VT Downing Small & Mid-Cap Income Fund
Quarterly Commentary – June 2025

The second quarter saw somewhat of a reversal of the first quarter, with UK small cap relative underperformance switching to relative outperformance. The fund delivered +11.11% in the period, outperforming both the +7.78% for the IA UK Equity Income sector and +10.40% for the IA UK Smaller Companies sector.

Whilst it was pleasing to see UK small caps stage a recovery from a low base, we remain cautious on the macro environment. Yes, Donald Trump's "Liberation Day" tariffs implementation has been delayed but their threat hasn't been completely removed. Our sceptical side is beginning to consider that now the "Big Beautiful Bill" has passed, the likelihood of tariffs being removed or severely reduced is limited, given that part of this fiscal expansion is to be funded by increased tariff revenue. From a UK perspective, securing a trade deal with the US is a positive step, and reassuringly, the UK economic data has continued to largely surprise on the upside (albeit against low expectations). However, it hasn't been all plain sailing for companies. There have been mixed results across the market, with some notable impacts from tariff uncertainty in some sectors. The resulting volatility is creating compelling opportunities for active managers. Most notably, the FTSE AIM market is up >20% from its April low, and we have seen a strong contribution to performance from our AIM holdings, adding c.3.5% to performance from only c.20% fund exposure. There were also notable performances from two new AIM holdings we added in Q1; Brooks Macdonald and Quartix Technologies.

We expect a degree of uncertainty and volatility as we pass through the remainder of the year. But, as ever, we will continue to look for compelling value opportunities when they present themselves. Interestingly, some of the new ideas we are working on currently include companies that have previously been out of scope based on valuation grounds, which are now looking just as compelling as ever.

The winners

The top contributor to performance in the period was Kitwave, a food wholesaler to independent retailers and foodservice distributor. The group released a half-year trading update where results were expected to be in line with guidance, despite a relatively difficult trading environment. Just post the June period end, these views were tempered by the company as softer trading continued through the typically busier summer months in May and June, with volumes similar to last year but with consumers trading down with their spend. Management noted competitors of its recently acquired Creed business began tendering for Creed customers with aggressive pricing, forcing Creed to fix prices for six months to secure customers despite suppliers pushing through price increases. This coincided with some operational issues relating to ramping up their new Southwest distribution centre, with management investing more to maintain customer service. Management highlighted that they could have traded out of one or two of these headwinds, but couldn't completely offset all three at once. Therefore, the share price gave up all of its gains from Q2. After speaking to management and from our own industry due diligence, we believe the Southwest distribution centre issue and competitive tenders are temporary problems that have largely passed. We see this as an opportunity and have bought more shares at a discounted valuation based on lowered earnings this year. We believe the future opportunity with the inclusion of Creed is still significant.

Galliford Try, a contractor in the infrastructure and construction sectors, issued no material news in the quarter. However, the company released strong half-year results in March along with upgrading full-year guidance. Given that these results were released during a highly volatile period for the market, we began to see investors focusing on fundamentals once more which saw the shares appreciate. We remain confident in the story with Galliford Try, which offers the highest investment exposure to the regulated water sector in the UK market. The latest water sector investment framework, AMP8, provides a near doubling of the investment budget of the previous framework, AMP7.

The losers

In terms of detractors to performance, the most notable was Victorian Plumbing, the UK's leading online retailer of bathroom products and accessories. The company reported half-year results in line with guidance, but also announced plans to relaunch the MFI brand, taking the company into the homewares sector. MFI was included with the recently acquired Victorian Plum business. Homewares significantly increases the total addressable market to >£20bn, far larger than the £1.5bn UK bathroom market. However, this comes at the expense of short-term profitability as the company invests in the infrastructure to attack the homewares market. Victorian Plumbing has built a dominant position in the UK bathroom products market, and if this can be replicated in the larger more fragmented UK homewares market then the future upside could be significant. We believe the current valuation provides near free optionality on any success in UK homewares.

Bloomsbury Publishing, an independent publishing house of adults, children and academic literature across both physical and digital formats, released full-year results ahead of recently upgraded guidance. However, the market was concerned by the forward guidance, expecting trading broadly in line with current consensus forecasts. Following discussions with management, they highlighted that whilst trading in the financial year was in line with guidance, they felt it prudent to add a degree of caution given the uncertainty around the macro environment. Not least, the current threats the US President is making towards higher education institutions. However, we believe this overlooks much of the future value of the Bloomsbury Digital Resources expansion, future Sarah J Maas titles and uses of high levels of cash generation from the existing portfolio.

Portfolio activity

During the quarter, the fund completed two full exits: Greggs and Supreme. While we think Greggs is an outstanding company, we felt sales volumes were under pressure and pricing is now less supportive. This, combined with the correct strategic supply chain investment impacting short-term margins, left us thinking the next 18-24 months would leave the company struggling to progress earnings sufficiently to support the premium valuation. Supreme, was exited following a period of strong performance from our book cost.

The fund initiated one new position, with most of the sales proceeds used to buy existing fund positions. We added Mitie Group to the portfolio following its offer to acquire testing and inspection company (TIC), Marlowe. We know the Marlowe business well, and it is held in another Downing mandate, and we agree with the strategic rationale for Mitie to acquire Marlowe and become the UK's largest TIC company. Mitie is the UK's largest facilities management company, which should afford it the opportunity to cross-sell TIC services into its customer base, who have largely contract out TIC services with multiple smaller players.

VT Downing Small & Mid-Cap Income Fund
Quarterly Commentary – June 2025

Stock spotlight

This quarter we would like to highlight Quartix Technologies, a provider of fleet telematic services mainly to smaller fleet sizes of <20 vehicles. This is a company we have followed for a long time and have always considered it a high-quality company with diligent founder management team. But we have never invested given the premium valuation which was often north of 6x EV/Sales which we regard as high, even for high quality SaaS (software-as-a-service) businesses. In summary, the founder CEO retired in 2021 but returned in late 2023 after the new management team failed to deliver on expectations. After a period of fixing and stabilising we felt the company under its new (old) leadership was ready to press ahead for growth. We felt no recovery was priced in at close to 2x EV/Sales despite signs the business could return to double-digit growth. That growth has now started to materialise, with annual recurring revenue up over 10% over the last 12 months. This is on a lower operational cost base which we believe will drive significant margin accretion. We believe there is potential to become a Rule of 40 business as it has done previously when the company traded on a higher valuation. Quartix has a policy of paying out 50% of operating cashflow over a threshold of £2m as special dividends. Based on our forecasts, we see no reason for our book cost position not to be yielding >10% in two years' time, which we find a particularly compelling opportunity from a high-growth recurring revenue business.

Josh McCathie

Fund Manager, VT Downing Small & Mid-Cap Income Fund