Marlborough

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Date
March 2024

Capital is at risk. Please read full risk warning at the end of this document.

Fund Update: European Special Situations

Why we see a big opportunity in Europe's smaller companies

We believe that quality European smaller companies in unloved sectors are presenting attractive opportunities for investors taking a long-term view.

These businesses have been contending with a number of headwinds in the near term including slowing economic growth, higher interest rates and inflation.

Inevitably, the share prices of many of these companies have declined, particularly in sectors such as industrials, which are viewed as highly cyclical and so more vulnerable in a slowdown.

However, we believe this share price weakness represents a long-term opportunity to invest in high-quality businesses with outstanding growth prospects at significantly lower valuations.

Our strategy is to look for companies with high-calibre management, relatively low levels of debt and strong drivers for growth. Most importantly, we seek out businesses we believe are undervalued relative to their growth potential.

While we are free to invest in companies of all sizes, we favour small-caps because we believe companies with strong prospects can often be overlooked simply because of their size. Far fewer analysts and fund managers are looking at these stocks.

There are an average of 26 analysts looking at every European mega-cap company, according to Canaccord. But at the other end of the market cap spectrum, there are, on average, only four looking at each small-cap company and for micro-caps – the average is just one. This creates an opportunity for an investment team doing their own research to identify companies with excellent prospects before they are on the radar of other investors.

The opportunity is even more pronounced in the current environment because many well-managed smaller companies in out-of-favour sectors are on significantly lower share prices than they were two years ago.

We are not the only ones who believe the current valuations of some European smaller companies look appealing. We have seen a flurry of merger and acquisitions activity, with bids for five companies held in the fund last year and one more already this year.

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Difference
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Stock examples

VBG Group

One company we hold in the portfolio that we believe looks undervalued relative to its growth prospects is Swedish industrial business VBG Group, which makes components for trucks.

VBG is the world's number-one producer of drawbars, couplings used to connect four-wheel trailers to heavy goods vehicles. And, through a combination of acquisitions and organic growth, the company has successfully expanded into other markets for niche components for trucks, off-road vehicles and buses. It recently entered the air-conditioning system market through an acquisition and is now also growing in this market.

VBG's strong position in niche markets gives it the 'pricing power' to pass on rising costs by nudging up prices for customers. We believe it is a well-managed business with robust prospects.

B&C Speakers

Another holding in our fund is Italian company B&C Speakers, which is the leading global supplier of key components used in high-end speakers for live entertainment. It makes the transducers that convert electrical energy into sound waves.

The business remains majority owned by the family of its co-founder Roberto Coppini, which we believe is a positive because it supports a stable, long-term business strategy.

B&C has superior product design and lower costs than smaller competitors, which is helping to drive continuing sales growth and high profitability.

The company is also benefiting from increased demand resulting from the resumption of growth in live entertainment after the interruption caused by the pandemic.

We believe both of these companies are strongly positioned for growth when the current headwinds begin to ease and that they look undervalued relative to their long-term prospects.

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