

Strategic European Smaller Companies Fund

February 2020 Fund Commentary

European equity markets plunged in February when the sudden spread of coronavirus outside of China caused panic. It appears that the transmission is no longer under control. Markets are completely driven by fear, uncertainties and by what the World Health Organisation calls an "infodemic"; the flow of rumour and misinformation.

There are several forecasts available – on average they suggest that the number of cases may peak around June / July. This could mean that economic activity returns to normal around Sept / Oct, with Q1 moderately impacted and Q2 taking a more severe hit across the board.

The fact that the number of cases in China and South Korea appears to be levelling off and that other countries are rapidly taking drastic measures is reassuring, even if Italian statistics remain puzzling and explain the country's extreme reaction. Coronavirus has overwhelmed Italy's health system, particularly in the north. More than 80% of the hospital beds in Lombardy are occupied by coronavirus patients. Intensive care units are overloaded while elective surgeries have been cancelled to free up beds. The healthcare systems capacity constraints explain why flattening the curve of infection through protective measures is almost as important as stopping it. The US however, was slow to react with a series of missed chances by the federal government to ensure more widespread testing, even downplaying the epidemic at the beginning, but things are changing rapidly through aggressive public health responses.

Travel bans, containment and event cancellations will inevitably take their toll on the economy. Certain sectors like air travel, restaurants and hotels may face a cash crunch if the situation continues; the Fund has no exposure to those sectors. The force of fiscal and monetary stimulus will ultimately be the dominant driver of markets once there is some clarity on the extent of the disruption.

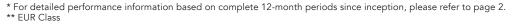
The Fund* declined -5.26%** in February while the benchmark was down -8.34% over the same period. The Fund has mitigated some of the downside thanks to the initial positioning of the Fund on 1 January in well managed, resilient companies with strong free cash flow generation and secondly through calm, fact led, de-risking decisions taken by the Investment Manager in two phases: one in late January and another mid-February. The first concentrated on reducing Chinese and Auto exposures while the second, more drastic, was about reducing cyclical, indebted or Italian exposed companies.

As always, the Investment Adviser aims to invest with a long term investment horizon in companies generating substantial free cash flow as this remains the best guarantee for capital preservation. Albioma, the Fund's largest position, published its 2019 results last week unleashing €125M of free cash flow compared to €930M market capitalisation the day prior to the announcement (13.5% value creation yield), a healthy return in a world of negative interest rates for a non-cyclical and regulated business with more than 25 years of average residual contract value.

Boozt was the largest monthly contributor to the Fund's performance in February, followed by Iliad and Valmet.

Boozt, a fast growing online textile retailer in the Nordics, was up 12.8% during February despite the market collapse, thanks to excellent 2019 results. Based on consensus expectations, Boozt trades on 23x PE for 2020 with EPS growth expectations of 67% (0.34 PEG ratio), this is incredibly attractive for such a well-managed and profitable business (3.2% operating margin in 2019). All listed peers in Europe produce lower growth, thinner margins and are all trading with a higher PEG ratio.

Iliad was up 6.4% in February, following the closure of the offer made by Xavier Niel, the company's founder, to purchase 20% of the company for €1.4bn, raising his stake from 52% to 72%. In addition to the offer, he also disclosed additional purchases made in the open market since 1 January. Several





Bertrand Faure PORTFOLIO MANAGER

INVESTMENT APPROACH

The Fund's competitive advantage and its key differentiator between it and its peers is the ability to focus on target companies from every angle and leverage the network of relationships and corporate access provided by a number of stakeholders, including founding partners to provide a real understanding of the market share and performance of the investee companies that results in the totality of the investment research being generated internally.

INVESTMENT OBJECTIVE

To outperform small and medium capitalisation firms in the European equity markets

A sub-fund of E.I. Sturdza plc. Registered in Ireland.

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brokers upgraded their recommendations and target prices during the month, including "permabear" BNP Exane.

Valmet was also up 9% during the month, in spite of a severe downturn in the days leading up to month end. Besides strong Q4 numbers, Valmet lifted its long-term margin target interval. The upgrade was bigger and came sooner than expected. It signals high quality in Valmet's order book and further room for improvement in its operations.

At the other end of the spectrum, Trigano, Akwel and Ferronordic Machines were the three main detractors. Those three companies were victims of the Italian/Auto/Cyclical shock that took place throughout the month. Trigano sold off in February, particularly on the days where Italy took the centre stage. Its revenue exposure to Italy was only 6% in 2019, however two of their production sites are located there, out of over 40 in total. One production site is in Tuscany and one is in Apulia, far away from the Lombardy and Veneto regions at the heart of the outbreak.

The Investment Adviser has been in close contact with the management to monitor the situation. Trigano's Italian factories are running normally and risks about potential supply chain disruptions, notably for Fiat chassis, are non existent.

The market was in panic selling mode through the early days of March. Valuations are no longer the relevant metric, only flows matter as hundreds of European companies are now pricing in a 2008 recession scenario that will last ad-vitam, which obviously has no fundamental backing. Today, as a result of this irrationality, the vast majority of the portfolio has over 100% upside to fair valuations. Even companies with contractually guaranteed earnings are trading at these levels. The cash prudently collected from the de-risking exercises in January and February has put the Fund in a strong position to remain calm and rational, to look at the numerous opportunities available. Similarly to the 2008-2010 period, the Investment Adviser strives to invest in companies able to manoeuvre in any potential upcoming liquidity crunch and get out of this temporary crisis on a stronger footing.

PERFORMANCE DATA As at end of February 2020

CUMULATIVE PERFORMANCE %

	1M	3M	1Y	2Y	3Ү	Fund Inception
EUR	-5.26	-4.54	4.40	-12.65	0.92	19.83
EURI	-5.37	-4.57	4.75	-11.90	2.16	21.31
STOXX Europe 600 NR EUR	-8.34	-7.49	3.74	4.82	10.33	9.44

CALENDAR YEAR PERFORMANCE %

	YTD 2020	2019	2018	2017	2016	Annualised Inception
EUR	-7.41	24.41	-24.86	22.80	13.55	3.82
EURI	-7.49	25.04	-24.48	23.17	13.55	4.09
STOXX Europe 600 NR EUR	-9.42	26.82	-10.77	10.58	1.73	1.89

Source: Morningstar.

Past performance is not an indicator of future performance.

IMPORTANT INFORMATION

The views and statements contained herein, including those pertaining to contribution analysis are those of Pascal Investment Advisers SA in their capacity as Investment Adviser to the Fund as of 12/03/2020 and are based on internal research and modelling.

Please contact info@eisturdza.com should you wish to have an update call with the investment team.

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