## Investment Objective and Policy

The investment objective of PFS Downing Active Management Fund is to generate capital growth from a portfolio consisting of companies within the Numis Smaller Companies Indicies. The Fund takes a pro-active private equity approach to investing in quoted smaller companies. Investee companies will typically be capitalised between £20m - £150m. The Fund will aim to hold a concentrated portfolio of 25-30 investments. The Investment Manager aims to identify investments that are valued on low price-cash flow ratios relative to peers, and will undertake rigorous due-diligence, modelled on that of a Private Equity style, to establish the robustness of management teams and company strategy. The Investment Manager will invest when the results of due-diligence highlight strength of management, a corporate strategy that has been largely overlooked by the market and the potential for the company to demonstrate an uplift in valuation of at least 30% in the first year of investment

## Investment Manager's Report

for the year ended 31 July 2013

### Performance

During the year to 31 July 2013 the Fund's quoted share price increased by 19.1% (net of all fees). As a reminder, we are now unwilling to compare the Fund's performance to that of our previous benchmark because of the large fees requested. We are focussed on absolute returns but will detail annual returns, compound returns and annualised returns in a table so that you can compare to relevant indices yourself.

| | PFS Downing Active Management Fund (net of TER) |
|---|---|
| 04/02/11-31/07/11 (6 months) | 0.3 |
| 01/08/11-31/07/12 (12 months) | 4.7 |
| 01/08/12-01/08/13 (12 months) | 19.1 |
| Cumulative Performance since inception | 24.1 |
| Annualised Performance since inception | 9.0 |

On an annualised basis (returns of the Fund after fees per year) the Fund's investment performance since inception is below our target hurdle of 15%. We detailed a number of factors that may have influenced this performance over the two and a half year period since Downing took on the management of this Fund in our last report to shareholders. The good news is that our 2012/13 performance of 19.1% was above our hurdle.

Our main focus is on the absolute annual returns (percentage gains in the value of the Fund net of all fees) over a 3-5 year period and to this end we consider that the Fund is on track.

### Fund Activity

The Fund has invested a significant amount of cash since our last update six months ago when it held 26% of its assets in cash at the time. As of 31 July 2013, 18.7% of the Fund's assets were in cash and as of 29 August 2013 its amount has reduced to 12%.

There have been no new shareholdings taken since our last report on 31 January 2013 that represent greater than 5% of the Fund's assets. Post reporting period the Fund acquired a holding in Science in Sport plc (investment made after 31st July 2013 and so not in the table of holdings overleaf). This holding was less than 5% of the Fund at cost but has since moved over 5% due to a 50% increase in its share price. We will introduce this holding in our next shareholder letter.

We took five new small holdings (all individually less than 2% of the Fund) and also added to our holdings in four existing portfolio companies.

We reduced our holding in both Accumuli and Dart Group during the period in order to re-weight the holdings after significant price increases.

We completely exited from five holdings (all of which individually occupied less than 2% of the Fund) over the last six months. We discussed two of these sales Stanley Gibbons and Telford Homes and our reasons for divestment in the last report. Our sales of Elektron Technology and Journey Group were because our monitoring of these companies gave us cause for concern with regard to the shareholder alignment of their respective management teams.

Despite the Fund's recent good performance, we are still confident that we hold a portfolio of companies that have the potential for significant upwards re-valuation. Having managed your Fund for over two years, we believe the turnover of companies within the portfolio should now

# Investment Manager's Report

continued

remain low. Our investment horizons are long term and so we only expect to replace holdings when they are trading at a price that leaves little upside/large downside potential, where we believe we have appraised the business or management incorrectly or an opportunity that is better presents itself.

**Holdings as at 31 July 2013**

| | Date of first purchase | Current weight* | Book cost per share (pence) | Total dividend per share (pence) | Current mid-market share price (pence) | Total return (incl div) v av net cost |
|---|---|---|---|---|---|---|
| INLAND HOMES PLC | Feb - 12 | 9.3% | 18 | 1 | 31.1 | 78% |
| DART GROUP PLC | Jan - 12 | 9.3% | 71 | 2.8 | 244 | 247% |
| SCISYS PLC | Oct - 11 | 6.1% | 53 | 2.6 | 70 | 37% |
| TRACSIS PLC | Feb - 11 | 5.9% | 66 | 1 | 163 | 148% |
| H&T GROUP PLC | Sep - 12 | 5.7% | 262 | 14 | 171 | -29% |
| ACCUMULI PLC | Feb - 11 | 4.8% | 7.7 | 0.4 | 15.6 | 108% |
| K3 BUSINESS TECH PLC | | 4.7% | 114 | 1 | 111 | -1.8% |
| UNIVERSE PLC | Aug - 12 | 3.5% | 2.8 | 0 | 4.3 | 54% |
| LUDORUM PLC | Aug - 11 | 3.3% | 190 | 0 | 125 | -34% |
| NORMAN BROADBENT PLC | Nov - 12 | 2.5% | 37 | 0 | 37.5 | 2% |
| 16 other investments | | 26.0% | | | | |
| Cash | | 18.9% | | | | |

**No new Investments with a greater than 5% weighting (since 31st Jan 2013)**

**Update on investments with weightings greater than 5%**

**Inland Homes plc**

Inland Homes plc has two main sources of income; land trading (purchasing brownfield land, achieving planning consent and selling consented land) and housebuilding. The housebuilding operation has grown successfully over the last couple of years. Inland Homes announced that their full year revenue from housebuilding will be £11.4m with current forward sales of £43m. We have been able to track each house sale, average sales price per development as well as new pipeline developments.

The group have purchased two new brownfield developments over the period and are currently considering purchasing strategic land plots. We expect Inland Homes plc to purchase several new plots over the next few periods, reinvesting the proceeds from their current land bank.

The company were granted planning consent for 268 homes and some commercial land at their development in Poole. We believe that this site will most likely be sold in chunks to other builders as well as Inland building out a proportion of the site themselves. Planning consent for 101 homes in the Southern Section of the St John's site in Chelmsford was also awarded in the period.

Inland Homes plc raised £4.9m in May 2013 at a price of 27p. Our calculation of intrinsic value for this company was significantly higher than this price and so we met with management to discuss the rationale of raising equity at such a large discount. We were happy that the cash being raised was being invested in two new sites that were at a deeper discount to Inland's expectations than we believed the group to be relative to our calculation of intrinsic value. The equity raising has also left the group in a stronger position to negotiate on deal at the Beaconsfield site, which has an expected GDV of c. £150m and could be purchased on a similar deferred payment basis as Drayton Garden Village.

Inland's share price was up 43% over the period.

**Dart Group plc**

The aviation business within Dart Group plc re-tendered for the royal mail contract during the period and was awarded 6 out of the 8 routes. This will result in a small loss of revenue per aircraft due to the reduction in routes flown for Royal Mail. However, the retention of the bulk of the contracts is very positive due to the incremental revenue associated with flying at night for Royal Mail.

Following the departure of Andrew Merrick, group FD, the company have employed Gary Brown to fill the role. We met with Gary and have had several phone conversations following his appointment.

Dart Group plc announced their full year results which reports on the year period up until 31st March 2013. Group Profit after Tax increased 37% to £31.2m. This increase in profit was mainly driven by a doubling of customers within Jet2holidays.com and further increases in load factor and ticket yield within the Jet2.com seat only business. Forward bookings for Summer 2013 were double that made at the same time last year. We therefore have confidence that the company can meet their expectation of doubling the Jet2holidays business again in the following year.

The group have driven the efficiency of the Jet2.com business through the introduction of their Jet2holidays.com business. Phillip Meeson the CEO and founder of the business has been very strict in maintaining the core business values and we are confident that the aviation business will remain family and customer service focussed and will only fly from airports with a lower number of competing low cost carriers on the same routes.

We purchased our holding in this company in January 2012 at 60-70p, however we did not value the Jet2holidays.com business, we now believe that this particular business derives a value of c. £200m. This is reflected in the company maintaining such a high weighting in the Fund despite the significant share price increase, since purchase (247%).

Dart Group's share price was up 67% over the period.

# Investment Manager's Report
continued

**SCISYS plc**
SCISYS announced their full year results in the period. Following on from their interim results they reported a drop in revenue – mainly due to the inclusion of very low margin hardware sales in the previous period – but with improved operating profit. Operating margins again expanded over the period and we forecast them to continue to expand due to greater operating efficiencies, a focus on project management and ancillary income generated from subletting space in their freehold site in Chippenham.

The integration of MakaluMedia seems to have been successful, with the group winning joint SCISYS-MakaluMedia contracts in the Space division.

The order book for the Group has again increased year on year with expected revenue and profit contributions from all divisions apart from Environment being healthy. The Environment division is breakeven; however, a few years ago it contributed close to £2m of operating profit. The division has been restructured over the last few years with many employees moving into other 'busier' divisions and the division focussing on specific niche verticals. Therefore the potential profitability of this division has probably reduced, nevertheless the expectation is for a significant return to profitability, the timing is however difficult to judge.

In May at the AGM, the company announced that they expect to meet market guidance on profitability for the full year.

In July, the company announced that they had signed a contract with Lockheed Martin for work on the Warrior project. SCISYS have been working on the preliminary stages of this project for quite some time. The total contract size is expected to be c. £6m; however as with all projects of this size, significant add ons are expected.

SCISYS's share price was up 1% over the period.

**Tracsis plc**
Tracsis, who are providers of software and solutions, predominantly to the road and rail industry have had busy period in the last 6 months. The Condition Monitoring Division (which provides hardware which monitors the integrity of rail assets, particularly signal boxes for Network Rail) has had a particularly strong year and we expect this to be reflected in Full Year results which will be announced in the autumn.

In the Summer Tracsis acquired Sky High Plc "Sky High", another AIM listed company for a consideration of £3.1m. Sky High is a leading traffic survey company based in the UK and Australia with 116 staff mainly based in Leeds, London, Cardiff, Edinburgh and Glasgow. The company undertakes traffic surveys for customers that are a mix of public sector and blue chip private companies who need to understand the traffic impact of change driven by infrastructure and construction projects. Sky High also have a growing data capture business with a blue chip client base including Virgin, John Lewis, Waitrose and Tesco. The Company was also awarded a 4 year framework contract for TfL processing bus survey information.

The Sky High acquisition is complimentary as there is a cross over in the Tracsis passenger counting business, called "Peeping" and there will be synergies as the combined group offer wider services to the growing client list.

Tracsis management have proven themselves to be competent operators who have been good at acquiring; having made 4 acquisitions over recent years at an average of 2x year 1 EV/EBIT. Given the Board costs that can be taken out of Sky High and the synergies that can be derived from the cross selling we anticipate that this acquisition will fit the rigorous earnings requirement that Tracsis has used in previous acquisitions.

Tracsis is a highly cash generative company, with a good amount of transparency in its revenue generation and cost base.

Tracsis's share price was up 2% over the period.

**H&T Group plc**
H&T Group plc announced both their full year and interim results in this period. Full year results to 31st December 2012 were as expected with pledge book growing in new stores resulting in a record group pledge book of £51m, the largest in the UK. Interest rate charged and redemption rates were also maintained, whilst a reduction in gold buying margin and volume reduced total group profitability.

H&T Group plc make the bulk of their profit from traditional pawnbroking. If an item is redeemed, the borrower repays debt plus interest and takes their item back; the profitability to H&T is independent from any movement in the gold price. 80% of H&T's loans are redeemed.

A movement in gold price has contrasting effects on the two methods of disposition. 13% of all pledges are scrapped for gold bullion. Suppose H&T lend money in January at £8.70 per gram of 9 carat gold and the market value of gold is £12 per gram of 9 carat. If during the 6 month loan term gold market price falls to £10 per gram of 9 carat gold, the margin on this segment of business falls from 38% to 15%. A significant effect on short term profit!

However, the natural move from all pawnbrokers would be to reduce lending rates once gold prices have fallen considerably. In the most recent fall in gold price (during June – August 2013) H&T have moved their lending rates to £7.70 per gram of 9 carat gold, increasing their expected scrapping margin on new loans to 30%.

Conversely, retail sales are often buoyed by a reduction in gold prices. Retail has been roughly selling at £18 per gram of 9 carat gold; the price in a shop window does not significantly reduce and increase depending on spot gold rates. Therefore, H&T are now taking in gold from loans at £10 per gram and selling for around £18. We therefore expect H&T to significantly increase their retail business throughout the next 6 months whilst the scrapping margin is heavily reduced. We mentioned in our last report that we believe H&T to have the best retail business of all the large pawnbrokers, this should create a natural hedge in this low scrap margin environment.

During 2008-2012 H&T (and several other pawnbrokers) made bumper profits from the introduction of gold buying as a service. Customers brought in their gold, sold it to H&T who then scrapped the gold for a profit. The business brought in as much as £50m of revenue and £17m of gross profit at its peak. This segment of the business has become far less profitable over the last year with annualised gold buying revenue estimated at £30m currently. Margins during 2011-2012 contracted due to the increased competition in this segment. Since the

# Investment Manager's Report
continued

**H&T Group plc (continued)**
gold price fall they have expanded as a number of participants have pulled out of the market recently. H&T have consequently managed to increase their margins.

The management team at H&T always saw gold buying and the boom time earnings from a steadily increasing gold price as a short term opportunity. They didn't sink in any additional cost that couldn't be quickly pulled back, mainly spending on small pop up stores in malls (55 at its peak and now only 3).

Pawnbroking is a very complex business with many levers that need to be correctly considered when managing. However, we believe that the gold price increase from 2008-2011 created greater than anticipated earnings that allowed H&T to increase market share and expand stores. The recent sharp fall in gold price will continue to suppress earnings during the August –December 2013 period. We then expect earnings to normalise from loans made after August 2013, which will be redeemed and reported on from January 2014.

The large increase in competition within the traditional pawnbroking business over the last few years could also be reversing due to the recent gold price fall. Several industry players greatly increased their gold buying units and installed large fixed costs on the back of this revenue. These businesses are now struggling and we expect several large players to suffer over the next year which could further open up market share for H&T.

We initially purchased a stake in this business at a market capitalisation of c. £100m, we still believe that this price is cheap for our expectation of H&T's future cashflows. During this Fund's reporting period the price fell sharply and continued to fall post year end. We greatly increased our holding in H&T post year end at a market cap of £50m. We now believe we are currently buying £1's for 25p.

H&T Group's share price was down 38.6% over the period.

**Downing LLP**
**30 September 2013**

# Fund Facts

### Accounting and distribution dates

| | Accounting | Distribution |
|---|---|---|
| Final | 31 July | 30 September |
| Interim | 31 January | 31 March |

### Fund performance

| Class | Net asset value as at 31.07.13 (pence per share) | Net asset value as at 31.07.12 (pence per share) | Net asset value % change |
|---|---|---|---|
| A accumulation | 106.07 | 89.81 | 18.10 |
| B accumulation | 112.33 | 94.41 | 18.98 |

### Net asset values

| Year as at 31 July | Net asset value (£) | No. of shares in issue | Net asset value (pence per share) |
|---|---|---|---|
| **Class A accumulation** | | | |
| 2011 | 6,524 | 7,399 | 88.17 |
| 2012 | 38,489 | 42,855 | 89.81 |
| 2013 | 113,430 | 106,942 | 106.07 |
| **Class B accumulation** | | | |
| 2011 | 2,712,197 | 2,947,264 | 92.02 |
| 2012 | 2,583,052 | 2,735,879 | 94.41 |
| 2013 | 5,654,396 | 5,033,738 | 112.33 |

# Fund Facts

continued

## Price history & distribution record

The table below shows the highest and lowest prices on a calendar year basis in pence per share since launch. Past performance is not necessarily a guide to the future performance

| Year | Highest (pence) | Lowest (pence) | Net distribution (pence per share) |
|---|---|---|---|
| **Class A accumulation** | | | |
| 2008^ | 100.00 | 75.95 | – |
| 2009 | 89.84 | 71.53 | 0.2326 |
| 2010 | 83.81 | 77.13 | – |
| 2011 | 90.47 | 76.94 | – |
| 2012 | 97.03 | 77.54 | – |
| 2013^^ | 108.57 | 96.32 | – |
| **Class B accumulation** | | | |
| 2008^ | 100.00 | 72.09 | – |
| 2009 | 90.60 | 69.06 | 0.3100 |
| 2010 | 85.45 | 79.51 | 0.0093 |
| 2011 | 94.34 | 80.48 | – |
| 2012 | 102.29 | 81.23 | – |
| 2013^^ | 114.96 | 101.58 | – |

^ From 5 September 2008
^^ As at 31 July 2013

## Ongoing charges

| Expense type | 31 July 2013 % |
|---|---|
| **Class A accumulation** | |
| Investment Manager's charge | 1.75 |
| Other expenses | 0.79 |
| Transaction charges | 0.05 |
| **Ongoing charge** | **2.59** |
| **Class B accumulation** | |
| Investment Manager's charge | 1.00 |
| Other expenses | 0.79 |
| Transaction charges | 0.05 |
| **Ongoing charge** | **1.84** |

## Synthetic risk & reward indicator

The risk and reward indicator table demonstrates where the Fund ranks in terms of its potential risk and reward. The higher the rank the greater the potential reward but the greater the risk of losing money. It is based on past data, may change over time and may not be a reliable indication of the future risk profile of the Fund. The shaded area in the table below shows the Fund's ranking on the risk and reward indicator.

**Typically lower rewards, lower risk** ← → **Typically higher rewards, higher risk**

| 1 | 2 | 3 | 4 | 5 | 6 | 7 |
|---|---|---|---|---|---|---|

The Fund is ranked 5 because funds of this type have experienced medium to high rises and falls in value in the past. Please note that even the lowest risk class can lose you money and that extreme market circumstances can mean you suffer severe losses in all cases.

## Risk warning

An investment in an Investment Company with Variable Capital should be regarded as a medium to long term investment. Investors should be aware that the price of shares and the revenue from them can fall as well as rise and investors may not receive back the full amount invested. Past performance is not a guide to future performance. Investments denominated in currencies other than the base currency are subject to fluctuation in exchange rates, which can be favourable or unfavourable.

# Fund Facts
continued

## Sector classification of investments

| Sector | % of fund as at 31.07.13 | Sector | % of fund as at 31.07.12 |
|---|---|---|---|
| Technology | 23.58 | Consumer services | 22.44 |
| Industrials | 21.58 | Industrials | 19.95 |
| Consumer services | 16.24 | Technology | 18.68 |
| Financials | 12.57 | Consumer goods | 13.46 |
| Consumer goods | 7.09 | Financials | 5.83 |
| Net other assets | 18.94 | Net other assets | 19.64 |

## Major holdings
The top ten holdings at the end of each year are shown below

| Holding | % of fund as at 31.07.13 | Holding | % of fund as at 31.07.12 |
|---|---|---|---|
| Dart | 9.32 | Boomerang Plus | 10.57 |
| Inland Homes | 9.30 | Tracsis | 6.98 |
| SciSys | 6.13 | SciSys | 6.27 |
| Tracsis | 5.91 | Dart | 5.60 |
| H&T | 5.76 | Accumuli | 5.43 |
| Accumuli | 4.75 | China Food | 5.35 |
| K3 Business Technology | 4.75 | Telford Homes | 4.59 |
| Universe | 3.51 | Stanley Gibbons | 4.27 |
| Ludorum | 3.27 | Ludorum | 4.25 |
| Games Workshop | 2.68 | Braemar Shipping Services | 3.25 |

## General information

### Authorised status

PFS Downing Active Management Fund (the "Company") is structured as an Investment Company with Variable Capital (''ICVC''), under regulation 12 (Authorisation) of the OEIC Regulations (Open-Ended Investment Companies Regulations 2001 (SI 2001/1228)).

The Company does not intend to have an interest in immovable property.

The Company is authorised and regulated in the UK by the Financial Conduct Authority (''FCA'') as a UCITS Retail Scheme under the COLL Sourcebook.

The Company was incorporated in England and Wales on 19 September 2007 under registration number IC563. The Shareholders are not liable for the debts of the Company.

### Buying and selling shares

The dealing office of the Authorised Corporate Director (ACD) is open from 8.30am until 4.30pm on each dealing day to receive request for the purchase or redemption of shares. Shares can be bought either by sending a completed application form to the ACD at PO Box 10879, Chelmsford, Essex CM1 9QW, or by telephoning the ACD on 0845 305 4215 fax 0845 280 0087. Requests to redeem shares may be in writing to the ACD at PO Box 10879, Chelmsford, Essex CM1 9QW, or by telephone on 0845 305 4215 fax 0845 280 0087. Shares will be issued or redeemed at a price calculated by reference to the next valuation point following receipt of the application.

A contract note giving details of the number and price of shares bought or redeemed will be issued no later than the end of business day following the later of receipt of the application to buy shares and the valuation point by reference to which the price is determined.

### Report and accounts

This document is a short report of PFS Downing Active Management Fund for the period ended 31 July 2013. The full Report and Accounts for the Company is available free of charge upon written request to Phoenix Fund Services (UK) Ltd, PO Box 10879, Chelmsford, Essex CM1 9QW.

### Other information

The information in this report is designed to enable you to make an informed judgement on the activities of the fund during the period it covers and the results of those activities at the end of the period.

### Risk profile

The fund has little exposure to credit or cash flow risk. There are no borrowings or unlisted securities of a material nature and so there is little exposure to liquidity risk. The main risks it faces from its financial instruments are market price foreign currency and interest rate risk. The manager reviews the policies for managing these risks in order to follow and achieve the investment objectives.

## Directory

### Authorised Corporate Director & Registrar

Phoenix Fund Services (UK) Ltd
Springfield Lodge, Colchester Road, Chelmsford, Essex CM2 5PW
Telephone: 01245 398950
Fax: 01245 398951
Website: www.phoenixfundservices.com
(Authorised and regulated by the Financial Conduct Authority)

### Customer Service Centre

PO Box 10879, Chelmsford, Essex CM1 9QW
Telephone: 0845 305 4215
Fax: 0845 280 0087
Email: downing@phoenixfundservices.com
(Authorised and regulated by the Financial Conduct Authority)

### Directors of the Authorised Corporate Director

R.W. Elliot (retired 15 March 2013)
R.W. Leedham
D.W. Munting (appointed 15 February 2013)
A.C. Reed
J.M. Rice (retired 30 April 2013)
D.C. Tibble (appointed 1 May 2013)

### Investment Manager

Downing LLP
10 Lower Grosvenor Place, London SW1W 0EN
(Authorised and regulated by the Financial Conduct Authority)

### Depositary

National Westminster Bank Plc
Trustee & Depositary Services
Younger Building, 1st Floor
3 Redheughs Avenue, Edinburgh EH12 9RH
(Authorised and regulated by the Financial Conduct Authority)

### Auditor

KPMG Audit Plc
Chartered Accountants & Registered Auditors
15 Canada Square, London E14 5GL

PHOENIX
Fund Services