European Assets Trust

European small-cap specialist

Investment trusts

European Assets Trust (EAT) aims to achieve long-term capital growth through investment in small and medium-cap companies in Europe (ex-UK). The investment approach is fundamental and bottom-up; EAT has a solid long-term track record and a high distribution policy underpins an attractive 5.2% yield. 2016 was a challenging year for EAT and NAV total return underperformed the index by 15.9pp. Since then, the performance has stabilised and the shares have returned to a modest premium to NAV (including income). The manager, Sam Cosh, is confident of the trust's investment philosophy and process and is positive on the economic outlook.

12 months ending	Share price (%)	NAV (%)	Euromoney Smaller European ex-UK (%)	FTSE AW Europe ex-UK (%)	FTSE All-Share (%)
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	18.3	(0.3)	0.4	2.6
30/06/16	(4.1)	2.7	14.2	6.3	2.2
30/06/17	41.7	31.2	35.8	28.7	18.1

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

Investment strategy: Bottom-up and patient

The manager's aim is to build a relatively concentrated portfolio of around 40-60 stocks across diverse sectors. The approach is fundamental and bottom-up, involving meetings with company managements and producing proprietary research on candidate stocks. Portfolio construction is unconstrained by benchmark sector and country weights, purely reflecting stock selection, which favours companies with quality management and franchises, and strong cash flow generation. Valuation discipline is of particular importance and attractive companies that do not meet EAT's valuation criteria are placed on a 'patient fisherman' list, awaiting a more attractive purchase price.

Market outlook: European recovery can broaden

The economic outlook for Europe is favourable for small-cap equities. Continued GDP growth momentum is supported by positive leading indicators, improving consumer confidence and falling unemployment. Political risks have abated since the start of the year which has allowed markets to refocus on fundamentals. However, while valuations are less attractive a broadening of economic and earnings recovery beyond Germany and exporters could present interesting investment opportunities.

Valuation: Premium supported by high yield

EAT trades at a 0.7% premium to cum-income NAV. The averages over one, three and five years show discounts of 4.5%, 1.1% and 2.0% respectively, which are skewed by events such as the EU referendum but belie the fact that EAT has mostly traded at a premium over the past few years. This premium is supported by its attractive 5.2% dividend yield, which is significantly higher than its peers.

7 July 2017

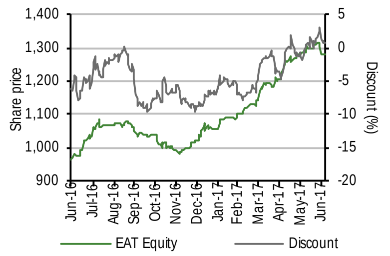
Price	**1,280.0p**
Market cap	**£428.3m**
AUM	**£425.1m**

NAV*	1,270.6p
Premium to NAV	0.7%

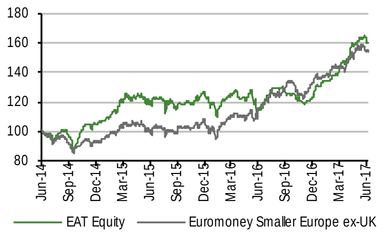
*Including income. As at 4 July 2017.

Yield	5.2%
Ordinary shares in issue	33.5m
Code	EAT
Primary exchange	LSE
AIC sector	European Smaller Companies
Benchmark	Euromoney Smaller Europe ex-UK

Share price/discount performance



Three-year performance vs index



52-week high/low	1,315.0p	972.5p
NAV** high/low	1,313.3p	1,030.9p

**Including income.

Gearing

Gross*	0.0%
Net*	0.5%

*As at 31 May 2017.

Analysts

Helena Coles	+44 (0)20 3077 5700
Mel Jenner	+44 (0)20 3077 5720

investmenttrusts@edisongroup.com

Edison profile page

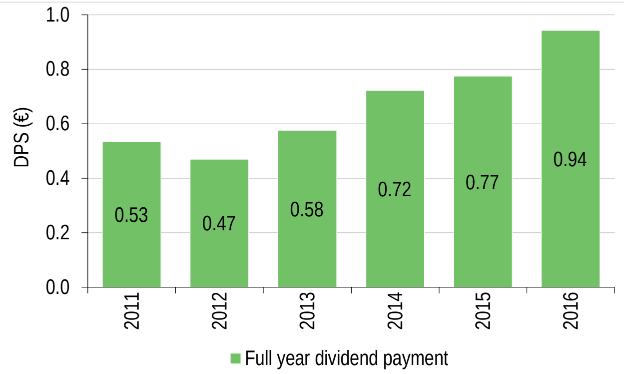
European Assets Trust is a research client of Edison Investment Research Limited

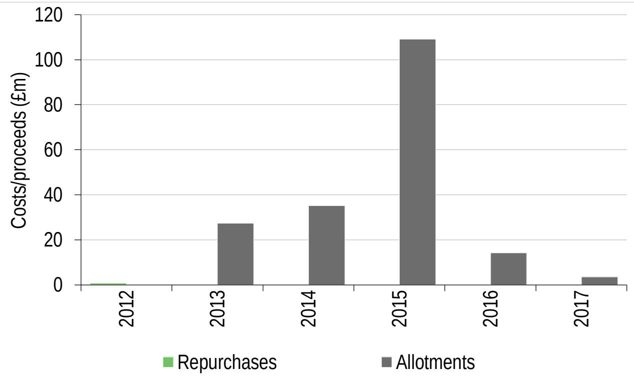
Exhibit 1: Trust at a glance

Investment objective and fund background	Recent developments
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 Euromoney 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.	■ 31 May 2017: Interim dividend paid €0.26. ■ 21 May 2017: All resolutions passed at general meeting. ■ 9 March 2017: 2016 annual results announced. Sterling NAV TR +7.4% vs +23.3% for benchmark. Sterling share price TR -2.7%. Distribution per share of €0.79 declared.

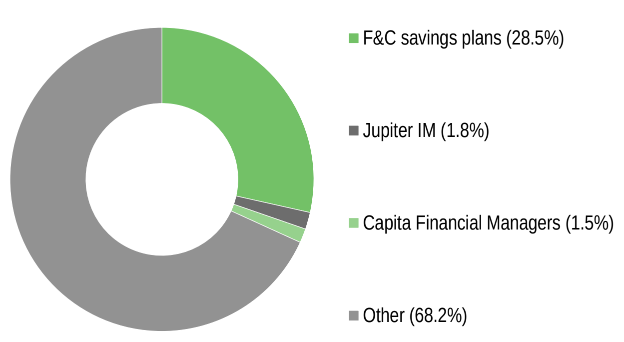
Forthcoming		Capital structure		Fund details	
AGM	May 2018	Ongoing charges	1.1%	Group	BMO Global Asset Mgt (formerly F&C)
Interim results	August 2017	Net gearing	0.5%	Manager	Sam Cosh
Year end	December	Annual mgmt fee	0.8% of gross assets	Address	Exchange House, Primrose Street, London, EC2A 2NY
Dividend paid	January, May, August	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

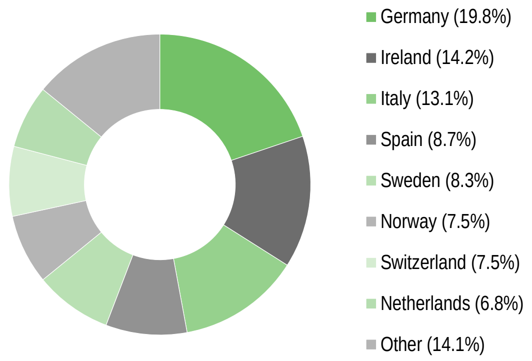
Dividend policy and history	Share buyback policy and history
The board targets a distribution of 6% of Euro denominated NAV as at the end of the preceding year, payable in January, May and August.	EAT is authorised to both repurchase and allot its ordinary shares. The chart of buybacks and issuance excludes shares issued as scrip dividends.





Shareholder base (as at 31 May 2017)	Portfolio exposure by geography (as at 31 May 2017)





Top 10 holdings (as at 31 May 2017)

			Portfolio weight %	
Company	Country	Main area of business	31 May 2017	31 May 2016*
Cerved Information Solutions	Italy	Solutions credit information provider	4.2	3.7
Gerresheimer	Germany	Glass and plastic containers	4.0	4.1
Forbo Holding	Switzerland	Flooring, adhesives and conveyor belts	3.7	3.8
CTS Eventim	Germany	Concert and ticketing	3.6	N/A
Origin Enterprises	Ireland	Agricultural nutrition	3.5	3.5
ASM International	Netherlands	Semiconductor equipment	3.4	N/A
IMCD Group	Netherlands	Specialty chemicals	3.4	N/A
Inwido	Sweden	Window and door manufacturer	3.3	N/A
Irish Continental	Ireland	Maritime transport company	3.3	4.2
Glanbia	Ireland	Agricultural nutrition	3.2	3.1
Top 10 (% of holdings)			35.6	36.7

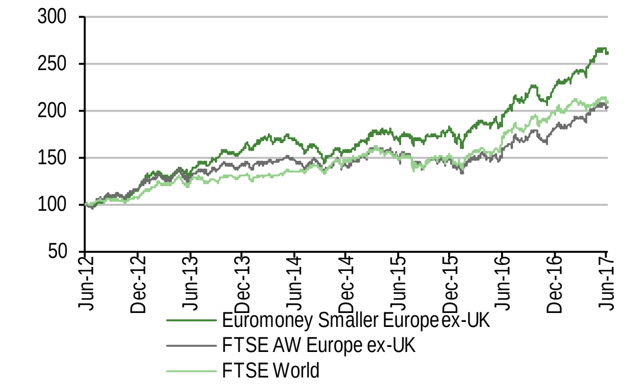
Source: European Assets Trust, Edison Investment Research, Bloomberg, Morningstar. Note: *N/A where not in May 2016 top 10.

Market outlook: Favourable for small-cap companies

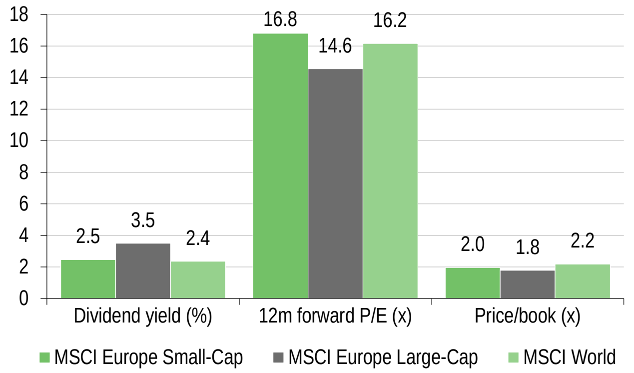
As shown in Exhibit 2 (left-hand side), small-cap European equities (ex-UK) have outperformed large-cap European and global equities over the past five years. A dip in late 2016 was largely attributable to the run up to the US elections and an increase in political uncertainty for Europe given a series of forthcoming elections. Political risk has since abated allowing markets to refocus on fundamentals, which have been increasingly favourable. European GDP growth has outpaced that of the US in four of the past five quarters while leading indicators, including purchasing managers indices above 50, suggest a positive outlook. Eurozone consumer confidence is at the highest levels since 2007 and unemployment continues to fall. Combined with a decent backdrop for global growth, economic conditions are favourable for European small-cap equities. Valuations, however, are now less attractive than a year ago. As shown in Exhibit 2 (right-hand side), European small-cap equities are now more expensive on a forward P/E valuation basis than Europe large-cap and global equities. Excluding Germany, however, European earnings have not recovered from recession lows and valuations reflecting normalised earnings are much more attractive. For investors looking for exposure to European small-caps, a fund with a rigorous bottom-up approach and solid long-term track record may be of interest.

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, MSCI. Note: *Valuation data as at 30 June 2017.

Fund profile: Long-term growth with high dividend

EAT was launched as a Dutch company in 1972, is listed on the London and Amsterdam stock exchanges, and is a member of the Association of Investment Companies. Its objective is to achieve long-term growth in capital through investment in listed small and medium-sized companies in Europe (excluding the UK). The investment approach is fundamental, bottom-up and benchmark agnostic, to build a relatively concentrated portfolio across diverse sectors. Key attributes for portfolio companies are strong balance sheets, healthy cash flows and high and sustainable returns on capital. As at end-June 2017, over 75% of the portfolio was held in stocks with a market cap of between €250m to €3bn. Sam Cosh has been the lead manager since 2011 and is supported by David Moss and Lucy Morris. EAT's board has adopted a high dividend distribution policy of 6% of year-end NAV in euro terms. Its current yield of 5.2% is significantly higher than that of peers.

The fund manager: Sam Cosh

The manager's view: Economic conditions favourable

This year, political risk in Europe has receded and markets have responded to increasingly favourable economic and earnings data, which has left valuations at levels that are not obviously attractive. The manager, however, believes traditional valuation measures to be blunt instruments and that the real picture is more interesting and nuanced.

Europe is not a homogenous region and since the recession, only Germany has staged a meaningful economic recovery, led by exports, while the rest of Europe and domestically-oriented industries have lagged. Current economic conditions should now be more supportive for a recovery to extend beyond exporters. These include positive leading indicators, improving consumer sentiment and falling unemployment. The manager notes that Q117 earnings were better than expected and positive earnings revisions are picking up pace. Should Europe stage a broader earnings recovery, valuations would look much more attractive, particularly against US equities. European cycle-adjusted P/E valuations relative to the US are now at historic lows (since 1980).

Furthermore, current economic conditions particularly favour smaller-cap stocks, which by their nature are more cyclical and domestically oriented. Cosh cautions, however, that quality stocks across the board are expensive. In response, the team has been looking at smaller companies and relatively newer listed companies, which are generally not yet on the radar of investors. These include two recent additions to the portfolio: Nordic Waterproofing, a construction supplies company; and Coor, a Scandinavian facilities management company.

Asset allocation

Investment process: Disciplined stock selection

The universe of European small and mid-cap companies consists of c 2,000-2,500 names, from which the manager builds a portfolio of around 40 to 60 stocks. The manager works with the European equities team at BMO Global Asset Management to screen and analyse the universe. Around 150 companies pass the screening process and are subject to rigorous fundamental analysis with particular focus on the areas of quality, management and valuation. Meeting managements of companies is an important part of this process. The team produce standardised proprietary research on its candidate companies, which include valuation targets and triggers for selling a stock. These help facilitate debate and discussion at the team's twice-weekly meetings. Attractive companies that do not meet the valuation criteria, are put on reserve (referred to as the 'patient fishermen' list), to await an appropriate purchase opportunity.

EAT's portfolio companies fall into four broad categories as follows:

- Durable franchise – these companies form the core holdings of the portfolio and are characterised by robust business models, disciplined management and sustainable returns with scope for modest growth. The typical allocation to this group is 40-50% of the portfolio (43.8% as at end-June 2017).
- Wide moat growth – these are faster-growing companies with strong brands, a sustainable competitive advantage or high market share in a competitive industry. They typically represent 25-30% of the portfolio (29.7% at end-June 2017).
- Transformation/recovery – these companies may be undervalued but have a catalyst for re-rating, for example new management or an improvement in capital allocation. They usually make up 15-20% of the portfolio (at end-June 2017 it was slightly below this range at 14.9%).

- Deep value – these are contrarian investments in companies that are out-of-favour, where the team believes the potential for recovery is underappreciated. Typically 10-15% of the portfolio, they represented 11.6% of the portfolio at end-December 2016.

In broad terms, the first two categories of companies are what investors would view as 'quality' stocks while the latter are 'value' stocks.

Portfolio holdings are closely monitored and a sell discipline is part of the investment process. A stock will be reviewed for sale when: it has reached the target valuation; its share price has moved by more than 25% (plus or minus) relative to the benchmark; and the sell triggers materialise.

Current portfolio positioning

As at end-May, EAT's portfolio held 40 stocks across 12 countries and seven sectors. As shown in Exhibit 3, the largest country exposure continues to be Germany at 19.8%. In the year to end-May 2017, the most significant geographic change is a 4.3pp decline in the Ireland weight to 14.2% where recent recoveries in share prices prompted profit-taking and Permanent TSB was sold.

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

	Portfolio end-May 2017	Portfolio end-May 2016	Change (pp)		Portfolio end-May 2017	Portfolio end-May 2016	Change (pp)
Germany	19.8	18.3	1.5	Industrials	34.3	29.4	4.9
Ireland	14.2	18.5	(4.3)	Consumer goods	22.9	22.1	0.8
Italy	13.1	13.2	(0.1)	Financials	15.2	19.8	(4.6)
Spain	8.7	9.2	(0.5)	Consumer services	10.7	16.1	(5.4)
Sweden	8.3	6.9	1.4	Technology	6.4	2.4	4.0
Norway	7.5	5.4	2.1	Healthcare	5.9	6.3	(0.4)
Switzerland	7.5	4.9	2.6	Basic materials	4.6	3.9	0.7
Netherlands	6.8	5.3	1.5				
Denmark	4.6	7.2	(2.6)				
France	4.6	3.6	1.0				
Finland	2.7	3.8	(1.1)				
Portugal	2.2	3.5	(1.3)				
	100.0	100.0			100.0	100.0	

Source: European Assets Trust, Edison Investment Research

Industrials continue to be EAT's largest sector and this has increased by 4.9pp to 34.3%. Recent purchases in the industrials sector include Dometic (Sweden), a market leader in appliances for recreational vehicles (RVs). Drivers include a cyclical economic improvement in Europe, but also structural trends in favour of outdoor recreation and an aging population; the traditional customer base for RVs. Increasing high margin aftermarket sales can also help improve profitability.

Vidrala (Spain) is a glass bottle manufacturer located in the Rioja region, where it has a high market share. Its proximity to local wine producers is a natural 'moat' against competition and furthermore, by regulation, Spanish wine must be bottled in Spain. The company has made acquisitions in Europe and is well-placed to be a consolidator in this industry.

Nordic Waterproofing (Sweden) is a recently listed manufacturer of water-proofing products, such as bitumen and rubber-based products, for the building and infrastructure industries. It is one of two pan-Nordic suppliers. With a fragmented customer base and improvement in the region's construction sector, there is scope for both revenues and margins to expand.

Financials have declined 4.6pp in weight to 15.2% following several sales including Permanent TSB and Leonteq, both due to weaker than originally assessed investment cases. Topdanmark was divested on valuation grounds following a takeover by Sampo. C&C was sold on a share price rally as the manager deemed its competitive position no longer sustainable. This sale contributed to the fall in the consumer services weighting to 10.7% of the portfolio.

Performance: Stabilised after a challenging year

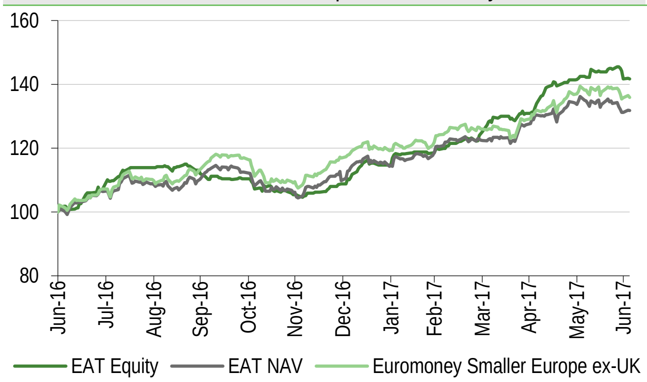
EAT's share price and NAV total return performance relative to its benchmark has been positive over three, five and 10 years. Over the same periods, performance has been significantly better compared to benchmarks for large-cap European equities and global equities (as illustrated in Exhibits 4 and 5). Over one year, the NAV total return underperformed its benchmark by 4.6%, although the share price outperformed by 5.9%. 2016 was a particularly challenging year as the portfolio suffered from poor stock selection in a small number of holdings and also from an overweight position to Ireland at the time of the EU referendum. A number of the Irish holdings had significant exposures to the UK and were substantially affected by the referendum result, both from a fall in sterling and investor expectations for a weakening UK economy. At the time, the manager assessed the share price falls to be excessive relative to fundamentals and selectively added to positions. Since then, many of these stocks have performed well and allowed for profit-taking.

NAV performance has stabilised over one, three and six months. The manager notes that the portfolio's more recent purchases, since the beginning of 2016, have performed strongly and reaffirms the team's investment philosophy and rigorous stock-selection process.

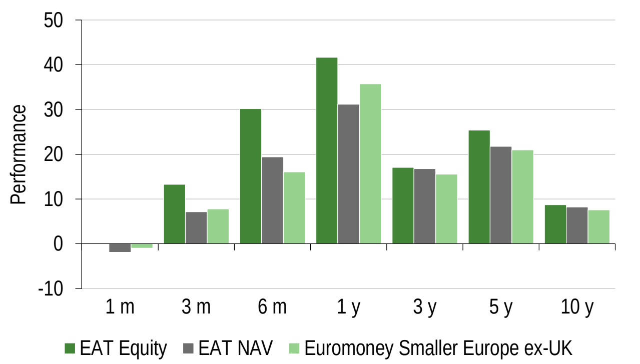
Despite the one year underperformance, EAT's share price has outperformed its benchmark over all periods shown. This is likely a reflection of its attractive dividend yield, solid long-term performance track record and, more recently, increased flows into European equities from investors seeking exposure to the region (ex-UK).

Exhibit 4: Investment trust performance to 30 June 2017

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



Price, NAV and benchmark total return performance (%)



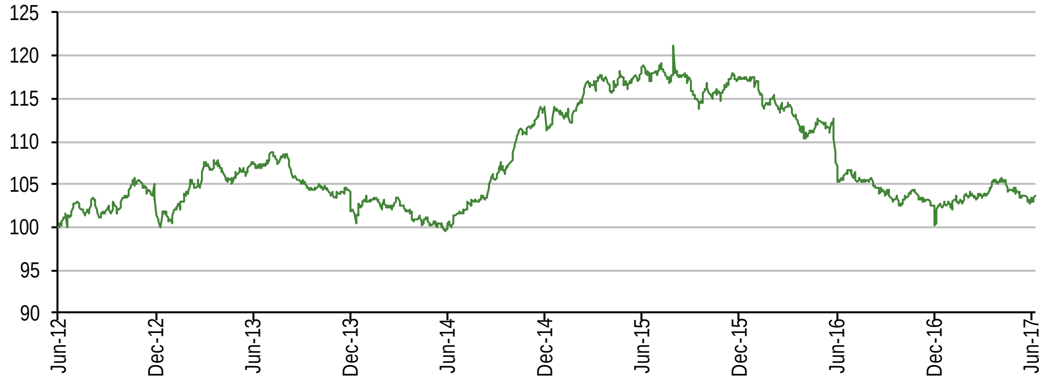
Source: Thomson Datastream, Edison Investment Research. Note: Three, five and 10-year performance figures annualised.

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 Euromoney Smaller Europe ex-UK	1.1	5.5	14.1	5.9	6.1	50.7	23.6
NAV relative to Euromoney Smaller Europe ex-UK	(0.9)	(0.6)	3.3	(4.6)	4.9	7.9	12.3
Price relative to FTSE AW Europe ex-UK	1.5	8.6	18.2	13.0	23.0	109.0	55.6
NAV relative to FTSE AW Europe ex-UK	(0.5)	2.5	7.4	2.5	21.9	66.3	44.3
Price relative to FTSE All-Share	2.6	11.9	24.7	23.6	36.7	145.1	63.2
NAV relative to FTSE All-Share	0.6	5.7	13.9	13.0	35.5	102.3	51.9

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

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

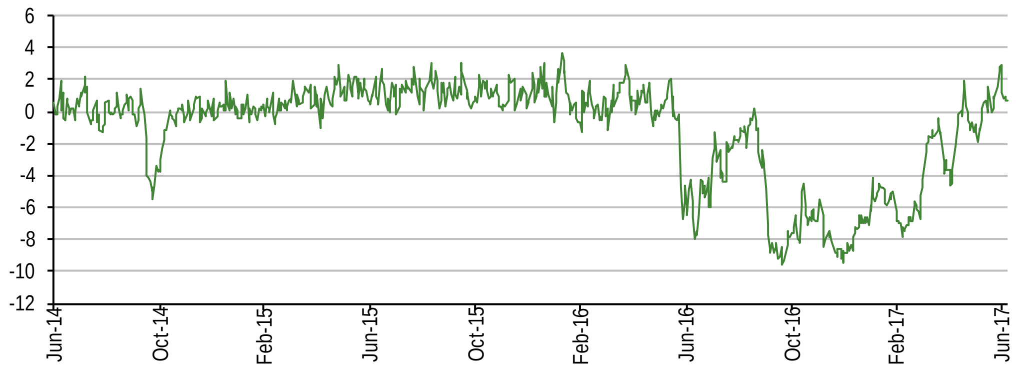


Source: Thomson Datastream, Edison Investment Research

Discount: Returned to premium

Exhibit 7 shows the volatility of the premium/discount over the past 12 months, which reached its lowest point on 20 October 2016, ahead of the US elections. EAT currently trades at a 0.7% premium to cum-income NAV. The averages, however, show discounts over one, three, five and 10 years of 4.5%, 1.1%, 2.0% and 5.9%, respectively. These figures are skewed by events such as the EU referendum vote and US elections, but belie the fact the trust has traded at a premium for most of the past three years.

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 shares; there are currently 33.5m ordinary shares in issue. The number of authorised shares is 50.0m and during 2016, the company issued 1.32m new shares at €13.65 per share. The trust has a €45m flexible facility with Kas Bank and as at end-May 2017, had net gearing of 0.53%. BMO Global Asset Management (formerly F&C Investment Business Limited) provides the investment management and services to the trust. It receives an annual fee of 0.8% of the gross value of assets under management paid on a quarterly basis. The Dutch management board received a fixed annual fee of €114,091 in 2016 (€103.975 in 2015).

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Dividend policy and record

Barring unforeseen circumstances, the board intends to pay an annual dividend of 6% of the euro-denominated NAV per share at the end of the preceding financial year. A scrip alternative is available. The policy is to pay dividends from a mix of current year net profits and other reserves. As the company reported a net loss in 2016, the declared dividends of €0.94 per share and cash dividends of €30.5m were fully paid out of distributable reserves, which as at end-2016, stood at €421.0m.

Peer group comparison

The AIC European Smaller Companies sector is small with just four companies and absolute performance over all periods shown has been strong for all funds. EAT's NAV total return performance is second among peers over one year and lower ranked over three, five and 10 years. Despite this, it is the only trust to trade at a premium to NAV, probably reflecting its significantly higher dividend yield. Ongoing charges are higher than the sector average.

Exhibit 8: AIC European Smaller Companies peer group as at 6 July 2017*

% 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	428.3	31.9	59.3	165.9	117.5	0.8	1.2	No	101	5.2
JPMorgan European Smaller Cos	595.2	28.1	66.2	191.0	131.6	(7.3)	1.1	No	97	1.3
Montanaro European Smaller	133.0	31.4	60.4	113.2	109.0	(8.7)	1.3	No	103	1.0
TR European Growth	530.4	54.0	84.6	231.9	125.5	(5.8)	0.8	Yes	108	0.0
Weighted average in sector		37.5	69.8	191.4	124.3	(4.9)	1.0		102	2.7
EAT rank in sector	3	2	4	3	3	1	2		3	1

Source: Morningstar, Edison Investment Research. Note: *Performance data to 5 July 2017. 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. The management board has a single director, FCA Management BV, represented by Wilbert van Twuijver and Tim Koster. The supervisory board is akin to a board of directors on a UK investment trust. It consists of five independent non-executive members: chairman Jack Perry, deputy chairman and chair of audit professor Robert van der Meer, senior independent director Julie Bond, Laurence Jacquot and Martin Breuer. Martin Breuer, the newest member of the board, joined in May 2016.

Frankfurt +49 (0)69 78 8076 960
Schumannstrasse 34b
60325 Frankfurt
Germany

London +44 (0)20 3077 5700
280 High Holborn
London, WC1V 7EE
United Kingdom

New York +1 646 653 7026
295 Madison Avenue, 18th Floor
10017, New York
US

Sydney +61 (0)2 8249 8342
Level 12, Office 1205
95 Pitt Street, Sydney
NSW 2000, Australia