



Results analysis: Downing Strategic MicroCap

DSM has outperformed the AIM index again...

Update
10 May 2023

- In the full year to 28/02/2023, Downing Strategic MicroCap (DSM) reported a NAV decrease of 8.7% and a 9.7% decrease in the share price, outperforming the FTSE AIM All-Share TR index over the period, which fell 17.4%
- This marked the third consecutive year of outperformance for the trust, as several of its investments reach maturity
- A couple of headline realisations over the period, including one sale at a 74.8% premium to the share price, demonstrated the DSM investment case, which seeks out mispriced companies with clear improvement potential
- The managers believe that small caps' ability to be nimble will prove fertile over the coming year despite challenging conditions, with the trust's portfolio holdings largely holding cash on their balance sheets
- The trust currently sits on a discount of -15.5% as small caps more broadly remain out of favour in a rising rate environment

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Kepler View

Downing Strategic Micro-Cap (DSM) has published another set of strong results, outperforming both the AIM and FTSE Small Cap indices for the third year running. Having consistently touted the long-term potential of its investments – with the investment case across the board generally focused on realising value over time as a result of improvement stories – the trust's strategy appears to now be proving its effectiveness over a challenging market cycle. DSM has a concentrated portfolio of between 12-18 holdings, aiming to invest in companies that are over-looked by other investors.

Notable highlights during the year include the acquisition of AdEPT by Macquarie Group subsidiary Wavenet Group at a premium of 74.8% to the closing price on 07/02/2023. This process was at least in part driven by DSM's managers, Judith Mackenzie and Nick Hawthorn, with the pair believing that AdEPT would struggle to improve the multiple it was trading on given the significant debt on its balance sheet.

Other highlights in a portfolio focused on idiosyncratic opportunities include a 23.9% rise in the share price of Centaur Media over the period, despite an apparently challenging environment for media-oriented businesses. Judith and Nick believe the business has potential to grow further in 2023, with a strong balance sheet allowing for further distributions to shareholders. Elsewhere, Ramsdens, a long-term holding for the trust, has recovered most of the significant losses it experienced during the COVID-19 pandemic.

All this good news aside, the NAV fell by 8.7% over the year, as small caps generally suffered from a perception of riskiness in a rising rate environment. Within the portfolio, the companies that suffered most were FireAngel, as a result of supply chain issues impacting delivery, and DigitalBox, where headwinds for ad spending caused market sentiment to decline dramatically. Despite the latter falling 42.3% in the period, Judith and Nick believe its management team have proven adept at handling



changing conditions for online ad spend, in particular evolving social media algorithms. Judith and Nick believe FireAngel should eventually be part of a much larger entity, who could benefit from the IP and its dominant market position.

Looking forward, the managers say that there is significant potential for earnings upgrades in many of the trust's 10 largest portfolio holdings over the next 12-24 months. These come from mixed sources, including latent COVID recovery and improving online and digital offerings from several portfolio companies. The team provide a detailed explanation on the investment case for each of their holdings in the announcement, accessible via the link below. With acquirers circling the UK, further M&A is likely.

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