

# TR European Growth Trust

## Small-cap value focus delivers outperformance

TR European Growth Trust (TRG) invests in a diversified portfolio of small and mid-cap European (ex-UK) companies, with the aim of achieving capital growth. Its manager at Janus Henderson Investors seeks companies that are undervalued as a result of being misunderstood by the market. The portfolio is weighted towards the smaller end of the market cap spectrum, where companies are less well-researched. As recovery has taken hold in Europe, TRG's recent performance has been exceptionally strong. It has beaten its benchmark, the EMIX Smaller Europe ex-UK index, in share price and NAV total return terms over the last five discrete years to 31 October, and cumulatively over one, three and six months, and one, three, five and 10 years. It also ranks first in its peer group over one, three and five years. TRG actively manages gearing in a range of up to 15% of net assets (13% at end-October 2017), does not tend to hedge currency exposure, and currently offers a dividend yield of 1.2%.

12 months ending	Share price (%)	NAV (%)	EMIX Smaller Europe ex-UK (%)	FTSE World Europe ex-UK (%)	FTSE All-Share (%)
31/10/13	58.7	49.6	44.3	32.5	22.8
31/10/14	(1.0)	(2.1)	(2.7)	(0.8)	1.0
31/10/15	19.8	18.0	13.2	5.2	3.0
31/10/16	35.1	40.0	29.5	19.7	12.2
31/10/17	57.9	33.4	23.0	19.9	13.4

Source: Thomson Datastream. Note: All % on a total return basis in GBP.

## Investment strategy: Diversified small-cap portfolio

TRG is managed on a bottom-up basis, with lead manager Ollie Beckett, assisted by Rory Stokes, employing a range of screens and valuation measures, and attending hundreds of company meetings each year, to identify undervalued stocks with attractive growth or recovery characteristics. The managers select from a universe of c 2,000 broadly sub-€4bn companies across Europe (ex-UK), and hold a diversified portfolio of 140+ companies in order to limit stock-specific risk.

## Market outlook: Time for a more selective approach

Equity markets have performed strongly in most regions of the world so far in 2017, shrugging off geopolitical tensions, monetary policy gear-shifts and risks from the UK's Brexit negotiations. Average valuations are at high levels relative to history, although strong earnings growth has provided a measure of support to share prices. Against such a backdrop, investors may favour a strategy that seeks out undervalued companies, which could offer greater-than-average upside potential.

## Valuation: Steady rerating to near-par

At 24 November 2017, TRG's shares traded at a 0.6% discount to cum-income net asset value. This is a significant rerating compared with average discounts of 8.8%, 10.9%, 12.1% and 13.3% respectively over one, three, five and 10 years, and comes on the back of exceptionally strong performance since mid-2016. The board has issued 395,000 new shares at a premium in order to satisfy investor demand.

## Investment trusts

28 November 2017

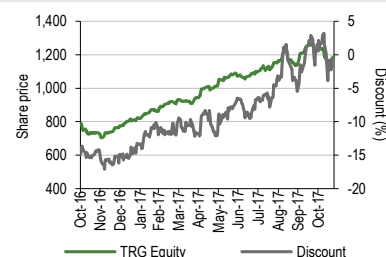
<b>Price</b>	<b>1,188.5p</b>
<b>Market cap</b>	<b>£595.5m</b>
<b>AUM</b>	<b>£634.6m</b>

NAV*	1,194.8p
Discount to NAV	0.5%
NAV**	1,195.3p
Discount to NAV	0.6%

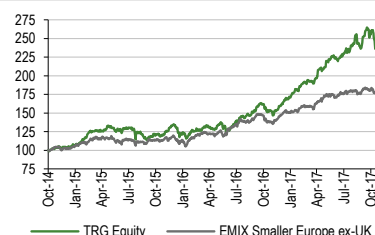
\*Excluding income. \*\*Including income. As at 24 November 2017.

Yield (including special dividend)	1.2%
Ordinary shares in issue	50.1m
Code	TRG
Primary exchange	LSE
AIC sector	European Smaller Companies
Benchmark	EMIX Smaller Europe ex-UK

## Share price/discount performance



## Three-year performance vs index



52-week high/low	1,270.0p	703.0p
NAV** high/low	1,244.9p	836.5p

\*\*Including income.

## Gearing

Gross*	13.0%
Net*	13.0%

\*As at 31 October 2017.

## Analysts

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**TR European Growth Trust is a research client of Edison Investment Research Limited**

### Exhibit 1: Trust at a glance

#### Investment objective and fund background

TR European Growth Trust's objective is to achieve capital growth by investing in smaller and medium-sized companies in Europe (ex-UK). It aims to achieve a net asset value total return in excess of the benchmark EMIX (formerly Euromoney) Smaller Europe ex-UK index (in sterling terms).

#### Recent developments

- 2 October 2017: Results for the year ended 30 June. NAV TR +54.0% versus +35.8% for benchmark. Share price TR +75.5% (all in sterling). Ordinary dividend of 11.5p plus 3.0p special dividend (FY16: 9.0p plus 2.5p special).
- 13 September 2017: Application for a blocklisting of 1m new shares.
- 11 May 2017: TRG director Christopher Casey appointed as a non-executive director of Eddie Stobart Logistics.

#### Forthcoming

AGM	November 2018
Interim results	February 2018
Year end	30 June
Dividend paid	November
Launch date	1990
Continuation vote	Three-yearly, next 2019

#### Capital structure

Ongoing charges	0.79%
Net gearing	13.0%
Annual mgmt fee	0.60%
Performance fee	Yes (see page 7)
Trust life	Indefinite
Loan facilities	£80m overdraft

#### Fund details

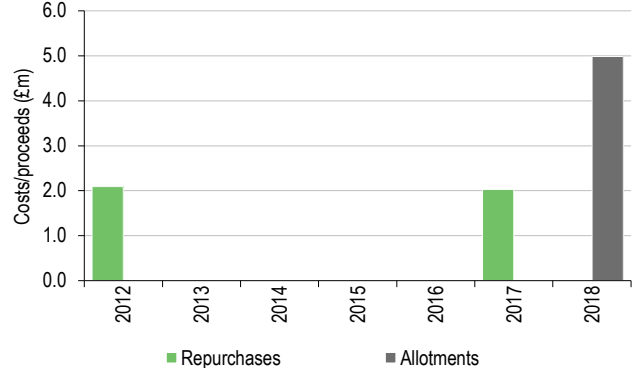
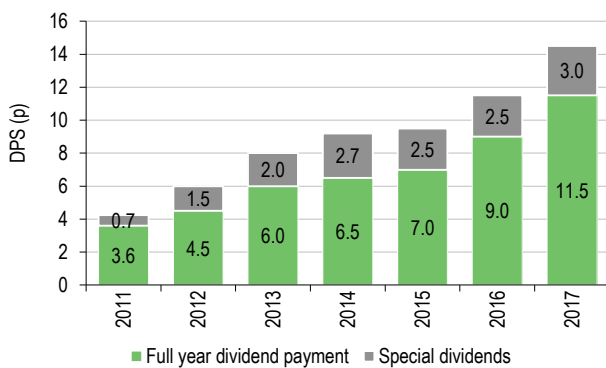
Group	Janus Henderson Investors
Manager	Ollie Beckett, Rory Stokes
Address	201 Bishopgate, London EC2M 3AE
Phone	+44 (0) 20 7818 6825
Website	<a href="http://www.treuropeangrowth.com">www.treuropeangrowth.com</a>

#### Dividend policy and history (financial years)

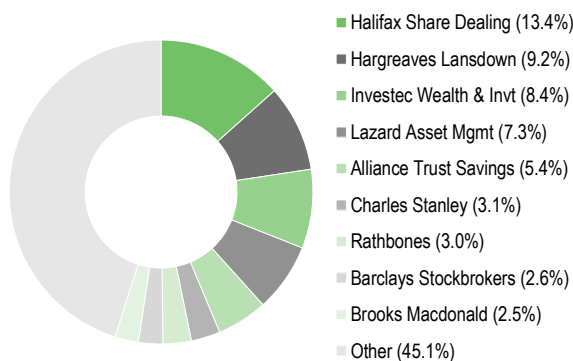
Dividends paid annually in November. While TRG's primary aim is to achieve capital growth, the board also hopes to maintain and grow the ordinary dividend. Special dividends have also been paid in each of the last eight financial years.

#### Share buyback policy and history (financial years)

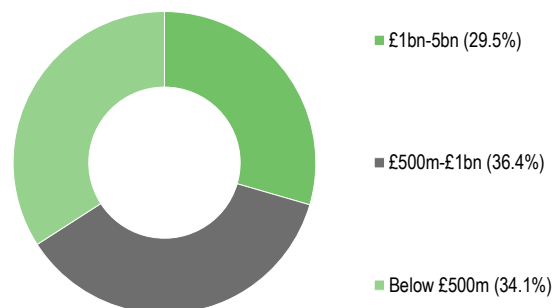
TRG has the authority, renewed annually, to buy back up to 14.99% of shares and allot up to 10% of shares to manage a discount or a premium. Buybacks are at the board's discretion following the removal in 2010 of an obligation to repurchase if the discount exceeded 10%.



#### Shareholder base (as at 31 October 2017)



#### Portfolio exposure by market cap (as at 31 Oct 2017, adjusted for gearing)



#### Top 10 holdings (as at 31 October 2017)

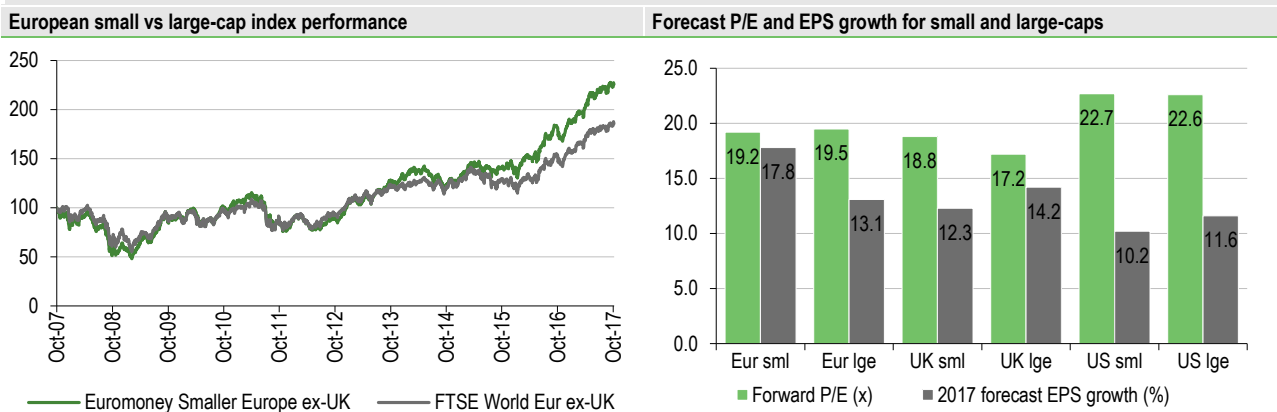
Company	Country	Sector	Portfolio weight %	
			31 October 2017	31 October 2016*
Van Lanschot Kempen	Netherlands	Financial	2.2	1.9
Brainlab	Germany	Industrial goods	1.9	2.7
FinecoBank	Italy	Financial	1.5	1.3
Meyer Burger Technology	Switzerland	Technology	1.4	N/A
OC Oerlikon	Switzerland	Technology	1.3	1.4
SOITEC	France	Technology	1.3	N/A
Kaufman & Broad	France	Consumer goods	1.2	N/A
Nexans	France	Industrial goods	1.1	1.1
DFDS	Denmark	Business providers	1.1	N/A
Lenzing	Austria	Basic materials	1.1	N/A
<b>Top 10 (% of holdings)</b>			<b>14.1</b>	<b>14.7</b>

Source: TR European Growth Trust, Edison Investment Research, Bloomberg, Morningstar. Note: \*N/A where not in October 2016 top 10.

## Market outlook: Strong earnings but high valuations

Equity market returns have been strong across the globe so far in 2017, with many indices reaching all-time highs. As shown in Exhibit 2 (left-hand chart), smaller companies in Europe (ex-UK) have opened up a performance advantage over large-caps since mid-2015, helping funds like TRG to achieve strong returns. Yet with average valuations in most markets looking extended relative to history, investors may wonder whether the next market move might be downwards. There are some concerns over the future pace of economic growth, the direction of monetary policy, the outcome of European elections (Italy goes to the polls next year) and the Brexit negotiations. However, the strong earnings growth seen in many markets this year (right-hand chart – figures are forecasts for the full year, calculated in September 2017) could provide a measure of support, with European smaller companies beating their larger brethren and both large- and small-caps in the US and the UK. Against such a backdrop, a fund with a focus on spotting undervalued opportunities could provide superior growth potential, and a measure of downside protection should markets go into reverse.

**Exhibit 2: Market performance and valuation**



Source: Thomson Datastream, TR European Growth Trust, Edison Investment Research

## Fund profile: Growth from undervalued small-caps

TRG invests for long-term capital appreciation in a diversified portfolio of small and mid-cap European (ex-UK) companies. Listed on the London Stock Exchange, it was launched in 1990 and has been managed since 1992 by Janus Henderson Investors and its predecessor companies. Lead portfolio manager Ollie Beckett has been in place since 2011, and is assisted by Rory Stokes (since 2013). Performance is measured against the EMIX (formerly Euromoney) Smaller Europe ex-UK index (in sterling), and the trust is a member of the Association of Investment Companies' European Smaller Companies sector. TRG does not tend to hedge currency exposure.

The managers prefer to seek undervalued opportunities, and focus on the smaller end of the investment universe, with slightly more than 70% of the portfolio in sub-£1bn stocks. The weighted average market capitalisation of portfolio companies at 30 June 2017 was c £1.1bn, compared with an average of c £1.5bn for the index. Because smaller companies can be less liquid and may carry higher business risk, TRG's broadly unconstrained portfolio is diversified across more than 140 stocks in order to mitigate stock-specific risk. Gearing is available in a normal working range of up to 15% of net assets, and up to 20% of the portfolio may be held in cash or fixed interest. Although capital appreciation is the primary objective, TRG also has a 13-year record of year-on-year dividend growth, with special dividends paid in 12 of the last 14 financial years. From FY18, the trust is expected to pay both an interim and a final dividend.

## The fund manager: Ollie Beckett

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### The manager's view: Contrarian approach reaps rewards

European small-caps have finally begun to reap the benefits of a global economic and earnings recovery that was slow to take root in Europe, according to Beckett. US and UK smaller companies had benefited sooner, as they are concentrated in tech and service sectors, whereas the more industrial European firms had suffered from lower-cost competition in Asia. The biggest earnings upgrades have been in Southern Europe and France, the latter driven in part by relief over Marine Le Pen's election defeat. Beckett says the continuance of this positive earnings trend will depend to an extent on whether the US or China begin to slow down, as growth in the world's top two economies helps fill the order books of European exporters. He adds that IPO and secondary issuance is buoyant, supported by positive fund flows. However, as a value-focused investor used to taking contrarian views, Beckett has reacted to this enthusiasm by reducing gearing from c 15% to c 10%, selling stocks with strong earnings momentum that have been bid up to what he sees as unsustainable valuations. "It is not easy for a new buyer to come in at 40x P/E; at some point it has to come to an end," he comments.

With both small- and large-cap fund managers crowding into mid-caps, Beckett and Stokes continue to seek opportunities in under-researched smaller companies, employing a variety of screens to filter the large universe for undervalued opportunities, and using face-to-face company meetings to pick up on moments of change that could lead to a market reappraisal.

## Asset allocation

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### Investment process: Value-focused, bottom-up portfolio

Beckett and Stokes aim to build a well-diversified portfolio of small and mid-cap European (ex-UK) stocks, drawn from a universe of c 2,000 companies with a market cap below c €4bn. They initially use quantitative screens to identify stocks that are undervalued, and where they believe the market perception is wrong. The managers meet hundreds of companies each year, preferring to be proactive in seeking meetings rather than relying on roadshows or analyst calls. This helps them assess the quality of management, business model durability, drivers of growth and catalysts for revaluation.

Promising investment candidates are modelled using a range of valuation metrics such as P/E, EV/EBITDA, free cash flow and dividend yield, to ensure the managers understand the relationship between current valuation and growth potential. Where they decide to invest, initial positions are sized according to conviction, although with more than 140 stocks in the portfolio, few holdings account for more than 1% of assets. The managers tend to be overweight the smaller end of the market, with 71% of the portfolio (adjusted for gearing, at 26 September) in companies with a market cap below £1bn, compared with 46% of the benchmark index. Stock selection is mainly bottom-up, with no constraints on country or sector weightings, although the managers do consider the macro backdrop. No stock may exceed 7% of the portfolio at the time of investment.

The majority of the portfolio is in stocks offering 'growth at a reasonable price', with structural drivers allowing them to grow throughout the cycle, and high returns on capital meaning the managers are 'paid to wait' for a rerating. Turnaround situations, where new management can drive positive earnings surprises, and unloved 'deep value' stocks, which are cyclically out of favour, make up the balance of investments. Holding a large number of names helps to reduce stock-specific risk. Gearing is permitted in a normal working range of up to 15% of net assets. Holdings may be sold when they reach the managers' assessment of fair value, if worsening fundamentals call the original thesis into question, or where there are better investment opportunities elsewhere. Turnover was 49.3% for FY17 and has averaged 50.0% over the past five years.

## Current portfolio positioning

At 31 October 2017, there were 149 holdings in the TRG portfolio, broadly unchanged on the figure of 148 at 31 October 2016. The top 10 holdings accounted for 14.1% of the portfolio, compared with 14.7% a year earlier. Beckett comments that the long stock list reflects TRG's positioning as a true small-cap fund, and also its focus on more value and cyclical situations. While mainly a bottom-up portfolio, geographical weightings (Exhibit 3) do reflect some top-down concerns – for example, Sweden is the largest underweight, as the market became very expensive. Conversely, Spain (more than 7% of the index but only 1.8% of the fund) has been a long-term underweight largely for stock-specific reasons, as Beckett tends to find relatively few well-run, entrepreneurial listed small-caps there. Finland is the largest overweight (more than twice the index weight, at 11.1%); it has also seen the biggest increase in exposure over the past 12 months, up 5.9pp. Beckett says this is partly a recovery trade, as the economy had suffered on weak demand from Russia and the demise of Nokia, although he also notes that many Finnish companies look interesting on a bottom-up basis.

**Exhibit 3: Portfolio geographic exposure vs EMIX Smaller Europe ex-UK index**

	Portfolio end-Oct 2017 (%)	Portfolio end-Oct 2016 (%)	Change (pp)	Index weight (%)	Active weight vs index (pp)	Trust weight/index weight (x)
Germany	18.6	19.3	(0.7)	16.1	2.5	1.2
France	12.7	14.9	(2.2)	11.4	1.3	1.1
Italy	10.6	7.9	2.7	12.6	(2.0)	0.8
Finland	11.1	5.2	5.9	N/S	N/A	N/A
Netherlands	9.8	10.5	(0.7)	5.8	4.0	1.7
Switzerland	9.3	8.7	0.6	9.5	(0.2)	1.0
Sweden	6.8	6.2	0.6	13.5	(6.7)	0.5
Norway	4.0	3.6	0.4	4.5	(0.5)	0.9
Belgium	4.4	4.4	0.0	N/S	N/A	N/A
Denmark	3.3	4.5	(1.2)	4.4	(1.1)	0.8
Other markets	9.4	14.8	(5.4)	22.2	(12.8)	0.4
	<b>100.0</b>	<b>100.0</b>		<b>100.0</b>		

Source: TR European Growth Trust, Edison Investment Research. N/S=not stated.

In sector terms (Exhibit 4), TRG has a long-standing bias towards industrials, consumer discretionary and technology. Beckett says the portfolio is always overweight technology, as “I am trying to buy smaller companies that are going to grow, and a lot of those will be tech companies”. The portfolio is underweight defensive areas such as consumer staples, utilities and healthcare.

**Exhibit 4: Portfolio sector exposure vs EMIX Smaller Europe ex-UK index**

	Portfolio end-Oct 2017 (%)	Portfolio end-Oct 2016 (%)	Change (pp)	Index weight (%)	Active weight vs index (pp)	Trust weight/index weight (x)
Industrial goods	24.0	26.4	(2.4)	15.6	8.4	1.5
Business providers	15.6	13.9	1.7	19.9	(4.3)	0.8
Technology	15.1	12.7	2.4	9.1	6.0	1.7
Financial	14.8	15.1	(0.3)	21.3	(6.5)	0.7
Basic materials	13.8	11.6	2.2	11.1	2.7	1.2
Consumer goods	10.3	10.4	(0.1)	14.7	(4.4)	0.7
Retail providers	5.7	8.7	(3.0)	6.8	(1.1)	0.8
Natural resources	0.7	1.2	(0.5)	1.5	(0.8)	0.5
	<b>100.0</b>	<b>100.0</b>		<b>100.0</b>		

Source: TR European Growth Trust, Edison Investment Research.

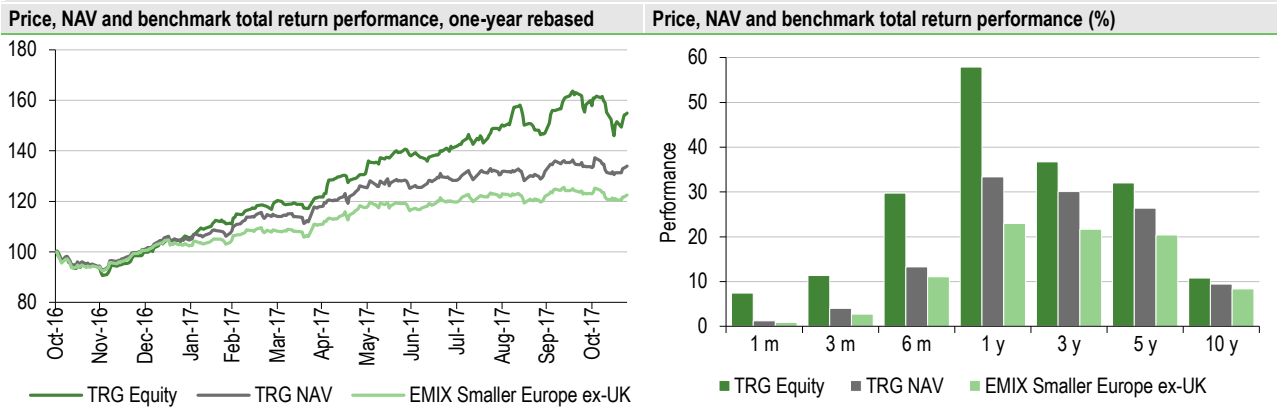
Recent purchases include Swedish online fashion retailer Boozt, Norwegian transportation and heavy machinery company Wallenius Wilhelmsen (a self-help situation with new management and potential cost synergies following a merger), Finnish real estate firm Technopolis, and Norwegian ferry operator Fjord1. Sales include Anglo-French IT services consultancy Sopra Steria and Irish building materials company Kingspan, both UK-exposed stocks that had rerated sharply from a low point following the Brexit referendum, as well as Italian gym equipment maker Technogym, bought at IPO in May 2016 and sold after reaching what Beckett sees as an unjustifiable mid-30s P/E ratio.

Dutch bank/wealth manager Van Lanschot Kempen is now the largest holding, having seen a 37% rise in its share price over one year to 23 November. Unquoted medical device company Brainlab is

the second-largest position; Beckett inherited the holding from a previous manager of TRG and says he continues to seek a buyer for the stake, as he prefers to concentrate on listed companies.

## Performance: Strong outperformance continues

**Exhibit 5: Investment trust performance to 31 October 2017**



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

TRG has continued an exceptional run of share price and NAV performance since June 2016, with a 12-month NAV total return of 33.4% to 31 October 2017, compared with 23.0% for the benchmark Euromoney Smaller Europe ex-UK index (all returns are in sterling). Strong demand for the shares drove a share price total return of 57.9%, eliminating the discount to NAV. Annualised returns over three, five and 10 years are also all ahead of the benchmark (Exhibit 5). TRG has also markedly outperformed both larger-cap European equities and the broad UK stock market over all but the most recent period (Exhibit 6).

**Exhibit 6: Share price and NAV total return performance, relative to indices (%)**

	One month	Three months	Six months	One year	Three years	Five years	10 years
Price relative to EMIX Smaller Europe ex-UK	6.5	8.4	16.8	28.4	41.7	58.6	24.9
NAV relative to EMIX Smaller Europe ex-UK	0.3	1.3	2.0	8.5	22.2	27.5	10.2
Price relative to FTSE World Europe ex-UK	5.9	7.9	18.5	31.6	69.1	102.1	51.7
NAV relative to FTSE World Europe ex-UK	(0.3)	0.7	3.5	11.2	45.9	62.4	33.8
Price relative to FTSE All-Share	5.5	8.3	22.5	39.3	94.9	147.0	63.0
NAV relative to FTSE All-Share	(0.7)	1.1	7.0	17.6	68.1	98.5	43.8

Source: Thomson Datastream, Edison Investment Research. Note: Data to end-October 2017. Geometric calculation.

**Exhibit 7: NAV total return performance relative to benchmark over five years**



Source: Thomson Datastream, Edison Investment Research

As befits a broadly diversified portfolio, performance has been driven by a large number of positions. From 1 January to 26 September 2017, the 10 biggest positive contributors added 5.34% to returns, led by medical device manufacturer LivaNova, Austrian IT firm S&T and outsourced drug

development specialist Evotec. Evotec was also the biggest single contributor to performance in FY17 (to 30 June), with a share price return of 290%.

## Discount: Substantial rerating wipes out discount

At 24 November 2017, TRG's shares traded at a 0.6% discount to cum-income NAV. This followed a substantial rerating of the shares from a three-year widest discount of 19.3% in July 2016, shortly after the UK's EU referendum. The current slight discount differs widely from historical averages of 8.8%, 10.9%, 12.1% and 13.3% over one, three, five and 10 years, respectively. The board has recently issued shares at a small premium in order to satisfy excess demand.

**Exhibit 8: Share price premium/discount to NAV (including income) over three years (%)**



Source: Thomson Datastream, Edison Investment Research

## Capital structure and fees

TRG is a conventional investment trust with one class of share and 50.1m ordinary shares in issue at 24 November 2017. The board may buy back or issue shares to manage a discount or a premium, although since the removal of a hard discount control mechanism in 2010, repurchases have been infrequent, with only 262,500 shares having been bought back in the past five years. Following the strong rerating in TRG's share price, 395,000 shares have been issued in October and November 2017, raising £5.0m. Gearing is permitted up to 30% of net assets, with a working limit of 15% without board approval, and is available via an overdraft of up to £80m with HSBC Bank, of which £49m (8.6% of net assets) was drawn at the 30 June 2017 year-end. This had increased to 13.0% at 31 October 2017, having ranged from 7.0% to 14.0% over the previous 12 months.

Henderson Investment Funds is paid an annual management fee of 0.6% of net assets. A performance fee of 15% of outperformance may be paid if TRG's NAV total return outperforms the Euromoney Smaller Europe ex-UK by more than 1.0% on a rolling three-year basis. Total fees are capped at 2.0% of net assets. For FY17, ongoing charges were 0.75% and a 0.70% performance fee was paid, totalling 1.45% (FY16: 0.79% and 0.40%, totalling 1.19%).

## Dividend policy and record

Historically, TRG has paid one dividend per year, announced in the annual results for approval at the AGM, and paid in November. Steady growth in the ordinary dividend (a compound annual growth rate of 20.6% over five years to FY17) has been enhanced by special dividends in 12 of the last 14 financial years. From FY18, the board has indicated it intends to move towards an interim and a final payment. For FY17, the 14.5p total dividend (11.5p final plus 3.0p special) was more

than covered by revenue of 17.09p per share, and was a 26.1% increase on total dividends of 11.5p for the previous year. TRG has revenue reserves equivalent to 51.6p per share, enough to cover the FY17 dividend for more than three-and-a-half years. Based on the 24 November share price and the total FY17 dividend, TRG has a dividend yield of 1.2%.

## Peer group comparison

TRG is a member of the AIC's European Smaller Companies sector, a small peer group of four funds. Strong NAV total return performance has propelled the trust to the top of the table over one, three and five years; over 10 years it ranks second. Ongoing charges are the lowest in the group, although TRG is the only trust to charge a performance fee. At 23 November 2017, it had the smallest discount, with one trust trading at a premium. Gearing was the highest in the peer group. TRG has the joint-lowest yield in the sector (excluding special dividends), although it is broadly in line with the two peers that have a natural yield; European Assets Trust pays a 6% annual distribution, but this is mainly funded from capital.

**Exhibit 9: AIC European Smaller Companies peer group as at 23 November 2017\***

% unless stated	Market cap £m	NAV TR 1 year	NAV TR 3 year	NAV TR 5 year	NAV TR 10 year	Ongoing charge	Perf. fee	Discount (ex-par)	Net gearing	Dividend yield (%)
<b>TR European Growth Trust</b>	<b>595.5</b>	<b>39.4</b>	<b>111.0</b>	<b>223.4</b>	<b>176.6</b>	<b>0.8</b>	<b>Yes</b>	<b>(0.8)</b>	<b>113</b>	<b>1.0</b>
European Assets Trust	443.4	24.9	56.2	140.4	157.1	1.2	No	0.7	100	5.6
JPMorgan European Smaller Cos	644.8	33.8	100.2	186.2	205.0	1.1	No	(8.5)	107	1.2
Montanaro European Smaller	133.9	29.6	81.5	110.5	158.5	1.3	No	(12.0)	103	1.0
<b>Sector weighted average</b>		<b>33.2</b>	<b>91.6</b>	<b>181.7</b>	<b>180.6</b>	<b>1.0</b>		<b>(4.0)</b>	<b>107</b>	<b>2.2</b>
<b>TRG rank in sector</b>	<b>2</b>	<b>1</b>	<b>1</b>	<b>1</b>	<b>2</b>	<b>4</b>		<b>2</b>	<b>1</b>	<b>=4</b>

Source: Morningstar, Edison Investment Research. Note: \*Performance data to 22 November 2017. TR=total return. Net gearing is total assets less cash and equivalents as a percentage of net assets (100 = ungeared).

## The board

There are five non-executive directors on TRG's board, all independent of the manager. Chairman (since 2002) Audley Twiston-Davies has served on the board since 2000. Andrew Martin Smith was appointed in 2008, and Christopher Casey (chairman of the audit committee) in 2010. Two of the directors, Alexander Mettenheimer (appointed 2011) and Simona Heidempergher (appointed 2014) are resident in continental Europe. The directors have backgrounds in banking, accountancy and investment management.

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