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

Looking at headline figures, Q4 was a rewarding quarter for investors. Many stock market indices reached all-time highs in the quarter, including the FTSE 100. Inflation figures, whilst still elevated, continued to ease and opened the door to base rate cuts, with both the Federal Reserve and Bank of England cutting headline rates towards the end of the year. This was combined with a renewed push to seek a peace deal in the Russia-Ukraine conflict, and although no deal has been reached yet, any progress should be taken positively by global equity markets. Despite the good headline numbers and news, investors were still expressing caution into the close of the year, with gold continuing to push to all-time highs and reaching more than $4,500 per ounce from less than $2,700 at the beginning of 2025.

Unfortunately, UK small and mid-caps failed to join in with the robust final quarter many other stock markets and asset classes enjoyed and they continued to lag as they had in Q3. We feel much of this underperformance can be directed towards the November Budget, which was delayed compared to historic norms and was accompanied by a somewhat speculation circus on what tax rises would be targeted by the Chancellor. This ultimately led to both business and consumer malaise, as all held off taking spending decisions until the details were announced. Ultimately, the actual event was a bit of a damp squib, but we hope it acts as a clearing event for concerns over the UK's fiscal position. Although tax take as a percentage of national income is set to hit its highest level ever and much of the tax raising measures are back-end loaded, valuations remain agonisingly cheap in UK small caps so any positive move in business and consumer spending compared to recent periods could create a strong foundation for future returns.

Fund performance was equally disappointing during the quarter, with the Fund delivering -3.13% compared to the IA UK Smaller Companies TR sector return of -0.31%. Longer term performance still remains significantly ahead of the sector.

The winners

The top contributor to performance in the period was Zegona Communications, a company that engages in acquiring, operating and improving European telecommunication businesses. Zegona currently owns and operates Vodafone Spain. As part of the acquisition of Vodafone Spain, the transaction was part funded through the issuance of preference shares to Vodafone plc. Zegona successfully completed the sale of minority interests in the fibre-to-the-home (FTTH) infrastructure to third party investors which allowed Zegona to repay and cancel the preference shares. In addition, Zegona paid a special dividend to ordinary shareholders equivalent to £1.62 per share. This compares to the equity raise to partially fund the acquisition of Vodafone Spain priced at £1.50 per share. Further proceeds were used to reduce debt by €200m and for a €200m share buyback.

Safestore is an owner, operator and developer of self-storage assets across Europe. The company issued a positive fourth quarter trading update, with key metrics all showing progress and increased momentum from earlier in the year, with like-for-like occupancy and revenue per available square foot up 4% and 2.4% respectively. We also believe the market is now beginning to give the company credit for the investment in expansionary markets which has depressed short term earnings whilst being highly accretive to long term earnings. With the majority of the investment now complete, earnings should begin to inflect upwards in the next financial year as revenue expansion markets continue to grow at an accelerated rate.

The losers

Cohort is the parent company of seven individual defence and security companies across two subsectors; communications and intelligence, and sensors and effectors. The company reported interim results in line with expectations and with 96% order book coverage for the full-year. Whilst H1 operating profit was lower than the previous year, this was largely due to one-off orders in one of the operating companies in the previous year. Whilst this skewed the six-month comparison we expect the company to show healthy growth in operating profit for the full-year. We believe the poor share price performance has been exacerbated by potential peace deals between Ukraine and Russia and between Israel and Hamas. Whilst this might dampen some investor enthusiasm near term, this doesn't change the structural shift in defense spend. We believe this will continue to increase as global governments commit to higher defense budgets, not least in Europe, with many countries targeting spend to more than double over the next five years. Cohort's companies have strong pipelines with tier 1 defense companies often supplying market leading counter-drone tracking technology and sonar equipment which we expect to be focus areas for future defense spend.

Telecom Plus is a company that offers customers multiple utilities ranging from gas, electricity, mobile, broadband and insurance and combined into one simple billing platform. The company issued interim results in the period which saw customer growth of 19% and annualised organic growth of 11%. The company reiterated full guidance of 25% customer growth and adjusted pre-tax profit of £132-138m which at the mid-point represents 6% year-on-year growth. The shares now trade on close to 10x earnings compared to its five-year average of 19x, and in fact is the cheapest valuation for over ten years. This is all despite the company now operating in a far more rationale marketplace than when many energy companies acquired customers with loss making tactics, which has now been removed post the UK energy price crisis in 2022. We understand some investors are uncertain about the companies' decision to acquire c.215k broadband customers from TalkTalk, which is a new customer acquisition tool for the company. However, we view this as an interesting development given the Telecom Plus proposition is usually energy utilities led and the customer saving proposition only really begins to stake up from taking three or more utilities from Telecom Plus. Therefore, if acquiring existing broadband customers and the potentially easier sell of gas and electricity to these customers, the deal has the potential to make this a powerful customer acquisition route.

Portfolio activity

During the quarter, the Fund completed three full exits; Forterra, given concerns that housebuilding activity may fail to materialise in the current environment; Secure Trust Bank, following strong performance from initiating the position; and Hilton Foods, following poor performance in their fish division and lack of near-term catalysts to drive earnings forwards. The Fund initiated five new positions; Mortgage Advice Bureau largely rotating from a similar holding but offering less upside; Advanced Medical Solutions, where we believe it can unlock synergies from a recent merger and tap into the structurally growing specialist tissue healing technology; CVS Group, that we believe can now focus on growth following the completion of the CMA's review of the UK veterinary industry; Moonpig, can use its market leading position to return significant levels of capital to shareholders; and SSP Group, which is now taking a more shareholder friendly attitude to growth and capital returns whilst addressing the valuation arbitrage between its own rating and that of its listed Indian joint venture.

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Stock spotlight

This quarter, we would like to highlight CVS Group, which owns and operates veterinarian practices in the UK and Australia, along with veterinary laboratories and an ecommerce B2C business in the UK. The company had a good track record of compounding both organic and acquisitive growth, as it acquired independent practices that could subsequently use the scale of the larger group to drive purchasing efficiencies and invest within the practice. This dynamic saw PE- backed roll-ups enter the market given it exhibited classic hallmarks PE investors look for. Given the market consolidation and large price inflation pushed through to consumers, the Competition and Markets Authority (CMA) launched a market investigation. The investigation failed to find mistreatment of consumers, with price inflation largely driven by vet wage inflation and drug price inflation. Despite the findings, CVS trades significantly below its pre-investigation levels. We believe the market is concerned whether the company can get back to its 4-8% growth target. Given vet wage inflation is likely to trend above headline wage inflation and post-CMA investigation, underlying practice vets are more confident to start to return to offering customers in-house procedures aggregate into organic growth north of 4%. The company is currently carrying out a share buyback, something we would like the company to continue to consider if acquisition multiples fail to stack-up in this new operating environment. But either way, given the highly cash generative model and our purchase price offering close to an 8% free cash flow yield, this gives the company optionality on capital allocation between deleveraging, acquisitions or shareholder distributions which could all be used to get back a double-digit earnings per share growth story.

Josh McCathie

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