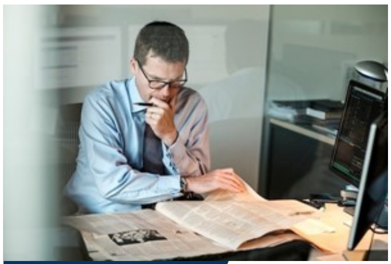


Friday Morning Coffee

Nr. 147 — Joined at the hip

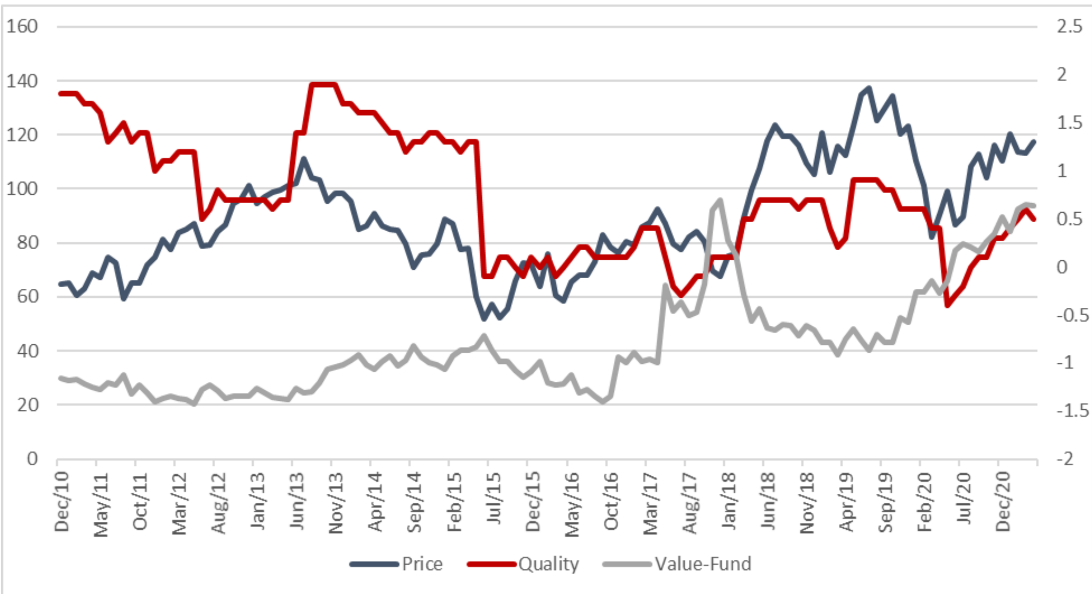
I recently came across extensive comments from so-called growth investors making the point that the reflation trade had created a unjustified rally in value stocks that were of low fundamental quality. In the long run however quality had always prevailed independently of valuation and the recent recovery in value would prove temporary. Growth investors should therefore simply sit out their current underperformance and of course stay invested in the growth funds.

Simple narratives like the one presented here have one big flaw: they are too simplistic. As Warren Buffett put it : "Growth and value investing are joined at the hip." Both approaches are certainly not mutually exclusive as some asset managers want to make us believe.

Value investing is indeed much more than investing in the cyclical, lowly valued businesses hardly earning their cost of capital. What we as value investors are really looking for is companies with undervalued earning power, or undervalued quality. Value investors are simply extremely price sensitive and want to make sure they invest only if a company trades in the stock market at a significant margin of safety, or discount to what they believe the company is worth. By investing in a stock, they behave in exactly the same way an entrepreneur would behave if he wants to acquire the whole business. At ECP, our hunting ground is composed of more than 1500 companies throughout all European countries, all industries and market capitalizations. The only 2 things that matter to us is the ability of a company to generate sustainable cash flows and the valuation of these cash flows.

In order to illustrate my point, I wanted to give 2 examples of companies we are currently invested in.

Example 1 : LafargeHolcim – Q-V chart



Source: ECP

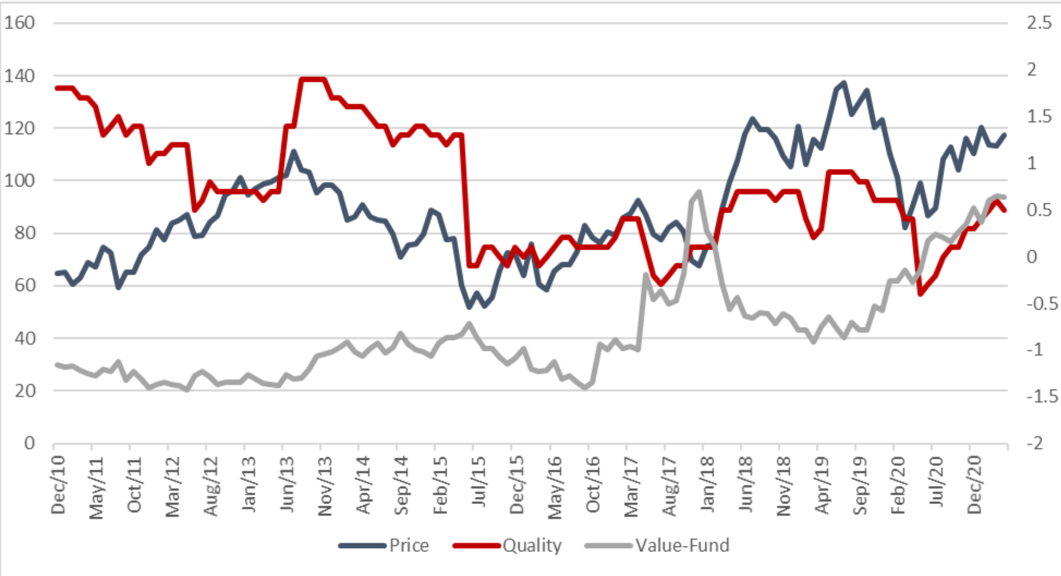
Friday Morning Coffee

European Capital Partners

Nr. 147 — Joined at the hip

At ECP, we started to invest in LafargeHolcim in September 2020. The investment rationale clearly appears in our proprietary quality-value framework: improving high quality of the business while valuation more than 1 standard deviation cheaper than the median company in our investment universe. This company, despite being in the cyclical business like cement, has a consistently shown superior quality to the median company. This chart motivated us to do an in-depth due diligence of the company that ultimately lead to a successful investment.

Example 2 : Elekta – Q-V chart



Source: ECP

The second example is the Swedish medtech company Elekta, definitely in a segment of the market where most investors would not suspect opportunities for value investors. We invested in mid-March 2020 almost at the through of the pandemic induced market correction. We had one advantage: we knew the company reasonably well as we were invested before. As hospitals were filling up with Covid-19 patients, the products from Elekta in radiation therapy for oncology patients were used less. As we believed this was temporary and created an opportunity for us to invest in a company of superior quality trading at a discount.

In conclusion, we expect the unprecedented amount of fiscal and monetary stimulus will lead to a higher economic activity, reflation and a rise in interest rates which is favorable for our value strategy. We remain very selective in our investments and have a particular focus on lowly valued quality companies. This is much more than investing in the cyclical, lowly profitable parts of the market. This is how value investors generate their returns in the long run.

Have a nice weekend,

Léon Kirch, CFA
Partner, CIO
April 16th, 2021