BlackRock Greater Europe

BRGE offers a concentrated portfolio of high-quality companies located across Europe...

William Sobczak

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Summary

KEY FACTS

Investment objective

The Company aims to provide capital growth, primarily through investment in a focused portfolio constructed from a combination of the securities of large, mid and small capitalisation European companies, together with some investment in the developing markets of Europe

As at:	**06/12/19**
Trust Name	**BlackRock Greater Europe**
Ticker	**BRGE**
Management Company	**BlackRock Inc**
Manager Name	**Sam Vecht; Stefan Gries;**
Association of Investment Companies (AIC) Sector	**Europe**
12 Mo Yield	**1.4%**
Dividend Distribution Frequency	**Semi-Annually**

Source: Morningstar

BlackRock Greater Europe (BRGE) offers investors an opportunity to access some of the highest quality companies across developed and emerging Europe.

The past five years have seen the trust perform exceptionally strongly. In particular, it has come into its own in 2019, outperforming both benchmark and peers by close to 10%. Much of this outperformance can be put down to the new partnership, formed in 2017, between managers Stefan Gries and Sam Vecht. Together they have changed the shape of the trust, building a more concentrated portfolio which has helped the trust to generate higher levels of alpha. Despite the punchier approach, the trust has not sacrificed volatility for gains, and continues to offer one of the lowest standard deviations in the sector.

Currently the trust trades at a discount of 3.5%, the narrowest in the sector.

Returns

As we discuss in the Portfolio section, Stefan Gries controls the majority of the portfolio, having been given responsibility for the developed Europe investments in June 2017. On arrival he made a number of changes, with the goal of increasing the alpha-generating capabilities of the trust. This has clearly been achieved, as the outperformance in the graph below shows. The trust has generated NAV total returns of 27.2% over the period since Stefan took over, in comparison to 9.8% from the benchmark FTSE World Europe ex UK. Equally the returns are impressive when comparing to the IA and AIC sector returns of 6.4% and 12.8% respectively. Moreover, in comparison to the iShares MSCI Europe ex UK ETF (a passive ETF which tracks European markets), the trust has generated close to double its returns.

NAV TOTAL RETURNS SINCE MANAGER TOOK OVER

Source: Morningstar

The trust has outperformed the benchmark in six of the past nine years; including every year since Stefan was appointed. This has been through both rising and falling markets, for example in 2018 and 2019 where the trust managed to preserve capital and then dramatically outperform during the rally.

CALENDAR YEAR PERFORMANCE

Source: Morningstar

In fact, over 2019 BRGE has been the standout performer in the sector of eight trusts: in the year to 8 November, the trust has delivered NAV total returns of 29.4%. In comparison the benchmark has returned 20.3%, and the IA and AIC peer groups 18.9% and 21.1%. Furthermore the trust has outperformed the iShares MSCI Europe ex UK index by close to 6%.

The trust's largest holding, Safran, has been a particularly strong performer over the period, on the back of strong results and increased full-year guidance levels. The incorporation and reorganisation of Zodiac Aerospace (which the company took over in 2018) has been encouraging, as has the high-margin civil after-market business and the order book for the company's new Leap engine. ASML is another holding that has rallied over the year. The company operates in the lithography equipment space, and has a strong market position. Last year saw the company launch an extreme ultraviolet (EUV) tool, which was well received and has been implemented by all major semiconductor manufacturers.

NAV PERFORMANCE

Source: Morningstar

Charges

BlackRock Greater Europe has an ongoing charges figure of 1.08%, which includes a management fee of 0.85%. This compares with the peer group average of 0.9% according to JPMorgan Cazenove. The trust does not, however, charge a performance fee.

The KID RIY for the trust is 1.47%, compared to a sector average of 1.4%. It is worth noting that calculation methodologies can vary.

Kepler View

Stefan has made an immediate impact on the trust since joining in 2017. He has helped the team to generate returns in excess of the benchmark and peers, explaining he has made the investment process more consistent and disciplined, and increasing emphasis on sustainable cash returns. The decision to increase the portfolio's concentration has also, in our view, given Stefan a better chance of generating alpha and outperforming the passive ETFs. It is also worth noting that, despite the more concentrated approach, over the past five years BRGE has among the lowest levels of volatility in the sector (source: Morningstar). Furthermore, over a five year period the trust has the highest Sharpe ratio in the peer group (1.05). We think this has largely been due to Stefan's unrelenting approach to finding high-quality names with strong management and good free cash flow. Furthermore, although the trust has a clear tilt towards growth companies, Stefan tries to balance some of these risks by holding more defensive, high-quality stocks. This has helped to keep volatility down, while giving investors access to the strong returns of the growth companies.

BULL	BEAR
A manager with a clear philosophy and process	Europe continues to be clouded with political and macroeconomic uncertainty
Strong risk governance with risk and returns diversified by end-market exposures	The discount to NAV is narrow relative to peers
A concentrated portfolio, which gives greater outperformance potential	

Portfolio

At the helm of BRGE are managers Stefan Gries and Sam Vecht, who look to generate capital growth from a portfolio of European companies across the whole range of the market cap spectrum.

Stefan is the lead manager of the trust, and runs the developed Europe portion of the portfolio. He was appointed in June 2017, since when he has made a number of key changes. One area he has clearly impacted has been the investment philosophy, emphasising sustainable cash returns and unique franchises. As he explains, his attitude is rooted in a desire to be an 'investor' rather than a 'trader'; as such, when considering a stock for the portfolio, he always aims to answer one fundamental question: can he own this company for a minimum of three to five years? Stefan believes that this question prevents him from being tempted into stock market fads and consensus trades, and enables him to remain focused on the longer term picture.

In addition, since Stefan took on the management of BRGE he has implemented a more structured and disciplined research process. Idea generation is the first step in the process, and here BlackRock's extensive resources stand out. The 21-strong team of analysts will use multiple channels to obtain an initial overview of industries and companies, including meeting with companies and using external research sources. Following this initial stage, the team conducts in-depth company analysis, looking in particular to identify four characteristics:

- Quality management with a record of value creation
- Some unique aspect, for example the brand or product
- High and predictable return on capital, with a strong free cash flow
- The capacity to invest in future growth

Financial models and templates are then created for the analysed companies, to ensure consistency going forward, and further company meetings are conducted to enable a better understanding of the dynamics of the target company's market.

Since Stefan assumed responsibility for the portfolio, the number of stocks has reduced, in order to maximise the chances of generating alpha by ensuring the best ideas have higher weighting. Typically, Stefan expects the portfolio to hold between 30 and 45 holdings: currently the total stands at 38 (Source: Morningstar). The table below highlights the top ten holdings in the portfolio, which in total make up 54.4% of the portfolio. This is an increase of almost 10% since we last covered the trust in early 2019.

TOP TEN HOLDINGS

COMPANY	% OF NAV
SAP	7.0
Safran	6.8
Adidas	5.8
Sika	5.8
Novo Nordisk	5.7
Royal Unibrew	5.3
Lonza Group	4.6
ASML	4.6
DSV	4.4
RELX	4.4
TOTAL	**54.4**

Source: BlackRock, 31 October 2019

Stefan has identified four key themes that run through the portfolio. The first, pricing power, includes companies that have strong brands and are backed by strong management teams. This theme includes companies such as Ferrari and ASML. Rémy Cointreau, the French cognac, liqueur and champagne producer, is another example that Stefan likes to point to as playing the theme. He believes that the company's competitors have high barriers to enter the market, and that the firm's management team understands the importance of its brand. This has also been demonstrated by a well-executed marketing programme, which has supported strong organic growth over the past four years.

The second theme, MedTech, illustrates how Stefan uses bottom-up analysis to form a bigger picture of an industry. This sector offers companies with strong earnings growth which he expects to persist over many years; including the likes of Lonza and Straumann. Straumann in particular has featured in the portfolio for a number of years. The Swiss mid-cap stock has a large market share in its dental implant market, and has been growing both organically and through earnings-enhancing acquisitions. Stefan and his colleagues have a strong relationship with the management of the company, and high confidence in its ability to deploy capital profitably.

The third theme, defensive elements, is a key factor behind BRGE's success in managing to keep volatility down while also increasing the concentration of the portfolio. This theme includes the likes of RELX and SAP, which are extremely high-quality, large cap companies. By way of example, SAP is one of the leading global enterprise software providers. The team believes that the company has created a platform for profitable, multi-year growth at high returns, while at the same time offering a more stable revenue profile relative to some of the more growth-focused names.

The final theme is companies with structural growth opportunities. This includes companies that offer products or services with strong demand and visibility on a multi-year basis. Many of these companies will benefit positively from the long-term impact of technology, such as Sika Group and Hexagon. Sika Group, a top ten holding at 5.8% of the portfolio, is a leading manufacturer of construction chemicals across Europe, enhancing the properties of materials used in a wide range of applications. Stefan believes the company's competitive edge is sustainable over the long term, through its extensive R&D efforts and very strong balance sheet, which gave it valuable protection during the 2008 financial crisis.

Although the managers are purely bottom-up stock selectors, they do build some macro views around sectors and industries from the insights they gain from their meetings with company management. Their detailed analysis helps them to uncover whether a sector might be impacted by technology; or whether their demand drivers are sustainable. As can be seen below, the trust's largest sectoral positions currently come from industrials (23.8%), health care (20.1%) and technology (18.5%).

SECTOR EXPOSURE

Source: BlackRock, October 2019

The trust also has the capacity to invest up to 25% of NAV in companies in developing Europe. This portion of the portfolio is handled by Sam Vecht, who also runs BlackRock Frontiers Investment Trust. The past few years have seen a reduction in the trust's allocation to this sub-sector, from 8.2% of the portfolio in August 2016 to just 3.5% in August 2018. However, this allocation has picked up again in 2019, to its current level of 5.6% of NAV, as Sam's sentiment towards emerging Europe has improved. The developing Europe sub-sector is attractively valued at a forward P/E ratio of 6.5, in comparison to the MSCI World and MSCI Emerging Markets at 13.3 and 10.6 respectively. Free cash flow, meanwhile, is high; while capex is also starting to pick up as companies invest in their businesses, raising the possibility of greater growth.

Gearing

Gearing is used tactically by the managers up to a maximum of 15% of NAV. Stefan does not aim to time markets, but sees gearing as a natural extension of the number of opportunities that he finds.

For example, during April and May 2018 the trust approached gearing levels of 10%. As valuations started to feel fuller, and the number of shorts in Stefan's Alternative UCITS fund (BlackRock European Absolute Return) increased, he started to bring gearing down again. This action proved prescient, given the sharp falls experienced by stock markets in Q4 2018.

As the graph below shows, the trust has remained at low single digit levels of gearing throughout 2019.

GEARING

Source: Morningstar

Dividend

The trust's strategy is very much growth-oriented, and so dividends are a product of the investment process rather than a specific objective. Nevertheless, the board appears keen to smooth the trajectory of the dividend.

Although the dividend was covered in the 2018 financial year (a payout of 5.75p from earnings of 5.95p), the board has decided it is appropriate to dip into the reserves for the 2019 full-year payout. In April the board declared an interim dividend of 1.75p per share (2018: 1.75p) and has now proposed a final dividend of 4.10p. This takes the total dividend for the year to 5.85p, an increase of 1.7% from 2018. Earnings per share equated to 4.87p per share.

Despite using reserves to maintain the progressive dividend policy, the trust has significant revenue reserves. We estimate the 2019 full-year dividend would be 2.92x covered. At the current price, the shares yield 1.5%.

DIVIDEND

Source: Morningstar

Management

The same team has managed BRGE since 2008, when a group of managers from Scottish Widows moved to BlackRock. Vince Devlin handed over the reins to Stefan Gries in June 2017.

Stefan also has responsibility for an open-ended fund (BlackRock Continental European Fund, with £601m of assets) and a long/short Alternative UCITS fund (BlackRock European Absolute Return, with assets of £1.52bn).

Stefan holds an MA in Economics & Spanish from the University of St. Andrews, and started his career in 2005 as European equity analyst and portfolio assistant at Scottish Widows Investment Partnership. He joined BlackRock's European equity team in 2008 and is responsible for the energy sector as part of the wider team of 20 analysts covering developed Europe (with seven on Eastern Europe). Sam Vecht acts as co-manager, with responsibility for developing European stocks. Sam is co-head of the BlackRock global emerging markets team and a co-manager of **BlackRock Frontiers Investment Trust**. Recently he was also appointed co-manager of **BlackRock Latin American Investment Trust**.

Discount

As the graph below shows, the board has achieved its wish of limited discount volatility, and the shares have traded within a relatively narrow band in recent years. The main lever that the board can pull to this end is the offer –not always used and at the board's discretion – of a semi-annual tender for up to 20% of share capital. In the past the board has used the tender extensively; however it has not been used since November 2018, when only 1.2% of shares in issue were tendered at a discount of 2%. This represented a significantly undersubscribed take-up, given the prescribed maximum was 20%.

The board clearly sees a narrow discount as a priority, and while it chose not to enact the May or November tender offers, it has been actively buying back shares in the market. During 2019 almost 1% of the total shares in issue have been bought back to treasury.

Historically, the combination of the periodic tender offer and buybacks has helped the trust trade on a tighter discount than most of its peers; currently it stands on a discount of 3.5% – less than half the peer group average of 8.7%.

DISCOUNT

Source: Morningstar

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