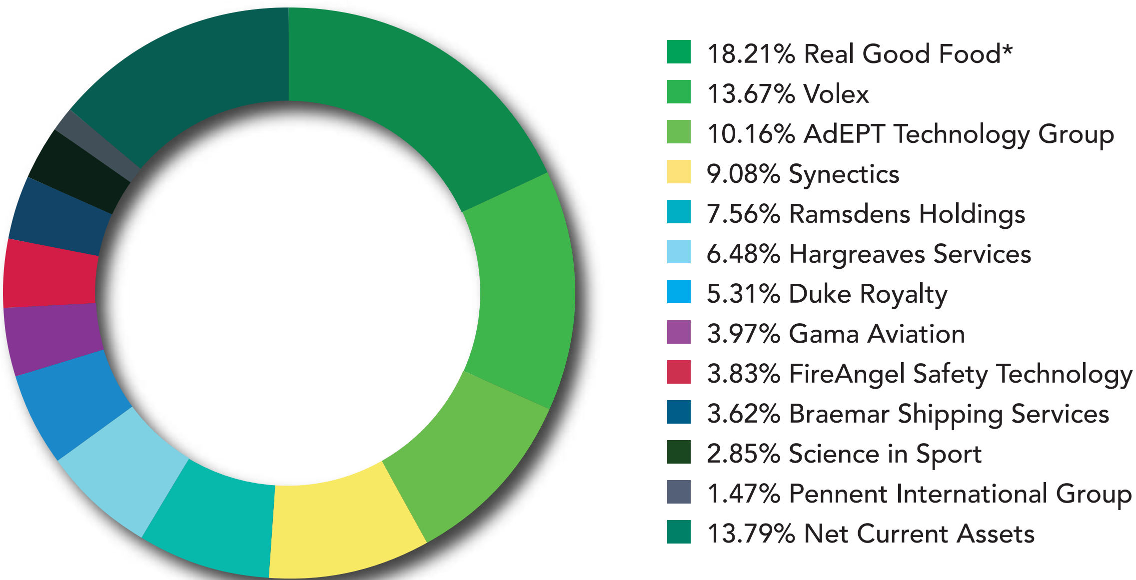
Judith MacKenzie
Partner and Head of Public Equity, Downing LLP
1 November 2019

Investment Portfolio

Holding	Market Value (£'000)	as at 31 August 2019 % of Total assets	as at 28 February 2019 % of Total assets
Real Good Food 10% Loan Note (29/06/2020)[1]	5,662	14.24	14.50
Volex	5,436	13.67	12.95
AdEPT Technology Group	4,040	10.16	8.76
Synectics	3,612	9.08	8.57
Ramsdens Holdings	3,007	7.56	6.30
Hargreaves Services	2,577	6.48	7.45
Duke Royalty	2,114	5.31	4.65
Gama Aviation	1,578	3.97	3.68
Fireangel Safety Technology	1,522	3.83	0.97
Braemar Shipping Services[2]	1,442	3.62	4.55
Real Good Food 12% 'C' Secured Guaranteed Loan Note (16/05/2021)[1]	1,232	3.10	2.88
Science in Sport	1,136	2.85	2.63
Pennant International Group	583	1.47	2.65
Real Good Food	345	0.87	0.77
Redhall Group	–	–	2.17
Redhall 12.8% Loan Note (01/10/2019)	–	–	1.69
Total Investments	34,286	86.21	85.17
Net current assets	5,485	13.79	14.83
Total assets	**39,771**	**100.00**	**100.00**

[1] Unquoted
[2] Quoted on the Main Market

All investments are in ordinary shares and traded on AIM unless indicated. The total number of holdings as at 31 August 2019 was 13 (28 February 2019: 13). Details of the equity interests comprising more than 3% of any company's share capital are set out in note 8.



Source: Downing

* Loan Notes represent 17.34% of the portfolio holding and equity 0.87%

Background to the investments

Key: GREEN: Good RED: Bad ORANGE: Neutral
(unless otherwise stated all information provided as at 31 August 2019)

AdEPT Technology Group PLC (AdEPT) (10.16% of net assets)
Cost: £3.63m. Value as at 31 August 2019, £4.04m.

Update to the investment case

- 12% increase in total dividends proposed for the year over the prior period
- Final results were positive, delivering an 11% increase to revenue, gross profit and underlying EBITDA for year ended 31 March 2019
- New NED, Richard Bligh appointed to the board
- Acquisition of ACS and debt facility increased to £40m to support acquisitive growth strategy

Progress against investment case

AdEPT is a quality business with attractive recurring revenue. Our investment case was predicated on the ability of management to acquire businesses at a good price, and the migration to become a managed service business. Managed services now account for 75% of total revenue. The full year results to March 2019 saw the board report a year of continued progress and delivery of its organic and acquisitive growth strategy. There was substantial growth across the group, alongside important acquisitions which have extended its geographic reach and the product range. AdEPT's latest acquisition is ACS Group, a well-established provider of IT services focused on the education sector. The acquisition is expected to be earnings enhancing from completion.

The extension to the banking facility provides flexibility for acquisitions going forward, however we are pleased that the company is keen to drive down the debt/EBITDA ratio which will prove their strong cash generative capabilities.

Braemar Shipping Services PLC (Braemar) (3.62% of net assets)
Cost: £2.07m. Value as at 31 August 2019, £1.44m.

Update to the investment case

- The first quarter was in line with management expectations and it is positive about the prospects for the remainder of the year
- The Shipbroking division has performed well
- Significant board changes to help drive long-term sustainable shareholder value
- Disposal of business lines within the Technical division

Progress against investment case

In the shipbroking division, newbuilding activity has been strong in recent months and has added to the forward order book. The group announced the completion of the disposal of three business lines within the Braemar Technical Services division (Offshore, Adjusting and Marine) to Aqualis ASA in exchange for a significant equity stake in the combined group. This allows the group to strengthen its focus on higher margin services and, as its largest shareholder, look forward to the development of AqualisBraemar and the growth of its investment in that business. The group is now well set to focus on the Shipbroking, Financial and Logistics businesses which have good prospects. We are encouraged that Ron Series, the new Chairman has begun to implement management changes.

Duke Royalty Limited (Duke) (5.31% of net assets)
Cost: £2.06m. Value as at 31 August 2019, £2.11m.

Update to the investment case

- **Final results released in September 2019 were positive; total income increased by 240%, operational cash flow increased by 1,500%**
- **Dividend increased by 7% quarter on quarter**
- **Revolving credit facility of £30 million, increased from the current level of £15 million**
- **New Royalty Agreements and follow-ons consistent with longer-term strategy**

Progress against investment case

Our investment case was predicated on the identification of suitable royalty partners and deployment of capital into these companies. Progress against this has been accelerated through the acquisition of Capital Step. In May, Duke announced a follow-on investment of £1.4 million into its royalty partner Welltel which represents the first follow-on investment that Duke has made into the portfolio recently acquired via Capital Step. Management believe the group has a strong pipeline of new opportunities and follow-on investments and although the political headwinds being felt in the UK mean uncertain times, near-term uncertainty makes the long-term nature of Duke's capital more attractive to business owners who require capital. Also, the predictability of its cash flow increases confidence for shareholders in times of volatility, a characteristic which ensures that royalty finance businesses are well positioned to weather economic and political headwinds. On 30 October 2019 the company announced that it had raised £17.5m in additional equity.

FireAngel Safety Technology PLC (FireAngel) (3.83% of net assets)
Cost: £3.82m. Value as at 31 August 2019, £1.52m.

Update to the investment case

- **Restructuring of balance sheet with £6m raise**
- **Significant board changes – CEO, Operations Director and NEDs**
- **Trading in line with revised expectations**
- **Further local council contract wins in Scotland**
- **Directors buying shares**

Progress against investment case

FireAngel, a manufacturer and distributor of home fire safety products, has faced a series of challenges over the period and in the last six months the company has gone through significant structural and management change. John Conoley moved to executive chairman following the departure of group CEO, Neil Smith, and Simon Herrick joined the board as a NED. In addition, we ensured that a £6 million open offer and placing was completed, and 'underwrote' 15 percentage of the raise, at what we believe was an attractive price. A trading update issued in September stated that the group has continued to make progress in repositioning the business during the first half of 2019. The board's focus over the next 18 months is on leveraging the investment made in differentiating FireAngel's technology and establishing the processes to deliver the large and more strategic opportunities this investment is opening up. That said, the completion of certain significant trials is now likely to take longer than originally expected which are likely to negatively impact the final results for 2019. However, the trials represent an important commercial validation of the group's strategy and investment in differentiating technology. The company will seek to execute on the range of opportunities it sees for gross margin progression in the short, medium, and long term.

Gama Aviation PLC (Gama) (3.97% of net assets)
Cost: £5.17m. Value as at 31 August 2019, £1.58m.

Update to the investment case

- **Interim results confirmed outlook for full year in line with previous guidance**
- **Directors buying shares**
- **Senior appointments – new Chairman, three new NEDs, new CFO**

Gama Aviation

Progress against investment case

There was significant newsflow in Gama over the period, which reflects the significant transformation taking place within the business. The degree of senior management change indicates that the existing governance was inadequate within the group – an issue that we underestimated when we invested. We have been pushing for change at board level for some time and unfortunately this took longer than anticipated. Simon To, Hutchison's representative, was appointed Chairman, alongside a number of other executive changes. 2019/2020 will be a year of transition for the business. The interim results give an indication of what the business is capable of and underline the initial positive impact of some of the strategic initiatives that have been implemented since the fundraise.

Hargreaves Services PLC (Hargreaves) (6.48% of net assets)
Cost: £3.65m. Value as at 31 August 2019, £2.58m.

Update to the investment case

- Latest preliminary results show underlying performance has been satisfactory
- £16.1m of exceptional provisions made against the insolvencies of British Steel and Wolf Minerals
- Conditional sales of first plots achieved at Blindwells
- Disposal of Brockwell Energy realised a £5.2m pre-tax profit

Progress against investment case

Hargreaves has had a mixed period. On the negative side, the company announced its material exposure to British Steel, which experienced difficulties. The board has made adequate provision against the deterioration in British Steel, and that of Wolf Minerals. More positively, the company announced the conditional sale of 10.75 acres of land at Blindwells, Edinburgh to Bellway. The transaction is valued at £9 million on completion of planning permission and approvals expected in 2020. This is a significant development on our investment thesis, demonstrating the viability of the NAV realisation of the land assets. The Blindwells site totals 390 acres and has planning permission for 1600 homes. By extracting capital from Hargreaves' UK mining activities, growth in the property business can be accelerated.

Pennant International Group PLC (Pennant) (1.47% of net assets)
Cost: £1.04m. Value as at 31 August 2019, £0.58m.

Update to the investment case

- Strong order book and pipeline
- Potential delay in significant contract award
- Directors buying shares
- Acquisitions strengthens offering
- Announcement of new contract wins

Progress against investment case

The company has a long trading history, great IP and accreditations. Chairman Simon Moore has invigorated the partly new management team and moved the company's culture and ambitions forward. Interim results announced in September show that trading in the first half was in line with management expectations and reused guidance issued by the company. In the period the group was focused on building a suite of generic training aids and, with this work being recognised as work-in-progress at the end of the period, a pre-tax loss of £1.8 million was recorded, in line with previous guidance. There have been a number of customer-driven timing challenges on specific projects however, the company's strategy is progressing to plan with two acquisitions already completed so far this year. The group is well-positioned to exploit its considerable pipeline which includes over £30 million of single-source opportunities. For us, the attraction of this company is that we think it can continue to invest and see a return above its cost of capital and while improving the quality and diversity of earnings of the business.

Ramsdens Holdings PLC (Ramsdens) (7.56% of net assets)
Cost: £2.62m. Value as at 31 August 2019, £3.00m.

Update to the investment case

- Trading update released in October 2019 – group profit performance in line with the board's expectations in the six months to 30 September 2019
- Acquisition of 22 Money Shop stores and 12 loan books from Instant Cash Loans
- Additional, non-recurring gross profit of approximately £600,00 reported
- The collapse of a large competitor highlights the importance of a highly-trusted customer proposition

Progress against investment case

Our investment case centres on management's ability to expand the estate at a rate of six new sites per year and drive organic growth from the existing estate across four diversified revenues streams. In the last six months, Ramsdens announced the acquisition of a total of 22 The Money Shop stores, and 12 loan books from Instant Cash Loans. We think that this consolidation adds a compelling growth element to the investment thesis on top of a business which has healthy organic growth and self-help margin opportunities. A recent trading update highlighted the group's positive performance in the first half of the year, which we think reflects the strength of its diversified income streams which offer resilience in what remains a challenging consumer environment.

Real Good Food PLC (Real Good Food) (including loan notes) (18.21% of net assets)
Cost: £8.75m. Value as at 31 August 2019, £7.24m.

Update to the investment case

- Investment in a new manufacturing line has almost doubled the capacity in Food Ingredients
- Shareholder debt remains high, but has now stabilised, and has been modestly reduced in recent months
- £0.3 million fine paid relating to failings of corporate governance in and prior to 2017
- Results to March 2020 to be 'significantly' ahead of prior period
- Enhanced terms on loan notes and increased redemption premium
- Board composition changed, as a part of the continuing process of making improvements to its governance regime

Real Good Food plc
Cake Decoration • Food Ingredients • Premium Bakery

Progress against investment case

The investment case was that the sum of the parts of the divisions was greater than the market capitalisation and enterprise value at our entry point, and this remains the case. Following a series of disposals, there are two remaining businesses, Brighter Foods and Renshaw. The expectation is for trading to be significantly ahead for the year to March 2020. The issues of recent years have largely been resolved. Although shareholder debt remains high, reflecting the historic issues of the group this has been modestly reduced in recent months.

Science in Sport PLC (SiS) (2.85% of net assets)
Cost: £1.50m. Value as at 31 August 2019, £1.13m.

Update to the investment case

- **Group revenue increased 150%, reflecting the first full six-month contribution from PhD**
- **SiS.com sales up 52% and PhD.com successfully relaunched in April 2019**
- **New highly experienced CFO appointed**
- **New product launches**

Progress against investment case

Science in Sport is currently investing heavily to fund strong revenue growth, with interim results for the six months to 30 June 2019 highlighting that group revenue increased to £24.87m, an increase of 150% over the prior year. This reflects the first full six-month contribution from PhD following its acquisition in December 2018. New product development remains a key growth driver for both brands, with new products delivering 32% of total group sales growth in the first half, with successful product launches including PhD's Smart Bar Plant and SiS's innovative range aimed specifically at footballers. Important milestones achieved in the first half include relaunching the PhD.com website, opening an e-commerce fulfilment facility and exploiting international distribution synergies, as well as the integration of teams across the SiS and PhD brands. We continue to believe that the combined entities could make an attractive portfolio of premium and high margin sports nutrition businesses to a strategic buyer.

Synectics PLC (Synectics) (9.08% of net assets)
Cost: £3.98m. Value as at 31 August 2019, £3.61m.

Update to the investment case

- **Multiple contract wins, latest a major European Transport Infrastructure project**
- **Interim results to 31 May 2019 in line with market expectations**
- **Directors buying shares**
- **Disappointing delay to contracts in the second half. Profits downgrade**

Progress against investment case

The company experienced a number of new contract wins in the first half of the year. These included a multi-million euro contract with a subsidiary of Deutsche Bahn AG, which is responsible for delivering and modernising rail provision in Berlin. Other notable wins were a multi-million dollar contract from a new customer in the gaming sector, and the largest new oil & gas order received by the group for a number of years. Less positively, the current financial year has shown a continuation of the trends in Synectics' markets - the global gaming security and surveillance sector continues to perform strongly, but new business in other sectors has been generally quite subdued. In the UK, in particular, the group has experienced a pattern of order deferrals and, in some cases, customer-led delays in the progress of existing contracts, which we believe is at least partly down to uncertainties related to the Brexit situation. The effect of these recent deferrals and delays is that profits will now move into 2020.

Volex PLC (Volex) (13.67% of net assets)
Cost: £4.78m. Value as at 31 August 2019, £5.43m.

Update to the investment case

- **Volex continues to perform well ahead of our expectations**
- **Jeffrey Jackson appointed as a non-executive director**
- **Acquisitions of Servatron and Ta Hsing**
- **Refinancing of the group's US$30 million revolving credit facility**
- **Management continue to buy shares**

Progress against investment case

Volex announced a positive set of financial results in June, following the transformational placing undertaken last year. Progress is continuing in improving operating margins across divisions. Power cords reported 6.7% operating margins, having been around 2% since new management took over and cable assemblies reported operating margins of 7.8%. We are confident that management will achieve the respective targets of 8% and 10%. We believe that organic growth is recovering, alongside an active acquisition strategy with Ta Hsing and Servatron being the most recent purchases. In our view, the shares remain significantly underappreciated, granted, there is some uncertainty around US and China tariffs, but Volex has mitigating strategies in place. The business is growing organically; it is able to grow inorganically at a reasonable price, and; it is generating considerable cash, with over $10 million of free cash flow in the second half of 2019 alone. Finally, management expect to be able to return to the dividend list at the interim and we expect a maiden distribution for the year of three cents per share. We think that there are numerous positive catalysts for the share price over the short term.

Our Expectations of the Investee Companies

When we invest in companies we expect, in return, rigorous and effective corporate governance; directors who understand their duties and who are familiar with The General Duties section of the Companies Act 2006, the UK Corporate Governance Code of 2018 from the Financial Reporting Council, the QCA Corporate Governance Code of 2018 and even, perhaps, the simpler Wates Corporate Governance principles of 2018.

- **Directors' responsibilities:** in our view directors' responsibilities are demanding. They stand accountable for the culture, foresight and success of the company, to which they should apply the best of their knowledge and ability to enquire and act in the interests of the company as a whole for its current and future shareholders and stakeholders. A company's success depends on investment in its long-term, sustainable advantage as well as its financial strength and profitability. A company's return on investment underpins its shareholders' returns.

- **Constructive challenge:** we look for alert, questioning, competent boards that constructively challenge management, help develop strategy and long-term objectives, monitor performance, ensure the build-up of necessary assets, skills and capable management and lead in setting a culture of integrity. We will take action if we do not find that level of competence.

  In particular we would expect to find:

- **Leadership:** every investee company should be headed by an independent Chairman leading an effective, questioning, challenging board that sees itself as collectively responsible for the long-term success of the company. We will encourage that if it is missing. We will say so publicly if we do not think the Chairman is up to the job.

- **Effectiveness:** the board and its committees should be engaged with the business and have the skills, experience, independence and knowledge to enable them to challenge constructively and fully undertake their duties. It should be clear to investors why each director is on the board, what skills and contribution that director is there to provide and all directors and senior management should regularly update and refresh their skills and knowledge. There should be a rigorous process for the appointment of new directors.

- **The Chairman:** should lead the board, create the conditions for overall board and individual director effectiveness, ensure that the board gets information in a form and of a quality sufficient to discharge its duties and should undertake a formal annual evaluation of the board and each director's performance.

- **Accountability:** we expect all directors to appreciate that accountability for culture, integrity, the 'tone from the top', the creation of value, of corporate and shareholder value, and the company's success lies with them.

  As to management: we would expect to find:

- Leadership and anticipation
- A balanced, competent team
- Informational grip followed by "make your numbers!"
- Strategy
- A very strong ethical code
- Health, safety and responsible business targets

It is with those expectations of the boards of directors and management that we invest.

Condensed Statement of Comprehensive Income

for the six months ended 31 August 2019

	(Unaudited) Six months ended 31 August 2019			(Unaudited) Six months ended 31 August 2018			(Audited) for the year ended 28 February 2019		
	Revenue £'000	**Capital £'000**	**Total £'000**	Revenue £'000	Capital £'000	Total £'000	Revenue £'000	Capital £'000	Total £'000
Losses on investments at fair value through profit or loss	**–**	**(921)**	**(921)**	–	(2,988)	(2,988)	–	(10,725)	(10,725)
Investment income (note 3)	**793**	**–**	**793**	658	–	658	1,326	–	1,326
	793	**(921)**	**(128)**	658	(2,988)	(2,330)	1,326	(10,725)	(9,399)
Investment management fee (note 4)	**(39)**	**(155)**	**(194)**	(50)	(205)	(255)	(95)	(380)	(475)
Other expenses	**(193)**	**(2)**	**(195)**	(207)	–	(207)	(395)	–	(395)
	(232)	**(157)**	**(389)**	(257)	(205)	(462)	(490)	(380)	(870)
Profit/(loss) before taxation	**561**	**(1,078)**	**(517)**	401	(3,193)	(2,792)	836	(11,105)	(10,269)
Taxation	**–**	**–**	**–**	–	–	–	–	–	–
Profit/(loss) for the period	**561**	**(1,078)**	**(517)**	401	(3,193)	(2,792)	836	(11,105)	(10,269)

	Revenue (p)	**Capital (p)**	**Total (p)**	Revenue (p)	Capital (p)	Total (p)	Revenue (p)	Capital (p)	Total (p)
Earnings/(loss) per Ordinary Share (note 5)	**1.02**	**(1.96)**	**(0.94)**	0.72	(5.74)	(5.02)	1.50	(19.97)	(18.47)

The total column of this statement represents the Statement of Comprehensive Income of the Company prepared in accordance with International Financial Reporting Standards ('IFRS') as adopted by the European Union.

The supplementary revenue and capital return columns are prepared under guidance published by the Association of Investment Companies ('AIC').

All items in the above statement derive from continuing operations. No operations were acquired or discontinued during the period.

Condensed Statement of Changes in Equity

for the period ended 31 August 2019

	Share capital £'000	Special reserve £'000	Capital reserve £'000	Revenue reserve £'000	Total £'000
Six months ended 31 August 2019 (Unaudited)					
At 28 February 2019	**56**	**54,506**	**(13,911)**	**824**	**41,475**
Profit/(loss) for the period	**–**	**–**	**(1,078)**	**561**	**(517)**
Cancellation of shares	**(1)**	**(495)**	**–**	**–**	**(496)**
Dividends paid	**–**	**–**	**–**	**(691)**	**(691)**
At 31 August 2019	**55**	**54,011**	**(14,989)**	**694**	**39,771**
Six months ended 31 August 2018 (Unaudited)					
At 01 March 2018	56	54,506	(2,806)	(12)	51,744
Profit/(loss) for the period	–	–	(3,193)	401	(2,792)
Dividends paid	–	–	–	–	–
At 31 August 2018	56	54,506	(5,999)	389	48,952
For the year ended 28 February 2019 Audited					
At 01 March 2019	56	54,506	(2,806)	(12)	51,744
Profit/(loss) for the year	–	–	(11,105)	836	(10,269)
Dividends paid	–	–	–	–	–
At 28 February 2019	56	54,506	(13,911)	824	41,475

Condensed Statement of Financial Position

as at 31 August 2019

	(Unaudited) 31 August 2019 £'000	(Unaudited) 31 August 2018 £'000	(Audited) 28 February 2019 £'000
Non-current assets			
Investments held at fair value through profit or loss	**34,286**	40,167	35,326
	34,286	40,167	35,326
Current assets			
Trade and other receivables	**1,529**	410	740
Cash and cash equivalents	**4,090**	8,491	5,504
	5,619	8,901	6,244
Total assets	**39,905**	49,068	41,570
Current liabilities			
Trade and other payables	**(134)**	(116)	(95)
	(134)	(116)	(95)
Total assets less current liabilities	**39,771**	48,952	41,475
Net Assets	**39,771**	48,952	41,475
Represented by:			
Share capital	**55**	56	56
Special reserve	**54,011**	54,506	54,506
Capital reserve	**(14,989)**	(5,999)	(13,911)
Revenue reserve	**694**	389	824
Equity shareholders' funds	**39,771**	48,952	41,475
Net asset value per Ordinary Share (note 6)	**72.47p**	88.04p	74.59p

Hugh Aldous
Chairman
1 November 2019

Condensed Statement of Cash Flow
for the six months ended 31 August 2019

	(Unaudited) Six months ended 31 August 2019 £'000	(Unaudited) Six months ended 31 August 2018 £'000	(Audited) For the year ended 28 February 2019 £'000
Operating activities			
Loss before taxation	**(517)**	(2,792)	(10,269)
Losses on investments at fair value through profit or loss	**921**	2,988	10,725
Increase in other receivables	**(365)**	(296)	(626)
Increase/(decrease) in other payables	**39**	(1,819)	(24)
Purchases of investments	**(969)**	(10,294)	(15,006)
Sales of investments	**664**	–	–
Net cash outflow from operating activities	**(227)**	(12,213)	(15,200)
Financing activities			
Cancellation of Ordinary Shares	**(496)**	–	–
Dividends paid	**(691)**	–	–
Net cash outflow from financing activities	**(1,187)**	–	–
Change in cash and cash equivalents	**(1,414)**	(12,213)	(15,200)
Cash and cash equivalents at start of period	**5,504**	20,704	20,704
Cash and cash equivalents at end of period	**4,090**	8,491	5,504
Comprise of:			
Cash and cash equivalents	**4,090**	8,491	5,504

Notes to the Condensed Financial Statements
as at 31 August 2019

1. Principal Activity
The company was incorporated in England and Wales on 17 February 2017 with registered number 10626295, as a closed-ended investment company.

The principal activity of the company is that of an investment trust within the meaning of section 1158 of the Corporation Tax Act 2010.

2. General Information
The unaudited financial statements for the six months to 31 August 2019 have been prepared using the same accounting policies set out in the company's financial statements for the year ended 28 February 2019 which were prepared in accordance with International Financial Reporting Standards ('IFRS') as adopted by the European Union ('EU') and with International Accounting Standard 34, 'International Financial Reporting'.

Insofar as the Statement of Recommended Practice ('SORP') for investment trust companies and venture capital trusts issued by the Association of Investment Companies ('AIC'), issued in November 2014 and updated in February 2018 with consequential amendments is compatible with IFRS, the financial statements have been prepared in accordance with guidance set out in the SORP.

The financial information in this half-yearly report does not constitute statutory accounts as defined in section 434 of the Companies Act 2006. The financial information for the six months ended 31 August 2019 and for the period ended 31 August 2018 has not been audited.

The information for the year ended 28 February 2019 has been extracted from the latest published audited financial statements which have been filed with the Registrar of Companies. The report of the auditors on those financial statements was unqualified and did not include a statement under sections 498(2) or 498(3) of the Companies Act 2006.

The financial statements are presented in sterling (£) and all values are rounded to the nearest thousand, except where otherwise stated.

3. Investment Income

	(Unaudited) Six months ended 31 August 2019 £'000	(Unaudited) Six months ended 31 August 2018 £'000	(Audited) For the year ended 28 February 2019 £'000
Income from listed investments			
UK dividend income	**417**	349	633
UK fixed interest income	**376**	309	693
Total	**793**	658	1,326

Notes to the Condensed Financial Statements
continued

4. Investment management fee

	(Unaudited) Six months ended 31 August 2019 £'000	(Unaudited) Six months ended 31 August 2018 £'000	(Audited) For the year ended 28 February 2019 £'000
Investment management fee			
Revenue	**39**	50	95
Capital	**155**	205	380
Total	**194**	255	475

5. Earnings/(loss) per Ordinary Share

	(Unaudited) Six months ended 31 August 2019		(Unaudited) Six months ended 31 August 2018		(Audited) For the year ended 28 February 2019	
	Net return £'000	**Per share pence**	Net return £'000	Per share pence	Net return £'000	Per share pence
Revenue return	**561**	**1.02**	401	0.72	836	1.50
Capital return	**(1,078)**	**(1.96)**	(3,193)	(5.74)	(11,105)	(19.97)
Total return	**(517)**	**(0.94)**	(2,792)	(5.02)	(10,269)	(18.47)
Weighted average number of Ordinary Shares		**55,245,682**		55,600,002		55,600,002

6. Net Asset Value per Ordinary Share

NAV per Ordinary Share is based on net assets at the period end and 54,880,002 (31.08.2018: 55,600,002, 28.02.2019: 55,600,002) Ordinary Shares, being the number of Ordinary Shares in issue at the period end.

	(Unaudited) 31 August 2019		(Unaudited) 31 August 2018		(Audited) 28 February 2019	
	NAV per share pence	**NAV attributable £'000**	NAV per share pence	NAV attributable £'000	NAV per share pence	NAV attributable £'000
Ordinary Shares:						
Basic and diluted	**72.47**	**39,771**	88.04	48,952	74.59	41,475

Notes to the Condensed Financial Statements
continued

7. Fair Value Hierarchy

Financial assets and financial liabilities of the company are carried in the Statement of Financial Position at their fair value. The fair value is the amount at which the asset could be sold or the liability transferred in a current transaction between market participants, other than a forced or liquidation sale. For investments actively traded in organised financial markets, fair value is generally determined by reference to Stock Exchange quoted market bid prices and Stock Exchange Electronic Trading Services ('SETS') at last trade price at the Statement of Financial Position date, without adjustment for transaction costs necessary to realise the asset.

The company measures fair values using the following hierarchy that reflects the significance of the inputs used in making the measurements. Categorisation within the hierarchy has been determined on the basis of the lowest level input that is significant to the fair value measurement of the relevant assets as follows:

Level 1 – Quoted prices (unadjusted) in active markets for identical assets or liabilities.

An active market is a market in which transactions for the asset or liability occur with sufficient frequency and volume on an ongoing basis such that quoted prices reflect prices at which an orderly transaction would take place between market participants at the measurement date. Quoted prices provided by external pricing services, brokers and vendors are included in Level 1, if they reflect actual and regularly occurring market transactions on an arm's length basis.

Level 2 – Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices).

Level 2 inputs include the following:

- quoted prices for similar (i.e. not identical) assets in active markets;
- quoted prices for identical or similar assets or liabilities in markets that are not active. Characteristics of an inactive market include a significant decline in the volume and level of trading activity, the available prices vary significantly over time or among market participants or the prices are not current;
- inputs other than quoted prices that are observable for the asset (for example, interest rates and yield curves observable at commonly quoted intervals); and
- inputs that are derived principally from, or corroborated by, observable market data by correlation or other means (market-corroborated inputs).

Level 3 – Inputs for the asset or liability that are not based on observable market data (unobservable inputs).

The level in the fair value hierarchy within which the fair value measurement is categorised in its entirety is determined on the basis of the lowest level input that is significant to the fair value measurement in its entirety. If a fair value measurement uses observable inputs that require significant adjustment based on unobservable inputs, that measurement is a Level 3 measurement. Assessing the significance of a particular input to the fair value measurement in its entirety requires judgement, considering factors specific to the asset or liability.

Notes to the Condensed Financial Statements

continued

7. Fair Value Hierarchy continued

31 August 2019 (unaudited)	Level 1 £'000	Level 2 £'000	Level 3 £'000	Total £'000
Quoted on the Main Market	**1,442**	**–**	**–**	**1,442**
Traded on AIM	**25,950**	**–**	**–**	**25,950**
Unquoted Loan Notes	**–**	**–**	**6,894**	**6,894**
	27,392	**–**	**6,894**	**34,286**

31 August 2018 (unaudited)	Level 1 £'000	Level 2 £'000	Level 3 £'000	Total £'000
Quoted on the Main Market	2,522	–	–	2,522
Traded on AIM	30,436	–	–	30,436
Unquoted Loan Notes	–	–	7,209	7,209
	32,958	–	7,209	40,167

28 February 2019 (audited)	Level 1 £'000	Level 2 £'000	Level 3 £'000	Total £'000
Quoted on the Main Market	1,889	–	–	1,889
Traded on AIM	25,528	–	–	25,528
Unquoted Loan Notes	–	–	7,909	7,909
	27,417	–	7,909	35,326

There were no transfers between Level 1 and Level 2 during the period.

A reconciliation of fair value measurements in Level 3 is set out in the following table.

	(Unaudited) 31 August 2019 £'000	(Unaudited) 31 August 2018 £'000	(Audited) 28 February 2019 £'000
Opening balance	**7,909**	5,749	5,749
Purchases	**36**	1,460	2,160
Sales	**(381)**	–	–
Total gains or losses included in losses on investments in the statement of comprehensive income:			
– on assets sold	**30**	–	–
– on assets held at period end	**(700)**	–	–
Closing balance	**6,894**	7,209	7,909

Notes to the Condensed Financial Statements
continued

8. Significant Interests

The company held interests amounting to 3% or more of the equity of the following investee companies as at 31 August 2019:

	31 August 2019	28 February 2019
	% of the equity of the investee company held	
AdEPT Technology Group	**4.8**	4.8
Braemar Shipping Services	**2.4**	3.4
FireAngel Safety Technology	**8.4**	3.7
Gama Aviation	**3.4**	3.5
Hargreaves Services	**3.3**	3.3
Ramsdens Holdings	**5.1**	5.1
Real Good Food	**5.3**	5.3
Synectics	**10.8**	10.8
Volex	**4.2**	4.3

9. Related Party Disclosure: Directors' Emoluments

The board consists of three non-executive directors. All are considered by the board to be independent of the investment manager. None of the directors has a service contract with the company. The Chairman receives an annual fee of £35,000, the Chairman of the Audit Committee receives an annual fee of £30,000 and all other directors receive £25,000.

As at 31 August 2019 the amount outstanding in respect of directors fees was nil (28 February 2019: nil).

At the period end, the interests of the directors in the Ordinary Shares of the company were as follows:

	31 August 2019	28 February 2019
Hugh Aldous (Chairman)	**200,000**	145,091[1]
Andrew Griffiths	**n/a[2]**	26,161
Robert Legget	**–**	n/a[4]
Stephen Yapp	**n/a[3]**	100,500
Linda Bell	**20,386**	–

[1] includes 19,791 shares held by Mrs Aldous.
[2] ceased to be a director on 11 October 2019.
[3] ceased to be a director on 31 August 2019.
[4] appointed as a director on 22 July 2019.

There were no changes in the directors' interests between the period end and the date of this report.

Interim Management Report

The directors are required to provide an interim management report in accordance with the UK Listing Authority's Disclosure and Transparency Rules ('DTR'). They consider that the Chairman's statement and the investment manager's report on pages 3 to 7 of this half-yearly report, the following statements on principal risks and uncertainties; related party transactions; and going concern, together with the directors' responsibility statement below together constitute the interim management report for the company for the period ended 31 August 2019.

The company is required to make the following disclosures in its half-yearly report.

Principal Risks and Uncertainties
The principal risks faced by the company fell into the following broad categories: investment performance; operational; financial; and legal and compliance. The board reported on the principal risks and uncertainties faced by the company in the annual report for the year ended 28 February 2019. Information on each of these area can be found in the strategic report on pages 29 and 30 and in note 14 on page 70 to 72 of the annual report available on the company's website at www.downing.co.uk/strategic.

Related Party Transactions
During the first six months of the current financial year, no transactions with related parties have taken place which have materially affected the financial position of the performance of the company during the period.

Going Concern
The directors, having considered the company's investment objective, risk management policies, the nature of the portfolio and the company's income and expenditure projections, are satisfied that the company has adequate resources to continue in operational existence for the foreseeable future. For these reasons, they continue to adopt the going concern basis in preparing the accounts.

Directors' Responsibility Statement

The directors confirm that to the best of their knowledge:

a) the condensed set of financial statements, contained within the half-yearly financial report has been prepared in accordance with International Accounting Standard 34 "Interim Financial Reporting";

b) the interim management report includes a fair review information required by the DTR 4.2.7R and 4.2.8; and

The half-yearly financial report for the six months ended 31 August 2019 has not been audited or reviewed by the auditors.

The half-yearly financial report was approved by the board on 1 November 2019 and the responsibility statement was signed on the board's behalf by Hugh Aldous, Chairman of the board.

Hugh Aldous
Chairman
1 November 2019

Directors and Advisors

Directors
Hugh Aldous (Chairman)
Linda Bell
Robert Legget (appointed 22 July 2019)

Company Secretary & Administrator
Maitland Administration Services Limited
Hamilton Centre
Rodney Way
Chelmsford
Essex
CM1 3BY
Telephone: 01245 398950

Solicitor
Stephenson Harwood
1 Finsbury Circus
London
EC2M 7SH
United Kingdom

Broker
Shore Capital
Cassini House
57 St James's Street
London
SW1A 1LD
United Kingdom

Investment Manager
Downing LLP
6th Floor
St Magnus House
3 Lower Thames Street
London
EC3R 6HD
Telephone: 0207 4167780

Registrar
Computershare Investor Services PLC
The Pavilions
Bridgwater Road
Bristol
BS99 6ZZ
United Kingdom
Telephone: 0370 7071358

Custodian
The Northern Trust Company
50 Bank Street
Canary Wharf
London
E14 5NT
United Kingdom

Auditor
Grant Thornton UK LLP
30 Finsbury Square
London
EC2P 2YU
United Kingdom

Shareholder Information

Financial Calendar

Company's year end	28 February
Annual results announced	1 May
Annual General Meeting	25 June
Company's half-year end	31 August
Half-yearly results announced	late October/early November

Share Price and NAV

The company's ordinary shares are listed on the main market of the London Stock Exchange. The market price of these shares can be found in the London Stock Exchange Daily Official List and in the Financial Times. The company's NAV is published daily.

Share Dealing

Shares can be traded through your usual stockbroker.

Website

Further information on the company can be accessed via the company's website. The address is: www.downing.co.uk/strategic

Shareholder Enquiries

The company's registrar is Computershare Investor Services plc. To gain access to your account online through the Computershare investor centre website the website address is investorcentre.co.uk. To gain access you will need your shareholder reference number. Alternatively Computershare can be contacted on 0370 702 0000. Changes of name and/or address must be notified in writing to Computershare at the address provided on page 27.

Company Information

Downing Strategic Micro-cap Investment Trust plc is an investment company as defined under section 833 of the Companies Act 2006 and is a member of the Association of Investment Companies.

This document has
been printed on 100%
recycled paper

Downing