ECP Flagship European Value

Quarterly report

December 2019

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

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The last quarter of 2019 continued to build on the positive returns made earlier in the year. For MSCI Europe the return for Q4 2019 was 5.71% and for the full year 26.05%. By all measures a good year. Those returns have been made in a volatile fashion with worsening fundamentals on both corporate and macroeconomic levels and investor sentiment ranging from FOLM (fear of losing money) over outright summer panic to FOMO (fear of missing out) in the autumn. It is fair to say that 2019 had something for everybody.

As the year progressed, and particularly in the second half, investors had more clarity on both Brexit and the trade war between US and China. This made the glass look more half-full than half-empty. During the last quarter the business cycle also improved from a sharp correction driven by too high inventories and lack of new orders.

How can equity markets generate these returns in such a volatile environment? It is against my logics, you may think. To answer that we must take a broader perspective and zoom out. Equity market returns are always generated from a combination of fundamental factors and psychological factors. And more importantly: the CHANGE in those factors.

The start of 2019 was close to perfect: 2018 was a weak year with losses of 10-20% across several markets and almost all of the losses were made in the last quarter of 2018. Many single stocks had losses 2x the market for the year. Investor panic (the psychological factor) was present as the perception of a nearby recession (the fundamental factor) created an urge to sell just about anything at any price.

In short, by January 2019 some asset prices were pressed far below their long-term value in fear of a recession that did not come in 2019. Buying lowly valued assets and wait for sentiment and/or fundamentals to improve is enough to make a lot of money in equity markets. This is what happened in 2019 and the psychological factor has as always been far more pronounced than the fundamental factor.

The combined compounded annual return of 2018 and 2019 is 6.15% per year which is closer to the long-term average returns for European equities. A longer perspective helps a better judgement of short-term results.

We close the year with a sense of satisfaction and high hopes for the years ahead of us. Value stocks are now able to keep up with Growth stocks and some of the small- to midsized companies that were left in dust one year ago have been rediscovered. That's a good thing because it means that solid company fundamentals again start to matter. We finally see valuation-based strategies like our own make a comeback. The last 10 years have favoured Momentum and Growth strategies fuelled by falling interest rates and leadership of a few companies within the technology sector. We see early signs that the next decade may belong to the Value investors.

Our strategy outperformed both the broad market and also the Value and the Growth indices in Q4 2019. We find that quite impressive since our strategy is more defensive than the market.

All our investments are made 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 Q4 2019 were **Anima (Asset Management, Italy), Krones (Machinery, Germany), and Dürr (Machinery, Germany).**

The 3 main negative contributors were **EuropCar** (Road & Rail, France), Hugo Boss (Textile and Apparel, Germany), FLSmidth (Machinery, Denmark),

In H1 2019 Central banks in Europe and in the US have shown that they will stand ready to support the economy if the negative effects from the trade war spread through the economy. In September they delivered on their promise by lowering their interest rates and the European Central bank restarted their asset purchase programme. These actions are designed to keep interest rates lower for longer and to foster economic growth. We doubt that lowering interest rates from an already ultralow level will have any meaningful impact on the economy. However, the signal from Central banks is that they will do their best to support economies in a time when politicians seem busier elsewhere.

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 Q4 2019 we have added three new companies to the portfolio and two companies have been sold.

⇒ **BUY**

We have bought Jost Werke, Norma Group, and Origin Enterprises. They can all be characterized as small companies in size but large companies in their respective industries. None of them are turnaround cases but we found that Mr. Market had punished them too hard for what we deem as temporary challenges which all companies face from time to time.

⇒ **SELL**

We have sold Loomis around the highest price the shares have seen in the last 10 years. Loomis is one of the industry leaders in offering solutions which help banks and retailers to have a much more efficient handling of their cash flows. The business ranges from traditional and safe transport of valuables in armoured vehicles that we see daily in traffic to sophisticated software. It's a high margin, high return, and growing business. We saw those qualities in February 2018 so we started buying the shares. In December we sold our last shares with an annual return of 18%. We sold the shares for valuation reasons.

Between January and September this year we have reduced our position in EuropCar by more than 50%. In October we sold our remaining shares in EuropCar as we lost our faith in the way shareholders' money is being spent by the company management.

EuropCar was not a profitable investment for us and serves as a lesson for how important it is for companies to allocate capital properly. As minority shareholders we do not control the capital allocation inside the companies. That is the most important role of company management to fulfill. A solid management team will maximize dividend or other forms of shareholder returns if they have weak opportunities to invest profitably back into the business. In the case of EuropCar the management kept on investing their cash flows into a New Mobility segment which had no signs of profitability. We did our best to have them refocus on paying down debt instead, but our wishes were left unanswered, therefore we decided to sell our shares and move on.

Investment cases

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

First, companies like Jost Werke, Norma Group and Origin Enterprises are unknown to most. However, in their respective industries they are well regarded as leaders and their customers love their products and services. They have over decades built themselves into a position where they hold a solid reputation while running very profitable businesses. That is important for the sustainability of any business.

Second, we enter these positions at a time where the market has extremely low expectations for them. We see a reasonable chance that over the next few years we will be rewarded from both an improvement in the investor sentiment (the before mentioned psychological factor) and in the fundamental factor.

Third, they operated in industries that will also be needed many years from now and where the disruption risk is low.

Jost Werke is the global leader in safety critical solutions for commercial vehicles. Most of the company revenues are generated in product categories where Jost has a global market share of 60%. The company is facing the truck and trailer industry and is thereby cyclical. Cyclical concerns in the end markets caused a collapse in the share price from 45 EUR in November 2017 to 25 EUR in October 2019. While we share the concerns for the truck and trailer market those concerns are well known to everyone. Above all, the concerns are of temporary nature and more than compensated for in a share price of 25 EUR at purchase. Higher safety requirements globally for the connection between truck and trailer helps pushing the fleet owners to renew their fleets which creates demand for Jost's products. We see a low risk for business disruption as road transport is still the most important form for goods transport globally. We also see low risk of price pressure because customers do not want to fight hard with their suppliers of safety critical components in fear of any reputational damage that could have on the customers' business should an accident happen.

The balance sheet is strong and Jost can pay off its debt in just 1,5 years. At our time of purchase Jost was trading at 12% free cash flow yield so we feel very well compensated for taking the cyclical risk on the end market. After we bought the shares, the price has gone up by more than 40%.

Norma Group produces clamps and connectors as well as fluid handling devices. Their products are used in all thinkable end markets from automobiles, construction, battery cooling, washing machines etc. Norma sells more than 40.000 different products each with an average unit price of 0,6 EUR. Most of the products are highly engineered and developed in connection with their customers. In short, Norma sells each year a high number of components where the value of the component is only a tiny fraction of the value of the end product. Any malfunction of Norma's product can have severe impact of the functioning of the final product and therefore Norma is less subject to price pressure from their customers.

Norma Group is a clear industry leader and consolidate the market by buying smaller competitors or new technologies. The company is 2-3x bigger than nearest competitor and 8-9x bigger than competitor number 3.

The company will benefit strongly from any shift towards hybrid vehicles. Two profit warnings during 2019 made it possible for us to buy the shares below 30 EUR. In the summer of 2018 shares were priced at 70 EUR on earnings similar to today. Some of the excess operating costs of 2019 clearly have a one-off character and additional planned cost savings will in our view expand the margin from 13% back to 16% and as business owners we shall be rewarded accordingly.

Our third addition to the portfolio is Origin Enterprises which is an agricultural service company operating in Ireland, United Kingdom, Brazil and Eastern European countries. Origin offers agronomy services including advisory and fertilizer products tailormade to the individual farmer with the objective to enhance the farmer's production yield. The main markets are UK and Ireland where they are 2x larger than their closest competitor and has built customer relationships over decades. The company is now diversifying away from UK into for example Ukraine where the agricultural land is 10x bigger than UK but where fertilizer spend is only 50% of the level in the United Kingdom. If Origin is successful in making farmers more efficient in their new markets it is a big business opportunity for the company.

Weather is obviously an important topic for Origin. Bad weather can destroy the planting season and in result reduce the need for Origin's fertilizer products. The autumn of 2019 was particularly rainy, so Origin had to issue a profit warning and the stock was sent down below 4 EUR for earnings similar to what the market was willing to pay 9 EUR for in 2015. The company now trades at a 7x EBIT which makes Origin a clear takeover target in the industry. While we wait for future planting seasons to be better than the one in autumn 2019, we will be paid 5-6% dividend yield from an almost debt free balance sheet.

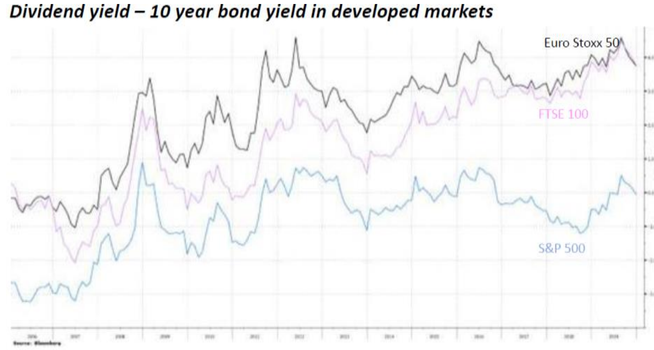
Market environment & outlook

With the new decade starting, we wanted to wrap-up the current state of affairs in European Value-land. In order to keep it short, we summarize the environment in European value-land with a couple of hopefully self-explaining graphs:

1) **Graph 1: European equities are attractively valued.**

Despite the run-up, European equities remain attractive on most valuation measures compared to their own history and compared to other developed markets like the US. In the graph below, we compare the dividend yield of Europe, US and UK to the respective 10-year bond yields. This is a good indication of how cheap equities are in Europe compared to bonds.

Dividend yield – 10 year bond yield in developed markets

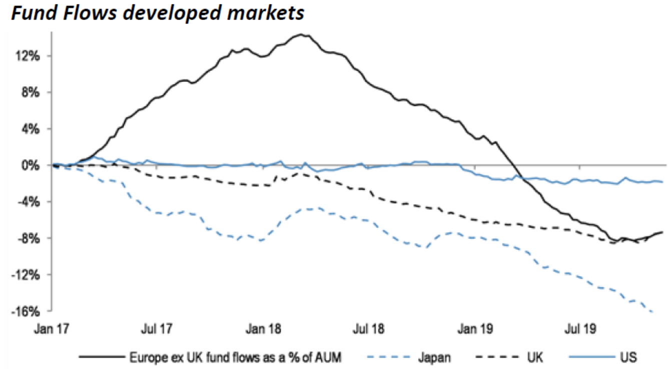


Source: Bloomberg

2) **Graph 2: Positioning in European equities remains light.**

European equities remain an out-of-favor asset class with more than 100 bn USD outflows in 2019. Over the last weeks, investors appear however to rediscover Europe and we saw timid inflows again. More clarity on Brexit, better news on tariffs and improving economic sentiment could see this trend continuing.

Fund Flows developed markets

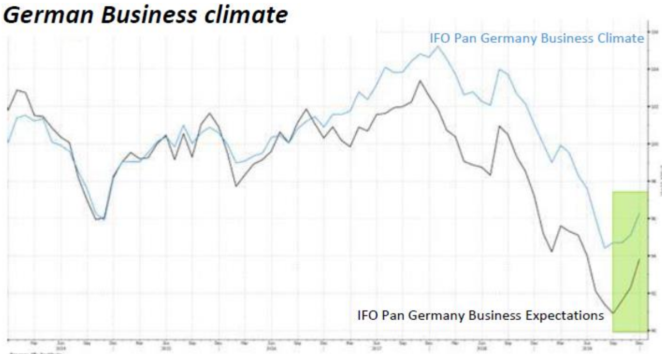


Source: JP Morgan

3) Graph 3: Signs of improving business sentiment in Germany

Recent economic data suggest indeed an improvement in business sentiment in the Germany. This increase in sentiment, partly on the back of the recent U.S.-China trade agreement, is still fragile and just the first step. As a reminder that the road to better economic hard data is still shaky, both industrial production and factory orders dropped at the start of the fourth quarter.

German Business climate

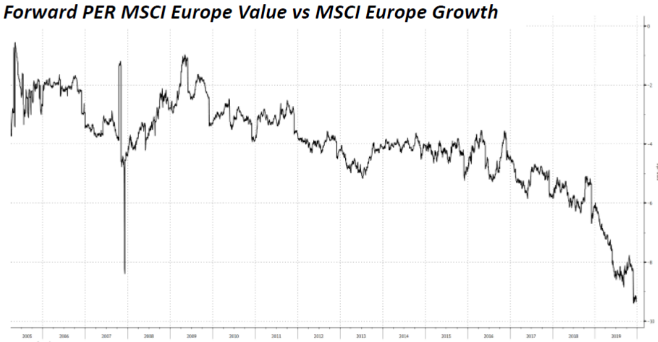


Source: Bloomberg

4) Graph 4/5: Value is cheap and interest rates start to provide support to value

The valuation gap between growth and value stocks remains at an all-time high.

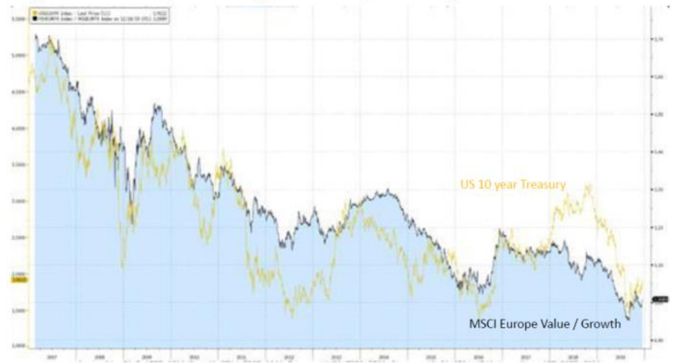
Forward PER MSCI Europe Value vs MSCI Europe Growth



Source: Bloomberg

One reason is the low interest rates in place since the financial crisis. There is indeed a strong correlation between interest rates (in this case the US ten-year treasury yield and the relative performance of MSCI Europe Value and MSCI Europe Growth. US interest rates have been edging up over the last weeks towards 2% supported by solid US economic data and retreating risks of escalating tariff war.

Performance Value / Growth against US 10 year bond yield



Source: Bloomberg

Conclusion

The current environment creates opportunities for the long-term investors we are. Staying rational and having a consistent view of the intrinsic value of a company are two cornerstones in our investment process. When investing in "out of fashion" companies it requires that you go against the crowd. More often than not, it involves increasing the position when prices are dropping. Therefore, we have always held the view that volatility ultimately is a good thing for the long-term investor. For 20 years this has generated healthy long-term returns for our strategies. The flip side is that being contrarian always involves the risk of looking foolish, sometimes even for an extended period. This is just something we have to accept.

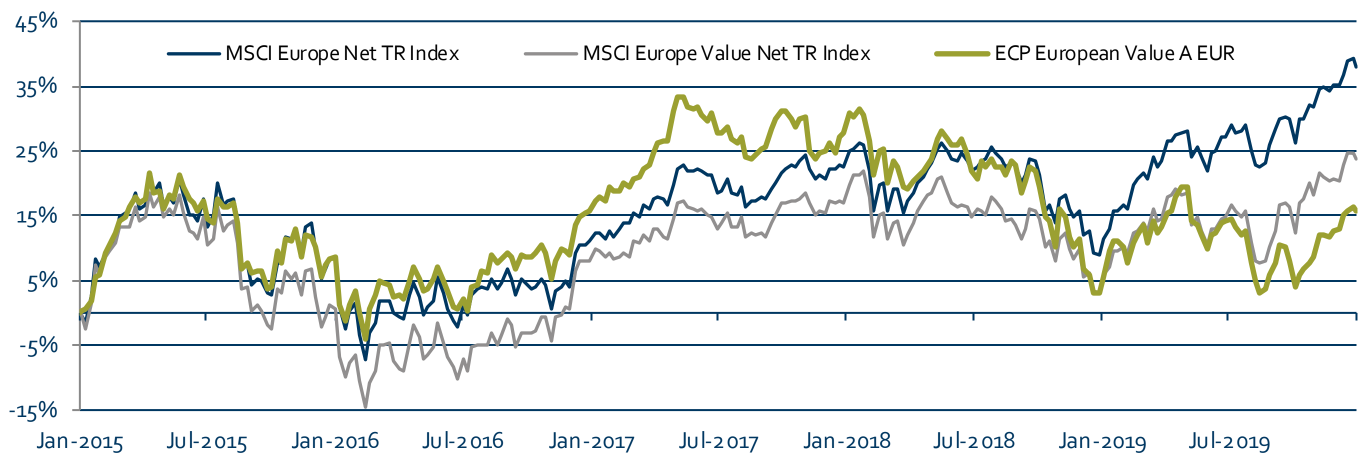
In our existing portfolio the margin of safety of the median company is currently at 35%. It is one of the highest margin of safety we have seen since we launched the European strategy at ECP in Dec 2014 and probably one of the highest we have seen since the bottom of the market after the financial crisis in March 2009. Our portfolio is positioned very attractively for the long-term investor.

European equities are for the moment unloved by Mr Market and value stocks are at a historically high valuation discount to their growth peers. It is only a matter of time till we reap the full benefits of our long-term approach.

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]	15.79%	37.96%	23.64%
3 years	0.09%	24.27%	14.37%
1 year	11.65%	26.05%	19.56%
YTD	11.65%	26.05%	19.56%
6 months	1.53%	8.43%	7.79%
3 months	7.11%	5.71%	5.74%
1 month	2.67%	2.06%	2.56%

Risk statistics (3 years rolling- annualised)

	European Value (A EUR share class)	MSCI Europe NR	MSCI Europe Value NR
Standard deviation	12.76%	11.02%	12.03%
Sharpe ratio	0.02	0.70	0.40

		MSCI Europe NR	MSCI Europe Value NR
European Value	Tracking error vs. index	5.71%	6.60%
	Active share vs. index	90.8%	93.6%
	1 yr Beta vs. index	1.01	0.89

[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

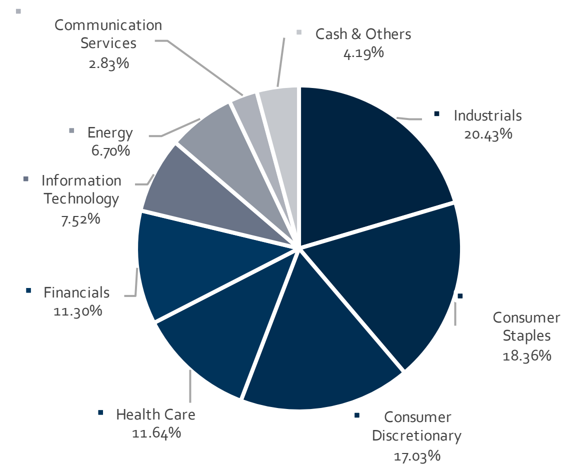
Higher Risk
Potentially Higher Rewards

1	2	3	4	5	6	7

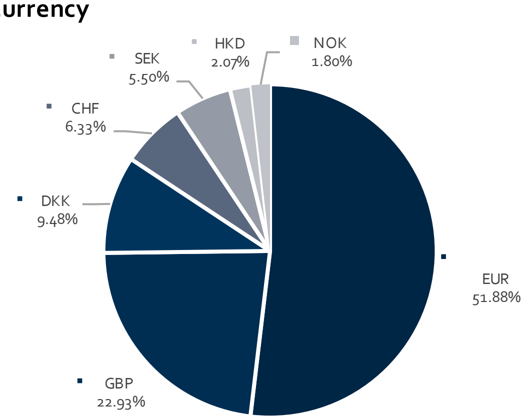
(*) Transformed from an AIF launched on 01/01/2015

Portfolio's breakdown (%)

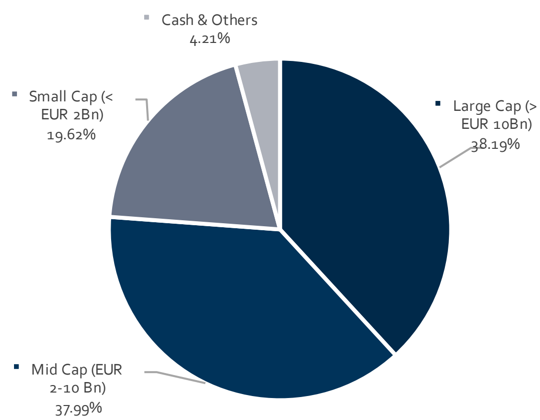
By Sector



By Currency



By Market Cap (*)



Portfolio holdings

Company Name	Sector	Industry Group	Country[1]	Market cap	Weight
SANOFI	Health Care	Pharmaceuticals, Biotechnology	France	Large Cap	3.86
FRESENIUS SE & CO KGAA	Health Care	Health Care Equipment & Services	Germany	Large Cap	3.83
BAWAG GROUP AG	Financials	Banks	Austria	Mid Cap	3.71
G4S PLC	Industrials	Commercial & Professional Services	United Kingdom	Mid Cap	3.69
RECKITT BENCKISER GROUP	Consumer Staples	Household & Personal Products	United Kingdom	Large Cap	3.61
CAIXABANK SA	Financials	Banks	Spain	Large Cap	3.57
SWATCH GROUP AG/THE-BR	Consumer Discretionary	Consumer Durables & Apparel	Switzerland	Large Cap	3.29
DANONE	Consumer Staples	Food, Beverage & Tobacco	France	Large Cap	3.18
KRONES AG	Industrials	Capital Goods	Germany	Mid Cap	3.09
ISS A/S	Industrials	Commercial & Professional Services	Denmark	Mid Cap	3.02
SAP SE	Information Technology	Software & Services	Germany	Large Cap	2.94
PUBLICIS GROUPE	Communication Services	Media & Entertainment	France	Mid Cap	2.82
NOVO NORDISK A/S-B	Health Care	Pharmaceuticals, Biotechnology	Denmark	Large Cap	2.80
SUPERDRY PLC	Consumer Discretionary	Retailing	United Kingdom	Small Cap	2.63
JOHN WOOD GROUP PLC	Energy	Energy	United Kingdom	Mid Cap	2.58
DUERR AG	Industrials	Capital Goods	Germany	Mid Cap	2.57
HENKEL AG & CO KGAA	Consumer Staples	Household & Personal Products	Germany	Large Cap	2.50
ONTEX GROUP NV	Consumer Staples	Household & Personal Products	Belgium	Small Cap	2.47
ROLLS-ROYCE HOLDINGS	Industrials	Capital Goods	United Kingdom	Large Cap	2.46
ATOS SE	Information Technology	Software & Services	France	Mid Cap	2.39
HUGO BOSS AG -ORD	Consumer Discretionary	Consumer Durables & Apparel	Germany	Mid Cap	2.33
UNILEVER NV	Consumer Staples	Household & Personal Products	United Kingdom	Large Cap	2.32
TECNICAS REUNIDAS SA	Energy	Energy	Spain	Small Cap	2.31
SAGE GROUP PLC/THE	Information Technology	Software & Services	United Kingdom	Mid Cap	2.18
HUSQVARNA AB-B SHS	Consumer Discretionary	Consumer Durables & Apparel	Sweden	Mid Cap	2.11
PRADA S.P.A.	Consumer Discretionary	Consumer Durables & Apparel	Italy	Mid Cap	2.06
STANDARD LIFE ABERDEEN	Financials	Diversified Financials	United Kingdom	Mid Cap	2.04
ANIMA HOLDING SPA	Financials	Diversified Financials	Italy	Small Cap	1.94
CLOETTA AB-B SHS	Consumer Staples	Food, Beverage & Tobacco	Sweden	Small Cap	1.84
MATAS A/S	Consumer Discretionary	Retailing	Denmark	Small Cap	1.83
FLSMIDTH & CO A/S	Industrials	Capital Goods	Denmark	Small Cap	1.81
SUBSEA 7 SA	Energy	Energy	United Kingdom	Mid Cap	1.80
JERONIMO MARTINS	Consumer Staples	Food & Staples Retailing	Portugal	Mid Cap	1.49
DOMINO'S PIZZA GROUP	Consumer Discretionary	Consumer Services	United Kingdom	Small Cap	1.49
ABB LTD-REG	Industrials	Capital Goods	Switzerland	Large Cap	1.36

Portfolio holdings (cont.)

Company Name	Sector	Industry Group	Country[1]	Market cap	Weight
NOVARTIS AG-REG	Health Care	Pharmaceuticals, Biotechnology	Switzerland	Large Cap	1.12
NORMA GROUP SE	Industrials	Capital Goods	Germany	Small Cap	1.03
ORIGIN ENTERPRISES PLC	Consumer Staples	Food, Beverage & Tobacco	Ireland	Small Cap	0.90

[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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In **Germany**, the paying agent is Marcard, Stein & Co, Ballindamm 36, D-20095 Hamburg.