



# European Small Cap Value

## Headlines

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## Fund Facts

Strategy	Value Equity
Risk	High (6)
ISIN	LU0256591552
Share Class Currency	EUR
Fund Inception	22-Jun-2006
Fund Managers	Karsten Løngaard & Lisbeth Søgaard Nielsen
Benchmark	MSCI Europe Small Cap (EUR)
Morningstar Category	Europe Small-Cap Equity



## Performance

In the year-to-date, Sparinvest European Small Cap Value had a negative return of 15.83% whilst the general small-cap equity market – as measured by the MSCI European Small Cap index – was down by 20.46%. In the third quarter, the fund dropped 14.83% while the index plunged 19.43%. A low weight in Southern Europe helped mitigate the fund's drop, as did a low weight in the financial sector, which plunged due to worries about the real value of banks' holdings in sovereign debt.

Sparinvest European Small Cap Value & Index Returns, in %	Q3 2011	YTD
Sparinvest European Small Cap Value	-14.83	-15.83
MSCI Europe Small Cap Index	-19.43	-20.46
MSCI Europe Index	-16.37	-15.62
MSCI Europe Value Index	-17.60	-16.16
MSCI Europe Growth Index	-15.16	-15.06

MSCI European Small Cap Index, MSCI Europe Index, MSCI Europe Value Index and MSCI Europe Growth are all indices that contain a broad selection of companies in Europe. All returns on investment are in EUR.

This year the focus has, to a large extent, been on the Eurozone and the crisis in Southern Europe, where Greece's huge public deficit, in particular, has been a major drag on stock market performance. Stock markets have been driven primarily by fear. In spite of a high Eurozone weight, the fund performed relatively well compared to the wider European stock market, due to very low exposure to Southern European cyclicals and also to good outcomes from individual stock selections.

Naturally, a negative return is not satisfactory, even if performance has been stronger than that of the index. However, we must stress that the recent extreme share-price movements bear little relation to what we have seen in fundamental developments at our holdings,

which have, in general, announced reassuring results. Moreover, these markets have been providing excellent opportunities to make new investments, with five new holdings bought during the quarter.

There are major problems to be solved in the Eurozone. Decisive political action is vital. As we have long said, the recovery from a credit crisis was never going to be quick and easy. We will not predict here precisely what macro scenario the world is facing, but the situation is very different from late 2008 in one crucial way. In 2008, the sheer speed of the downturn took many companies by surprise. Today in late 2011, business conditions themselves have not yet shown a significant downturn; generally, our holdings report that orders and earnings remain roughly on track. But if a down-swing does come, companies are prepared. Balance sheets have been shored up, with, for example, reduced leverage and lower inventories. Disciplined cost cutting has led to dramatically lower breakeven points. This is a theme we expand on in our current letter to shareholders.

So, while we share concern about the current situation in Europe, and can certainly see risks of relatively low growth globally in the near term, current stock markets strike us as deeply irrational. We have no doubt that, whatever macro developments may come, the current share prices of our holdings offer deep discounts to intrinsic value, which will drive solid performance over the years to come.

### **Portfolio Composition**

At the end of the quarter, the cash position was 4.4% of assets under management. The fund had 40 holdings and our ten largest positions accounted for 47.96% of the total.

During the quarter, we made five new investments. We bought shares in Polytec (Austria, industrial plastics), and in Nyrstar (Belgium, zinc mining and smelting). We also invested in KSB (Germany, industrial valve maker), Coltene (Switzerland, maker of dental consumables), and Sabaf (Italy, maker of burners for gas cookers).

Demag Cranes has been sold from the portfolio, and is discussed below. In general rebalancing of the portfolio, we made additional investments in some existing holdings and reduced others.

*For further data on the fund, including complete portfolio holdings, performance and breakdowns by industry and geographical sector, please refer to the fund factsheet at the end of this document, or to our website.*

### **Portfolio**

European stock markets in general are now trading at compellingly low valuations. As a rough indication, we amalgamate the fund holdings into one theoretical company.

This company has a price-to-book of 1.16 times, compared to 1.21 times for the MSCI European Small Cap index. And yet the balance sheet remains solid, with low financial leverage (median net-debt-to-equity of 29.5% versus 29.1% for the MSCI European Small Cap Index). The last time these low multiples were seen was in March 2009 whereafter markets surged, due to more tangible political action being taken.

Earnings-based multiples suggest that a very negative scenario is now priced in. The price-to-earnings ratio, based on consensus estimates, is 10.05 times for the current fiscal year, and 8.67 times for the following fiscal year (compared with 10.95 and 9.38 times, respectively, for the MSCI European Small Cap). EV/EBITDA, which is a useful indicator of the price of companies relative to their raw earnings power, is just 4.85 times current year estimates, and 4.42 times next year estimates – compared with 5.67 and 4.78 times respectively for the MSCI European Small Cap Index. If one compares these multiples to what is actually paid for companies in M&A transactions, the implicit upside in the entire market, and the fund in particular, looks significant.

Despite the current volatile stock markets, the intrinsic value of the portfolio remains very much intact, and we are confident that this portfolio will generate healthy investment returns over the years to come.

### **Individual Positions**

We have often stressed that M&A will eventually pick up in a market where many companies have reduced debt and lowered their cost bases. Considering that smaller companies can make easier takeover targets, it is perhaps no surprise that the fund has received two takeover bids during the year. Demag Cranes has now exited the portfolio, while a takeover offer is pending for Derby Cycles (we will discuss this latter in greater depth if the offer becomes unconditional and completes).

#### **Demag Cranes**

##### *Takeover*

We bought shares in Demag Cranes (Germany) in December 2007, paying EUR 30 after the stock plunged. Demag is one of the leading producers of harbour and industrial cranes. Its cranes help industrial customers

to become more efficient and offer an improved work environment. They help harbours to load and off-load containerships quickly and reliably. This meant that Demag benefitted from the structural increase in world trade. Continuing its cost cutting and lean manufacturing, the company managed to increase margins and lower the break-even point. Therefore Demag Cranes emerged from the crisis having announced negative operating earnings only once – in the third quarter 2009 – and even more lean and mean than before.

Demag was finally taken over in the third quarter of 2011, by the large American crane producer Terex. Together with dividends received of EUR 3.10 per share, the average annual return in the holding period was 14%, while the European stock market has trended down. The transaction serves as an example of the fact that companies with valuable assets are likely to be taken over eventually if their shares are mispriced by the stock market.

**Karsten Løngaard**  
Senior Portfolio Manager  
11 October 2011

**Lisbeth Søgaard Nielsen**  
Portfolio Manager

This Fund Update should be read together with the latest 'Letter to Shareholders', in which our Value Equities team offer their perspective on value investment and market developments.



Sparinvest is a signatory of UN PRI and member of Eurosif and Dansif.

UN PRI is an international investor initiative sponsored by the UN and based on six principles for responsible investments. The aim is to help investors actively to incorporate environmental, social and governance issues into their investments.

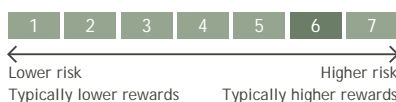
The mentioned sub-fund is part of Sparinvest SICAV, a Luxembourg-based, open-ended investment company. For further information we refer to the full and/or simplified prospectus and the current annual / semi-annual report of Sparinvest SICAV which can be obtained free of charge at the offices of Sparinvest or of appointed distributors/representatives together with the initial statutes of the funds and any subsequent changes to such statutes. Investments are only made on the basis of these documents. Past performance is no guarantee for future returns. Investors may not get back the full amount invested. Investments may be subject to foreign exchange risks. The investor bears a higher risk for investments into emerging markets. The indicated performance is calculated Net Asset Value to Net Asset Value in the fund's base currency, without consideration of subscription fees. For investors in Switzerland the funds' representative and paying agent is RBC Dexia Investor Services Bank S.A., Zurich Branch, Badenerstrasse 567, P.O. Box 101, CH-8066 Zurich. Published by Sparinvest, 28, Boulevard Royal, L-2449 Luxembourg. Sparinvest makes reservations for typos, calculation mistakes and other possible mistakes in the material.

## Description

### Investment Concept: Value Equities

The Fund seeks to provide long term attractive returns, making investments primarily in stocks of small and medium sized European companies with market capitalisation of between EUR 100 million and EUR 1.5 billion. By using a value approach in the investment process the Fund seeks stocks that are believed to be priced at a significant discount to the Fund's calculated fair value. The portfolio aims to consist of 30-50 financially solid companies.

## Risk and Reward Profile



## Basic Information

ISIN	LU0256591552
Bloomberg	RHAMEUR LX
Share Class	EUR R
Fund Inception	22-Jun-2006
Share Class Currency	EUR
Income Type	Accumulating
Company name	Sparinvest S.A.
Domicile	Luxembourg
Share Class Inception	22-Jun-2006
Fund size (MN) - 31-May-2011	3.31 EUR
Manager	Sparinvest Fondsmæglerelskab
Fund Manager	Karsten Løngaard, Lisbeth Nielsen
Managed Since	22-Jun-2006
Benchmark <sup>1</sup>	MSCI Europe Small Cap (EUR)
Morningstar Category <sup>2</sup>	Europe Small-Cap Equity
Latest NAV - 30-Sep-2011	89.93 EUR
Subscription fee (up to)	3.00 %
Redemption fee (up to)	0.00 %
Management Fee	1.85 %
Total expense ratio - 30-Sep-2010	4.37 %

## Returns - Month End, Sep-2011

Returns	Fund	Benchmark <sup>1</sup>	Difference
YTD	-15.83%	-20.46%	4.63%
1 Month	-2.92%	-7.03%	4.12%
3 Months	-14.83%	-19.43%	4.60%
1 Year	0.35%	-9.75%	10.10%
3 y ann.	5.27%	4.88%	0.39%
5 y ann.	-2.29%	-3.62%	1.33%
10 y ann.	-	-	-

## Risk 3 years - Month End, Sep-2011

Risk	Fund	Benchmark <sup>1</sup>	Morningstar <sup>2</sup>
Volatility	20.75%	24.63%	22.62%
Sharpe R.	0.29	-	0.21
Info Ratio	-0.04	-	-

Morningstar Rating™ **★★★★★**

## Performance - 30-Sep-2011

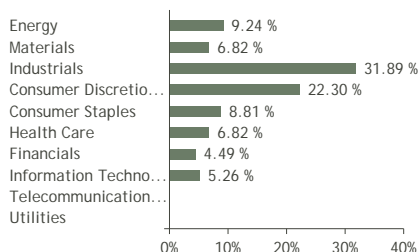


Returns	2007	2008	2009	2010	09-2011
Fund	1.02%	-44.98%	30.91%	35.40%	-15.83%
Benchmark	-7.51%	-51.87%	59.50%	29.91%	-20.46%
Morningstar Category™	-4.57%	-50.48%	48.19%	29.58%	-18.99%

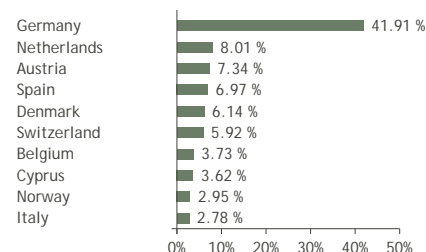
## Asset Allocation

Holdings	Equities	Bonds	Other	Cash
40	95.6%	0.0%	0.0%	4.4%

## Sector Breakdown



## Top 10 Countries



## Portfolio (Top 10) - 30-Sep-2011

Name	Sector	Type	Country	Weight
Derby Cycle Ag	Consumer Discretionary	Equities	Germany	9.35%
Washtec Ag	Industrials	Equities	Germany	6.08%
Wolford Ag	Consumer Discretionary	Equities	Austria	5.33%
Brodrene Hartmann A/S B	Materials	Equities	Denmark	4.37%
Aareal Bank Ag	Financials	Equities	Germany	4.04%
Vossloh Ag	Industrials	Equities	Germany	3.94%
Zehnder Holding Ag	Industrials	Equities	Switzerland	3.77%
Arseus Sa	Health Care	Equities	Belgium	3.73%
Pescanova Sa	Consumer Staples	Equities	Spain	3.73%
Prosafe Se	Energy	Equities	Cyprus	3.62%

## Notes:

The mentioned sub-fund is a part of Sparinvest SICAV, a Luxembourg-based, open-ended investment company.

## Benchmark Comment

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