BlackRock Greater Europe

Update
23 April 2019

Summary

BlackRock Greater Europe (BRGE) aims to generate capital growth from large, mid and small-cap companies listed in Europe. The managers have flexibility to invest all over the continent (ex UK) – including up to 25% in countries listed in developing Europe. This flexibility clearly differentiates it from its peers.

Despite having been managed by the same team since 2008, responsibility for BRGE was handed to Stefan Gries in June 2017, which has seen a marked change in the way portfolio is assembled. Stefan now clearly defines the investment philosophy, has a higher conviction portfolio, and lastly tries to deliver the best ideas of the European team more effectively, having changed the way that ideas get into the portfolio. Stefan has also committed to use gearing more fully in the future, when his optimism warrants it.

The portfolio of stocks has been reduced to 42 holdings, and the changes have resulted in strong relative performance - although not yet a meaningful narrowing of the discount. Stefan's philosophy is clearly rooted in a desire to be an "investor" rather than a "trader", and aims to own a company for a minimum of three to five years. He aims to find "giants in their niches", have a good proportion of recurring business, high cash-flow conversion and have good growth optionality.

Compared to other funds and trusts, BRGE has a relatively high exposure to Morningstar's "growth style", and definite bias to mid and small-cap stocks. Stefan tries to balance risks by holding a proportion of the portfolio in more defensive stocks. Exposure to emerging Europe is decided purely on a bottom-up basis, and currently constitutes around 7% of the portfolio.

Since Stefan was given responsibility for the trust in June 2017, the trust has outperformed the benchmark and investment trust peer group by over 6%. Despite having a more concentrated portfolio than average, over the past three years BRGE has achieved its strong returns with amongst the lowest volatility compared to peers (source: Morningstar). Over the longer term, BRGE has outperformed the index in seven out of the ten full calendar years since the team took over management of the trust.

Gearing is used tactically by the managers up to a maximum of 15% of NAV. Stefan sees gearing as a natural extension of the number of opportunities that he is finding, and whilst gearing was approaching 10% during early summer last year, as valuations started to feel fuller, he started to bring gearing down again. This proved prescient, given the sharp falls stock markets experienced in Q4 2018. Currently, BRGE has negligible gearing employed.

The board has been successful at managing the trust's discount volatility, and the shares have traded within a relatively narrow band. While it didn't choose to enact the May 2019 tender offer, it has been buying shares back in the market, most recently at a discount (we estimate) of around 4.3%. As such, BRGE currently stands on a discount of 3.8% - narrower than the peer group average

Analysts:

William Heathcoat Amory
+44 (0)203 384 8795

Pascal Dowling
+44 (0)203 384 8869

Thomas McMahon, CFA
+44 (0)203 795 0070

William Sobczak
+44 (0)203 598 6449

Portfolio

BlackRock Greater Europe (BRGE) aims to generate capital growth from large, mid and small-cap companies listed in Europe. The managers have flexibility to invest all over the continent (ex UK) – including up to 25% in countries listed in developing Europe. In this way, we believe it is clearly differentiated from its peers in terms of mandate. However, as one might imagine from a stock-picking approach, allocations to developing Europe are not slavishly maintained – and exposure is determined purely on an opportunity-led basis.

Despite having been managed by the same team since 2008, responsibility for BRGE was handed to Stefan Gries in June 2017, which has marked a defined change in the way the portfolio is assembled. Having contributed to the process for a long time and now taken charge, Stefan has sought to more clearly define the investment philosophy, to have a higher conviction portfolio (maximizing alpha, by having higher weightings to the best ideas) and lastly, to deliver the best ideas of the European team more effectively by changing the way that these ideas get into the portfolio. Stefan has also committed to use gearing more fully in the future, when his optimism warrants it.

Since Stefan took over, the portfolio of stocks has been reduced to 42 holdings, and as we discuss in the return section the other changes have resulted in strong relative performance - although not yet a meaningful narrowing of the discount. His philosophy is clearly rooted in a desire to be an "investor" rather than a "trader", and as such aims to answer the fundamental question when considering a stock for the portfolio – 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. He aims to buy companies which has strong earnings and cashflow growth, with high quality management and a unique aspect to what the company does.

In this regard, Europe is a rich hunting ground, and the companies in the portfolio tend to be very different to those that one might find in a UK share portfolio. Stefan aims to find (in his words) "giants in their niches", and own those companies for the long term which he views as "wealth creators". These companies tend to have common characteristics, including having created value historically, a good proportion of recurring business, high cash-flow conversion and good growth optionality. Stefan observes that his companies' prospects have very different characteristics to that of the "European economy" as a whole, and to badge BRGE as a "European fund" from a geographic allocation perspective would be entirely missing the point.

Stefan points to Straumann as a good example of the type of company he likes to own. It is a Swiss mid-cap company, which has a 25% market share in its dental implant market. The company has been growing at double digits, both organically and through earnings-enhancing acquisitions. The team meet the management four times a year, and have developed an extremely strong relationship as a long-term investor in the business. As such, Stefan and his team have a high degree of confidence in the management and their ability to deploy capital profitably - in a way that will increase shareholder returns. The "Med-Tech" space (in which Straumann sits) is an area in which Stefan has high conviction currently, represents c.13.5% of NAV currently.

Other areas of high conviction include companies with very strong pricing power, such as Ferrari, ASML and Remy Cointreau. Stefan also looks for structural growth opportunities, within which an example, currently in the top ten holdings, is Sika Group. In Stefan's view, the company is uniquely positioned in Europe as a leading manufacturer of construction chemicals, which enhances the properties of materials used in a wide range of applications. The company is capable of growing 6-8% organically, but also boosts this through acquisitions. Stefan believes its competitive edge is sustainable over the long term, through its extensive R&D efforts and its very strong balance sheet, which saw it well protected during the 2008 financial crisis.

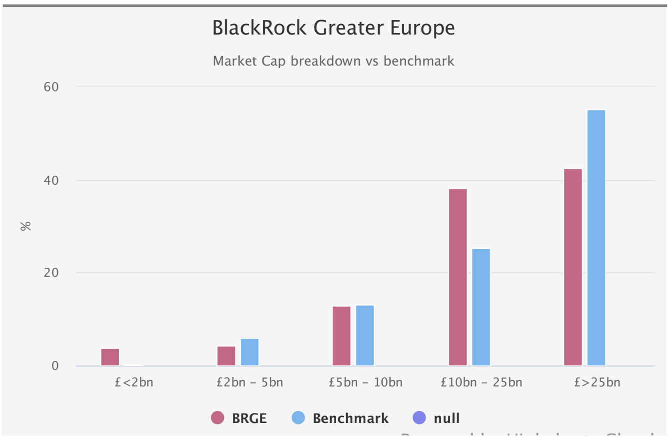
Top 10 Holdings

	% OF NAV
Safran	6.7
Novo Nordisk	5.8
SAP	5.4
Sika	5.0
Lonza Group	5.0
RELX	4.1
ASML	3.5
Unilever	3.3
Thales	3.1
Frensius Medical Care	3.0
Total	**44.9**

Source: BlackRock, 28 February 2019

The trust aims to be concentrated and have a high bar in terms of new ideas finding their way into the portfolio. At the same time, it also aims to be diversified across end markets. Top holdings typically range between 3-7% of NAV. Within the team, each member holds research responsibility for specific sectors. Each stock has an analyst assigned to it, although the investment decisions are entirely the responsibility of Stefan and Sam. The team place a high degree of emphasis on company meetings, conducting around 1,200 between them per year. Over time Stefan has covered ten different sectors, and he has observed that the ability of a manager to add value is significantly enhanced in the mid and small-cap areas of the market. As such, the trust has a bias away from the largest companies in the benchmark, as shown in the graph below.

Fig.1: Portfolio Exposure By Market Capitalisation

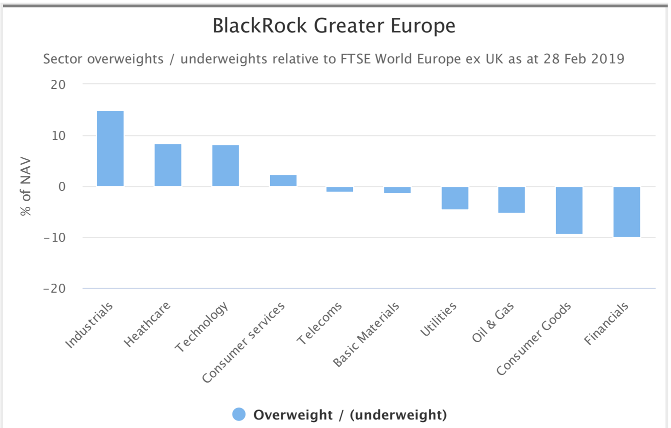


Source: BlackRock, 28 February 2019

Compared to other funds and trusts, BRGE currently has a relatively high exposure to Morningstar's "growth style" (at 71%). Recognising that pure "growth" portfolios do expose investors to risks, especially in a scenario when "value" is resurgent, Stefan tries to balance some of these risks by holding more defensive, high quality stocks of which Unilever, SAP and RELX are examples. Indeed, the entire emerging Europe universe can in some ways be viewed as "value". Stocks here are "proposed" by Sam Vecht, but allocations are based entirely on a bottom-up evaluation of the opportunities available.

An example is BRGE's current holding in Sberbank, the Russian bank which dominates the local market. With very few exceptions in Europe, Stefan views developed market European banks as uninteresting – especially on a three to five year view. In Sberbank, Sam believes he has found

Fig.2: Sector Exposure



Source: BlackRock, 28 February 2019

a highly attractive growth opportunity, which generates a high and sustainable return on capital, but at a significant discount to developed Europe banks. Importantly, aside from the growth opportunity, Stefan believes it also complements the rest of the portfolio in terms of diversification. "Emerging Europe" constitutes around 7% of the portfolio currently. Stefan tends not to overweight single countries or sectors by a margin of more than 15% relative to the benchmark. On the other hand, he can have zero exposure to sectors or countries that he doesn't like the look of.

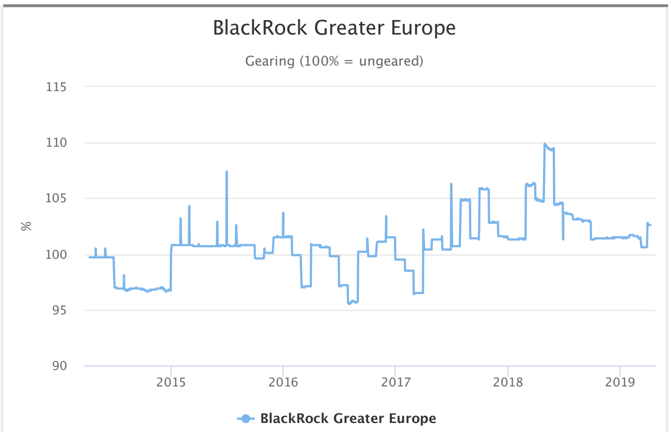
The trust is highly concentrated when compared to the European investment trust and fund universe, measured both by number of holdings, and percentage of the portfolio in the top ten holdings (43%). As we note above, exposure to "growth" (according to Morningstar) is also high relative to peers. Overall, the portfolio's 1 year forward PE is higher than the benchmark at 18.9x vs 14x for the benchmark, but has a significantly higher EPS growth expected (3 year growth of 16.5%, against the benchmark of 9.4%) (all figures from Reuters).

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 is finding. During April and May 2018 for example the trust approached gearing levels of 10%, but as valuations started to feel fuller and the number of shorts started to rise in his Alternative UCITS fund (BlackRock European Absolute Return), he started to bring gearing down again. This proved prescient, given the sharp falls stock markets experienced in Q4 2018.

As the graph below shows, the trust currently has negligible gearing employed, reflecting Stefan's relatively cautious optimism on prospects. Stefan continues to believe strongly in prospects for his companies, especially

Fig.3: Gearing



Source: Morningstar

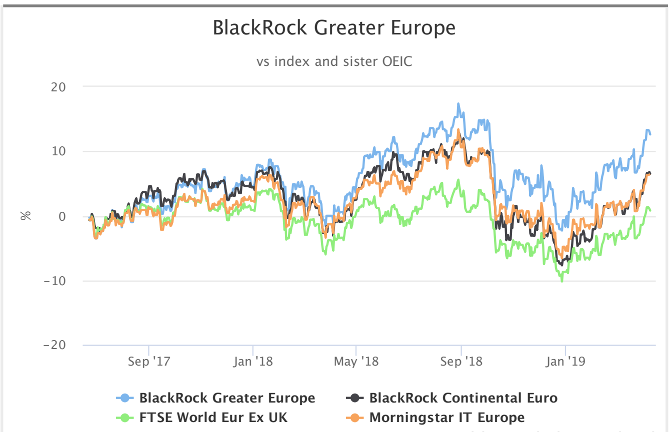
given the relative valuations when compared to US equity markets.

Performance

As we discuss in the portfolio section, Stefan Gries was given responsibility for the trust in June 2017, whereupon he made a significant number of changes to the shape of the portfolio in an attempt to significantly increase the amount of alpha. As the graph below shows, the trust has outperformed the benchmark and investment trust peer group by over 6% since then.

We think it noteworthy that the trust has also outperformed the closest BlackRock open-ended fund by a decent margin too. It is also worth noting that despite having a more concentrated portfolio, over the past three years BRGE has achieved its strong returns with amongst the lowest volatility compared to peers (source: Morningstar).

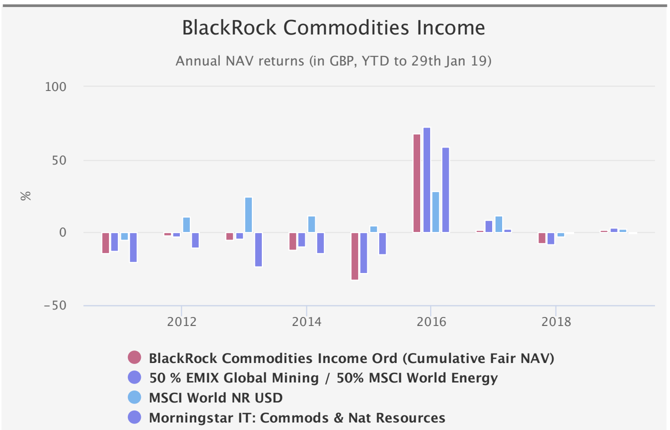
Fig.4: Nav Returns Since Manager Took Over



Source: Morningstar

The trust is benchmarked against the FTSE World Europe ex UK, and has outperformed the index in seven out of the ten full calendar years since the team took over management of

Fig.5: Calendar Year Performance

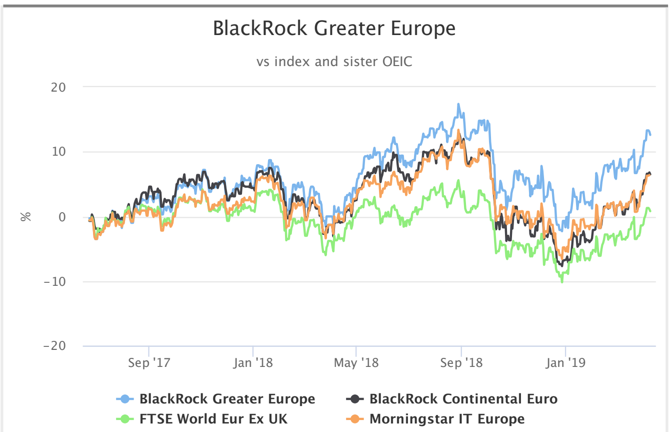


Source: Morningstar

the trust. The trust's bias toward higher-quality companies with what they view as sustainable growth rates has, according to the managers, led to underperformance of the benchmark in periods when value stocks have performed – especially financials such as 2014 and 2015. Nevertheless, BRGE has delivered an excellent cumulative return over the long term, and the trust is up 258% in NAV total return terms over the ten years to 10 April 2019, with the index up 168% over the same period, representing outperformance of 6.6% per annum.

As the graph below shows, over five years, BRGE has kept pace with the average AIC Europe investment trust on a NAV basis, and outperformed the benchmark and average European open-ended fund by quite some way.

Fig.6: Nav Performance

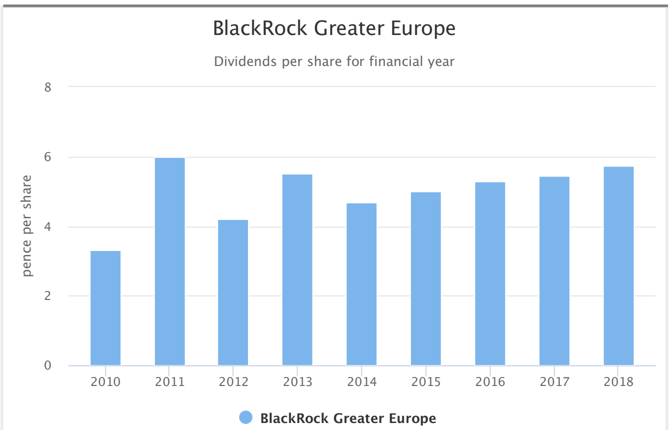


Source: Morningstar

Dividend

The trust's strategy is very much a growth one, 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. Whilst the dividend was covered in the 2018 financial year (dividend of 5.75p from earnings of 5.95p), the board dipped

Fig.7: Dividend



Source: Morningstar

very lightly into reserves in 2017. Overall the trust has significant revenue reserves, which we estimate amount to c. 1.5 years' worth of dividends, which are available to help smooth the dividend going forward. At the current level, the shares yield 1.6%.

Management

The same team has managed BlackRock Greater Europe 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 £550m of assets) and a long/short Alternative UCITS fund (BlackRock European Absolute Return, with assets of £2bn).

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 covering the energy sector as part of the wider team of 20 covering developed Europe and seven covering Eastern Europe. Sam Vecht acts as co-manager, with responsibility for emerging European stocks. Sam is co-head of the global emerging markets team at BlackRock who runs **BlackRock Frontiers** Investment Trust, and more recently was made co-manager of BlackRock Latin American Investment Trust.

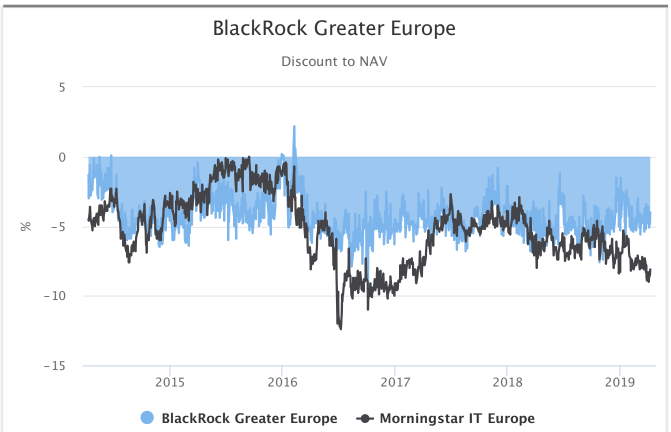
Discount

As the graph below shows, the board has been successful in managing the trust's discount volatility, and the shares have traded within a relatively narrow band. The main route that the board uses to achieve this has been the offer – not always used and at the board's discretion – of a semi-annual tender for up to 20% of share capital. The board has used the tender extensively – most recently in November 2018, when only 1.2% of shares in issue were tendered at a discount of 2% (representing a significantly undersubscribed tender, with the maximum being 20%).

The board clearly sees a narrow discount as a priority, and whilst it didn't choose to enact the May 2019 tender offer, it has been buying shares back in the market, most recently at a discount (we estimate) of around 4.3%.

Historically, the combination of the periodic tender offer and buybacks has meant that the trust has traded on a tighter discount than most of its peers over time, and currently stands on a discount of 3.8% - narrower than the peer group average.

Fig.8: Discount



Source: Morningstar

Charges

BlackRock Greater Europe has an ongoing charge figure of 1.09% which includes a management fee of 0.85%. There is no performance fee. This compares with the weighted peer group average of 0.88% according to JPMorgan Cazenove. The KID RIY is 1.47%, although we note that calculation methodologies do vary across the sector.

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