



# Results analysis: Downing Strategic MicroCap

DSM's wind-down could unlock the value in its portfolio...

Update  
16 November 2023

- Downing Strategic MicroCap (DSM) has released its half-year financial report for the period ending 31/08/2023. Over the six-month period, the trust saw its NAV decrease by 8.2% on a total return basis, which compares to a 12.8% decrease in the FTSE AIM All-Share Index in the same period.
- M&A has continued to feature in the period, with two portfolio companies being taken out in the past six months which has contributed to returns. When these are combined with the companies undertaking strategic reviews, there is now over 20% of net portfolio assets with agreed bids or under review which should contribute to capital returns.
- The managers have identified numerous potential catalysts which could improve the intrinsic value of the portfolio companies, such as companies undertaking strategic reviews, seeing an improvement in earnings and M&A.
- However, after a number of years of unrealised potential, and with investor appetite for micro cap stocks being low, the board has announced a planned wind down. A redemption option had been planned for May 2024, but the board have decided a journey towards a full redemption will be a better way of unlocking value in the trust. The first return to shareholders of at least 20% of the portfolio is expected to come in early 2024.
- Chairman Hugh Aldous said, “Most of DSM’s portfolio is performing well and more is ripe for M&A or rerating”, but despite this ongoing uncertainty means he “has concluded that it would advantage all shareholders equally and fairly to commence a managed wind down of the company’s investment portfolio in an orderly manner”.

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Judith and Nick highlight that two holdings received bids in the period and another has announced a strategic review. We understand these will likely make up the first capital repayment of c. 20%. Before the announcement, the shares traded at a 17.8% discount to NAV. We believe this approach of selling the ‘low-hanging fruit’ should offer investors a near-term boost of a well-defined capital return in the interim, at a price that is likely to be much closer to NAV than the shares currently trade at, with the potential for future returns as the wind down process continues.

The managers also highlight positive performance from a number of holdings. Examples include Volex plc which rose 44% in the period which benefitted the trust as the managers had recently added to the position. Similarly, Journeo rose c. 38% thanks to an acquisition DSM helped fund and a new director they appointed. We believe this demonstrates the potential in the portfolio which could contribute to further returns going forward, though clearly returns from this point on will be primarily led by exit values achieved.

## Kepler view

Managers Judith Mackenzie and Nick Hawthorn have released, in our opinion, a bittersweet half-yearly annual report for **Downing Strategic MicroCap (DSM)**. On the one hand, they have delivered another period of outperformance from their concentrated portfolio of companies at the smallest end of the market cap spectrum. However, they also acknowledge the ongoing headwinds towards the sector mean that the prospects for their holdings are unlikely to be fulfilled in the foreseeable future. As such, they believe shareholders will be best served by a winding up of the trust and a returning of capital to shareholders.



Going forward, we believe this means the discount could be seen as attractive. While it will take some time to wind up the portfolio, and markets could move in the interim, there is the scope for periodic distributions at or near NAV. Furthermore, there is still potential for Judith and Nick to deliver value for shareholders through their active approach. We appreciate it may take some time to fully realise the value in the portfolio, as by the managers own admission, the UK remains out of favour and is therefore deeply undervalued, but this wind down approach could deliver strong returns if the managers achieve exits close to the current value in the NAV.

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