

This is an edited version of a fund profile produced for subscribers to the Money Makers circle. [Find out more here](#)

Profile: European Smaller Companies

By Stuart Watson

15 March 2023

European Smaller Companies (ticker: ESCT) was launched in 1990 and up until last year was known as TR European Growth. The trust was managed by Stephen Peak for its first two decades before Ollie Beckett took over in 2011. Over the last decade, it has comfortably beaten its benchmark and it has also been the best performer of the four European small-cap trusts. Compared to the other trusts in the sector, it is a little less growth-orientated and tends to invest in slightly smaller companies — around half of its portfolio has a market cap of €1bn or less. ESCT has a fairly large portfolio of around 125 positions, net assets of around £700m, and its typical level of gearing is around 10%. Apart from a few brief periods, it has traded on a double-digit discount for much of the last 20 years. An 8-for-1 share split, the name change, and a small fee cut, all announced in late 2021, were an attempt to improve the trust's rating and although the discount did narrow for a short time, it is currently around 16% with investors cooling on both Europe and small caps.

The small-cap effect is well documented across most major equity markets and suggests that smaller companies, as a group, tend to outperform their larger cousins. It's a theory that is widely followed across the investment trust universe with small-cap sectors that specialise in UK, North American, European, Japanese, Asia Pacific, and global small caps. Altogether there are over forty small-cap trusts that look after around £20bn in assets.

European Smaller Companies (ESCT) is one of the larger trusts in this space. It was launched in 1990, raising around £40m, and was originally called TR European Growth. Stephen Peak, then in his early thirties, was the trust's first manager and he looked after the portfolio for over two decades.

The first decade

The trust was highly successful in the 1990s with a number of years where the NAV rose by 30% or more. Two C share issues in 1994 and 1997, the second taking place after a failed bid to take over the ill-fated Kleinwort Benson European Privatisation Trust, also helped the trust balloon in size.

ESCT's tenth year saw a mammoth NAV gain of 96% and its net assets rise to nearly £775m as the dot com frenzy reached its peak. At this point, the share price was up around tenfold from its launch with an annualised gain of 28%, far ahead of the 15% a year generated by European markets over the same period. The trust frequently traded at a small premium.

The second decade

The second decade did not go well. The NAV fell 46% in the year that ended June 2001 and 30% the year after. The discount widened and ESCT began to buy back its shares and launched a tender offer for around 30% of shares in 2005. It also put a discount control mechanism in place whereby shareholders could redeem 10% of their shares each year if the average discount exceeded 10%.

There were four successive years of 30%+ gains from 2004 to 2007 but these were followed by two years of significant losses in 2008 and 2009. The second decade saw a NAV total return of -6% compared to +75% for the trust's blended benchmark of two European indices.

The third decade

Ollie Beckett, who looked after the Henderson Horizon Pan-European Smaller Companies Fund, joined the trust's management team in 2010. After consulting with shareholders, the discount control mechanism was ditched as keeping so much cash on hand to fund possible redemptions was reckoned to be a drag on its performance. It also resulted in the trust shifting towards holding slightly larger stocks as they were more liquid.

Peak stepped down in June 2011, citing the fact that his other duties on other funds had taken him away from specialising in European smaller companies. In particular, he also ran a hedge fund that was performing considerably better than ESCT. The trust's NAV fell by 29% in Beckett's first year in charge while he attempted to reconfigure the portfolio in the midst of the European debt crisis.

However, under Beckett, ESCT has performed pretty well. Its third decade ended with a NAV total return of +216%, ahead of the +178% produced by the trust's benchmark but slightly behind the +236% NAV gain for the European small-cap sector.

The trust's manager

Janus Henderson manages a total of £240bn of which £8bn relates to its twelve UK-listed investment trusts including Bankers, City of London, Henderson Smaller Companies, and ESCT. Janus Henderson and its predecessors have managed ESCT since it joined the London market in 1990.

As mentioned above, this trust has only had two lead managers in its 33 years. Ollie Beckett has been the lead since 2011 and he is about 50 years of age. Beckett first worked at Henderson from 1998 to 2003, coming on board when it merged with AMP Asset Management, and then re-joined the company again in 2005. He manages three other open-ended funds, also focused on European smaller companies, with combined assets of around £1bn. Rory Stokes is Beckett's deputy or co-manager on all four of Beckett's funds. Stokes joined Henderson in 2013 and is in his early forties.

Beckett's AGM presentation from a few months ago is worth watching and covers a lot of ground in just sixteen minutes ([link](#)). There are also a few short interviews on YouTube, but they are a little more dated.

Share capital history

Here is the full history of ESCT's returns since 1990:

Year to 30 Jun	Net assets (£m)	NAV per share (p)	NAV return (capital only)	Share count (m)	Share price (p)	Discount	Dividend (p)
1991	38.6	6.6	n/a	584	6.0	-9.3%	0.16
1992	35.5	6.1	-7.6%	581	4.5	-26.4%	0.09
1993	42.7	7.3	18.8%	588	6.5	-10.5%	0.11
1994	96.9	10.3	41.7%	942	10.2	-1.0%	0.11
1995	110.1	11.6	12.5%	951	11.5	-0.6%	0.11
1996	154.3	15.9	37.1%	972	15.8	-0.8%	0.11
1997	259.1	20.9	31.7%	1,240	21.8	4.4%	0.11
1998	407.5	30.9	47.9%	1,318	31.6	2.3%	0.03
1999	378.8	28.7	-7.3%	1,322	26.3	-8.2%	0.11
2000	773.4	56.0	95.6%	1,380	57.8	3.1%	0.13
2001	408.0	30.5	-45.6%	1,339	29.9	-1.9%	0.18
2002	274.9	21.2	-30.3%	1,294	18.0	-15.2%	0.18
2003	241.4	19.5	-8.1%	1,236	15.8	-19.3%	0.26
2004	343.5	28.3	44.9%	1,214	24.1	-14.9%	0.36 *
2005	294.9	38.9	37.5%	758	34.4	-11.6%	0.50 *
2006	365.4	52.1	34.0%	701	46.1	-11.6%	0.33
2007	460.1	70.6	35.5%	651	63.6	-9.9%	0.35
2008	331.9	57.3	-18.8%	579	52.5	-8.4%	0.63 *
2009	215.4	41.8	-27.1%	516	37.9	-9.3%	0.69 *
2010	199.5	48.3	15.7%	413	43.3	-10.3%	0.53 *
2011	264.4	65.3	35.1%	405	53.4	-18.2%	0.53 *
2012	185.0	46.3	-29.1%	400	35.4	-23.6%	0.75 *
2013	246.1	61.6	33.0%	400	51.2	-16.9%	1.00 *
2014	325.7	81.5	32.3%	400	71.7	-12.0%	1.15 *
2015	337.6	84.5	3.7%	400	78.0	-7.6%	1.19 *
2016	377.7	94.5	11.9%	400	77.5	-18.0%	1.44 *
2017	569.5	143.2	51.6%	398	133.9	-6.5%	1.81 *
2018	574.6	143.3	0.1%	401	127.5	-11.1%	2.38
2019	521.0	130.0	-9.3%	401	111.5	-14.2%	2.75
2020	523.3	130.6	0.4%	401	105.5	-19.2%	2.76
2021	840.7	209.7	60.6%	401	185.6	-11.5%	3.13
2022	652.5	162.8	-22.4%	401	140.0	-14.0%	4.35

** = includes a special dividend, all per shares figures have been adjusted for an 8-for-1 share split in December 2021 and a 2-for-1 share split in 1997*

The 2020s have continued ESCT's rollercoaster history with a 61% NAV gain in 2021 followed by a 22% drop in 2022. The six months to December 2022 showed a 9.3% NAV gain and, at the time of writing, the trust's NAV was up 6% so far in 2023.

The double-digit discount has proved to be a sticking point, although there was a dash to a premium rating in 2017 after a strong year of gains, resulting in a brief period of share issuance. There were a handful of buybacks up until 2016 but, overall, ESCT's share count has hardly changed for ten years now.

After a review, a package of measures was announced in October 2021 to appeal to retail investors. The trust's name was changed from TR European Growth to the slightly more intuitive and search-engine-friendly European Smaller Companies Trust, an 8-for-1 share split took place, and the trust's basic fees were cut slightly although its long-standing 15% performance fee remained. Although the discount has shifted up and down a little, it is now back at the same level as when these announcements were made.

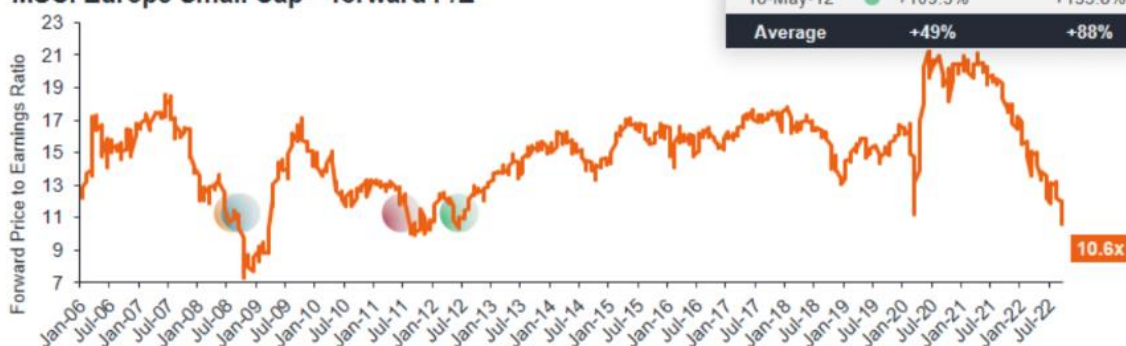
Beckett continues to make the case for smaller companies being the place to look for growth over the medium term and his recent AGM presentation emphasised the low valuation level of European small caps. This chart shows the three- and five-year returns when valuations were last this low in 2008, 2011, and 2012:

Buying at current valuations has historically been a good idea

- Earnings estimates are likely too high but valuations are reaching the low end of historic range
- What would have happened had you bought the index the last four times it breached 11.0x P/E?

Date index hit 11x P/E	3 year subsequent return	5 year subsequent return
04-Jul-08	+10.6%	+28.4%
26-Sep-08	+8.1%	+78.4%
05-Aug-11	+69.0%	+108.2%
18-May-12	+109.3%	+135.8%
Average	+49%	+88%

MSCI Europe Small Cap – forward P/E



Source: Bloomberg, Janus Henderson Investors Analysis, as at 30 September 2022.

Note: Price-to-earnings (P/E) ratio is a popular ratio used to value a company's shares, compared to other stocks, or a benchmark index. It is calculated by dividing the current share price by its earnings per share. There is no guarantee that past trends will continue, or forecasts will be realised. The views are subject to change without notice.
Past performance does not predict future returns.

Key stats for European Smaller Companies

- **Launched:** Sep 1990
- **Domicile:** UK
- **Management firm:** Janus Henderson
- **Manager:** Ollie Beckett (since July 2011)
- **Ticker:** ESCT
- **AIC Sector:** European Smaller Companies
- **NAV return for the last 10 years:** 283% (1st out of 4)
- **Benchmark:** MSCI Europe ex UK Small Cap Index
- **Recent price:** 155p
- **Indicated spread:** 154.5p-155.5p (0.6%)
- **Market cap:** £621m

- **Share count:** 400.9m
- **NAV per share:** 184.3p
- **NAV update frequency:** Daily
- **Discount to NAV:** 16%
- **Five-year average discount:** 13%
- **Charges:** 0.65% (OCF) and 1.4% (KID)
- **Management fee:** 0.55% up to £800m of net assets and 0.45% thereafter
- **Performance fee:** Yes, 15% of any outperformance after a 1% hurdle
- **Discount control policy:** None stated
- **Continuation vote:** Yes, every three years with the next vote due in Nov 2025
- **Net gearing:** 10% (31 Jan 2023)
- **Number of holdings:** 125 (31 Jan 2023)
- **Top ten holdings:** 20% (31 Jan 2023)
- **Year-end:** 30 Jun
- **Results released:** Oct (finals) and Mar (interims)
- **Historical dividend and yield:** 4.35p and 2.8%
- **Dividends paid:** Apr and Dec
- **Links for more info:** [Website](#) – [AIC page](#) – [Edison \(paid research\)](#)

Price and related data as of 13 Mar 2023

Investment style and policies

ESCT aims to deliver “a long-term sustainable return from investing in smaller and medium-sized European companies.” The trust’s definition of smaller and medium-sized is any company smaller than the largest stock in the MSCI Europe Ex-UK Small Cap Index. Currently, that means any company valued at less than £6bn.

The trust can invest in shares, securities, and related financial instruments, including derivatives for the purpose of efficient portfolio management. Unquoted investments can be held if there is prior Board approval. There were some legacy unquoted investments dating from when Peak was in charge, but these were gradually sold off and there appear to be no unquoted investments in the portfolio right now.

There are guidance ranges of 80-100% for equities and 0-20% for fixed income and cash and, at the time of its acquisition, no single holding should exceed 7%. With over 100 holdings, the largest position tends to be around 3%. Net gearing is limited to 30% but tends to average around 10%.

Currency hedging can be done with board approval but typically isn’t used. About 70% of net assets (including all current borrowing) are in Euros, 11% are in Swedish Krone, 9% are in Swiss Francs, and 11% are in other European currencies.

ESCT says its investment process is “fundamentally one of bottom-up stock picking, rather than allocating capital to specific sectors or geographies, although we carefully monitor the overall structure of the portfolio to ensure we avoid risky concentrations. We do not use the benchmark as a guide to structure and are content to run the portfolio with substantial divergence from the benchmark.”

The trust reckons it has a more balanced approach between growth and value than the other three trusts in its sector and splits its holdings into four main buckets.

This chart shows the attributes sought, the valuation measures used, and the main sell criteria for each bucket:

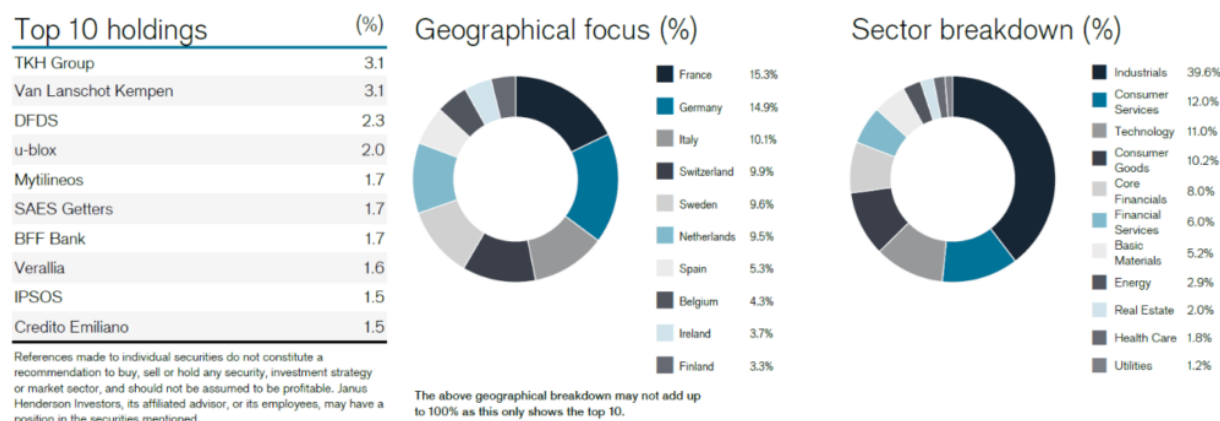
For businesses in each phase of the company life cycle, the fund management team has clear attributes and valuation metrics for measuring success and seeking out mispriced securities. This is coupled with a sell discipline to ensure underperforming companies are removed from the portfolio.

	Early cycle	Quality growth	Mature	Turnaround
Attributes looking for	<ul style="list-style-type: none"> • Growth • Clear strategy • Operating leverage 	<ul style="list-style-type: none"> • High ROIC • Top line growth • Margin sustainability • 'Moat' barrier to entry 	<ul style="list-style-type: none"> • Steady ROIC • Cash generation • Equity cheap relative to assets 	<ul style="list-style-type: none"> • Management cost cutting • Margins • Asset disposal
Valuation metrics	<ul style="list-style-type: none"> • EV/Sales 	<ul style="list-style-type: none"> • PE • EV/EBIT • EV/IC 	<ul style="list-style-type: none"> • EV/IC • EV/EBIT • FCF yield 	<ul style="list-style-type: none"> • EV/IC • EV/EBIT • FCF yield
Sell discipline	<ul style="list-style-type: none"> • Disappointing growth • Narrative drift • Management sales • No operating leverage 	<ul style="list-style-type: none"> • Margin progression • Incoherent M&A • Deteriorating accounting quality 	<ul style="list-style-type: none"> • Valuation • Competitive environment • Technology shift 	<ul style="list-style-type: none"> • No margin progression • Rapid sales deterioration

Edison reckons that in June 2022 the portfolio was 37% in Quality Growth, 35% in Turnarounds, 29% in Mature, and 9% in Early Cycle.

Portfolio

With around 125 positions, the portfolio commentary is fairly brief and at quite a high level. This is the summary from the January 2023 factsheet showing the largest positions and the geographical/sector split:



A full list of the portfolio is provided in the annual accounts. Only a handful of positions are greater than 2%, around 35 are between 1% and 2%, about 65 are between 0.5% and 1% and 20 are below 0.5%. Very few positions are below 0.3%, however. Portfolio turnover tends to be fairly high, however. It was around 65% for 2019, 2020, and 2021 but fell to around 45% in 2022.

Geographical overweights include Germany (although less so than previously), the Netherlands, and Ireland with underweights towards Sweden and Switzerland, which make up around 16% and 13% of the benchmark. When it comes to sectors, ESCT is tilted towards industrials, financials, and consumer discretionary and away from health care, real estate, and utilities.

Edison reckons the average market cap for ESCT's portfolio is €1bn, compared to €2.2bn for its benchmark, and €3.2bn for its three sector rivals. That is quite a significant difference and suggests that ESCT's returns are likely to be more volatile over the economic cycle. That certainly seems to have been the case in the past, with the trust performing strongly in bull markets but struggling in bears.

This table of portfolio metrics comes from the AGM presentation a few months ago and is as of 31 October 2022:

Characteristics	The European Smaller Companies Trust Plc	MSCI Europe ex UK Small Cap Index
Dividend yield forecast ¹	3.8%	4.1%
P/E ² forecast	10.1x	10.6x
ROE ³	14.1%	14.1%
Historic EPS ⁴ growth (3 years)	14.7%	16.6%
Forecast EPS growth (next 12 months)	15.5%	19.7%
Net debt / EBITDA ⁵	1.2x	1.9x

The valuation and ROE figures reflect the theory that ESCT has a balanced portfolio in terms of value and growth. It is a bit surprising to see slightly slower growth than the benchmark although such metrics are very much in flux at the moment so this may not be meaningful. The lower debt multiple is reassuring.

Performance

This table summarises the trust's last decade. Although there has been decent NAV and dividend growth, as is the case with many UK small-cap trusts, it is also a story of two halves with a very strong performance from 2012 to 2017 but a mediocre period from 2017 to 2022, thanks largely to the decline in 2022:

At 30 June	Net assets £'000	NAV per ordinary share p	Mid-market price per ordinary share p	Discount %	Profit/(loss) for year £'000	Revenue return p	Capital return p	Total return p	Total dividend p	Ongoing charge (AIC formula) %
2013	246,124	61.56	51.16	16.9	64,115	1.16	14.88	16.04	1.00	0.74
2014	325,676	81.46	71.72	12.0	83,548	1.39	19.50	20.89	1.15	0.69
2015	337,645	84.45	78.00	7.6	16,565	1.42	2.72	4.14	1.19	0.78
2016	377,683	94.46	77.50	18.0	44,782	1.69	9.51	11.20	1.44	0.79
2017	569,459	143.19	133.88	6.5	199,540	2.14	47.96	50.10	1.81	0.75
2018	574,591	143.34	127.50	11.0	9,936	2.76	(0.27)	2.49	2.38	0.71
2019	521,023	129.98	111.50	14.2	(42,795)	3.01	(13.69)	(10.68)	2.75	0.72
2020	523,374	130.56	105.50	19.2	13,525	1.49	1.88	3.37	2.76	0.73
2021	840,667	209.71	185.63	11.5	328,517	2.59	79.36	81.95	3.13	0.71
2022	652,464	162.76	140.00	14.0	(174,712)	5.16	(48.75)	(43.59)	4.35	0.65

ESCT currently has the best 10-year NAV return in its sector at +280%, which coincides fairly neatly with Beckett's tenure as lead manager. That compares to 203% for Montanaro, 191% for JPMorgan, and 123% for European Assets. Montanaro takes the gold over five years, but ESCT wins out over one and three years.

Trustnet's data going back to 1995 shows there is not that much to choose between this quartet over a longer timeframe with JPMorgan at 12.6% per annum in share price terms,

ESCT at 11.7%, Montanaro at 11.4%, and European Assets at 10.9%. But it has been a volatile ride with significant peaks and troughs along the way.

European Smaller Companies has been one of the strongest of the AIC's various small-cap sectors at 207% in NAV terms over the last ten years, with Global at 194%, the UK at 126%, Asia Pacific at 98%, and Japan at 184%. There is no weighted average for North America but the two trusts currently in this sector have NAV returns of 143% and 267%.

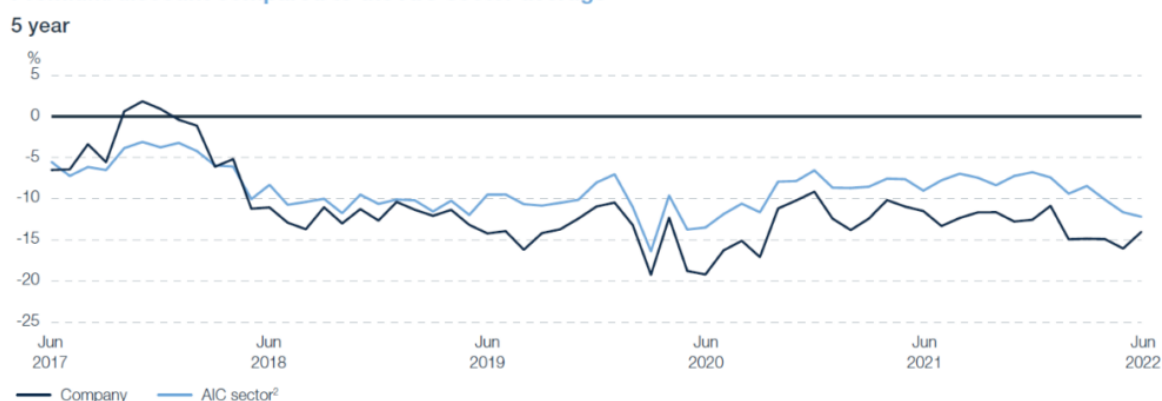
Rating

Small-cap trusts have often traded at a wider discount than mainstream equity funds and ESCT is no exception.

There was a major rerating in 2017, no doubt helped by the 52% NAV return that year, and the trust even traded at a premium for a brief time. The 61% NAV gain in 2021 saw no such rerating, unfortunately.

Helpfully, the trust publishes a five-year chart of its discount versus the sector average so we can see its rating has been a little weaker than its rivals for nearly all of the past five years:

Premium/discount compared to the AIC sector average



Currently, ESCT and JPMorgan European Discovery, which are around the same size, are trading on discounts of 16% and 15% while Montanaro is at 12% and European Assets is at 8%. European Assets has a fairly punchy enhanced dividend policy set at 6% of its NAV each December, which might be why it enjoys a slightly better rating.

The Board does not set any targets for the discount, preferring to keep a flexible approach, and hasn't done any buybacks since 2016. At the AGM, Beckett admitted the situation was a "frustration" but that current antipathy towards both European markets and small caps was felt to be the main factor. It seems like buybacks have been dismissed as "not achieving a great deal" in the past. But buybacks have not been used to any significant degree since 2010 so I'm not wholly convinced by that argument.

Directors and major shareholders

ESCT currently has four directors, all of whom are considered independent. Christopher Casey joined the board in 2019 and has been Chairman since then. The other directors were appointed in 2014, 2019, and 2019. A fifth director retired a few months ago but no replacement has been announced yet.

All four directors own shares with a combined holding of around 83,000, which is a fairly low £0.14m. One director bought their first shares in the trust in November 2022, but you have to go back to June 2021 for the next most recent director buy. Beckett says ESCT is by far his largest personal investment having been awarded shares via his role as manager and also buying for his own account.

Unusually, there is only one major shareholder with a notifiable position and that is Allspring Global Investments (formerly Wells Fargo Asset Management) with around 15%.

Charges

ESCT's current basic fee structure is 0.55% up to £800m of net assets and 0.45% thereafter. There is also a 15% performance fee that is payable on any returns greater than 1% over the trust's benchmark, measured over rolling three-year periods. The combined fee is limited to 2% a year. ESCT's net assets are currently just below the level where the cheaper basic tier kicks in.

There have been a few fee changes in recent years. The base fee was reduced from 0.8% to 0.5% in 2004 when the performance fee was first introduced. In 2014, the base fee was increased to 0.6% in return for the extra 1% hurdle over the benchmark for the performance fee and reducing the overall cap for the combined fee from 2.4% to 2.0%. In 2018, a cheaper tier of 0.5% was added for net assets over £500m. The current fee structure took effect in October 2021.

ESCT is the only one of the four trusts in its sector to have a performance fee, so although it looks the cheapest on the basis of its ongoing charge, it is probably the most expensive overall but not by much. European Assets charges 0.75% up to €400m of net assets and 0.6% thereafter, JPMorgan European Discovery is a flat 0.8% of net assets, and Montanaro European Smaller Companies is 0.9% up to £500m of market cap, then 0.75% up to £750m, and 0.65% thereafter. European Assets is only just into its cheaper tier, but Montanaro's market cap is only £275m so it is still charging 0.9% on all of its assets.

The KID puts total costs at 1.4% with 0.24% of portfolio transaction costs, 0.58% of management fees, 0.11% for other operating expenses, 0.11% for interest costs, and 0.35% for the performance fee.

Dividends

There is no formal dividend policy stated in the accounts, but the trust usually increases its dividend each year in line with its underlying earnings. The full dividend history can be seen in the long table near the top of this article while earnings per share and dividend per share for the last decade are in the chart in the Performance section above.

From 2004 to 2017, ESCT often paid a final and a special dividend each November, with the special making up between 20% and 40% of the total payout. Since 2018, dividends have been paid twice a year with the final payment normally being significantly larger than the interim.

ESCT has increased its total payout every year since 2002 if we include the specials, although its yield was only around 0.6% two decades ago so it was starting off a low base. Dividends were covered in most years although the trust did need to dip into its revenue reserves for both 2020 and 2021.

The year ended June 2022 saw very strong underlying earnings growth to 5.2p, well ahead of the 3.0p achieved pre-pandemic in 2019, so last year's dividend of 4.35p was covered with ease. The revenue reserve was £30m, also well ahead of the £17.5m needed for the 2022 annual dividend. The recently announced interim dividend was 1.45p, up from 1.25p the previous year, so it looks like the dividend for the year ending June 2023 will show another decent rise.

Gearing

ESCT is permitted to gear itself up to 30% of net assets but 10% has been the average over the past few years with a range from 7% to 16%. Borrowing takes the form of a secured multicurrency overdraft with HSBC allowing the trust to borrow up to the lesser of £160m and 25% of custody assets. The terms of the overdraft are not disclosed. If fully drawn down, the overdraft would represent around 20% of net assets. £71m of the £160m was drawn down as of December 2022.

Most gearing level changes arise from market movements but occasionally the trust will either increase or decrease its overdraft and change the gearing level by two or three percentage points, based on its overall view of the market.

ESCT tends to be a little more geared than other trusts in the sector, which have averaged around 5% in recent years. JPMorgan European Discovery has a similar gearing level to ESCT, Montanaro has a light level of gearing, and European Assets tends to be ungeared.

Closing thoughts

I owned this trust myself when it was run by Stephen Peak but parted company with it in the 2005 tender offer. I remember it as being highly volatile and that still seems to be the case today. That is largely a function of the sector it specialises in of course combined with ESCT's focus on slightly smaller companies and its marginally higher leverage.

Beckett appears to have done a very respectable job in his twelve years as lead manager and given his age, should be around for a few more years yet. Having taken some simple steps over a year ago, a more robust longer-term plan would be welcome to tackle the persistent discount. Even if the rating doesn't improve in the short term, buying shares at a discount of greater than 10% should still benefit existing shareholders.

This is an edited version of a fund profile produced for subscribers to the Money Makers circle. [Find out more here](#)

Disclaimer: Please note that neither Jonathan Davis nor Stuart Watson are authorised or regulated by the Financial Conduct Authority and as such are not permitted to offer financial or investment advice to UK resident investors, whether or not the intended investments are regulated or unregulated. Nothing appearing on the Money Makers website or in any of the content offered as part of the Money Makers service should be construed as financial advice. We strongly encourage you to consult an FCA-authorized Independent Financial Adviser before committing to any form of investment. This is not an offer to participate in a collective investment scheme as defined in section 235 of the Financial Services and Markets Act (2000) and therefore investors will not have access to the Financial Services Compensation Scheme or the Financial Ombudsman Service.