

## Q&A: Investing in undervalued European companies with strong growth potential

April 2019

For Professional Clients only. Not for distribution to or to be relied upon by Retail Clients.



*"Lower valuations mean there are companies with attractive prospects that are significantly cheaper than they were."*

David Walton

The Marlborough European Multi-Cap Cell offers access to the Master onshore Marlborough European Multi-Cap Fund which has been honoured for the third successive year in the 2019 Lipper Fund Awards, earning the title **best European small and mid-cap equity fund over five years.**

Here Manager David Walton explains why lower valuations are creating attractive opportunities in European equities and shares his view on the investment outlook for the region.

**European equities are looking substantially cheaper than a year ago, has that created stock-picking opportunities for you and the team?**

"Trade tensions between the US and China, slowing economic growth - both in Europe and at a global level - and uncertainty around Brexit have all weighed on investor sentiment and resulted in lower valuations for European equities.

"According to JP Morgan, in July last year the P/E multiple on small and mid-cap Europe ex-UK

equities was 19 times and now the one-year forward P/E multiple is 14.9 times, so that's a drop of just over 20% in valuations.

"The sell-off has primarily been in cyclical stocks, because they're viewed as more sensitive to weaker economic growth, while valuations for non-cyclicals have remained firmer.

"Broadly though, what we're hearing from the companies we talk to is that, despite wider economic concerns, they're continuing to trade well. As a consequence, we believe there are interesting opportunities to be found among unloved cyclical companies."

**Can you give some examples of companies you've been buying?**

"We've taken advantage of lower share prices to add to our holdings in French staffing



---

company Synergie and Italian firm Sabaf, which makes components for gas cookers.

Both stocks have de-rated even though the two companies are continuing to trade strongly and have capable management teams and healthy balance sheets.

"In the case of Synergie, it's achieving particularly strong growth outside France and these international markets now account for just over half of sales. The company has taken over a couple of businesses during the past two years and any additional acquisitions are likely to further strengthen earnings.

"Sabaf has carved out a strong position in the fairly niche business area of manufacturing components for household gas cookers. Now, following a couple of recent acquisitions, it's broadening the business into related markets, such as making components for cookers used by commercial operations like hotels and restaurants. This is creating new growth opportunities for Sabaf and they're benefiting from synergies in areas like manufacturing and sales.

"We already liked both companies and lower valuations have, in our view, made them look more attractive."

**The fund is one of the top performers in the IA Europe ex-UK sector over three and five-year timeframes, what's driven this?**

"We're bottom-up stock-pickers with the freedom to roam across the market cap spectrum and we've been able to identify undervalued companies with above-average growth potential, particularly at the small and mid-cap end of the market. In many cases these businesses have gone on to grow very successfully.

"A good example is Italian IT company Sesa, which has been a strong performer for us over the past three years. We bought it at just under €15 in April 2016 and at the time of writing the share price is around €29. The business is continuing to grow through acquisition, as it buys up smaller regional IT services companies, and organically, through increasing sales of IT infrastructure services to large companies in Italy.

"Another stock that's done well for us is French pharmaceutical business Ipsen. It produces a drug called Somatuline, which has now established itself as the leading drug to treat neuroendocrine tumours. We first bought the stock at €46 in March 2015 and at the time of writing the share price is just over €120.

"It's true that the fund has lagged the sector over the past year. That's partly because of our exposure to cyclicals, our two biggest sectors were industrials and consumer discretionary. So, when cyclicals were the main focus of the sell-off we were hit. Compared to most funds in the sector we also have a bigger weighting to small caps, which suffered last year too.

"Since then we've worked hard to weed out any stocks where we had doubts about the investment case, but we'll be sticking with our investment process, which has served us well over the longer term, and we've been finding interesting new companies to add to the portfolio."

**How does the macroeconomic backdrop look in Europe?**

"There are certainly challenges at a macroeconomic level in Europe. A number of forecasters have revised downwards their predictions for economic growth in the Eurozone in 2019, with the European Central Bank, for example, reducing its forecast

from 1.7% to 1.1%.

"Italy slipped into recession at the end of last year, although the ECB is forecasting it will return to modest growth of 0.6% this year, and Germany, often described as the powerhouse of Europe, is experiencing a slowdown in growth.

"One of the key things about our fund though is that we look for companies that can grow their earnings without relying on the tailwind of a strong economic backdrop.

"One of the stocks we've added to the fund is Eckert and Ziegler, which is a German group that operates in a number of specialist areas, including supplying the isotopes for radioactive medicines used to treat cancer tumours.

"It's a highly specialised area and, as the market for these 'radiopharmaceuticals' grows, the company is well-positioned to benefit, so we think it has strong prospects, and the success of the business isn't reliant on the German or European economies powering ahead."

**How would you characterise the outlook for European equities?**

"The outlook has improved and we certainly see it as more positive than a year ago. Lower valuations mean there are companies with attractive prospects that are significantly cheaper than they were.

"We're also seeing an increase in merger and acquisition activity, particularly among small listed European companies. In 2017 there were takeover bids for two of our portfolio companies, last year there were five and in the first two months or so of this year we've already had two.

"The takeover bids are coming both from other companies trading in similar areas and from private equity firms. That's a

---

positive signal because it shows that they believe these businesses are attractively valued and have strong potential for the future.

"Overall, our view is that the pullback in share prices, particularly among smaller companies, has resulted in an increase in the number of interesting opportunities for stock-pickers who, like us, take a selective approach."

### Risk Warnings

The following is a summary only of some key items in the Prospectus.

Investors in Protected Cell Company (PCC) must have the financial expertise and willingness to accept the risks inherent in this investment.

**Past performance is not a reliable indicator of current or future performance and should not be the sole factor considered when selecting funds.**

It should be appreciated that the value of Shares is not guaranteed and may go down as well as up and that investors may not receive, on redemption of their Shares, the amount that they originally invested.

Investment in the Company should only be undertaken as part of a diversified investment portfolio.

Investment in the Shares should be viewed as a medium to long term investment.

Shares may not be redeemed otherwise than on any Dealing Day.

There will not be any secondary market in the shares of the Company.

The Marlborough European Multi-Cap Master Fund (The Master Fund) may use derivatives to protect the value of the Fund's assets or to reduce the costs of investing, although this may not be achieved. It is not anticipated that the use of derivatives will have any significant effect on the risk profile of the Fund. The Master Fund invests in smaller companies which carry a higher degree of risk than larger companies. The shares of smaller companies may be less liquid and their performance more volatile over shorter time periods. The Master Fund will be exposed to stock markets. Stock market prices can move irrationally and be affected unpredictably by diverse factors, including political and economic events

### Regulatory Information

The Marlborough European Multi-Cap Cell referred to is a cell of Marlborough International Fund PCC Limited (the 'Company'), a protected cell company incorporated in Guernsey and authorised as a Class B Collective Investment Scheme under the terms of the Protection of Investors (Bailiwick of Guernsey) law, 1987, as amended. Investment may only be made on the basis of the current Prospectus.

Marlborough International Management Limited is incorporated in Guernsey. Registration No. 27895. Regulated by the Guernsey Financial Services Commission.

---

 **Marlborough International Management Limited, Town Mills South, La Rue du Pre, St Peter Port, Guernsey, GY1 3HZ, Channel Islands**

 **Investor Support: +44 (0)1204 589 336**

 **Email: [enquiries@marlboroughfunds.com](mailto:enquiries@marlboroughfunds.com)**

 **Website: [www.marlboroughinternational.gg](http://www.marlboroughinternational.gg)**

**Marlborough**  
International