



Downing Strategic Micro-Cap Investment Trust

Launched
May
2017

Judith MacKenzie
Lead manager

Given the difficulty of buying and selling the very smallest UK companies, many investors have long preferred to use investment trusts over open-ended funds when it comes to holding this segment of the market.

Launched in May 2017, the Downing Strategic Micro-Cap Investment Trust (DSM) invests in UK listed companies that typically have a market capitalisation of below £150 million which are trading at a significant discount to their intrinsic value. The managers identify strategic catalysts which can close the gap between the current and intrinsic value of these businesses, engaging with management teams to close the valuation gap.

Lead manager and founder of Downing Fund Managers, Judith MacKenzie, explains how the trust invests and what makes it different to its competitors.

A strategic take on micro caps

Describing the investment process as almost unique, Judith says the investment team managing DSM take strategic stakes in the companies they invest in, owning between 3-25% of the underlying business.

“Taking large, influential positions in these companies allows us to actively engage with management teams and work with them constructively to realise value,” she says. “The micro-cap space provides an excellent hunting ground for bottom-up stock pickers and many of the companies that we invest in are not on the radar of other managers. It is often not a quick fix to turn these businesses round though, we are long-term strategic partners with an investment horizon of between three and seven years.”

As a result, the trust adopts a focused approach, investing in between 12 to 18 holdings. Judith notes that this marks it out as quite different to its peer group. “We take strategic stakes of influence and are looking for a change catalyst which can generate shareholder value. We are very focused and highly engaged.”

Trust aims to hold 3-25% equity of investee companies

The case for value

Investors like to compare and contrast the performance of value and growth strategies, the former having returned to favour in late 2020, and the latter outperforming for much of the last decade. With this in mind, Judith notes that the value approach adopted by DSM is different to mainstream funds.

“We typically look for unloved businesses which combine an earnings recovery in the short term, with longer term earnings growth. Recovering businesses often trade at significantly depressed multiples to earnings, thus we can combine earnings growth with multiple expansion to achieve market beating returns.”

Holdings in the portfolio: 12-18

Private equity approach

By proactively engaging with, and working alongside aligned management teams to drive returns, Judith says the micro-cap philosophy at Downing Fund Managers is very much a private equity style approach.

“It is very much a hands-on, high maintenance approach involving everything from helping a company put together an acquisition strategy, refinancing their debt, promoting improved corporate governance and board structure, or identifying opportunities to dispose of non-core operations to drive synergies and efficiencies over the long term.”

When it comes to this type of investing, Judith admits that there is somewhat of a J-curve, meaning a dip to begin with before things start to improve. “We are investing in a largely unloved area where we can find companies that are fundamentally undervalued by the market. We’re not afraid to put in the hard yards that it takes to turn things around and ultimately realise value for shareholders.”

For more information about the Downing Strategic Micro-Cap Investment Trust

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“It involves everything from helping a company put together an acquisition strategy, refinancing their debt, buying out older shareholders, or restructuring a board

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