European Assets Trust

European small-cap specialist with attractive yield

Investment trusts

European Assets Trust (EAT) aims to generate long-term capital growth through investing in listed European small and mid-sized companies. It has a distribution policy to pay 6% of its prior year-end euro-denominated NAV, which supports an attractive yield, currently 5.4%, significantly higher compared with peers. This has helped support a share price premium to EAT's cum income NAV. The EMIX Smaller Europe ex-UK index had another strong year in 2017, and equity valuations are now more challenging. Notwithstanding, the manager Sam Cosh observes that earnings recoveries are far from mature for many sectors and believes that EAT is well positioned to benefit as Europe's recovery broadens out.

12 months ending	Share price (%)	NAV (%)	EMIX Smaller European ex-UK (%)	FTSE AW Europe ex-UK (%)	FTSE All-Share (%)
31/01/14	29.6	25.3	22.9	9.8	10.1
31/01/15	9.6	11.5	1.3	6.1	7.1
31/01/16	11.3	11.8	8.2	(1.8)	(4.6)
31/01/17	9.2	14.9	31.8	25.7	20.1
31/01/18	31.3	21.1	22.4	17.8	11.3

Source: Morningstar, Thompson Datastream. Note: All % on a total return basis in GBP.

Investment strategy: Bottom-up, high-conviction

EAT aims to achieve capital growth through investment in small and medium-sized listed companies in Europe ex-UK. Its investment approach is bottom-up, seeking high-quality companies with long-term growth potential, at reasonable valuations. Meeting company managements and undertaking its own in-depth analysis are important parts of EAT's investment process, and the manager is supported by a well-resourced team of European equities specialists. Unconstrained by sector and geographic weights, the portfolio of 40-60 stocks represents the manager's high-conviction stock picks.

Market outlook: Earnings recoveries can broaden

Small-cap European equities have had another year of strong performance in 2017, and the EMIX Smaller Europe ex-UK index rose 23.3% in sterling terms. Higher valuations present a headwind for this asset class. However, earnings recoveries have been heavily skewed to global sectors (excluding commodities), while many domestic sectors have yet to recover or have lagged behind. Economic recovery has been broadening across Europe, and positive leading indicators in H217 augur well for earnings prospects to extend beyond export sectors.

Valuation: Modest 0.4% discount to cum income NAV

Over the past three years, EAT has mostly traded at a modest premium to cum income NAV, although it currently trades at a 0.8% discount. This sets it apart from the peer group, which trades at discounts to NAV, and is likely a reflection of EAT's 5.4% dividend yield. EAT's board recently declared a total €0.88 dividend payable for 2018, representing an 11.6% increase over 2017.

7 February 2018

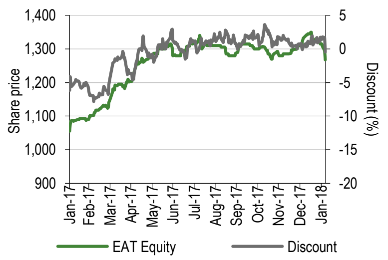
Price	**1,267.5p**
Market cap	**£446.8m**
AUM	**£443.4m**

NAV*	1,273.2p
Discount to NAV	0.4%

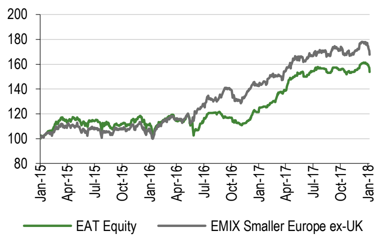
**Including income. As at 5 February 2018.

Yield	5.4%
Ordinary shares in issue	35.3m
Code	EAT
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	1,350.0p	1,084.5.0p
NAV** high/low	1,337.1p	1,138.9p

**Including income.

Gearing

Gross*	0.3%
Net cash*	0.0%

*As at 31 December 2017.

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European Assets Trust is a research client of Edison Investment Research Limited

Exhibit 1: Trust 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 Amsterdam. It targets capital growth through investment in quoted small and medium-sized companies in Europe (ex-UK), taking the EMIX Smaller Europe ex-UK index as a benchmark. It has adopted a high distribution policy; dividends have been paid from a combination of income and capital.

Recent developments

- 5 January 2018: Declaration of 2018 total dividend €0.88 per share, payable in four equal instalments (previously three instalments).
- 16 November 2017: Announcement of a tiered management fee; assets in excess of €500m will be charged at a reduced rate of 0.65%.
- 31 August 2017: Final dividend paid net 0.26p per share.
- 2 August 2017: Interim results announced. Sterling NAV TR +17.3% vs 16.2% for benchmark. Sterling share price TR 30.3%.

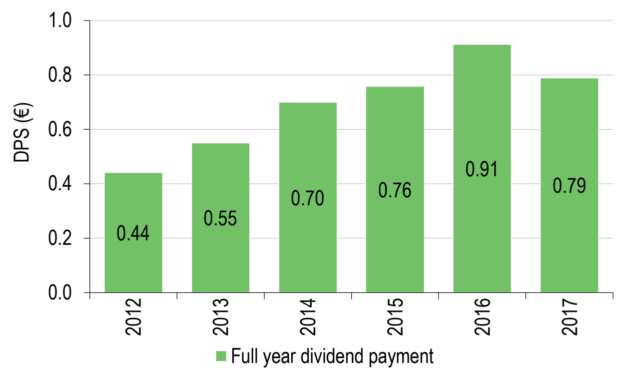
Forthcoming		Capital structure		Fund details	
AGM	May 2018	Ongoing charges	1.1%	Group	BMO Global Asset Mgt (formerly F&C)
Final results	March 2018	Net cash	0.0% as at end-Dec 2017	Manager	Sam Cosh
Year end	December	Annual mgmt fee	0.8% of gross assets reducing to 0.65% above €500m	Address	Exchange House, Primrose Street, London, EC2A 2NY
Dividend paid	Quarterly	Performance fee	None		
Launch date	1972	Trust life	Indefinite	Phone	+44 (0)800 136420
Continuation vote	None	Loan facilities	€45m with Kas Bank	Website	www.europeanassets.eu

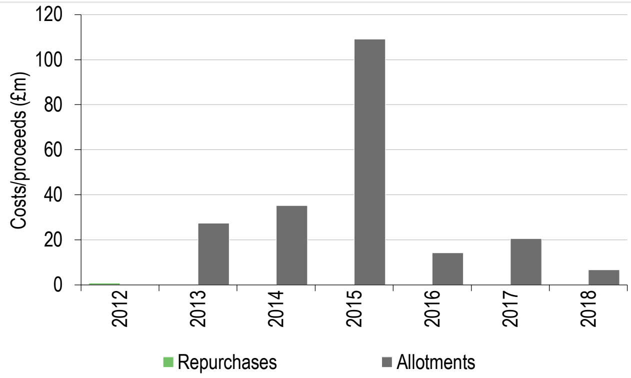
Dividend policy and history

The board targets a distribution of 6% of euro-denominated NAV as at the end of the preceding year, payable in January, April, July and October.

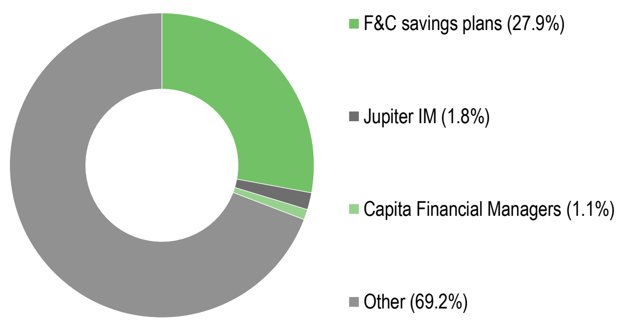
Share buyback policy and history

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

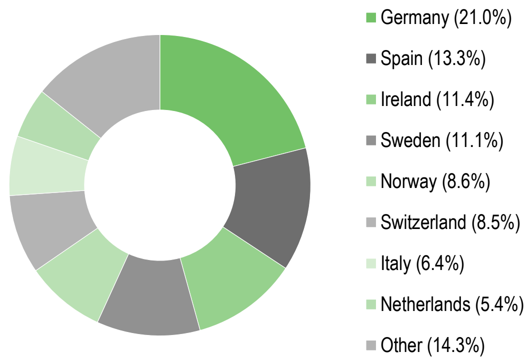




Shareholder base (as at 31 January 2018)



Portfolio exposure by geography (as at 31 December 2017)



Top 10 holdings (as at 31 December 2017)

			Portfolio weight %	
Company	**Country**	**Main area of business**	**31 December 2017**	**31 December 2016***
CTS Eventim	Germany	Concert and ticketing	3.6	N/A
Gerresheimer	Germany	Glass and plastic containers	3.6	4.2
Cerved Information Solutions	Italy	Solutions credit information provider	3.4	4.2
Forbo Holding	Switzerland	Flooring, adhesives and conveyor belts	3.4	4.4
Sparebank	Norway	Banking	3.4	N/A
Storebrand	Norway	Long-term savings and insurance	3.3	N/A
Origin Enterprises	Ireland	Agricultural nutrition	3.2	3.8
Vidrala	Spain	Glass bottle manufacturer	3.1	N/A
Amer Sports	Ireland	Sporting goods	3.1	3.5
Norma Group	Germany	Joining machinery manufacturer	3.0	N/A
Top 10 (% of holdings)			**33.1**	**38.0**

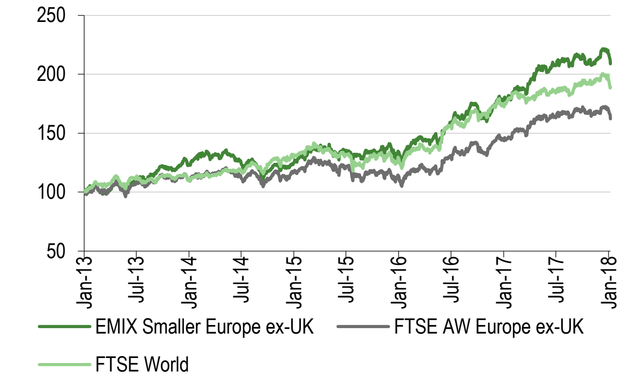
Source: European Assets Trust, Edison Investment Research, Bloomberg, Morningstar. Note: *N/A where not in December 2016 top 10.

Market outlook: A broadening recovery in Europe

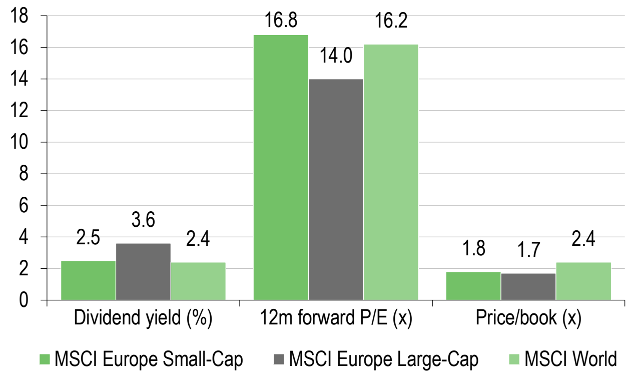
As shown in the left-hand chart of Exhibit 2, European equities performed strongly in 2017, in particular smaller companies outside the UK. The EMIX Smaller Europe ex-UK index rose by 23.3%, significantly outpacing the FTSE AW Europe ex-UK index (16.9%) and the FTSE World index (13.8%). This has been driven by a recovery in earnings and relatively benign political outcomes, including the diffusion of fears over the outcome of German elections and Catalan secession. Smaller companies have particularly benefited from the broadening of Europe's recovery beyond exporters to domestic economies, signalling a cyclical upturn for the region. The right-hand chart shows valuations are no longer cheap and could pose a challenge to continued share price performance, absent continued earnings momentum. The earnings recovery cycle in Europe had been led by global sectors (ex-commodities). However, domestic sectors started to provide a more balanced recovery from H217. Economic leading indicators during H217 have continued to be positive, an encouraging sign for earnings recoveries to extend into the current year.

Exhibit 2: Market performance and valuation

European and world index total returns over five years (£)



Valuation metrics for European small cap, large cap and world equities*



Source: Thomson Datastream, Edison Investment Research, Bloomberg, MSCI. Note: *Valuation data as at 6 February 2018.

Fund profile: High-yield European small-cap fund

EAT was launched as a Dutch company in 1972 and is dual-listed on the London and Amsterdam stock exchanges. Its objective is to generate capital growth through investment in listed small and medium-sized companies in Europe (excluding the UK), defined as those with a market capitalisation below that of the largest company in the EMIX Smaller European Companies (ex-UK) Index. Companies within this segment of the market typically have lower trading volumes than large-cap stocks, and can require a more patient approach to investing, thus a closed-ended investment trust structure is well suited to this asset class.

The investment approach is fundamental, seeking reasonably valued, high-quality companies to build a high-conviction 40-60 stock portfolio. Sam Cosh has been the lead portfolio manager since 2011 and is supported by co-fund manager Lucy Morris. They are members of a 12-strong European equities team at BMO Global Asset Management, from which they are able to draw considerable expertise. The board adopts a high distribution policy to pay dividends representing 6% of prior year-end NAV in euro terms, funded from income and other reserves. EAT's current yield of 5.3% is significantly higher than its peers (see Exhibit 8).

The fund manager: Sam Cosh

The manager's view: Still finding exciting investments

High valuations for quality European small-cap equities remains a challenge, and the team's 'patient fishermen' list of candidate stocks has seen little movement into the portfolio, as share price corrections have not materialised. However, Cosh and his team continue to find interesting ideas from meeting with new companies, in particular those less well-known to the investment community, typically those sparsely covered by sell-side brokers.

Furthermore, Cosh finds conventional headline valuations less informative, focusing instead on long-term cash flow generation, which is not captured by metrics such as P/E and price-to-book multiples. He notes that there are many 'pockets' where companies have yet to see earnings recoveries, or where they are nascent. Cyclical earnings recoveries are most mature for exporters, while domestically focused companies have typically been laggards. Cosh expects Europe's economic recovery to continue to extend beyond Germany and the export sectors, which presents interesting investment opportunities elsewhere.

Recent additions to the portfolio illustrate these views. Spain-listed Fluidra was not previously on the team's radar and the stock is not well covered by the sell side. Fluidra is the global market leader in the construction and maintenance of swimming pools outside the US. Its market position, combined with a strong brand and well entrenched sales network, creates a high barrier to entry for competitors. Its business cycle is aligned to a recovery in the European housing market, which Cosh believes is far from mature. The manager and his colleagues have also been impressed with the management's capability and ability to allocate capital. A recent merger with a significant US player, Zodiac, extends its global footprint into the world's largest swimming pool market, a development which was very well received by investors.

Sparebank is a Norwegian regional bank. Since the financial crisis, bank shares have suffered from general investor concerns over asset quality and capital adequacy issues, while Norwegian banks suffered additionally due to weak oil prices further depressing the country's prospects for economic recovery. At the time of acquisition, Cosh viewed the stock's below book valuation as unjustifiably pessimistic for a bank with a strong balance sheet and franchise. Sparebank was generating returns on equity (ROE) of around 11-12% and he believes an ROE of 14% is in prospect over the next few years, which could help re-rate the stock to a premium-to-book valuation.

Asset allocation

Investment process: Bottom-up and disciplined

The investment process is bottom-up. Unconstrained by benchmark weight considerations, the portfolio of around 40 to 60 stocks is a reflection of the manager's high-conviction stock selection. The universe of European small and mid-cap companies consists of over 2,000 names, and a well-resourced team enables screening and initial analysis to identify around 150 companies for further consideration. The manager is particularly focused on a company's characteristics of quality, management and valuation. Companies must have competitive advantages, attractive business models, low leverage and be cash generative. Managements must be good allocators of capital, capable, with appropriate incentives in place to align interests with those of minority shareholders. Valuations should be reasonable, presenting upside to intrinsic value and durable return potential. Meeting managements is an important part of the investment process to help establish conviction in each company, while detailed propriety research is produced for candidate companies, including valuation targets and triggers for selling the stock. These disciplines give rise to the 'patient fishermen' list of companies that meet the manager's stringent investment criteria, but are currently unattractively valued, awaiting lower share price levels.

EAT further defines its investible universe into four investment themes:

- Durable franchise companies have robust business models, disciplined management, sustainable returns and modest growth. EAT targets holding 40-50% of the portfolio in these stocks.
- Wide moat growth companies have sustainable competitive advantages and higher capital growth potential. They make up around 25-35% of the portfolio. Together with durable franchises, these are, broadly speaking, 'quality' stocks.
- Transformation/recovery stocks represent around 15-25% of the portfolio and are companies undergoing change that can positively turnaround prospects, such as new management or reallocation of capital.
- Deep value stocks are typically out of favour companies, presenting very attractive valuations, where the manager identifies a good trade-off between risk and reward. The portfolio targets holding 10-15% in these stocks, and in the currently environment the manager finds this the most challenging category for identifying investments.

Current portfolio positioning

EAT is unconstrained by country and sector weights and these exposures in the portfolio reflect stock selection rather than asset allocation. As shown in Exhibit 3, there have been significant geographical changes to the portfolio over the past year to end-December 2017, while sector changes are relatively modest.

Exhibit 3: Portfolio geographic and industrial exposure* (% unless stated)

	Portfolio end-Dec 2017	Portfolio end-Dec 2016	Change (pp)			Portfolio end-Dec 2017	Portfolio end-Dec 2016	Change (pp)
Germany	21.0	20.1	0.9		Industrials	30.7	33.3	(2.6)
Spain	13.3	7.2	6.1		Consumer goods	24.9	24.6	0.3
Ireland	11.4	15.7	(4.3)		Financials	16.4	15.3	1.1
Sweden	11.1	7.6	3.5		Consumer services	10.6	11.3	(0.7)
Norway	8.6	8.0	0.6		Basic materials	6.2	4.7	1.5
Switzerland	8.5	6.9	1.6		Healthcare	5.9	6.2	(0.3)
Italy	6.4	13.5	(7.1)		Technology	5.4	4.6	0.8
Netherlands	5.4	6.8	(1.4)					
Denmark	5.0	4.4	0.6					
France	4.2	3.0	1.2					
Finland	3.1	3.7	(0.6)					
Austria	2.1	0.0	2.1					
Portugal	0.0	3.1	(3.1)					
Total	**100.0**	**100.0**			**Total**	**100.0**	**100.0**	

Source: European Assets Trust, Edison Investment Research. Note: *All figures are subject to rounding.

The biggest country exposure increase is to Spain (6.1pp), which includes new positions, such as Fluidra (discussed on page 4), and strong gains from glass bottle manufacturer Vidrala, now a top 10 holding. A recent acquisition of a competitor in Portugal bolsters the company's scale and market position in the Iberian Peninsula. The attractive valuation achieved by the company helped reaffirm Cosh's confidence in the company's earnings prospects and ability to allocate capital. Sweden's weight has increased by 3.5pp following the purchase of Alimak, a leading supplier of lifts, hoists and work platforms to the construction industry. The company made two acquisitions last year, which the manager believes offer good synergies and, under Alimak's management, could become more profitable.

The largest decline in country exposure was to Italy (-7.1pp) where EAT's stocks performed well operationally. Its Italian holdings were also boosted by tax changes favourable to investment in small-caps for domestic investors, helping propel valuations to levels prompting the manager to take profits. Ireland's weight in the portfolio declined by 4.3pp. Many of EATs holdings in the country suffered significant falls in share prices as a result of the EU referendum, as they were heavily exposed to the UK and sterling. A rigorous assessment at that time led the manager to hold onto most of the positions, and opportunistically added to selected holdings. A recovery in the Irish stock market subsequently has presented excellent profit-taking opportunities for the portfolio. Although this has reduced the portfolio's exposure to the country, the manager has nevertheless continued to find new investments, to capture Ireland's domestic recovery. This includes Cairn Homes, a residential property developer with a large and prime land bank, well placed to capitalise on a shortfall in housing supply, caused by a lack of homebuilding in the years following the financial crisis.

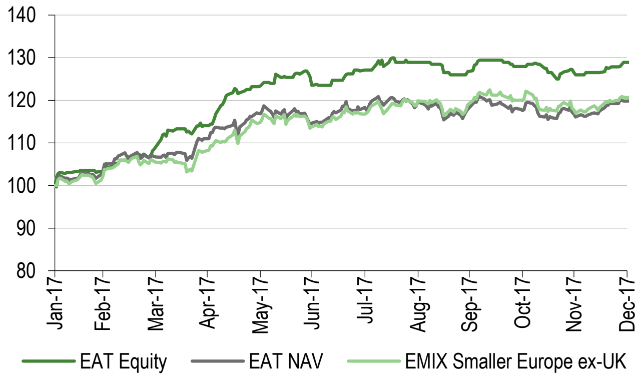
The manager steadfastly focuses on investing in good businesses, with strong potential for long-term growth, at reasonable valuations. He believes the portfolio is well positioned to benefit from the broadening economic recovery across Europe.

Performance: Solid long-term performance

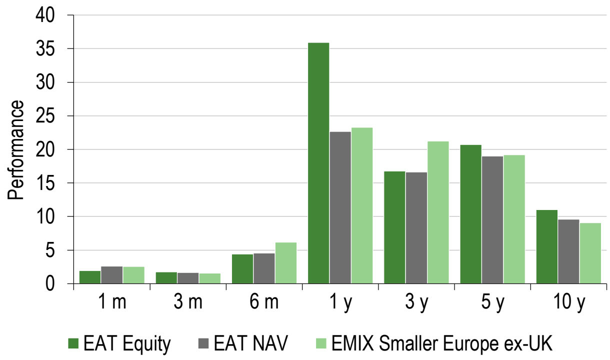
Exhibits 4 and 5 show EAT's track record. Its NAV total return has underperformed the benchmark over one, three, and five years, and outperformed over 10 years. EAT's share price, however, has returned gains above the index over one, five and 10 years as the discount narrowed, likely a reflection of investors' appetite for yield. The most pronounced underperformance is over three years due to a marked decline at the time of, and in the months following the EU referendum in June 2016 (Exhibit 6). The trust was poorly positioned for the referendum outcome, including a significant exposure to Irish companies with large UK exposures, which fell sharply as sterling weakened and investors feared a deteriorating outlook for the UK economy. Performance has since stabilised, but this period of weakness will continue to weigh on three year performance relative to the index.

Exhibit 4: Investment trust performance to 31 December 2017

Price, NAV and benchmark total return performance, one-year rebased



Price, NAV and benchmark total return performance (%)



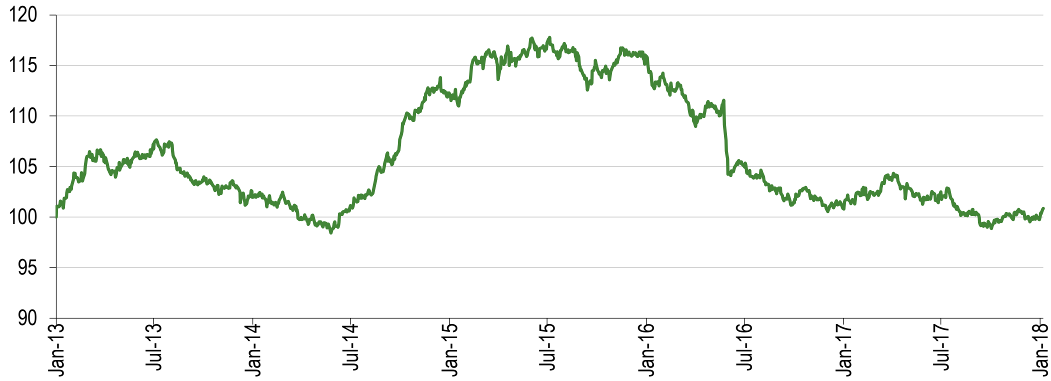
Source: Thomson Datastream, Edison Investment Research. Note: Three, five and 10-year performance figures annualised.

Exhibit 5: 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	(0.6)	0.2	(1.7)	10.3	(10.6)	6.6	19.0
NAV relative to EMIX Smaller Europe ex-UK	0.1	0.1	(1.6)	(0.5)	(11.0)	(0.7)	4.7
Price relative to FTSE AW Europe ex-UK	1.3	1.3	0.1	16.3	6.6	40.3	62.1
NAV relative to FTSE AW Europe ex-UK	2.0	1.2	0.2	5.0	6.2	30.7	42.5
Price relative to FTSE All-Share	(2.7)	(3.1)	(2.6)	20.2	19.4	57.3	53.9
NAV relative to FTSE All-Share	(2.1)	(3.1)	(2.5)	8.4	18.9	46.5	35.3

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

Exhibit 6: NAV total return performance relative to benchmark over five years

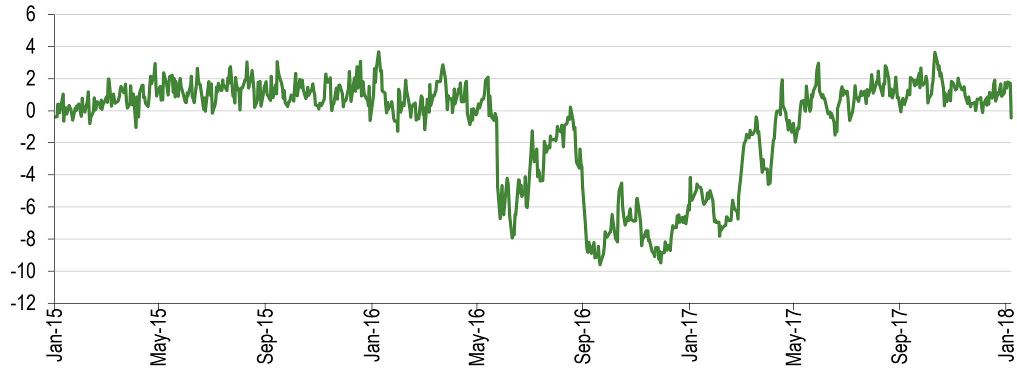


Source: Thomson Datastream, Edison Investment Research

Discount: Modest to cum-income NAV

At the current share price, EAT is trading at a 0.4% discount to cum-income NAV. This is above the three-year average discount of 0.9% and within the range of 3.7% to -9.6%. As shown in Exhibit 7, over this period EAT has mostly traded at a premium to cum income NAV. The three-year average has been skewed by a period of unusual volatility in 2016, encompassing events such as the EU referendum vote and US presidential election.

Exhibit 7: Share price premium/discount to NAV (including income) over three years (%)



Source: Thomson Datastream, Edison Investment Research

Capital structure and fees

EAT has one class of share; there are currently 35.3m ordinary shares in issue. The trust has a €45m loan facility with Kas Bank, and as at end-December 2017 net gearing was zero. An annual management fee is paid to the investment manager, BMO Global Asset Management, and a tiered fee was recently introduced on 16 November 2017. The company maintains a 0.8% pa fee on the value of funds below €500m, reducing to 0.65% pa on funds above €500m The Dutch management board, FCA Management, is paid an annual fee (€114,091 in 2016).

Dividend policy and record

Barring unforeseen circumstances, the board's dividend policy is to pay an annual dividend equivalent to 6% of the NAV of the company at the end of the preceding year, funded from current-year net profits as well as other reserves. On 5 January 2018 EAT's board declared total dividends for 2018 of €0.88 per share (2017: €0.7884), an increase of 11.6%. The total dividend in sterling terms will be determined by the exchange rates prevailing on the payment dates. The board also announced that, with immediate effect, the dividend will be paid in four equal instalments in January, April, July and October (previously three instalments in January, May and August). A scrip alternative (to receive shares instead of cash) is available. For 2017, total net dividends paid amounted to £0.69, representing a dividend yield of 5.4% at the current share price.

Peer group comparison

The AIC European Smaller Companies sector is a small universe consisting of four trusts. Absolute returns for the sector have been strong over one, three, five and 10 years, and EAT ranks third or fourth in each of these periods. EAT stands out with a significantly higher yield than its peers and is the only trust to trade at a premium to NAV.

Exhibit 8: AIC European Smaller Companies peer group as at 6 February 2018*

% unless stated	Market cap £m	NAV TR 1 year	NAV TR 3 year	NAV TR 5 year	NAV TR 10 year	Discount (ex-par)	Ongoing charge	Perf. fee	Net gearing	Dividend yield (%)
European Assets Trust	446.8	16.6	50.7	110.5	184.7	1.2	1.1	No	101	5.4
JPMorgan European Smaller Cos	644.8	23.8	82.8	146.3	229.1	(6.5)	1.1	No	107	1.2
Montanaro European Smaller	130.5	17.4	73.5	76.3	185.7	(11.8)	1.3	No	102	1.1
TR European Growth	570.2	25.0	99.2	170.5	201.1	(3.1)	0.8	Yes	114	1.0
Weighted average in sector		**21.9**	**79.4**	**140.0**	**205.9**	**(3.9)**	**1.0**		**107**	**2.2**
EAT rank in sector	**3**	**4**	**4**	**3**	**4**	**1**	**3**		**4**	**1**

Source: Morningstar, Edison Investment Research. Note: *Performance data to 5 February 2018. TR = total return. Net gearing is total assets less cash and equivalents as a percentage of net assets.

The board

EAT is incorporated in the Netherlands and has a two-tiered board structure. The management board has a single director, FCA Management, which is represented by Wilbert van Twuijver and Tim Koster. The supervisory board is similar to the board of directors of a UK investment trust and consists of five independent members: Chairman Jack Perry (elected in 2014), deputy chairman and chair of the audit committee, Professor Robert van der Meer (2007), senior independent director Julia Bond (2014), Laurence Jacquot (2011) and Martin Breuer (2016).

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