

European Assets Trust

Growth and yield from small-cap specialist

European Assets Trust (EAT) is a concentrated portfolio of small and mid-cap European companies, chosen for their capital appreciation potential. The manager blends stocks that have secure growth characteristics with those that may benefit from re-rating or recovery, although all the companies in the portfolio are likely to be conservatively financed and cash generative. A high distribution policy adopted in 2001 means EAT pays out 6% of its 31 December NAV as a dividend, in three instalments spread throughout the year. This has proved popular with investors and EAT often trades at a premium to NAV. Total returns over the past year have been particularly strong versus benchmark, outperforming by c 18%.

12 months ending	Share price (%)	NAV (%)	Euromoney Smaller Europe ex-UK (%)	FTSE AW Euro ex-UK (%)	FTSE All-Share (%)
30/06/12	(11.0)	(13.3)	(26.3)	(20.2)	(3.1)
30/06/13	58.9	42.5	32.6	26.7	17.9
30/06/14	21.7	17.9	26.8	15.6	13.1
30/06/15	18.2	18.1	(0.3)	0.4	2.6

Source: Thomson Datastream. Note: Total return figures.

Investment strategy: Focused but diverse portfolio

Fund manager Sam Cosh draws on the well-resourced European equity team at BMO Global Asset Management (formerly F&C) in London, to help narrow down the universe of c 2,000 European small and mid-caps to a concentrated stock list of 40-60 companies. The manager is seeking well-financed companies with healthy cash flows and high and sustainable returns on capital, and blends fast-growing businesses, those with more modest growth rates but durable franchises, and value or recovery situations to create a diversified portfolio with a quality bias.

Market outlook: Proceed with caution

European stocks have performed well so far in 2015, and have seen only limited impact from volatility around the Greek debt negotiations (interestingly, the FTSE All-Share fell further between 1 June and 15 July than either the European large-cap or small-cap indices). Looking ahead, there is less obvious valuation support for further improvements, although small-cap valuations (based on trailing P/Es) are less extended relative to history than the large-cap index average. With thin trading volumes likely over the summer and the Greek situation still fragile, investors should be mindful of potential bumps in the road over the coming months.

Valuation: Issuance keeps a lid on premium at c 2%

EAT's shares fell briefly to a discount in the market volatility of October 2014, but have since returned to trade close to net asset value, and stood at a 1.6% premium to NAV on 20 July. Demand remains strong, probably owing to the high distribution policy, as well as strong performance from the investment portfolio (+18% over 12 months to 30 June versus -0.3% for the benchmark index). This has led to significant new share issuance and the expansion of the authorised share capital to facilitate further issues (see page 7), which should prevent the premium from rising much above the current level.

Investment companies

21 July 2015

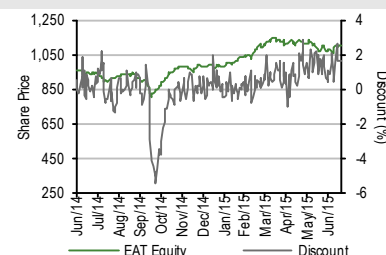
Price 1,107.5p
Market cap £308.6m
AUM £309.0m

NAV* 1,089.6p
 Premium to NAV 1.6%
 Yield 5.0%

* Including income. Data to 20 July 2015.

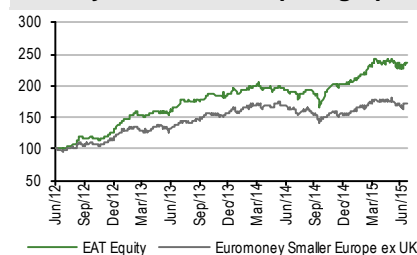
Ordinary shares in issue 27.9m
 Code EAT
 Exchanges LSE and Euronext Amsterdam
 AIC sector European Smaller Companies

Share price/discount performance*



*Including income. Positive values indicate a premium; negative values indicate a discount.

Three-year cumulative perf. graph



52-week high/low 1,155.0p 809.0p
 NAV high/low 1,148.2p 842.4p

Gearing

Gross 1.1%
 Net 1.1%

Analysts

Sarah Godfrey +44 (0)20 3681 2519
 Andrew Mitchell +44 (0)20 3681 2500

investmenttrusts@edisongroup.com

[Edison profile page](#)

Exhibit 1: Company at a glance
Investment objective and fund background

European Assets Trust is an investment company incorporated in the Netherlands and listed on the LSE and Euronext. It targets capital growth through investment in quoted small and medium-sized companies in Europe (ex-UK), taking the Euromoney Smaller Europe (ex-UK) index as benchmark. It has adopted a high distribution policy; dividends have been paid from a combination of income and capital.

Recent developments

12 May 2015: interim management statement for the three months ended 31 March. NAV TR (£) of +13.9% for the period, versus +11.3% for the index.
7 May 2015: announcement of EGM to seek agreement to increase authorised share capital from 30m to 50m shares.

Forthcoming

AGM	April 2016
Half-year results	August 2015
Year end	31 December
Dividend paid	January, May, August
Launch date	1972
Continuation vote	None

Capital structure

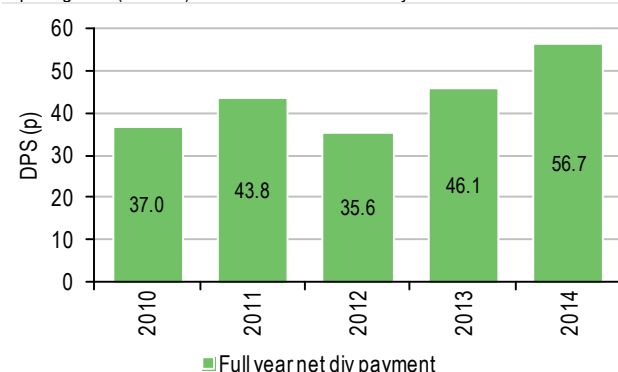
Ongoing charges	1.3%
Net gearing	1.1%
Annual mgmt fee	0.8% of gross assets
Performance fee	None
Trust life	Indefinite
Loan facilities	€45m with Kas Bank

Fund details

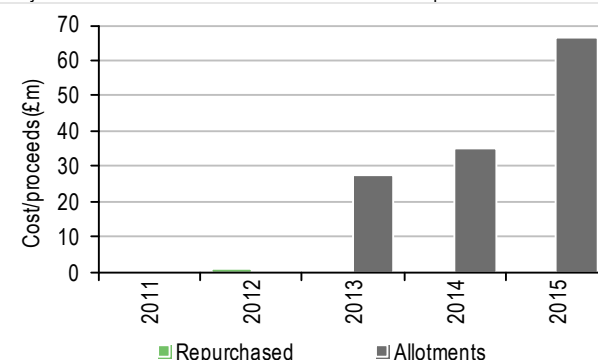
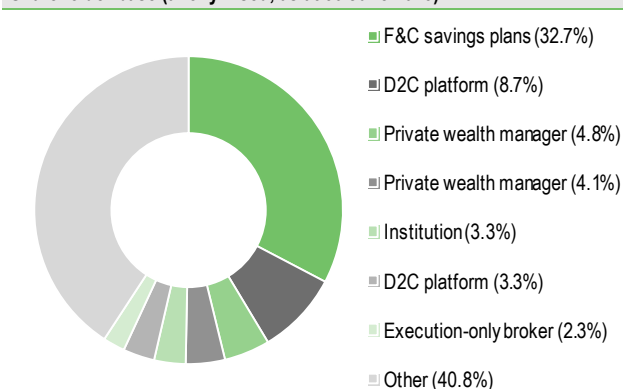
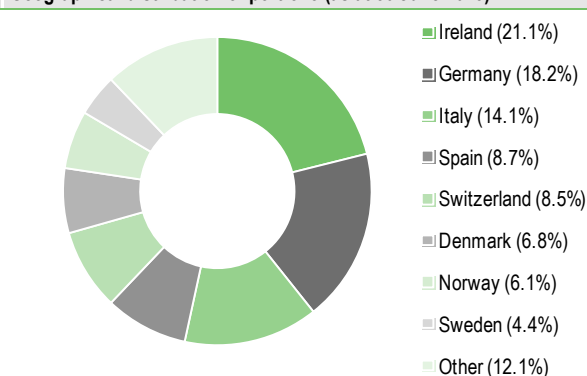
Group	BMO Global Asset Mgt (formerly F&C)
Manager	Sam Cosh
Address	Exchange House, Primrose Street, London, EC2A 2NY
Phone	+44 (0) 800 136420
Website	www.europeanassets.eu

Dividend policy and history

Three dividends are paid annually (January, May and August) totalling 6% of the opening NAV (in euros) at the start of the financial year.


Share buyback policy and history

EAT is authorised to both repurchase and allot its ordinary shares. The chart of buybacks and issuance excludes shares issued as scrip dividends.


Shareholder base (anonymised, as at 30 June 2015)

Geographical distribution of portfolio (as at 30 June 2015)

Top 10 holdings as at end June

Company	Country	Sector	Portfolio weight %	
			30 June 2015	31 December 2014*
Glanbia	Ireland	Food & nutrition	3.6	3.7
Amer Sports	Finland	Sporting goods	3.2	N/A
Leonteq	Switzerland	Financial products provider	3.2	N/A
Ringkjøbing Landbobank	Denmark	Local bank	3.2	3.1
Grafton Group	Ireland	Builders merchant	3.2	2.9
Origin Enterprises	Ireland	Agricultural services	3.1	3.1
Plastic Omnium	France	Automotive equipment	3.1	3.1
CTT Correios de Portugal	Portugal	Postal/financial services	3.1	3.1
Azimut Holding	Italy	Asset management	3.0	3.0
Gerresheimer	Germany	Medical packaging	3.0	N/A
Top 10 (% of portfolio)			31.7	31.3

Source: European Assets Trust, Edison Investment Research, Morningstar. Note: *Top 10 – N/A where not in top 10 at end December 2014.

Market outlook: A balance of considerations

European equities have performed well so far in 2015, buoyed by the introduction of quantitative easing in the eurozone (announced in January and implemented in March). Smaller companies as measured by the Euromoney Smaller Europe ex UK index produced a total return of 11.1% from 1 January to 15 July, with the mainstream FTSE All World Europe ex-UK index a little behind this at 8.8%. The recent (and potentially ongoing) Greek debt crisis has had limited impact, with the small-cap index posting a negative total return of 2.3% from 1 June to 15 July, while the large-cap index declined by 1.8%. Interestingly, the UK FTSE All-Share index has fallen further than both European indices during this period, down 2.6% from 1 June to 15 July.

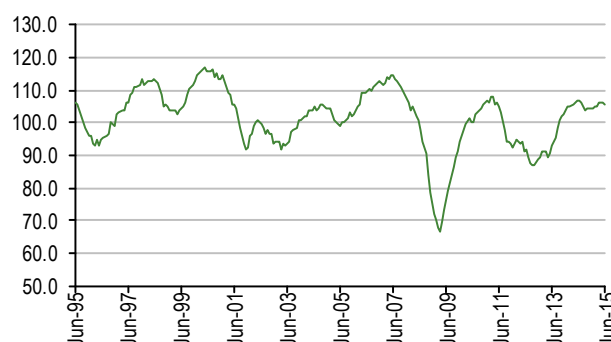
Signals are mixed as to what is likely to happen next. Economic sentiment in the EU (Exhibit 3) is above the long-term average of 100, although recent readings have been relatively flat. Meanwhile, valuations for both small and larger companies in various European markets and across the continent are in most cases above long-term averages (Exhibit 4), which may indicate that near-term price upside is limited. However, small-cap valuations are less extended in aggregate than those of larger companies, meaning there may be better value opportunities in this area.

Exhibit 2: European small-caps relative to large-caps



Source: Thomson Datastream

Exhibit 3: EU economic sentiment indicator



Source: European Commission services

Exhibit 4: Valuation comparison

Price to earnings ratio (x)	Last	10-year average	Last % of average
Europe ex UK	18.1	13.8	131%
Germany small cos	16.2	14.5	112%
France small cos	14.4	14.2	102%
Italy small cos	19.8	23.5	84%
UK	17.4	13.0	134%
World	18.3	15.4	118%

Source: Thomson Datastream. Note: As at 15 July 2015. Uses Datastream indices. Trailing P/E ratios.

Fund profile: Small-cap growth with 6% distributions

European Assets Trust was launched in 1972 as a Dutch company and has stock market listings in London and the Netherlands. It has been managed since launch by the same firm, recently renamed as BMO Global Asset Management (formerly F&C) following its acquisition in 2014 by the Bank of Montreal. Lead fund manager Sam Cosh joined the company in 2010 and has been at the helm of EAT since October 2011.

The fund invests in European small and mid-caps, not in itself a high-yielding area, but since 2001 EAT has had a high distribution policy, initially adopted in order to distribute its reserves tax-efficiently following a Dutch rule change. The distribution is set at 6% of the 31 December NAV, declared each 1 January (see page 7), and may be paid out of capital as well as income. The ability to pay dividends out of capital has only recently become available to UK investment trusts, so for some time

EAT was unusual among its closed-ended peers. The high yield has led to strong demand for EAT's shares, and it manages the premium to NAV by regularly issuing new shares (5.9m in 2015 to date).

The fund manager: Sam Cosh

The manager's view: Pockets of value remain

Manager Sam Cosh notes that with European equities having been buoyant through most of the first half of 2015, there is less obvious value in the market. Two areas where valuations remain less extended are financials and resources; of these Cosh prefers financials, which make up the largest portion of the portfolio (see Current positioning). Regulatory provisions such as Basel III and Solvency II are more problematic for larger players, giving rise to opportunities for smaller and more nimble financial companies, such as Swiss structured product provider Leonteq, Italian asset managers Azimut and Banca Generali, and Irish consumer bank Permanent TSB. "Because of poor decision making at the peak of the last cycle, there has been massive capital destruction among the large banks, at the same time as they face more difficult regulatory requirements," says Cosh. He adds: "smaller, more nimble companies can exploit this situation and are emerging as winners as the market recovers, and we do not think that these businesses look expensive."

While acknowledging that some of the performance of European equity markets in 2015 has come as a result of late-cycle quantitative easing, implemented earlier in the year, Cosh notes that the recent earnings season has been supportive of further gains. "There is more reason to think a profits recovery is happening," he says. "There have been structural reforms across most of Europe, cheaper energy prices, bank lending is on the up, consumer confidence is increasing and leading indicators are pointing in the right direction."

Cosh notes that the situation in Greece has caused volatility, but says he does not see a systemic risk to the region, arguing that other peripheral countries have made a great deal of progress since the financial crisis, and pointing out that Greece is a very small part of the eurozone economy.

Asset allocation

Investment process: Focus on cash-generative small-caps

EAT's manager chooses the stocks for the concentrated portfolio (c 40-60 holdings) from a broad pool of around 2,000 quoted European small and mid-cap companies. Cosh is supported in this by the European equities team at BMO Global Asset Management (formerly F&C), who research the universe and produce a note on all potential holdings, giving each stock a ranking, a qualitative score and an intrinsic value figure. This gives Cosh an information advantage, because the European small-cap sector is not well covered by sell-side analysts, and he uses these internal analyst notes, as well as meetings with company management, to identify stocks with the attributes he seeks: strong balance sheets, healthy cash flows and high and sustainable returns on capital.

The manager assigns portfolio holdings to one of four broad categories:

- Durable franchise – the core of the portfolio (typically 40-50%; currently 38.6% at 30 June) is in companies with at least modest growth potential, that have disciplined management and robust business models.
- Wide moat growth – 25-30% of the portfolio (currently 32.9%) is in faster-growing companies with a strong brand, a unique product or a high market share in a competitive industry.
- Transformation/recovery – 15-20% of the portfolio (currently 20.6%) is in stocks that may be undervalued but have a catalyst for change, such as new management.
- Deep value – 10-15% of the portfolio (currently 7.9%) is invested in out-of-favour companies where Cosh feels the recovery or growth potential is underappreciated.

The current category weightings represent a reduction in deep value positions from 11.8% in September, and an increase in wide moat growth from 28.3%. However, moves in the category weightings do not necessarily denote portfolio changes; the 'buckets' are reviewed quarterly and stocks may be moved from one to another – for example Dutch semiconductor company ASMI has been reclassified from transformation/recovery to wide moat growth, as the manager feels the transformation has now taken place and the company is well placed to continue to grow.

In terms of sell discipline, holdings are monitored against valuation targets and will be reviewed when they reach these targets or if they have risen or fallen in value by more than 25% relative to the benchmark.

Current portfolio positioning

At 30 June 2015, EAT had 43 holdings, towards the lower end of its 40-60 stock range. The top 10 stocks made up 31.7% of the portfolio but only 1.4% of the benchmark, illustrating EAT's high 'active share'. The portfolio is more focused than any of its European smaller company peers.

Exhibit 5: Portfolio sector allocations

Euromoney sector	Portfolio 30 June (%)	Benchmark* 30 June (%)	Active weight (% pts)	Trust weight/ benchmark weight
Financials	30.2	21.6	8.6	1.4
Industrial goods	18.6	14.3	4.3	1.3
Consumer goods	19.2	16.9	2.3	1.1
Retail providers	8.7	7.2	1.4	1.2
Technology	6.6	7.7	-1.1	0.9
Natural resources	0.0	1.8	-1.8	0.0
Basic materials	4.4	10.6	-6.2	0.4
Business providers	12.4	19.9	-7.6	0.6
	100.0	100.0	0.0	

Source: European Assets Trust, Euromoney, Edison Investment Research. Note: EAT holdings classified by Euromoney sectors. *Benchmark is Euromoney Smaller Europe (ex-UK). Ranked by active weight.

In line with Cosh's favourable view of the sector (see The manager's view), financials make up the largest absolute and relative weighting (Exhibit 5). A notable holding in this area is Leonteq, bought during 2014 and now a top-10 position as a result of strong performance. Cosh says the Swiss company, which designs and manages structured financial products, is quickly taking market share because its custom-built and integrated systems are much more efficient and lower cost than those of its main competitors, the banks, which are beginning to withdraw from the market and instead place their own structured products business with Leonteq.

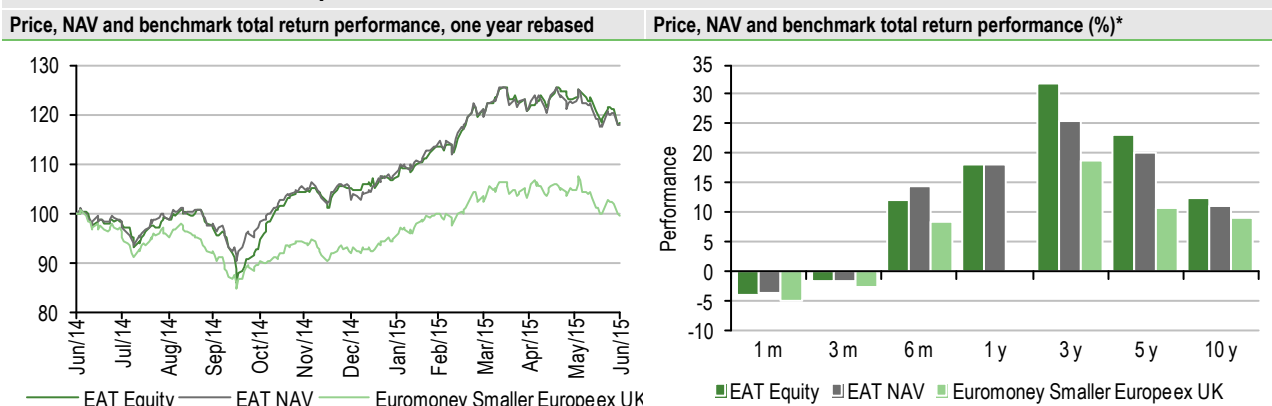
New purchases in 2015 include: Cerved Information Solutions, an Italian provider of credit information to corporates and banks; Atresmedia, a Spanish broadcaster well-placed to benefit from an expected improvement in advertising sales; and Permanent TSB, a conservatively run Irish bank which trades on a valuation below its book value, giving plenty of scope for recovery.

Recent sales include Partners Group, whose share price had risen by 270% since it was first purchased in 2007, sold as the valuation no longer looked attractive. Other exits from the portfolio have been as a result of M&A activity; Nutreco, Jazztel and Exact were all taken over in recent months, with Aer Lingus also expected to leave the portfolio after a takeover approach from International Airlines Group. Poor performance does not necessarily trigger a sale; Cosh has added to holdings in agricultural stock Origin Enterprises and Norwegian financials Sparebank and Storebrand on recent price weakness, as he sees recovery potential in all three companies.

Large inflows as a result of new share issuance have largely been deployed in topping up existing holdings. Cosh notes that market liquidity is good so there is no difficulty in adjusting positions. The current low level of gearing is partly a function of having sufficient cash from newly-issued shares to expand the portfolio without needing to borrow, and partly a result of there being fewer obvious value opportunities in the market at present.

Performance: Outperforming over all periods

Exhibit 6: Investment trust performance



Source: Thomson Datastream, Edison Investment Research. *Note: Three-, five- and 10-year figures are annualised.

Exhibit 7: Share price and NAV total return performance (sterling adjusted), relative to indices (%)

	One month	Three months	Six months	One year	Three years	Five years	10 years
Price relative to Euromoney Smaller Eur ex UK	1.0	1.2	3.7	18.6	36.4	70.8	36.9
NAV relative to Euromoney Smaller Eur ex UK	1.4	1.4	5.8	18.5	18.3	51.3	21.8
Price relative to FTSE AW Europe Ex UK	1.7	4.3	7.4	17.7	55.4	86.6	61.5
NAV relative to FTSE AW Europe Ex UK	2.2	4.5	9.6	17.5	34.8	65.3	43.7
Price relative to FTSE All Share	1.9	0.0	9.0	15.2	67.0	70.2	64.9
NAV relative to FTSE All Share	2.3	0.2	11.3	15.1	44.8	50.8	46.8

Source: Thomson Datastream, Edison Investment Research. Note: As at end June 2015. Geometric calculation.

EAT has significantly outperformed the Euromoney Smaller Europe ex UK index over the past 12 months (Exhibit 6), with NAV and share price total returns of c 18%, while the benchmark has been flat. Outperformance was most notable between October and March, with the quality focus of the portfolio a major driver of returns, particularly in the early part of this period, when Europe was less favoured by many investors. The market rallied broadly following the introduction of quantitative easing by the ECB in early 2015, and with no particular style or sector performing better than others in this period, performance has been closer to, although still ahead of, the index in recent months. In spite of a relatively dull period versus the index from mid-2013 until mid-2014 (Exhibit 8), EAT has outperformed not just the small-cap benchmark but also the broader European market and the FTSE All-Share over all periods up to 10 years (Exhibit 7) on both a share price and NAV basis.

We have previously noted that EAT tends to underperform in a strongly rising market. This has not been the case since the start of 2015, and the manager explains that this is because the increase has been broad-based, rather than a classic cyclical value rally in which lower-quality stocks (under-represented in the EAT portfolio) tend to perform most strongly.

Exhibit 8: Five-year NAV performance relative to benchmark, rebased to 100

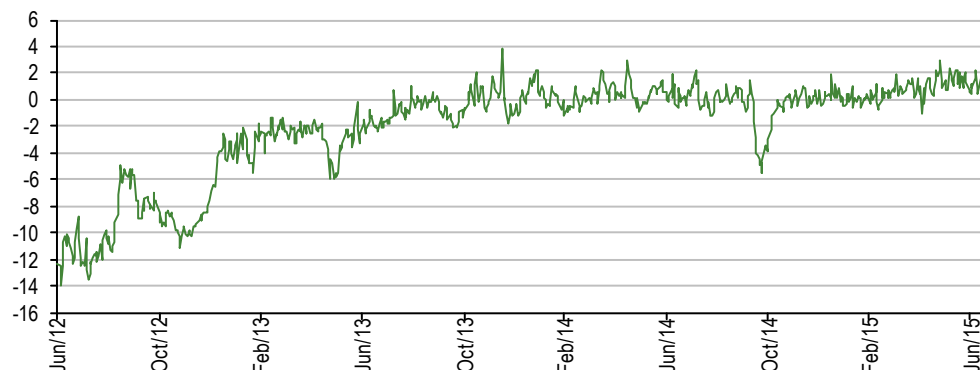


Source: European Assets Trust, Thomson Datastream, Edison Investment Research

Discount: Back at a premium since October dip

Following a spell of market volatility in October 2014, during which the discount widened to a 12-month high of 5.5%, EAT's shares rerated and during 2015 have traded broadly close to par or at a small premium. At 20 July, the cum-income premium to NAV was 1.6%, higher than the 0.2% average premium over one year. Over three and five years, EAT has traded at an average discount of 2.0% and 5.9% respectively. Continued share issuance (see Capital structure, below) has helped keep the premium at a manageable level.

Exhibit 9: Discount/premium over three years (including income)



Source: Thomson Datastream, Edison Investment Research. Note: Data to 20 July 2015.

Capital structure and fees

EAT is conventionally structured, with one class of share. With the shares trading more or less consistently at a premium since early 2013, the company has issued a significant amount of new shares (7.0m in the 12 months to 20 July 2015, raising £74.4m), and in early July it was granted the authority to increase its authorised share capital from 30 million to 50 million shares, with a nominal value of €0.46. At 20 July there were 27.9m shares in issue. The company may gear up to 20% of net assets and at 30 June had net gearing of 1.1%. There is a €45m borrowing facility in place with Kas Bank.

FCA Management BV (the Dutch management board director) receives a fixed fee for its services, amounting to €102,947 in FY14, with a one-off extra payment of €24,200 in connection with Alternative Investment Fund Management Directive (AIFMD) implementation. F&C Investment Business (the investment manager), a subsidiary of BMO Global Asset Management, receives a quarterly fee of 0.2% of net assets. Ongoing charges for FY14 were 1.33%, or 1.27% excluding one-off AIFMD costs. Fees are charged to the revenue account, and there is no performance fee.

Dividend policy and record

EAT's Dutch incorporation status allowed it to adopt a high distribution policy in 2001, well before UK rules allowed the payment of dividends from capital. A dividend equivalent to 6% of NAV on 1 January is paid in three equal instalments (in January, May and August), the value of which may vary for UK investors because the annual dividend is declared in euros but the sterling value is calculated shortly before each payment. Shareholders may elect to receive the dividend as further shares (a 'scrip' dividend). Because the distribution is paid as a fixed percentage of NAV rather than being based on income received, it will vary from year to year and may fall as well as rise. The 2015 dividend will be €0.7581 per share, an 8.5% increase on the previous year. Applying the exchange rate used for the 30 January dividend payment to the whole annual distribution gives a

figure of 58.0p, which equates to a dividend yield of 5.2% based on the 20 July share price of 1,107.5p. All dividends are paid net of Dutch withholding tax where applicable.

Peer group comparison

There are four funds in the AIC's European Smaller Companies peer group, of which EAT is the second-smallest. In NAV total return terms, EAT has the strongest performance over one, three and five years, and is also first of four for risk-adjusted performance as measured by the Sharpe ratio, over one and three years. Because of its 6% capital distribution policy, EAT has substantially the highest yield, which is a source of demand underlying the premium to NAV (1.7% compared with an average discount of 5.9%). EAT has the lowest gearing in the peer group and is ranked mid-table for ongoing charges.

Exhibit 10: European Smaller Companies investment trusts

% unless stated	Market cap £m	TR one year	TR three years	TR five years	Ongoing charge	Perf. fee	Discount(-)/premium	Net gearing	Yield	Sharpe NAV 1 year	Sharpe NAV 3 years
European Assets Trust	309.4	22.3	103.6	141.4	1.3	No	1.7	102.0	5.3	1.4	1.9
JPMorgan European Smaller Cos	401.6	14.0	93.3	76.5	1.3	No	-9.2	112.0	1.3	0.4	1.3
Montanaro European Smaller	88.8	4.4	36.8	51.7	1.5	No	-8.4	105.0	1.5	-0.3	0.8
TR European Growth	322.6	13.1	102.5	81.6	0.7	Yes	-8.5	109.0	1.0	0.4	1.6
Sector weighted average		15.3	94.3	93.9	1.2	0.0	-5.9	107.8	2.3	0.6	1.5
EAT rank in sector	3	1	1	1	2		1	4	1	1	1

Source: Morningstar, 17 July 2015, Edison Investment Research. Notes: TR = total return. The Sharpe ratio is a measure of risk-adjusted return. The ratios we show are calculated by Morningstar for the past 12- and 36-month periods by dividing a fund's annualised excess returns over the risk-free rate by its annualised standard deviation. Net gearing is shown here as total assets less cash/cash equivalents as a percentage of shareholders' funds.

The board

EAT is incorporated in the Netherlands and has a two-tier board structure, in line with Dutch corporate governance practice. The management board has a single director, FCA Management BV, represented by Wilbert von Twuijver and Tim Koster. The supervisory board is broadly analogous with the board of a UK investment trust, and currently has six directors. Jack Perry, who joined the board in 2014, was appointed chairman at the April 2015 general meeting, in place of Sir John Ward, who – with fellow director Neville Cook – has previously announced his intention to retire from the board later this year. The other directors are Professor Robert van der Meer, Julia Bond and Laurence Jacquot. A seventh director, Duco Sickinghe, stood down at the end of FY14.

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