European Assets Trust

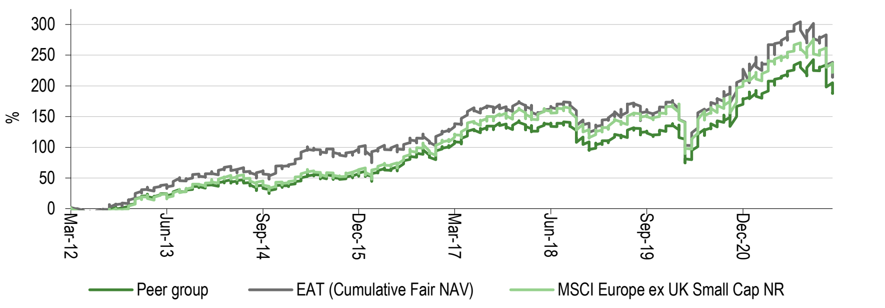
Well placed to deliver further capital growth

Investment trusts
European Smaller Companies

29 March 2022

European Assets Trust (EAT) aims to achieve long-term capital growth through a portfolio of 40–50 smaller European (ex UK) companies. EAT's managers Sam Cosh and Lucy Morris consider that such companies are often under researched, which leads to exploitable market inefficiencies. They believe that their strategy of identifying undervalued sustainable growth is key to delivering long-term returns for investors. EAT performed well through 2021, although thus far 2022 has been a difficult time for investors in European smaller companies. EAT has a unique feature within the peer group in that it provides investors a high and regular distribution from a portfolio of high-quality growth assets.

Long term outperformance of peers



Source: BMO. Peer group: Morningstar Europe ex UK Small/Mid cap equity category

Why invest in European small caps now?

The current war in Ukraine, rising oil prices and inflation, and a sell-off in growth and risk assets more generally have conspired to generate a significant reversal in European small caps in the year to date. That said, the fundamental attractiveness of the opportunity set persists, in that this extensive cohort of companies is home to a range of nimble, technologically innovative and disruptive companies. In general analyst coverage remains low, providing an informational advantage for those investors able to conduct fundamental stock research. Following the recent selloff, valuations are in line with long-term averages, with the prospect of higher forecast earnings growth than for European large caps and global equities.

The analyst's view

EAT could appeal equally to investors wishing to diversify their large-cap Europe ex-UK exposure and those seeking a regular and relatively high income. The combination of an experienced management team and a defined and repeatable process makes this trust an attractive long-term proposition for investment in this dynamic part of the European market.

Discount

EAT's share price has historically traded at a narrower discount to its net asset value (NAV) than peers (Exhibit 18). This can in part be attributed to the trust's enhanced dividend policy. Despite the relative lack of buy backs from the board, the unique attractiveness of the mandate is likely to see a continuation of that trend.

NOT INTENDED FOR PERSONS IN THE EEA

Price		**114.5**
Market cap		**£412m**
AUM		**£449m**

NAV*		117.7p
Discount to NAV		2.7%
*Including income. As at 29 March 2022.		
Yield		7.7%
Ordinary shares in issue		360.1m
Code/ISIN		EAT/BD0BSY3
Primary exchange		LSE
AIC sector		European Smaller Companies
52-week high/low	150.5p	100.0p
NAV* high/low	157.1p	105.8p
*Including income		
Net gearing*		0.0%
*As at 29 March 2022		

Fund objective

European Assets Trust was launched as a Dutch company in 1972 and was previously dual listed on the LSE and Euronext Amsterdam exchanges. The trust formally migrated from the Netherlands to the UK on 16 March 2019. It targets capital growth through investment in quoted small and medium-sized companies in Europe (ex-UK), using the EMIX Smaller Europe ex-UK Index as a benchmark.

Bull points

- Well-resourced and experienced team.
- ESG integrated into investment process.
- An exploitable and attractive opportunity set.

Bear points

- European small caps can be volatile.
- EAT's stylistic factors can be a headwind.
- CTI acquisition could be a short-term distraction.

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Market outlook: Scope for small caps to outperform

Historically, European smaller companies have outperformed their large-cap brethren six to 12 months after a financial shock, as central banks seek to support and stimulate economic activity through accommodative monetary policy. In the mid to late 1990s there were a number of emerging market crises (Mexican, Asian and Russian), and then the dot-com bubble burst in 2000–01, and European smaller companies underperformed during all of these events. However, post the dot-com crash, European smaller companies posted six years of outperformance. They again underperformed during the global financial crisis of 2007–08, before recovering very strongly in the next two years. The European sovereign debt crisis saw underperformance in 2011, however since then and throughout the COVID-19 pandemic, smaller companies have continued to outperform larger European companies. As a segment of the market sensitive to economic growth, the recent stabilisation in the purchasing managers' index (PMI) indicators seen across Europe could provide further support to European smaller companies.

After the market correction seen in 2022, the European market including smaller companies is currently trading broadly in line with its average long-term valuation. Given that many economies are not yet fully open, corporate earnings are likely to remain somewhat depressed but as COVID-19 restrictions ease and the reopening of economies gathers pace, earnings could grow quickly, with European smaller companies forecast to grow at a higher rate than larger companies.

The fund managers: Sam Cosh and Lucy Morris

The managers' view: Staying the investment course

Equity markets have been weaker since Q321 as investors began to adjust to higher levels of inflation (UK RPI reached 7.8% in January 2022) with associated expectations for interest rate rises. This took the wind out of high-multiple growth stocks. Successive central banks signalled an end to multi-year expansionary monetary policy, with the Bank of England becoming the first G7 central bank to raise interest rates at its meeting in December 2021, and it followed this with two further 0.25% increases in February and March 2022. The US Federal Reserve raised rates to 0.25% in March.

Optimism that the worst of the COVID-19 economic and social disruption is over have evaporated due to events in Ukraine. In 2022 to date, the global stock market has seen accelerated declines due to the geopolitical turmoil associated with the Russian invasion of Ukraine. This situation seems unlikely to be resolved in the short term and, while this is a human tragedy, it is also increasing inflationary pressures and will continue to resonate through markets. However, it may delay the hand of further central bank tightening if they choose to let inflation persist, rather than choke off the post-COVID-19 recovery. In conclusion, this does not feel like the most supportive environment for equities, but it may well present a contrarian opportunity and EAT has been disciplined in investing in a portfolio of high-quality dynamic growth businesses for over 50 years, through a variety of economic conditions. The managers believe that, overall, their portfolio of good-quality companies should be relatively well placed to pass on increased costs, counter margin pressures and take advantage of opportunities within the market.

Asset allocation: Continued bias to quality assets

Current portfolio positioning

EAT's portfolio is built from the bottom up. The managers look to invest in high-quality businesses led by good management, at attractive valuations. For them, quality means the ability of a company to grow sustainably and reinvest superior cash flows into high-returning assets. To achieve this enduring competitiveness, a company must have significant barriers to entry, which could include first mover advantage (CANCOM – IT hardware & software reseller), intellectual property (Lectra – CAD for textile processing) and strong brands (Lotus Bakeries – biscuits and chocolate snacks). Management should be good capital allocators, with proven skills and an alignment with investors. The valuation paid should also include a margin of safety taking into account cash flows and ESG risks.

Despite the stock-specific approach there are some themes within the structural growth opportunities the managers seek to exploit, including technological innovation (Nordic Semiconductor – leader in Bluetooth semiconductor manufacturing), health and wellbeing (MIPS – helmet safety systems), sustainability (Forbo–- flooring) and emerging growth (Royal UNIBREW – Baltic beverages). The portfolio is substantially overweight information technology, financials and consumer staples (Exhibit 3), and underweight real estate, industrials and utilities (Exhibit 4). Within technology, the largest position is Nordic Semiconductor, which has performed strongly since it was added in March 2020. Other holdings in this sector include IT services companies CANCOM and Atea. Within financials, around half of the exposure is through three northern European banks: Ringkjoebing Landbobank, SpareBank and Avanza Bank. Within consumer staples, the three largest holdings are food suppliers: Dutch and Belgium wholesale food distribution group Sligro Food, Italian peer Marr and Belgian Lotus Bakeries, best known for its Lotus Biscoff biscuits.

Exhibit 1: Top 10 holdings

Company	Sector	28 February 2022 (%,pp)	26 February 2021 (%,pp)	Change (pp)	Benchmark weight (%,pp)	Active weight vs benchmark (%,pp)
Ringkjobing Landbobank	Financials	4.0	3.1	0.9	0.2	3.8
Lectra	Technology	3.7	2.7	1.0	0.1	3.6
Cancom	Technology	3.1	2.7	0.4	0.1	3.0
FlatexDEGIRO	Financials	3.1	3.0	0.1	0.1	3.0
Sparebank	Financials	3.1	N/A	N/A	0.2	2.9
Stratec	Health care	3.0	N/A	N/A	0.1	2.9
SIG Combibloc	Industrials	3.0	N/A	N/A	0.0	3.0
Tecan	Health care	2.9	N/A	N/A	0.3	2.6
Interpump	Industrials	2.9	N/A	N/A	0.3	2.6
Sligo Food Group	Consumer staples	2.8	N/A	N/A	0.1	2.7
		31.6				

Source: BMO

Geographic weighting is a factor of where the most attractive stocks are domiciled rather than a call on the attractiveness of one country over another.

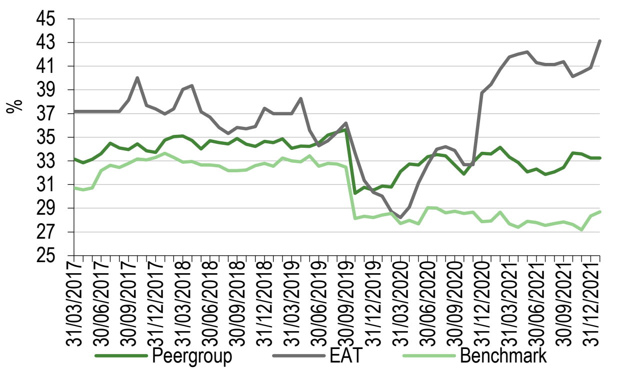
Exhibit 2: Country weightings

Country/Region	28 February 2022 (%,pp)	26 February 2021 (%,pp)	Change (%,pp)	Benchmark (%,pp)	Active weight vs BM (%,pp)
Germany	21.9	25.3	(3.4)	15.7	6.2
Sweden	15.0	15.6	(0.6)	14.9	0.1
Norway	12.6	11.7	0.9	6.2	6.4
Netherlands	7.2	8.5	(1.3)	5.6	1.6
Italy	7.1	6.9	0.2	9.4	(2.3)
Switzerland	10.2	8.6	1.6	11.6	(1.4)
Denmark	7.5	6.5	1.0	4.2	3.3
France	8.3	5.6	2.7	12.4	(4.1)
Spain	2.1	5.5	(3.4)	5.4	(3.3)
Iceland	1.9	2.7	(0.8)	0.0	1.9
Portugal	1.9	1.8	0.1	0.9	1.0
Ireland	2.2	1.3	0.9	1.6	0.6
Belgium	2.1	N/A	N/A	4.6	(2.3)
	100.00	100.0			

Source: BMO.

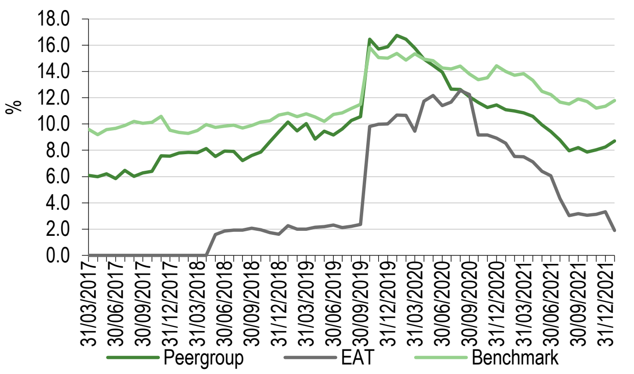
The manager does not favour any one sector over another. However, given the focus on quality companies that operate within secular growth markets with sustainable barriers to entry and pricing power, it might be expected that the fund's allocation to certain sectors such as Utilities, telecommunications, real estate and basic materials may be limited, which is illustrated in Exhibit 4 below. Correspondingly, is it likely that many of these types of companies will operate in sectors such as technology, consumer discretionary and financials, which is illustrated in Exhibit 3.

Exhibit 3: Cumulative exposure to financials, consumer discretionary and technology



Source: Morningstar. The peer group is the Morningstar universe of European ex UK small and mid-caps. Benchmark refers to MSCI European ex UK smaller cos index.

Exhibit 4: Cumulative exposure to utilities, real estate, telcos and basic materials



Source: Morningstar. The peer group is the Morningstar universe of European ex UK small and mid-caps. Benchmark refers to MSCI European ex UK smaller cos index.

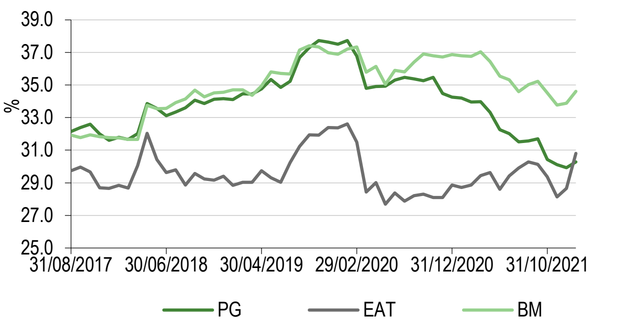
Exhibit 5: Sector exposure

	28 February 2022 (%,pp)	26 February 2021 (%,pp)	Change (%,pp)	Benchmark (%,pp)	Active weight vs benchmark (%,pp)
Industrials	21.8	22.9	(1.1)	25.6	(3.8)
Consumer discretionary	18.4	18.8	(0.4)	9.8	8.6
Information technology	18.6	18.5	0.1	9.8	8.8
Financials	16.2	14.9	1.3	11.5	4.7
Consumer staples	10.8	9.9	0.9	5.0	5.8
Healthcare	9.8	8.5	1.3	9.8	(0.0)
Basic materials	4.2	3.1	1.1	7.5	(3.3)
Real estate	0.2	2.0	(1.8)	9.3	(9.1)
Utilities	0.0	1.4	(1.4)	4.2	(4.2)
Communication services	0.0	0.0	0.0	5.1	(5.1)
Energy	0.0	0.0	0.0	2.5	(2.5)
Total	**100.0**	**100.0**		**100.0**	

Source: BMO

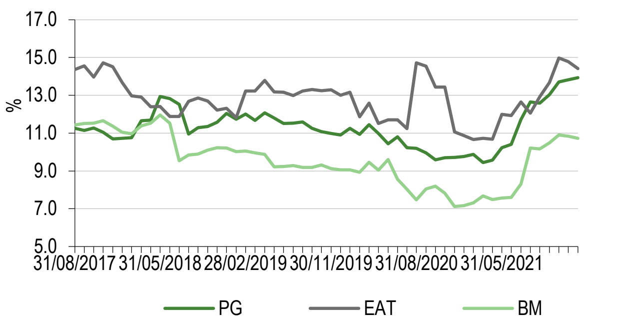
The focus on quality is evident via historically lower debt compared with peers and the index while the portfolio has tended to have better returns on equity, as illustrated in Exhibits 6 and 7 below.

Exhibit 6: Lower historical debt to equity



Source: Morningstar. The peer group is the Morningstar universe of European ex UK small and mid-caps. Benchmark refers to MSCI European ex UK smaller cos index.

Exhibit 7: Higher return on invested capital



Source: Morningstar. The peer group is the Morningstar universe of European ex UK small and mid-caps. Benchmark refers to MSCI European ex UK smaller cos index.

Portfolio turnover was especially high in FY20 (95.8% using FCA methodology) relative to EAT's historical trends as the managers looked to take advantage of some heavy price falls in favoured stocks. FY21 was more normalised (41.6%) in this respect and there were four new positions added through the period: Mister Spex, Tecan, Thule and Lotus Bakeries. These companies share attractive characteristics such as strong brands and growing market share in structural growth markets, for example in leisure or health and wellbeing.

Tecan is an example of a health and wellbeing stock. It provides automated personalised healthcare diagnostics and has been held previously in the fund. It was sold in late 2020 and it subsequently underperformed. After Tecan announced an attractive acquisition that bolstered long-term growth expectations the managers bought back in. The Thule group is known for its high-quality car bike racks and cargo carriers, where it has a large market share, but has latterly made good inroads into pushchairs and strollers. This company is a direct beneficiary of the post COVID-19 demand for outdoor pursuits and its strong brand gives it an element of pricing power and barriers to entry. Lotus Bakeries has a very strong brand in biscuits and spreads and is expanding in the United States, which could provide further potential for growth. The core products lend themselves to adjacent goods such as ice cream and chocolate. In addition, it has a suite of healthy eating options in TREK and BEAR. Mister Spex is a disruptor to incumbent operators within the premium and luxury glasses market and was listed via IPO in 2021. Its retails through a combination of online and physical stores across 10 countries within Europe.

Performance: A strong 2021, challenged 2022 ytd

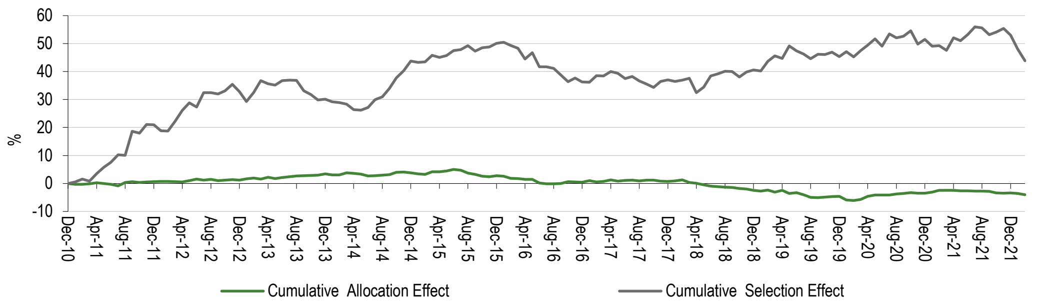
Exhibit 8: Five-year discrete performance data

12 months ending	Total share price return (%)	Total NAV return (%)	MSCI Europe ex UK Small (%)	MSCI Europe Ex-UK (%)	CBOE UK All Companies (%)	MSCI World (%)
28/02/18	25.2	16.4	20.9	12.1	4.4	6.6
28/02/19	(17.1)	(9.5)	(9.5)	(2.8)	1.6	4.6
29/02/20	(1.7)	1.1	7.5	7.0	(2.1)	9.6
28/02/21	35.6	34.7	27.6	13.9	2.8	18.8
28/02/22	2.7	(0.7)	4.7	9.2	16.7	15.9

Source: Refinitiv. Note: All % on a total return basis in pounds sterling.

Performance for the financial year ended December 2021 was good, with the company's NAV increasing by 16.3%, and the share price returning 23.2%, while the fund's benchmark returned 14.9% over the same period.

Exhibit 9: Stock selection has been the primary determinant of returns



Source: BMO

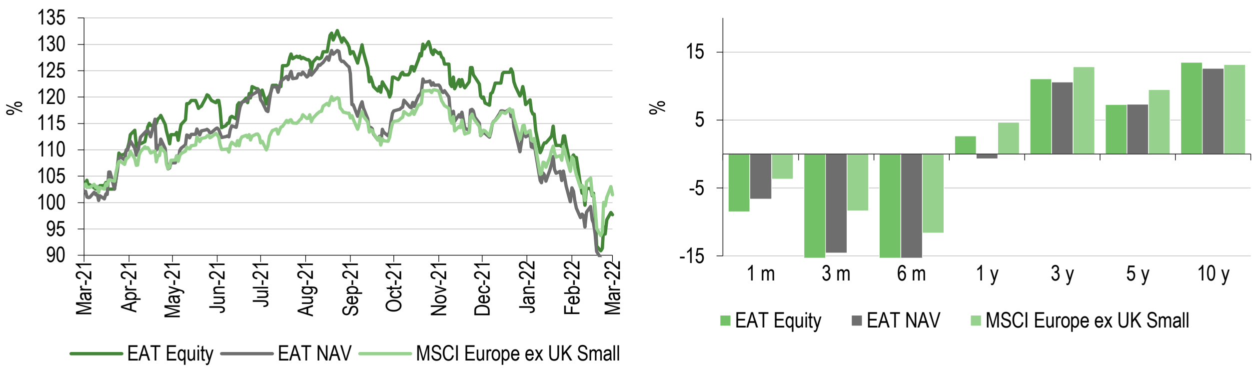
Performance over this period was primarily driven by stock selection, as investors can expect from this strategy (see Exhibit 9). Stocks within the overweight technology sector performed well, including those added in 2020 during the COVID-19 driven sell off, for example Norwegian Nordic Semiconductor, which is the global leader in low power Bluetooth chips and is benefiting as such from the proliferation of connected devices. Other holdings in this sector include Dutch chip maker ASM International, French listed provider of engineering R&D IT outsourcing Alten and a longstanding position in Lectra, a French manufacturer of material cutting machines and related software. Other holdings that drove performance were Swedish safety technology business MIPS and Dutch chemicals producer IMCD. The overweight financials position was also accretive to performance. Ringkjoebing Landbobank, a regional Danish bank, continued to perform well, aided by the prospect of rising rates. Sparebank, a regional Norwegian bank, benefited from rising energy prices that should boost the local economy. Storebrand, a Norwegian life insurance company, also performed well. The prospect of rising rates should be a fillip for its legacy guaranteed life business and bolster the fee-based part of the business.

Holdings that detracted the most over the period were German clothes retailer Global Fashion Group (GFG). As an online retailer GFG was a beneficiary of the COVID-19 pandemic and so was sold off as investors rotated out of COVID-19 winners into reopening plays. While it posted some disappointing results due to increased competition faced by its Latin American business, the managers retain their positive view for its longer-term prospects, feeling that the price correction is overdone. Fjordkraft (a Norwegian energy provider) was weaker due to Norwegian lockdowns affecting its ability to gain new customers, while margins were hurt by it being slow to pass on rising energy costs. The managers sold after a review of the business model. UK-listed Just Eat was weaker due to rising costs and greater competition, and the managers took the decision to sell the holding.

Through 2022 to date European smaller companies (MSCI Europe ex UK Smaller companies) equities have returned -8.69%, underperforming global equities, which have returned -4.15%. The physical closeness of the war in Ukraine is clearly affecting the region's outlook and investor demand for European stocks. There are no holdings domiciled in Russia or Ukraine within the portfolio and the managers have reduced any holdings with sales exposure to either country in February. Both smaller and larger European companies have performed similarly, however EAT is lagging with a -16.8% return over this period. Growth stocks in Europe have underperformed value stocks, which accounts for some of the underperformance. The fund's overweight consumer cyclicals and technology positions detracted as did its zero weighting in energy, as the price of oil increased from $75 to a peak of $124 per barrel during this period. Stock selection in the broad industrials sector has hurt performance in the year to date with budget airline Wizz Air and hydraulic pump manufacturer Interpump particularly weak over this period. This is a relatively short period on which to scrutinise however. The managers are focused on ensuring that they execute their investment process to the optimal benefit for investors and are closely monitoring high-quality stocks on their radar for attractive entry points with a hope, that as in 2020, these will drive long-term outperformance.

Exhibit 10: Investment trust performance to March 2022

Price, NAV and benchmark total return performance, one-year rebased | **Price, NAV and benchmark total return performance (%)**



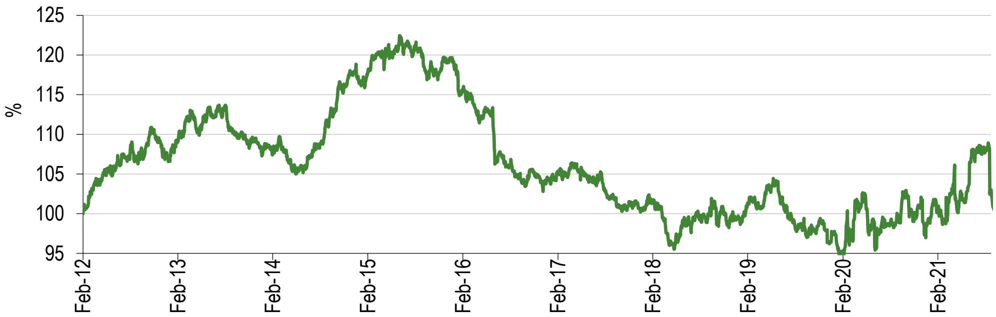
Source: Refinitiv, Edison Investment Research. Note: Three-, five- and 10-year performance figures annualised.

Exhibit 11: Share price and NAV total return performance, relative to indices (%)

	1 month	3 months	6 months	1 year	3 years	5 years	10 years
Price relative to MSCI Europe ex UK Small	(5.0)	(8.2)	(10.9)	(1.9)	(4.7)	(9.6)	3.3
NAV relative to MSCI Europe ex UK Small	(3.0)	(6.8)	(11.5)	(5.1)	(5.9)	(9.4)	(4.6)
Price relative to MSCI Europe Ex-UK	(4.8)	(11.1)	(14.9)	(6.0)	2.9	(2.0)	39.5
NAV relative to MSCI Europe Ex-UK	(2.8)	(9.7)	(15.5)	(9.1)	1.6	(1.8)	28.9
Price relative to CBOE UK All Companies	(8.5)	(19.4)	(23.5)	(12.0)	16.6	14.1	82.1
NAV relative to CBOE UK All Companies	(6.6)	(18.2)	(24.0)	(14.9)	15.2	14.4	68.2
Price relative to MSCI World	(6.2)	(11.4)	(19.6)	(11.4)	(9.2)	(15.4)	1.9
NAV relative to MSCI World	(4.2)	(10.1)	(20.2)	(14.3)	(10.3)	(15.3)	(5.8)

Source: Refinitiv, Edison Investment Research. Note: Data to end-February 2022. Geometric calculation.

Exhibit 12: NAV performance versus MSCI Europe ex UK over 10 years



Source: Refinitiv, Edison Investment Research

Peer group comparison

EAT is a member of the Association of Investment Companies (AIC) European Smaller Companies sector, which consists of just four funds (Exhibit 14). All members of this sector target capital growth. However, EAT is the only trust committed to a higher dividend distribution policy, which results in a dividend yield more than four times greater than any of its peers (Exhibit 13).

Exhibit 13: AIC peer group portfolio characteristics (%)

Name	Historic Yield	Beta	Tracking error	Std dev	Sharpe ratio	Correlation
European Assets	7.7	0.94	6.73	15.41	0.82	0.90
The European Smaller Companies	1.7	1.18	6.22	18.23	0.84	0.95
JPMorgan European Discovery	1.7	1.12	6.83	17.79	0.75	0.93
Montanaro European Smaller	0.6	0.93	9.26	16.54	0.88	0.83
EMIX Smlr European Cos Ex UK TR GBP		1.00	0.00	14.71	0.83	1.00
MSCI Europe ex UK Small Cap NR EUR		1.01	1.73	14.90	0.83	0.99
Europe ex-UK Small/Mid-Cap Equity		0.93	3.33	14.01	0.78	0.97
EAT rank	**1**	**2**	**2**	**1**	**2**	**2**

Source: Morningstar. Note: 10-year annualised. Benchmark: EMIX Smaller European Coms Ex UK TR GBP.

EAT's portfolio has historically exhibited low levels of volatility, as evidenced by its standard deviation compared to peers, and it has provided investors with excellent risk-adjusted returns, as it has the second highest Sharpe ratio in the category. The trust has the lowest sensitivity to the market (Beta), and the second lowest correlation to the index, which would suggest that the returns are derived via active stock selection, independent of the market's returns.

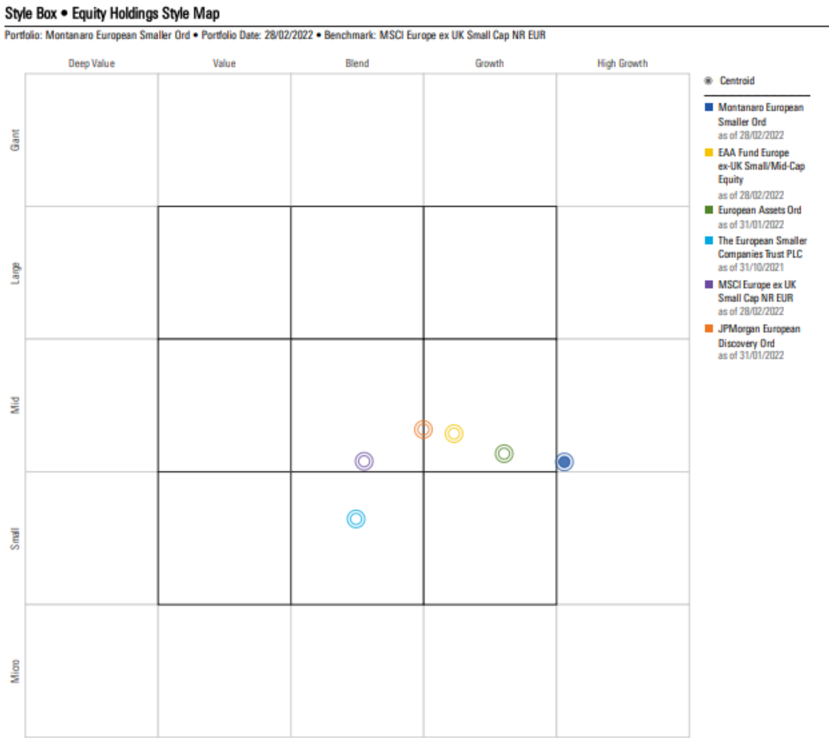
Exhibit 14: Portfolio performance characteristics versus peers

	1yr		3yr		5yr		10yr	
	NAV TR (%)	Price return (%)	NAV TR (%)	Price return (%)	NAV TR (%)	Price return (%)	NAV TR (%)	Price return (%)
European Assets	-6.1	-4.3	29.1	31.3	33.1	32.3	212.3	239.2
JPMorgan European Discovery	-5.5	-12.0	32.1	26.6	38.6	39.4	226.2	223.5
Montanaro European Smaller	1.2	-7.0	66.0	71.9	103.9	128.1	281.8	315.0
The European Smaller Companies	-6.2	-7.2	54.8	48.8	49.3	47.0	289.3	329.5
Europe ex-UK Small/Mid-Cap Equity	-1.6	N/A	34.8	N/A	34.1	N/A	181.1	N/A
EMIX Smlr European Coms Ex UK TR	-2.4	-2.4	36.5	36.5	44.2	44.2	209.9	209.9
MSCI Europe Ex UK Small Cap NR	-0.2	-0.2	38.1	38.1	44.8	44.8	217.5	217.5

Source: Morningstar. Note: Data at 16 March 2022. All cumulative beyond one year, in pounds sterling terms.

Three of the cohort are stylistically 'growth' in terms of their investment approach, according to work done by Morningstar (Exhibit 15), with The European Smaller Companies Trust exhibiting more core stylistic characteristics compared with the other three companies in the AIC European Smaller Companies peer group.

Exhibit 15: EAT stylistic profile – core growth



Source: Morningstar

EAT has total assets of £442m and is the third largest in the AIC group. It has a growth style bias to its portfolio, with a premium portfolio valuation in terms of P/E and P/B versus most peers (with the exception of Montanaro) and the index. For this premium the portfolio is exposed to better quality companies, with a higher return on equity and return on invested capital (Exhibits 7 and 16).

Exhibit 16: Portfolio characteristics – a premium paid for higher quality

	Portfolio date	Morningstar Equity Style Box	Fund size (£m)	Average market cap (£m)	P/E ratio (x)	P/B ratio (x)	Net margin (%)	ROE (%)	ROIC (%)
European Assets Ord	31/01/2022	Mid Growth	442	2,368	25.8	3.3	12.5	17.1	14.4
The European Smaller Companies Trust PLC	31/10/2021	Small Blend	721	1,069	16.1	1.8	6.5	11.1	7.8
JPMorgan European Discovery Ord	31/01/2022	Mid Growth	808	3,240	19.6	2.5	9.1	15.8	13.0
Montanaro European Smaller Ord	28/02/2022	Mid Growth	313	2,002	35.2	5.5	17.5	26.2	20.6
EAA Fund Europe ex-UK Small/Mid-Cap Equity	28/02/2022	Mid Growth	N/A	3,008	20.0	2.6	12.9	18.8	14.0
EMIX Smlr European Coms Ex UK TR GBP	31/05/2018	Small Blend	N/A	1,744	15.3	1.8	13.7	12.9	9.3
MSCI Europe ex UK Small Cap NR EUR	28/02/2022	Mid Blend	N/A	2,179	14.1	1.7	15.0	14.8	11.3

Source: Morningstar. Morningstar Equity Style Box and Ave market cap at the “portfolio date”. Other figures at end of February 2022.

Dividends

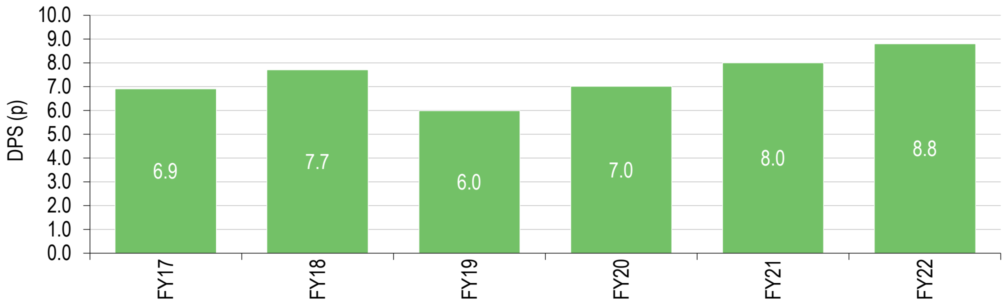
EAT’s board is committed to an enhanced dividend distribution policy, paying an annual dividend of 6% of NAV as at the end of the preceding financial year (31 December) with the annual total dividend declared in January each year and paid quarterly in January, April, July and October. EAT’s dividend can be funded from a variety of sources, which gives the managers a degree of flexibility founded upon many years of managing this mandate. Historically revenue from dividends has accounted for around a third of the annual requirement. This is augmented by the selective use of a combination of income and distributable reserves, gearing or portfolio rebalancing.

For FY22, the board announced an annual dividend of 8.80p (FY21: 8.00p) per share, which represents a 10% increase on FY21. The first three quarterly instalments of 2.20p per share will be paid at the end of January, April and July 2022 and the remaining quarterly instalment of 2.20p per share will be paid in October.

The dividend environment for European smaller companies was volatile through the worst of the COVID-19 pandemic, but there has been a recovery from the March 2020 lows. While the portfolio tends to yield in line with the index, the level of absolute or relative dividends is less important for this strategy given the sources of capital available to pay the dividend to investors with EAT's distributable reserve standing at £322.7m at the financial year end (2020: £346.0m) sufficient to cover more 11 years of total annual dividend payments at the current rate. EAT allows investors to receive a high regular income from what is fundamentally a quality growth portfolio investing in smaller companies. Cosh and Morris would prefer that their portfolio companies reinvest cash flows into higher returning projects in order to grow and make the most of their competitive advantage rather than returning cash to investors as a matter of course.

Beginning in FY20, dividends have been paid in sterling, rather than euros, which had been the previous practice before the trust's migration to the UK (see Fund profile below). At the current share price, which in common with many other investment trusts has seen a significant decline since the end of FY21, EAT's prospective dividend yield for FY22 is 7.7%.

Exhibit 17: Dividend history since FY17

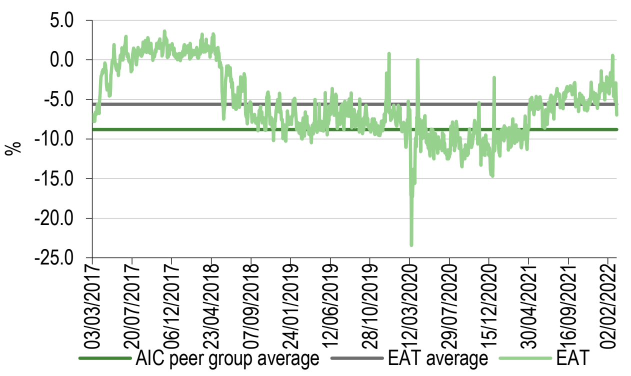


Source: Bloomberg, Edison Investment Research. BMO

Discount

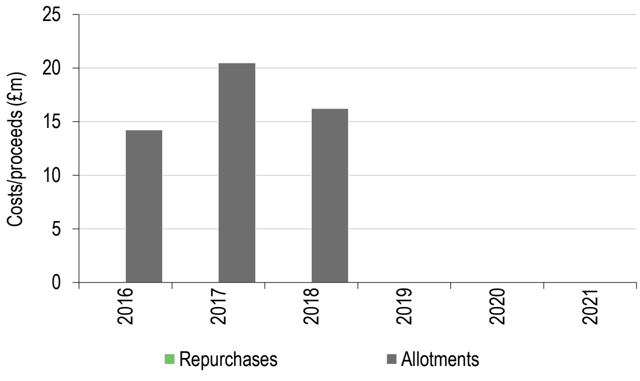
EAT's board is committed to managing the volatility of the company's share price discount relative to its NAV and has the authority to buy up to 10% of the issued shares in order to influence the demand and supply balance. However, the board has not conducted any buybacks in the past decade. The board believes that the migration of the trust to the UK in March 2019 has broadened its investor base, and this, combined with the high dividend pay-out policy, a fee reduction in April 2020 and its recently improved performance, has supported EAT's discount in recent years and may help it narrow further over time. Over the past five years EAT's discount on average has been narrower than peers (Exhibit 19). The company's discount to NAV at its financial year end was 4.4% (FY20: 9.4%).

Exhibit 18: Discount over five years



Source: Refinitiv, Edison Investment Research

Exhibit 19: Buybacks and issuance



Source: Morningstar, Edison Investment Research

Fund profile: Above-average income

The history of EAT

The trust was launched in 1972 as a Dutch company and, until March 2019, its shares were dual listed on the Amsterdam and London stock exchanges. In March 2019 the board completed a migration of the fund to the UK. EAT now has a premium listing on the London Stock Exchange. This move to the UK was motivated by many considerations, including the fact that a large majority of the trust's shareholders are UK residents and because it would also create the potential, recently realised, to reduce ongoing charges (see Fees and charges section on page 15).

CTI purchase of BMO's EMEA operations

In April 2021, BMO announced its agreement to sell its asset management business in Europe, the Middle East and Africa, which included the manager of EAT to Columbia Threadneedle Investments (CTI) who are the global asset management arm of Ameriprise Financial. The purchase was completed on 8 November 2021. During the acquisition process the board sought and received confirmation from senior management at CTI of the importance of maintaining stability and continuity of the teams who which support EAT. In the trust's recently released full year report to end December 2021, EAT's chairman welcomed this assurance of stability and continuity. He said that the board is monitoring this situation closely and will keep shareholders informed of developments. To date, there have been some investment interactions between the respective smaller companies' desks.

Fund profile: Above-average income

EAT targets capital growth through investment in quoted small and medium-sized European companies. Its benchmark is the EMIX European Smaller Companies ex-UK Index. The fund is managed by Sam Cosh (lead manager) and Lucy Morris, who have been working together on this fund since 2011.

Cosh joined BMO in 2010 from BNP Investment Partners, having been involved in analysing and investing in European smaller companies since 2000. Morris joined BMO in 2007 and worked in the performance analytics team before moving to the European smaller companies' desk in 2011. Cosh and Morris are part of the broader global small-cap team, which numbers nine in total, and team members have an average of 17 years' investment experience. While most team members have sectoral analytical responsibilities, Cosh and Morris, as dedicated European small-cap investors, have a free hand to search out opportunities in their sphere of specialisation, regardless of the country or sector. Cosh and Morris also manage the open-ended BMO European Smaller Companies fund which, at January 2022, shared 80% commonality with EAT. They also manage the European smaller companies sleeve of BMO's Global Smaller Companies fund, which is managed by Peter Ewins. Aside from their work with the global small-cap team, they can draw on interactions with members of the wider global equities team, who may also be looking at European small-caps as part of multi-cap mandates.

BMO has recently been purchased by CTI, and this has provided Cosh and Morris with additional resources. CTI manages a range of European smaller companies mandates with a similar quality growth investment approach. Although there is relatively low commonality between EAT and the Threadneedle European Smaller Companies fund, CTI has experienced and well-resourced capability, including 12 investment professionals on the European equities desk, and has managed smaller companies mandates since 1997. There has already been an element of information sharing and this interaction has the ability to further enhance the effectiveness of EAT's investment process.

Investment process: Quality growth at the right price

There are approximately 4,000 quoted European small- and mid-cap companies, a large and diversified universe where companies are not always well-researched by sell-side broker coverage, which can result in investor misunderstanding. This leads to market inefficiencies, which Cosh and Morris seek to exploit to deliver superior long-term investment performance via a portfolio of typically 40–50 holdings.

More specifically, they seek high-quality smaller companies, which they define as having the following characteristics:

- proven business models that are defended by scale, intellectual property, brand or market positions;
- management teams that have the right balance of entrepreneurial flair and rational capital allocation and where team members are incentivised appropriately;
- higher growth rates, margins and returns on capital than the market;
- superior cash flow generation and strong balance sheets that provide stability and opportunity for value-added deployment; and
- investments fit for the future, with attractive environmental, social and governance (ESG) credentials.

An assessment of the strength of a company's competitive advantages or 'moats' is also essential to the team's selection process, as these are what will allow a business to defend or improve its market position and deliver growing profits to its shareholders.

The managers adopt a well-established, bottom-up, fundamental analysis approach and are supported by BMO Global Asset Management's well-resourced small-cap and global equities teams. They meet with around 250 companies a year and produce detailed analysis of each potential investment, including valuation targets and sell triggers. Cosh and Morris monitor all positions continuously. Their approach is benchmark-agnostic and they are happy to adopt a contrarian stance when a business satisfies their investment criteria. The managers' active and stock-specific approach leads them to a portfolio with an active share at December 2021 of 94% versus the index (this is a measure of how a fund differs from its benchmark, with 0% representing full index replication and 100% no commonality) and tracking error or active risk of the portfolio versus a benchmark of 5–7%.

The managers' focus is on quality, and they believe the evolution of a company's profits and cash generation will be the principal determinant of shareholder returns. However, they view valuation as another important driver of long-term performance, and they are disciplined about adopting or adding to positions only at the right price. They look for companies that trade at a substantial discount to their intrinsic value. Companies that meet EAT's investment criteria but are not trading at acceptable valuations are placed on a watch list of stocks, awaiting a better price entry point. This allows the team to execute quickly when opportunities present themselves.

EAT's approach to ESG

EAT's managers believe that solid ESG credentials are essential if a business is to succeed over the long term. They do not apply an ESG screen to potential holdings – instead, they give consideration to the sustainability of a company's production process, its carbon footprint and the treatment of its suppliers, employees and customers is thus integral to EAT's investment process. The trust's managers are supported in this regard by input from BMO Global Asset Management's Responsible Investment (RI) team, which is one of the industry's longest established and largest ESG teams. This team uses a scoring system that is developed using input from several external sources, such as MSCI and the Institutional Shareholder Services Group (ISS) but adapted by the RI team to take account of the most relevant factors. The RI team makes continuous efforts to improve the depth of its ESG research. Recent refinements include the introduction of measures to identify 'greenwashing' – a practice whereby companies make false or exaggerated claims intended to mislead consumers and investors about the environmental merits of their products.

Where necessary, BMO's RI team engages actively with the management of investee companies, to encourage them to adopt the highest standards of ESG practice. It may join with other major investors to strengthen their efforts to drive change. In the year ended 31 December 2021, BMO's RI team engaged with the managements of EAT's investee companies 28 times (2020:13 times) across six countries. Almost 30% of these engagements concerned corporate governance issues, 30% related to labour standards and the remainder involving environmental standards and climate change. BMO Global Asset Management is also a signatory of the United Nations Principles for Responsible Investment (UNPRI), under which signatories contribute to the development of a more sustainable global financial system. During the year EAT's management voted at 40 of its investee companies' AGMs against management on at least one resolution on 83% of occasions (supporting 91% of all resolutions). Renumeration was the area that saw most dissention by the managers, with EAT voting against 26% of all management resolutions relating to this matter.

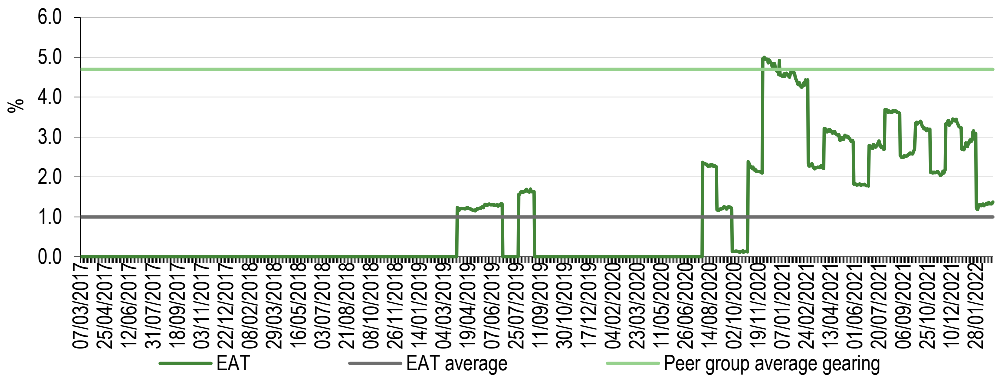
All ESG considerations are important, but EAT's managers have particular focus on climate change factors in investee companies given the potential this has to impact on all other areas of society. As active custodians of client capital, company engagement can bring about positive change can be an effective way to influence corporate behaviour for the benefit of all. A more quantifiable measure is the carbon footprint of the portfolio, and it is very pleasing to note that the portfolio has over the past three years consistently illustrated materially less carbon intensity than its benchmark, and for FY21 was around a third less polluting on this measure. EAT also has a four (out of five) global rating from Sustainalytics, meaning that the portfolio has better than average ESG characteristics than a wide range (785) of global mid- and small-cap investment funds. In addition, CTI embeds ESG criteria in its investment process and has dedicated ESG analytical resources, with the result that the Threadneedle European Smaller companies fund also scores above average on ESG considerations.

Gearing: Historically a modest factor for EAT

EAT has scope to borrow up to 20% of NAV, although historically its use of gearing has been cautious dependent on available opportunities and market conditions. The trust has a €45m multicurrency revolving loan facility with Royal Bank of Scotland International, €30m of which was drawn as at end December 2021.

Current market sentiment is very sensitive to news coming from Ukraine, so the managers reduced gearing at the onset of hostilities and have since held a small net cash position. They reduced any holdings that had operations in the region or that are affected by rising energy prices and held no Russia- or Ukraine-domiciled holdings.

Exhibit 20: Modest use of gearing



Source: Morningstar

Fees and charges

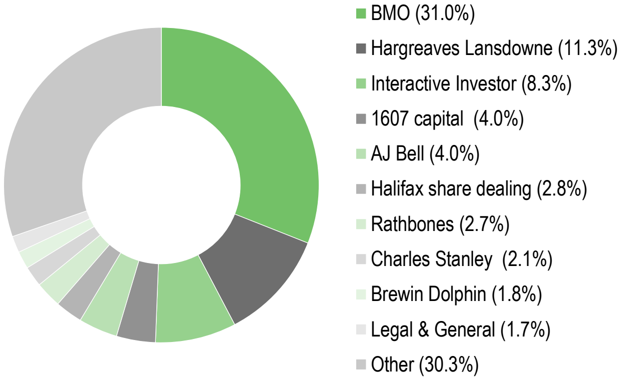
On 1 April 2020, the annual management fee received by BMO Global Asset Management was reduced to 0.75% on up to €400m of assets under management (AUM), and 0.60% on assets above this level. Previously, the manager received a fee equal to 0.80% of AUM, falling to 0.65% for funds in excess of €500m. The company's ongoing charges for the year ending December 2021 were 0.89% (FY20: 0.95%), compared to the AIC peer group average of 0.92%.

Capital structure

Following the migration of EAT from the Netherlands to the UK in March 2019, the trust now has only one share class. As at 14 March 2022, there were 360.1m shares in issue. Historically, demand for EAT's shares has been solid and the board has issued new shares to meet investor demand, although in the financial year ended December 2020, new share issuance amounted to only 0.2m, up slightly from the previous year. No shares have been issued so far in FY22.

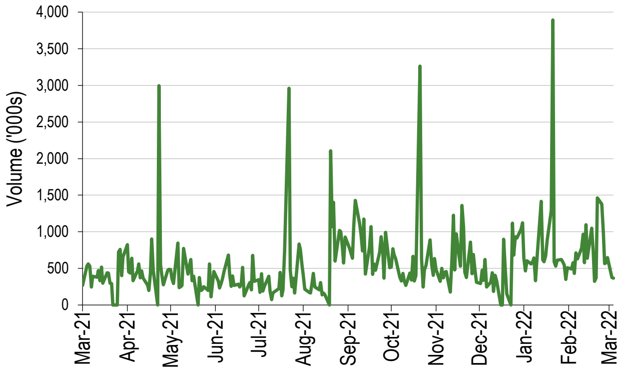
In March 2020, the board announced that with effect from the reporting period starting on 1 January 2020, the reporting currency would change from euro to sterling and that all future financial statements would be presented in sterling. The board anticipates that this change will improve the clarity of the trust's financial statements for its shareholders, the overwhelming majority of whom are located in the UK.

Exhibit 21: Major shareholders



Source: Bloomberg, as at 22 Feb 2022.

Exhibit 22: EAT average daily volume



Source: Refinitiv. Note: 12 months to 9 March 2022.

The board: Relevant skills and alignment of interest

Exhibit 23: EAT's board of directors

Board member	Date of appointment	Fees in FY22*	Shareholdings at end-FY21
Jack Perry (chairman)	Apr-14	£46,250	81,606
Stuart Paterson (audit & risk committee chair)	Jul-19	£36,750	95,000
Julia Bond (senior independent director and remuneration & nomination cttee chair)	Mar-14	£35,750	91,428
Martin Breuer	Nov-15	£31,500	90,000
Pui Kei Yuen	Feb-21	£31,500	7,700

Source: EAT. Note: *With effect from 1 April 2022.

The board of five has an average tenure of a little over five years, with tenures ranging from eight years for Jack Perry and Julia Bond, to the most recent appointment of Pui Kei Yuen a little over a year ago. All board members are shareholders, with the collective average value of the shareholdings equating to more than twice the average annual renumeration. This is welcome as it is material evidence of board members' alignment with investors' interests. Board members possess a range of complementary and relevant skills and backgrounds, including senior corporate management experience, accountancy and investment management.

Chairman Jack Perry has an accountancy background, having been a managing partner at Ernst & Young and he is also a former chairman of CBI Scotland. He serves on the boards of a range of FTSE-quoted companies, private companies and other investment trusts. **Stuart Paterson** is also an accountant by background and has 20 years' experience as co-founder and partner of Scottish Equity Partners, a private equity investment business focused on high-growth unquoted technology companies. **Julia Bond** has nearly 30 years' experience of financial markets, most recently at Credit Suisse, where as a managing director she led global client-facing teams. She has a variety of experience, serving on the boards of investment trust and government agencies such as the Ministry of Defence's Strategic Command and the British Foreign and Commonwealth Development Office. **Martin Breuer** was formerly an executive with Siemens, CFO of SEVES and Intercos Group, CEO of Intercos in Asia Pacific and CEO of Italian cosmetic manufacturer Gotha Cosmetics. He is also the founder and CEO of 2M SRLS and Gruppo Glossip Srl, both of which are international beauty businesses. **Pui Kei Yuen** has over 25 years' experience in institutional pan-European equity portfolio management and research at Mercury Asset Management, UBS and Bank of America Merrill Lynch. She has more recently worked with earlier-stage private companies.