EI STURDZA
INVESTMENT FUNDS

STRATEGIC EUROPEAN SMALLER COMPANIES FUND

2018 PERFORMANCE REVIEW

2018 YTD PERFORMANCE*:

Mid December, the Fund's year to date performance stands at approximately -25% (as at 14/12/2018) while the Fund's benchmark has lost ~8.5%. Since inception in May 2015, the Fund has returned +4% while the benchmark is down by -2%. Most of the outperformance created in 2015, 2016 and 2017 evaporated this year.

The Fund's performance in 2018 is obviously a source of frustration for the investment team, and understandably for the people invested in the vehicle. Multiple articles have been written about the valuation dichotomy in the market between growth and value, with some statistical studies showing that it has reached a level not seen since 1999. It is however always difficult to call an inflection point in such a trend and the Investment Adviser would refrain from doing so.

The team has always stressed that the Fund's performance is only a reflection of the value created by the companies in which the Fund is invested. This has always been the case, not only since May 2015 when the Fund was launched, but from July 2002 when the Investment Adviser started managing third party assets. This year, it is unfortunately not the case that markets are reflecting the value created by companies. **Some quality companies producing excellent results have seen their stock price fall by 30% or sometimes 40% during the year.**

*For detailed performance information, please refer to page 5.

ALBIOMA HAS BEEN THE FUND'S LARGEST POSITION FOR MOST OF THE YEAR**:

The Fund's largest position over most of the year has been Albioma, which is an independent energy producer developing and operating projects in thermal biomass and solar power. Albioma's core business is high-performance energy recovery from biomass that is free from any conflict of use, with particular emphasis on bagasse, the fibrous residue that remains after sugar cane has been crushed.

Year to date, Albioma has declined by 20% in spite of the fact that it is the least cyclical company held in the portfolio (its returns are guaranteed by the regulator), and the year is developing exactly as planned.

Recent news flow has been very positive for the company, but this has not been reflected in the stock price.

- 15th November – The French energy regulator approved the terms of a draft amendment between EDF and Albioma Caraïbes power plant in Guadeloupe, allowing the conversion of the only 100% coal-fuelled facility to operate with biomass. Converting the power plant to operate with biomass will increase the share of renewable energy in Guadeloupe's energy mix to approximately 35% (from 20.5% in 2017).

- 4th December, the Company announced that the warrants issue reserved for 42 employees and the CEO was met with great success with a subscription rate of over 140%. Each employee paid €0.90 for each warrant struck at €20.9 with an exercise period between 2021 and 2024. Each employee implicitly created the stock at €21.80, a great sign of confidence for a stock that closed at €15.70 yesterday.

- 11th December - Jacques Veyrat, 51% shareholder of the recently listed company Neoen, acquired 5.50% for the company for €31.7 Million to clean up the residual stake held by the historical private equity owner of the business at a 20% premium to yesterday's closing price. A 20% premium for a minority stake.

This specific example is here to demonstrate that the year to date mark to market evolution of Albioma, albeit frustrating, is totally disconnected from the underlying fundamentals, the trust of its employees in the future of the Company and the capital that investors with deep knowledge in the industry are willing to invest in the business. The contrast is so staggering that, in the Investment Adviser's opinion, it cannot remain as mispriced as it is indefinitely.

Since the announcement on the 11th December, the stock price rebounded from €15.7 to €18.5, aligning itself to the price of the latest block trade, and recovering by 18% since the lows but it still remains far below the team's fair value calculation that stands between €28 and €30. **As per the Investment Adviser's assessment more than 50% upside remains from current levels.**

** Source EI Sturdza / Bloomberg PORT.

THE PORTFOLIO'S UPSIDE POTENTIAL:

Markets this year have been heavily influenced by:

- Growth in Europe, and in general, being a bit lower than expected at the beginning of the year; with expectations downgraded continually during the year;
- Sizeable cash outflows from European equities, especially in the Small and Mid-Caps space, triggering forced selling;
- Trade barriers and protectionism creating a wide range of uncertainties and an inevitable pull back in investments;
- Turkey, Italy, the yellow vest movement in France and emerging markets economies being an unpleasant and constant background noise.

The reality is that the Fund's companies have the ability to sustainably create value for their shareholders, measured through their free cash flow generation streams. The team believe that this is true today and will continue to be true, even if the world enters into a period of slower growth for a certain period of time and that the Fund's companies have the resources to adapt in case this scenario materialises, be it through the soundness of their balance sheet, through a reduction of their variable cost base and capital expenditures, and through the cash coming from a deflation of their working capital.

Years like 2018 require patience and discipline; the team consider that they have planted the seeds for future performance. **The upside potential, as per the Investment Advisers internal models, for the Fund is today at an unprecedented level of over 60%, on the basis of very conservative assumptions.**

The average PE ratio for 2019 is now below 10x with a 9% Free Cash Flow yield. **7 out of the 26 companies in the portfolio trade below their book value i.e. below the replacement value of their assets minus their debt.**

INTERESTING RECENT OBSERVATIONS:

Even though markets have continued selling off month in the early days of December, we are observing changes:

- In recent conferences the Investment Adviser has **attended the mood from companies was cautiously**

relaxed and positive. Investors were clearly desperate for companies to say that the cycle is rolling over and that they're seeing weakness, but they simply aren't in most areas outside autos, semis and retail, and even in those sectors there are pockets of strength.

- There has been a **clear increase in insider buying** very recently in the Fund's universe.
- Lastly, **M&A activity has finally picked up** from November, with takeovers announced by several companies in Europe: Amer Sports, Basware, Poyry, Ahlsell, Osram Lighting to name but a few.

All these observations are important factors to watch and keep in mind for 2019. **We would not be surprised if 2019 is a similar scenario to 2009, with volatility in the early months of the year and a strong rebound of the portfolio companies after the annual results have been published.**

Please note that past performance is not indicative of future returns.

The views and statements contained herein are those of Pascal Investment Advisers SA in their capacity as Investment Adviser to the Fund as of 19/12/18 and are based on internal research and modelling.

Please contact info@eisturdza.com should you wish to have an update call with the investment team.

*PERFORMANCE DATA (AS AT 14/12/2018):

	EUR	STOXX Europe 600 Net Return Index
Weekly	-0.46	0.51
MTD	-4.96	-2.85
YTD 2018	-24.68	-8.31
2017	22.80	10.58
2016	13.55	1.73
2015	-0.72	-5.09
Since Fund Inception	4.27	-2.11

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