# ECP Flagship European Value

## Quarterly report

**March 2020**

**This document is intended exclusively for professional or institutional clients and counterparties**

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## Portfolio review

### Executive Summary

- **Performance overview**
  - MSCI Europe down 22.6% during Q1 2020
  - Our portfolio suffered too, since small & mid caps, together with value stocks, were particularly affected
- **Portfolio changes**
  - Selective buyer to put dry powder in terms of cash to work
  - 7 new names joined portfolio, 1 name was sold
- **Market environment & Outlook**
  - Economic impact of COVID-19 unknown as depends on lock-down length and fiscal and monetary response
  - Fiscal responses and central banks' actions appear up to the task and will help in after-Corona world
  - Our portfolio companies are adapting and will survive 2020 financially: valuation opportunities unfold as they return to long term earning power
  - Abundant investment opportunities

In the first quarter of 2020 we experienced the fastest stock market correction in history. Up until mid-February the key European stock indices showed small positive returns build upon solid returns made in 2019. A very contagious COVID-19 virus spread from China with rapid pace across the globe. Uncertainty on how to deal with this new threat led governments first to react slowly and subsequently to close entire countries. In short, COVID-19 made the whole world panic in less than 6 weeks.

In time of writing, the situation is still unfolding in Europe but there are signs that the measures taken (primarily virus testing, social distancing, and lockdowns) are starting to work. In China, where the virus originated, people are again back to work and with the learning from China a country like South Korea managed quickly to bend the curve lowering the growth of new infected people. We expect the situation to remain unstable for the coming weeks and we also expect to see more and more positive signs that the efforts taken to combat the virus are bearing fruit.

The financial markets have naturally reacted sharply to the uncertainty. Government bond yields have collapsed while equities and corporate bonds have tumbled. In 4 weeks, from 19th of February till 18th of March, MSCI Europe fell 35%! In the 2008 crisis a similar fall in equity prices took 1 year and 3 months from the peak in 2007. By any standard, we are going through historic moments now.

Thanks to a small recovery over the last 2 weeks of March, MSCI Europe finished the quarter with "only" a loss of 22.6%. With all sectors posting negative returns there has not been any good place to hide for investors. The best performing sectors were Health Care, Utilities and Consumer Staples while they still generated negative returns of 7 -13%. The worst performing sectors were Energy, Financials, and Consumer Discretionary loosing around 30% each.

Our strategy fell more than the market. This is not entirely surprising as value stocks corrected more than the market overall and we have a significant part of the portfolio in some small- and midsized companies which still remain out of favour for many investors and have been dumped by forced sellers in the market. When value stocks and small-/midsized companies again come back into focus our portfolio has significant built-in potential just waiting to be unlocked.

Meanwhile we have been active in the portfolio. The significant negative returns on sector levels has resulted in some significant mis-pricings of some individual companies. In some cases, forced sellers have thrown the baby out with the bathwater. We have not been shy to make use of those situations to start buying those quality companies. In total we have added seven new companies to our portfolio, and we have sold one company.

We entered this turbulent period with some dry powder from positions we had sold or reduced before the panic sat in. We had of course no magic foresight or ability to predict the sharp downward draft in stock prices but raising cash was a natural consequence of our investment discipline where company valuation and fundamentals take centre place. We have re-invested some of that cash in new companies. Our portfolio is full of companies with strong balance sheets who will not only survive the crisis, but we also expect them to prosper significantly post-crisis.

If history is any lesson (and we think it is) then this shall not take too much time. Investing some additional money now and over the coming months, will probably generate significant returns over the next 5 years, and at the same time, your current investments recover from the selling pressure currently seen. Selling your investments now AFTER the prices have adjusted downward is an almost sure way to handicap yourself because it is very difficult to get back into the market once they have turned. Not only do you need to buy at probably higher prices than today, but you will also have to fight your own emotions and arguments for staying on the side-lines which felt so comfortable when markets were bad. Time in the market matters more than timing the market.

We make all our investments on a company-by-company basis. We like to spread our investments across +/- 40 companies where a good part of the companies will provide high and growing cash flows in any economic environment. The other part is of more cyclical character and we like to buy those when they are priced for recession.

The 3 main positive contributors in Q1 2020 were Jeronimo Martins (+22 bps contribution), Novo Nordisk (+19 bps) and new joiner Elekta (10 bps).

The 3 main negative contributors were G4S (-218 bps), Superdry (-207 bps) and John Wood Group (-178 bps).

## Portfolio changes

We continue to follow our investment process as we have done for many years. We do so regardless of the opinion of Mr. Market. Our investment horizon is oriented towards the long-term with an average holding period of 4 to 5 years. This is the time normally needed for the market to recognise the earnings power of an undervalued company and thus for the valuation gap between the stock price and the estimated intrinsic value to close.

The investment process aims to identify companies with undervalued earnings power without any geographic, sector or market capitalisation considerations.

In Q1 2020 the skies opened up and vastly increased both the number and the quality of companies available to invest in. We added seven new companies to the portfolio and sold one. This is an unusual high activity for us but when Mr. Market throws good and cheap companies at us, we naturally react when the window of opportunities is open.

⇒ BUY

We have bought Sandvik, Adidas, Philips, Applus, Elekta, Exor, and Stabilus. These companies are all leaders of their respective industries and they represent excellent long-term value in our opinion. We believe that Mr. Market has priced in temporary (cyclical) challenges as being permanent (structural) challenges. We do not agree with Mr. Market here.

⇒ SELL

We have sold Novartis after having owned it since late 2015. Novartis has been a good contributor to performance. The company has gone through positive transformation by optimising their asset base and putting more focus on innovation to obtain higher margins. We sold 85% of our shares during the summer of 2019 at prices around 90 CHF, and in March 2020 we sold our remaining shares to fund new purchases. Our reason to sell was based on valuation.

## Investment cases

Our seven new companies are strikingly different, yet they also share some strikingly similar characteristics.

**Sandvik**
Sandvik is a world-leading manufacturer of tools and tooling systems for metal cutting, mining, and construction equipment and high value-added products in advanced stainless steels, special alloys, and titanium. The Swedish company, founded in 1862, is based in Stockholm and operates in 130 countries. In 2018, Sandvik generated revenues of SEK100bn (EUR10bn) and had almost 43,000 employees.

Since 2015 Sandvik has gone through significant transformation leaving a business generating higher margins and returns across the cycle. The company today stands as a first-class Swedish Industrial company. Mr. Market still fails to recognize the underlying improved fundamentals and still values the company as a low-quality industrial with a fortress balance sheet.

**Adidas**
Adidas is the largest sportswear manufacturer in Europe, and the second largest in the world, after Nike. The CEO Rorsted is a specialist in improving consumer franchises and has made Adidas a desired brand again and he sells more at full price. The company margins have improved from <7% in 2015 to >11% in 2019 which is almost to the closing gap to Nike. Higher margins are sustainable as they come from improved gross margins leaving more room for brand support.
We have had in the past a successful investment in Adidas.

**Philips**
Philips is one of the largest electronics companies in the world, currently focused in the area of health technology, with other divisions being successfully divested. This pure health care technology company is still priced as a conglomerate. Philips has stable growth opportunities from ageing population. It became a global leading company in imaging technology.

Philips is what we would describe as a non-cyclical long-term wealth compounder. People are getting older and the health care systems needs better technology to make better patient diagnoses and monitoring. This is the cornerstone of Philips business. With all health care professional focused on dealing with COVID-19 we expect near term sales figures to be below normal run rate, but this is just a temporary effect.

**Applus**
Applus is an engineering company providing design, testing, engineering and homologation services to the automotive industry. It is one of the global leading players in testing, inspection and certification (TIC) services operating through four global divisions. 40% of the company earnings come from multi-year statutory vehicle inspection with no major contract renewal before 2022.

The company has exposure to some oil and gas activities which are at a cyclical low for the moment. A good part of the earnings come from stable sources and the market has priced the company as if it is more cyclical than it really is. This gap between perception and reality creates an opportunity for us to invest. The stock trades 50% below its usual multiples.

**Elekta**
Elekta is a Swedish global leader company that provides radiation therapy, radiosurgery related equipment and clinical management for the treatment of cancer and brain disorders. The company has a significant underpenetrated market in Asia. We expect significant cash flows to come after years of high investments.

The world has a large, growing and unmet need for cancer treatment and Elekta is a leading player in that field. We have been invested in Elekta before.

**Exor**
Exor is a holding company with investments running over a century. Its most important investments include FIAT Chrysler, PartnerRe, Ferrari, CNH Industrial, Juventus and The Economist. Its CEO, Elkann is known to be the Warrant Buffett of Europe. The company's net cash per share is at 23EUR versus 36EUR the share price as of 19th February 2020.

The company has sold their insurance business and the deal is expected to close later this year. When that happens Exor consists of a selection of first-class companies and a huge cash pile in the hands of a very smart capital allocator, Mr. Elkann. With company valuations getting lower during COVID-19 crisis the value of that cash increases dramatically.

**Stabilus**
Stabilus is the world leader in the manufacture and supply of gas springs to automotive and industrial markets and a leading player in the market for electromechanical opening and closing systems for vehicle tailgates. The group has 70% market shares in gas springs, whereas almost 50% market share in the single sided systems, which is underpinned by significant barriers to entry. The group's key automotive and industrial markets are set to stay positive in the long run and Stabilus has number of opportunities for the group to outperform underlying market growth. Stabilus derives 60% of its revenue from automotive industry and reaming 40% from other industrial segments.

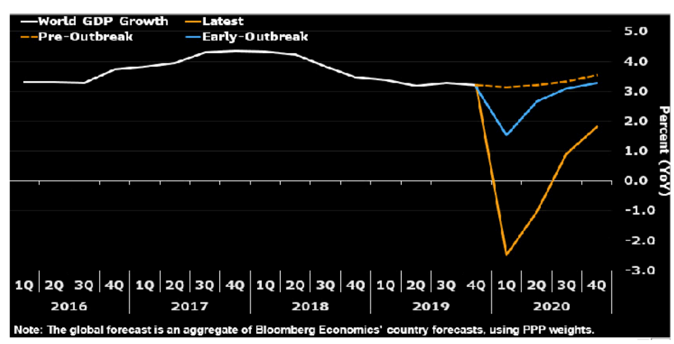
Several parts of the automotive industry are closed down for the moment, therefore we expect the news flow around Stabilus to be negative in the short run. When the industrial and automotive cycle turns better, Stabilus is a key beneficiary. Their products are low cost but high value for the automotive manufacturers. A failure of a Stabilus product in an expensive car or industrial application could be very costly for the car or equipment manufacturer. Therefore, Stabilus is less prone to price pressures compared to other industrial companies. In 2018 Mr. Market was willing to pay 71 EUR for earnings similar to what we expect for next year. The share price is now around 32 EUR.

## Market environment & outlook

In this quarterly update we are focusing on the economic and financial implications of COVID-19. Nevertheless, we are fully aware that the current crisis is foremost a human and social tragedy. The biggest pandemic since the Spanish flu is bringing the health care systems in many developed countries to their limits. Tough choices need to be made daily by doctors to choose what patient is put on a lifesaving ventilator. Millions of people already lost their jobs especially in the US where less government measures are in place to support employment. We want to thank foremost the healthcare workers who are our first line of defense but also all the other workers ensuring that essential services are continuing to function: policemen, fireman, retail workers, bakers, .... Thanks for your courage and dedication for the common good! You are the real heroes of the battle against the Corona virus!

The economic toll is substantial. For example, according to German IFO Institute, the current lockdown costs the German economy between 150 billion and 260 billion EUR a month due to the standstill of the industrial sector, trade and services. With every month passing, the cost is increasing and the return to normal takes longer with rising unemployment. Economists and strategists are busy revising downwards their forecasts for economic growth, earnings, and asset prices out of their home offices. These forecasts range wildly from 20%, or 50% or 70% declines on any of these measures. As my colleague Alberto Tocchio, CIO of Colombo Wealth Management in Lugano, pointed out very rightly: "In reality, all of the measures forecasted heavily depend on how long the economy will stay shut down in response to the pandemic (estimates range from weeks to months or even quarters). The time to re-start the economy depends on the dynamic of the virus itself and choices politicians and society make in the process."

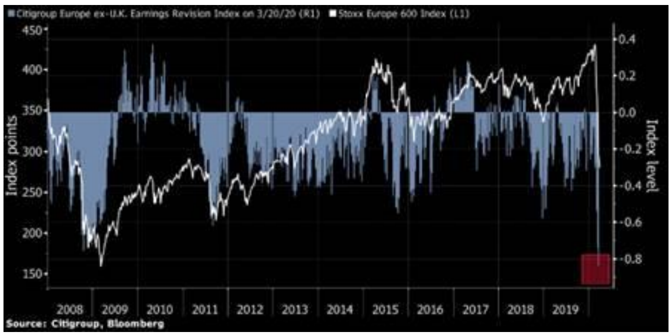
So it is impossible to know at the current stage what shape the recovery takes : is it v shaped, V shaped or in the worst case scenario w shaped ?




*Source: Bloomberg Economic estimates as of 20/03/20*

We therefore also believe trying to forecast this year's earnings is a futile exercise. Sell-side analysts are axing their earnings estimates for the companies they follow at an unseen speed. The Citigroup Europe (ex UK) Revision Index shown below tracks the number of profit upgrades by analysts minus the number of downgrades: the downgrades outnumbered the upgrades by the biggest margin on record, even higher than during the financial crisis!!

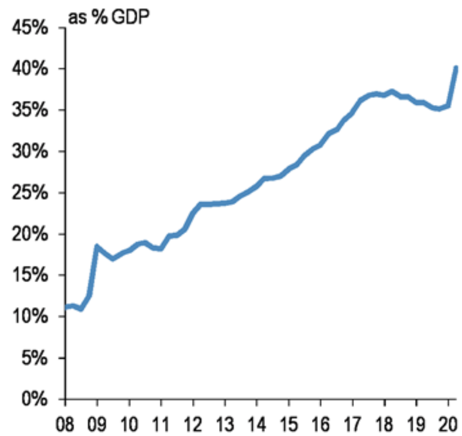
**Citigroup Europe ex-UK Earnings Revision Index (blue) and the Stoxx 600 (white)**




*Source: Citigroup*

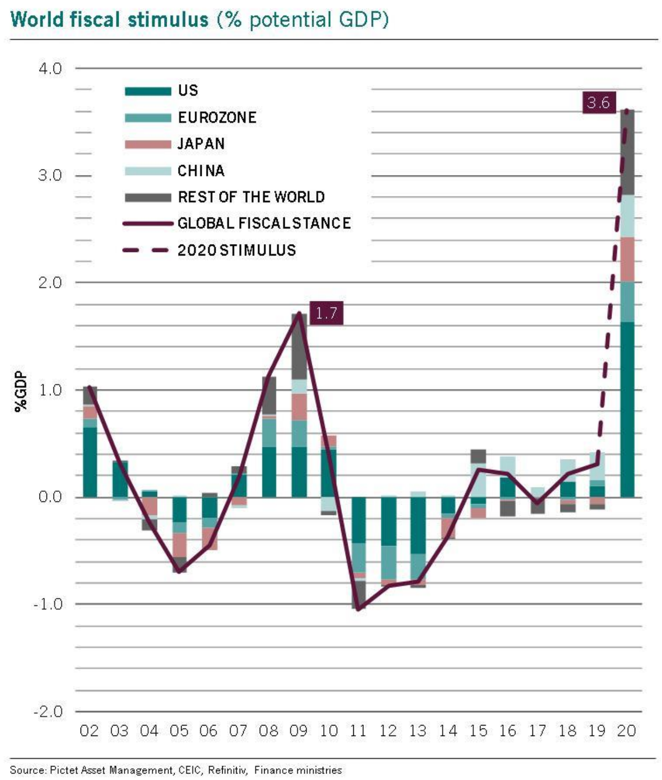
... and the bloodbath of downward revisions of earnings is only starting.

As all eyes are on infection rates, central Banks and governments are aware of the gravity of the external choc and have been proactive to an extend that is even bigger what we have seen in the financial crisis. That is why Ed Yardeni, the well-known equity strategist from Yardeni Research, is no longer speaking about the Fed throwing helicopter money into our economies like what we have seen during the financial crisis. He is now speaking about B-52 bombers throwing carpets of financial weapons in order to make sure our economies are not falling into another Great Depression.
We believe he is 100% right and the size of the central banks intervention should not be underestimated.
Central bank's balance sheets are now expanding at an unseen speed and currently represent 40% of the GDP of the G4 countries:




*Source: Colombo Wealth Management*

There has already been a wave of fiscal measures and government spending in all major economies as can be seen from the diagram below from Pictet :




What does this mean for our portfolio companies? The only relevant question is whether our companies can survive the loss of business activity they are currently experiencing. We do our best to ensure our companies can weather the storm. Our focus on strong balance sheets is now playing off. The companies we own have been through rough times before and we expect them to come out stronger on the other side. Some of our companies will for sure use their strong balance sheets to acquire weaker competitors, new technology etc.

In the simulation below, we tried to estimate the economic impact of COVID-19 on our average portfolio company. For the sake of simplicity, we did not consider the 4 financial companies we own in our European portfolio.

**Main assumptions**
- Sales cut by 25%
- Gross margin stays the same
- Operating expenses cut by 15%

| | Before Corona | After Corona |
|---|---|---|
| Sales | 100 | 75 |
| Gross Profit | 44.4 | 33.3 |
| *Gross Margin* | *44%* | *44%* |
| Operating expenses | 30.8 | 26.2 |
| Operating profit | 13.6 | 7.1 |
| *Operating Profit Margin* | *14%* | *9%* |
| | | |
| EBITDA | 18.3 | 11.8 |
| *EBITDA Margin* | *18%* | *16%* |
| Depreciation & Amortization | 4.8 | 4.8 |
| | | |
| Net debt / Ebitda | 1.46 | 2.25 |

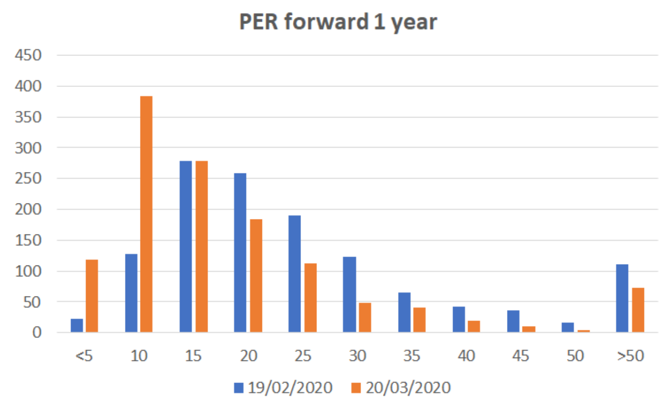
**Conclusion**
- Net debt / Ebitda increases to 2.25 x
- Still lower than the 3 times of MSCI Europe before crisis

*Source: ECP, Bloomberg as of 20/03/20*

We estimate the average portfolio company to lose 1 quarter of sales this year, id est 25% of its forecasted turnover for the year. The average gross margin of our portfolio company was forecasted to be 44% by consensus before the crisis, that number could stay roughly the same as the companies need less raw materials and services for production. However, they need time to adjust their operating expenses to the fall in demand for their products. These operating expenses include selling, general and administrative costs and R&D expenses: we assume companies will reduce them by 15% at a heavy social cost. Depreciation & amortization could stay constant as the companies depreciate the fixed assets, they have on their books over long years.
Under this simplified and arguably simplistic framework, the net debt / EBITDA of our average company will increase from 1.46 to 2.25. It will therefore take the average company 2.25 years to reimburse its entire debt instead of 1 ½ years. To us this is acceptable as it compares to the 3 years for the average European company in MSCI Europe already before the crisis. We are currently running detailed analysis on all the individual companies we own to make sure they are not bumping into covenant or liquidity issues, a lesson we learned in 2008. We conclude that our portfolio companies will survive the current crisis however painful as it is.

If we ignore 2020 and look at the valuations based on the long term earning power the companies generate, our portfolio now trades at a 52% margin of safety compared to its estimated fair value, a discount we have not seen even at the height of the financial crisis in 2008.

Furthermore, the opportunity set in our screenings has noticeably increased. In the histogram below, the valuation dispersion of more than 1400 European companies (ex-financials) is summarized before (in blue) and after the correction in stock-prices due to Corona (in orange). The median forward price earning in our screening universe has fallen to 11 times and you have more than 1/3 of the companies now trading at a PER below 10 times. There are certainly opportunities amongst the ones with solid balance sheets who make it through the crisis.




*Source: ECP*

## Conclusion

We can only conclude that Mr Market is excessively focusing on 2020 earnings and extrapolates the earnings produced this year to perpetuity. While the current crisis is severe and it is difficult to estimate its lengths and therefore its economic impact, we can be certain of one thing: it is an external choc that will last months and not years. For those investors taking a longer-term view on the earning power of the companies they analyse, a sea of opportunities is opening in the current market correction. To date, ECP has not been a forced seller, on the contrary we have new high-quality names while keeping some dry powder in terms of cash. To us the famous quote from Warren Buffett applies:

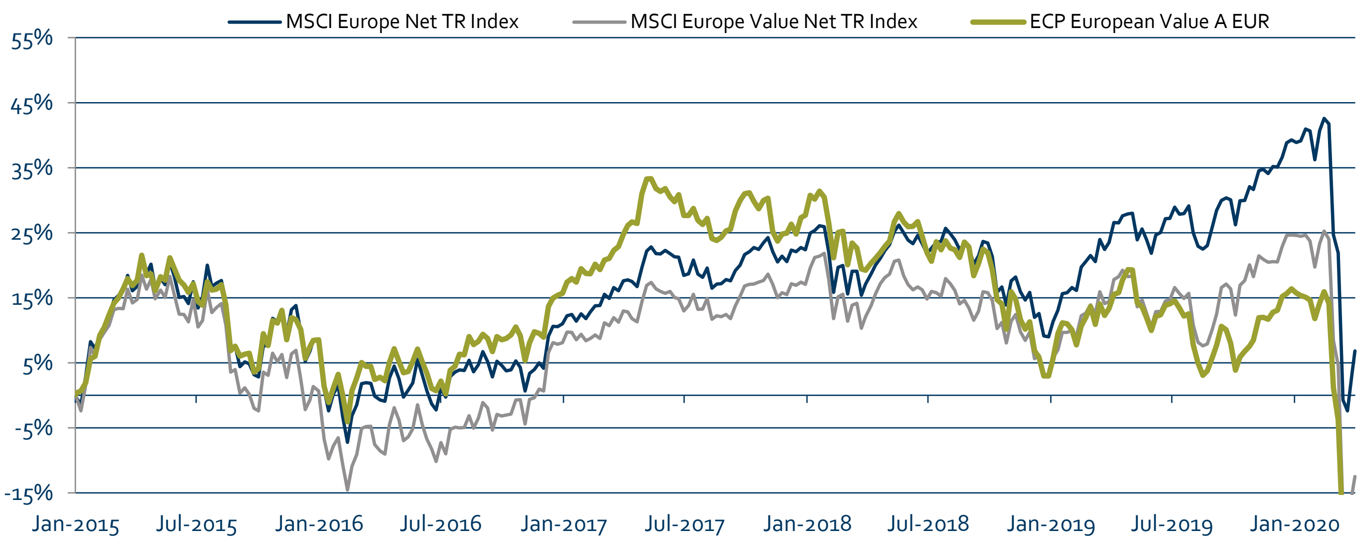
"Be greedy when others are fearful and fearful when others are greedy"

Our goal is to generate long term wealth for our customers. This is something that takes time and there will be bumps along the way. To reach the final destination of wealth creation is it very important to stay on the bus.

# Portfolio profile

## Performance analysis

### Cumulative performance since inception[1]




### Performance statistics

| | European Value (A EUR share class) | MSCI Europe NR | MSCI Europe Value NR |
|---|---|---|---|
| **Since inception[1]** | -20.77% | 6.79% | -12.48% |
| **3 years** | -36.49% | -9.21% | -22.53% |
| **1 year** | -30.13% | -13.53% | -23.51% |
| **YTD** | -31.57% | -22.59% | -29.21% |
| **6 months** | -26.71% | -18.17% | -25.15% |
| **3 months** | -31.57% | -22.59% | -29.21% |
| **1 month** | -21.707% | -14.35% | -19.28% |

### Risk statistics (3 years rolling- annualised)

| | European Value (A EUR share class) | MSCI Europe NR | MSCI Europe Value NR |
|---|---|---|---|
| **Standard deviation** | 18.97% | 17.60% | 19.75% |
| **Sharpe ratio** | -0.73 | -0.17 | -0.40 |

| | | MSCI Europe NR | MSCI Europe Value NR |
|---|---|---|---|
| **European Value** | Tracking error vs. index | 6.38% | 6.98% |
| | Active share vs. index | 89.6% | 94.2% |
| | 1 yr Beta vs. index | 0.87 | 0.76 |

[1] The sub-fund ECP Flagship European Value has been managed by the same investment manager, with the same investment strategy and a comparable fee structure since 1 January 2015. The sub-fund has been managed under the legal form of an Alternative Investment Fund according to EU Directive 2011/61/UE until 8 August 2015 when it was converted into its current UCITS status according to EU Directive 2009/65/EC. The historic performance, return and risk data presented herein cover the full period from 1 January 2015 to date.

## Fund Key Facts

- **Legal Form**: UCITS Compliant Luxembourg SICAV
- **Investment Manager**: European Capital Partners
- **Management Company**: European Capital Partners
- **Custodian**: Banque de Luxembourg
- **Administrator**: European Fund Administration
- **Auditor**: Deloitte Audit
- **NAV frequency**: Daily

**European Value**

| | A EUR | I EUR | C EUR |
|---|---|---|---|
| ISIN Code | LU1169207518 | LU1277321912 | LU1768645753 |
| Investor focus | Retail | Institutional | Retail |
| Inception date | 08/08/2015 (*) | 28/08/2015 | 28/02/2018 |
| Max. Mgt fees | 1.50% | 0.80% | 0.90% |
| Performance fee | - | - | - |
| Min. subscription | - | EUR 1mn | - |
| Registered in | LU, DE, CH, SE, FR, NL | | LU, DE, NL |

**Synthetic Risk and Reward Indicator**

Lower Risk
Potentially Lower Reward

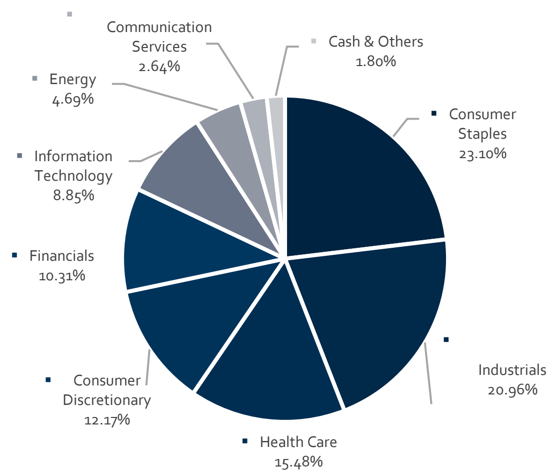
Higher Risk
Potentially Higher Rewards

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

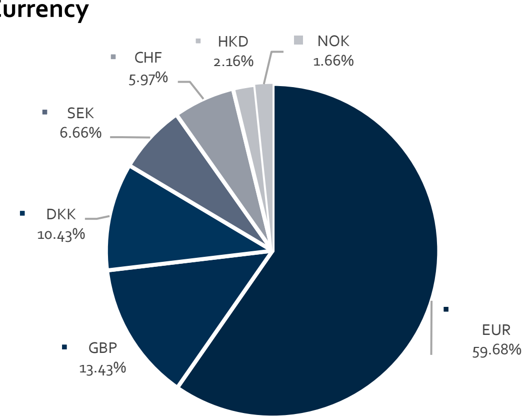
*(*) Transformed from an AIF launched on 01/01/2015*

## Portfolio's breakdown (%)

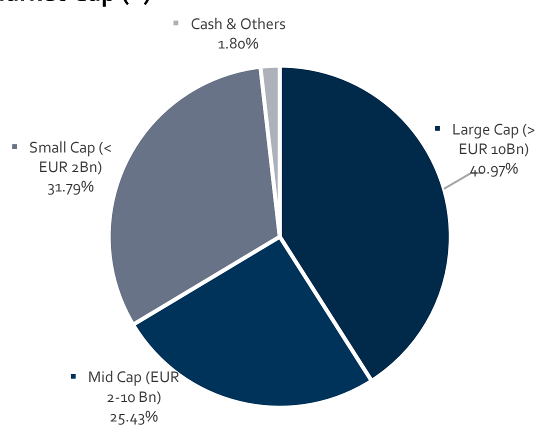
### By Sector




### By Currency




### By Market Cap (*)



## Portfolio holdings

| Company Name | Sector | Industry Group | Country[1] | Market cap |
|---|---|---|---|---|
| ABB LTD-REG | Industrials | Electrical Equipment | Switzerland | Large Cap |
| ADIDAS AG | Consumer Discretionary | Textiles, Apparel & Luxury Goods | Germany | Large Cap |
| ANIMA HOLDING SPA | Financials | Capital Markets | Italy | Small Cap |
| APPLUS SERVICES SA | Industrials | Professional Services | Spain | Small Cap |
| ATOS SE | Information Technology | IT Services | France | Large Cap |
| BAWAG GROUP AG | Financials | Banks | Austria | Mid Cap |
| CAIXABANK SA | Financials | Banks | Spain | Large Cap |
| CLOETTA AB-B SHS | Consumer Staples | Food Products | Sweden | Small Cap |
| DANONE | Consumer Staples | Food Products | France | Large Cap |
| DUERR AG | Industrials | Machinery | Germany | Small Cap |
| ELEKTA AB-B SHS | Health Care | Health Care Equipment & Supplies | Sweden | Mid Cap |
| EXOR NV | Financials | Diversified Financial Services | Netherlands | Large Cap |
| FLSMIDTH & CO A/S | Industrials | Machinery | Denmark | Small Cap |
| FRESENIUS SE & CO KGAA | Health Care | Health Care Providers & Services | Germany | Large Cap |
| G4S PLC | Industrials | Commercial Services & Supplies | United Kingdom | Small Cap |
| HENKEL AG & CO KGAA | Consumer Staples | Household Products | Germany | Large Cap |
| HUGO BOSS AG -ORD | Consumer Discretionary | Textiles, Apparel & Luxury Goods | Germany | Small Cap |
| HUSQVARNA AB-B SHS | Consumer Discretionary | Household Durables | Sweden | Mid Cap |
| ISS A/S | Industrials | Commercial Services & Supplies | Denmark | Mid Cap |
| JERONIMO MARTINS | Consumer Staples | Food & Staples Retailing | Portugal | Large Cap |
| JOHN WOOD GROUP PLC | Energy | Energy Equipment & Services | United Kingdom | Small Cap |
| JOST WERKE AG | Industrials | Machinery | Germany | Small Cap |
| KONINKLIJKE PHILIPS NV | Health Care | Health Care Equipment & Supplies | Netherlands | Large Cap |
| KRONES AG | Industrials | Machinery | Germany | Small Cap |
| MATAS A/S | Consumer Discretionary | Specialty Retail | Denmark | Small Cap |
| NORMA GROUP SE | Industrials | Machinery | Germany | Small Cap |
| NOVO NORDISK A/S-B | Health Care | Pharmaceuticals | Denmark | Large Cap |
| ONTEX GROUP NV | Consumer Staples | Personal Products | Belgium | Small Cap |
| ORIGIN ENTERPRISES PLC | Consumer Staples | Food Products | Ireland | Small Cap |
| PRADA S.P.A. | Consumer Discretionary | Textiles, Apparel & Luxury Goods | Italy | Large Cap |
| PUBLICIS GROUPE | Communication Services | Media | France | Large Cap |
| RECKITT BENCKISER GROUP PLC | Consumer Staples | Household Products | United Kingdom | Large Cap |
| ROLLS-ROYCE HOLDINGS PLC | Industrials | Aerospace & Defense | United Kingdom | Large Cap |
| SAGE GROUP PLC/THE | Information Technology | Software | United Kingdom | Large Cap |
| SANDVIK AB | Industrials | Machinery | Sweden | Large Cap |
| SANOFI | Health Care | Pharmaceuticals | France | Large Cap |
| SAP SE | Information Technology | Software | Germany | Large Cap |

| Company Name | Sector | Industry Group | Country[1] | Market cap |
|---|---|---|---|---|
| STANDARD LIFE ABERDEEN PLC | Financials | Capital Markets | United Kingdom | Large Cap |
| SUBSEA 7 SA | Energy | Energy Equipment & Services | United Kingdom | Small Cap |
| SUPERDRY PLC | Consumer Discretionary | Specialty Retail | United Kingdom | Small Cap |
| SWATCH GROUP AG/THE-BR | Consumer Discretionary | Textiles, Apparel & Luxury Goods | Switzerland | Large Cap |
| TECNICAS REUNIDAS SA | Energy | Energy Equipment & Services | Spain | Small Cap |
| UNILEVER NV | Consumer Staples | Personal Products | United Kingdom | Large Cap |

*[1] Country of Risk as defined by Bloomberg*

## Key risk factors

- **Equity**: The Fund may be affected by stock price variations, the scale of which is dependent on external factors, stock trading volumes or market capitalization.
- **Currency**: Currency risk is linked to exposure to a currency other than the Fund's valuation currency, through direct investments.
- **Liquidity Risk:** A decreased or insufficient liquidity in the markets could negatively impact the prices at which positions are bought or sold by the sub-fund.

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