ALANTRA

A new approach to identifying global small cap opportunities

January 2025

Introduction

The world is in a state of flux as geopolitical risks escalate around the globe. In this context, investors could benefit from adopting a value-driven strategy and identifying compelling opportunities at the company level.

It also can be helpful to consider 'out of the box' investment styles and a proactive approach to engaging with underlying companies.

This has long been the tactic of private equity investors - they find and then invest in promising companies for the long haul.

It’s a methodology that can also serve investors in listed equities well - particularly with regards to global small cap equities. Adopting an approach of “friendly activism” can reap strong benefits over the long term.

This is an approach that we have long espoused at Alantra EQMC, and our investors have benefited from it. By making a significant investment in a growing small cap company, up to around 25 per cent, we have the power to initiate and encourage real change.

Small cap companies offer investors the opportunity to get in at ground level and benefit from the growth that happens as companies mature. Small caps are also generally an under-researched sector of the market, with most analysts focussing on larger cap companies. But this creates potential for those analysts willing to do the research.

An important consideration, however, is where the company you are investing in is domiciled. While global growth in many regions of the world is desirable, not every jurisdiction offers the regulatory and legislative certainty of Europe. A focus on European listed companies - not as a European play but rather investing in those companies that have a global growth exposure to other parts of the world – can be a strategy that adds good value.

Alantra EQMC's Investment Strategy

Alantra EQMC has a hands-on, constructive corporate engagement strategy that applies private equity techniques to pan-European small-cap publicly listed equities in order to de-risk investments and accelerate returns.

Just like a private equity portfolio, our small cap portfolio is highly concentrated with approximately 15 companies. We aim to have seven companies comprise two thirds of the portfolio while the other seven to eight stocks make up the rest. This, for us, is a seed and core approach and it is a product of our process.

Initially we conduct thorough due diligence and research before investing in a company. But then we start small. Initially, an investment in a company will represent approximately 2 per cent of our total portfolio. With that stake we learn more about the company and its reform opportunities and potential. Once it has started on that reform journey, and we are pleased with its progress and outlook, we look to increase our holding to around a 10 to 25 per cent stake.

The fund's investible universe is companies with a market cap up to €2 billion and we find a market cap of between €500 million to €1 billion to be the sweet spot.

Our team seeks out quality companies at attractive prices where we can help actively create value through a number of initiatives including:

- Strategic and capital allocation views and assistance.
- Improving investor relations through better transparency, visibility and coverage.
- Assisting with corporate governance via management team and board alignment.
- Focussing on financial themes and helping to optimise capital structure and returns to shareholders.
- Finally, we often assist with operational improvements, efficiencies and restructures.

We invest for the long haul with a three-to-five-year time frame and our exit strategy focusses on merger and acquisitions or block or other open market trades.

While a board position can be helpful, and when we first started our fund we thought it was essential, we also learned that it can invoke 'Stockholm syndrome' where it can become difficult to see the faults in a company. Now we are also comfortable with an independent advisor representative of ours on the board, as they can remain impartial while also understanding our intent.

The opportunities in Pan-European Small Caps

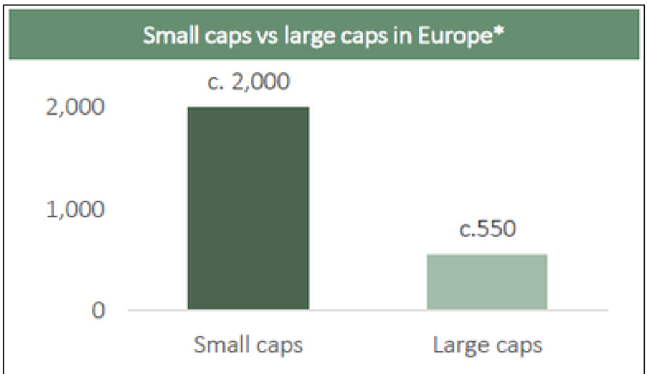
We believe European small caps currently find themselves at a nadir both in their profit cycle and in terms of historical valuation metrics. The high interest rates of the last few years have dampened the M&A activity that in the past provided support in these situations. However, with monetary policies beginning to ease, the environment is becoming more favourable for a recovery.

Lower rates should reignite corporate transaction activity in the European small-cap space, with the chart to the right reflecting a rebound in the second half of 2024. Meanwhile, private equity buyout "dry powder" has been accumulating, fueled by strong fundraising but a challenging deal-making environment. This has created significant pent-up demand for acquisitions, positioning European small caps as attractive targets for renewed transaction activity.

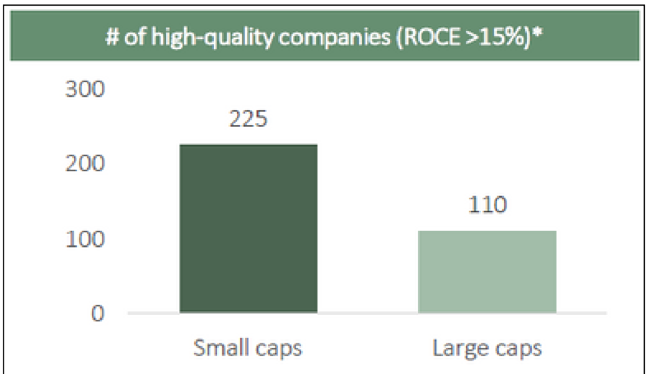
If you know where to look, the market conditions and environment in Europe continue to provide opportunities for small cap investors.

Equity markets in Europe, particularly in small caps, are quite inefficient. The introduction of the Markets in Financial Instruments Directive (MiFID) regulation, which was designed to provide greater transparency in markets in Europe, effectively meant brokers had to split their trading and research functions. This has created a dynamic where there are lower fees for the broker, and in turn they have less resources. Unsurprisingly, many have stopped researching some parts of the market, most notably the premium small cap sector.

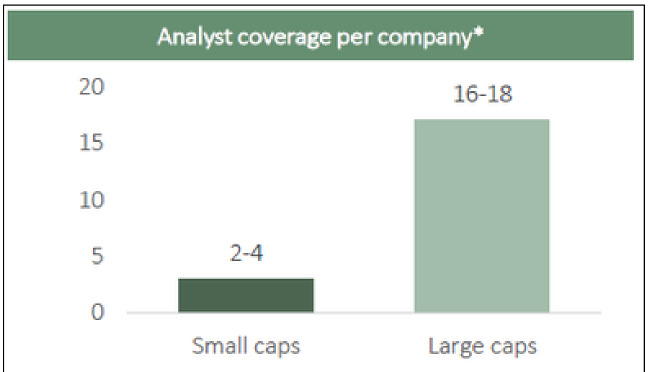
That now presents an opportunity for those still in the space and willing to do the research, to find those European listed companies that are poised to gain from their investments and activities in global markets.



(*) Listed co's in Western Europe, (ex Financials, Real Estate, Oil & Gas exploration, commodities).; Small Caps: >€50 <€1,500m market cap; Large Caps: >€5.000m market cap



(*) ROCE calculated as EBIT/Capital Employed. Based on Bloomberg data



(*) Average number of analysts covering a company taking a random sample high quality companies both in Small Caps (100 out of 400) and Large Caps (50 out of 105)

The benefits of friendly activism

Like a private equity investor buying out a company and transforming it, the small cap space is a good sector to try and encourage change within a company. The relationship whereby a company board supervises a management team on behalf of the shareholders, is what we call the agency relationship. Ultimately, we believe active ownership can reduce agency costs. By virtue of being a significant relevant owner and having a shareholder oversight, we believe investors can help companies to function better.

But it is better for all involved if this kind of engagement is done on a 'friendly' basis. More benefits accrue to the company, and it is always favourable to work alongside management, rather than against it.

Often, we find that the small cap companies we are researching and investing in are led by first time CEOs. These individuals are often executives from the upper tiers of large corporations who seek a fresh and more dynamic start.

They are usually strong at managing people and products but have never been responsible for final capital allocation decisions. Unlike large cap CEOs who constantly have advisers knocking on their door, the small cap CEO is sometimes starved for this type of assistance and advice, and very keen to engage with a 'friendly activist' investor.

We also promote sustainability with a pragmatic and customer centric approach. This is another tool to boost operational performance and terminal value across our companies, typically increasing the total addressable market, margins, or improving capital allocation. Complementing this, our ESG framework helps us to monitor risk.

Finding the best companies

There are approximately 2500 small companies in Europe. We exclude sectors such as financials, real estate, oil and gas exploration and commodities. After applying that lens, and other relevant filters from our process, our investible universe comes down to approximately 625 companies of which we focus our attention on the top quartile, or approximately 125 companies.

By default, the majority of our holdings are located in the UK, Germany or Southern Europe as these are some of the biggest markets and where companies with a global focus are likely to situate themselves.

CIE Automotive

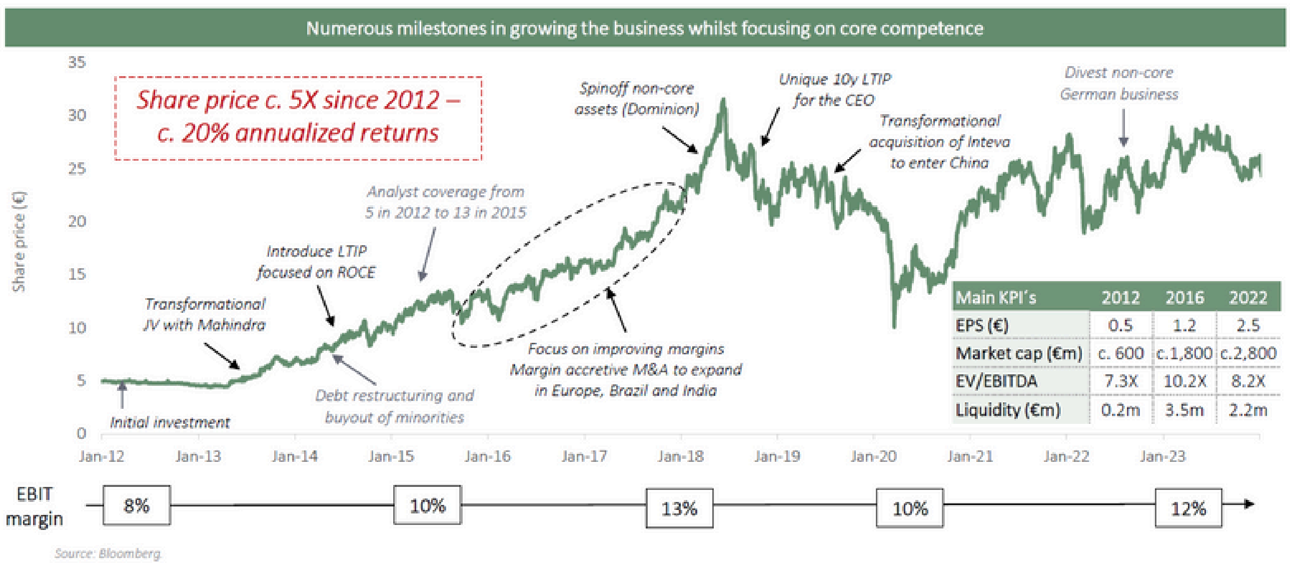
CIE automotive is a company which specialises in supplying automative components and subassemblies and is based in Spain. It represents a global play with 42 per cent of its sales sourced from the Americas, 24 per cent from Asia and 34 per cent from Europe.

It has been in our portfolio for over 10 years and has performed extremely well during that time.

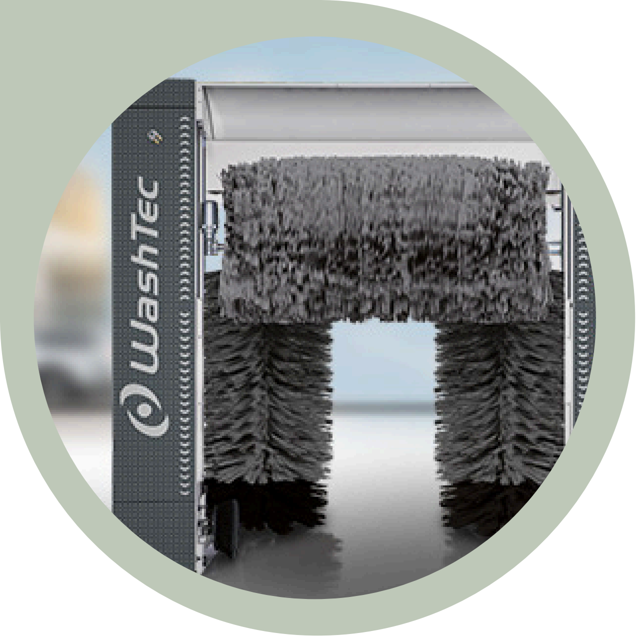
When we made our first investment in CIE Automotive it was primarily servicing just the local market of Spain, but it has since become one of the largest 35 companies listed in that country.

We recognised the potential early on when they were starting to expand internationally. We've worked with them to grow by both acquisition and through organic growth to the point where they are now a $3 billion mid cap company.

We helped them with investor relations, internationalisation, diversifying their business, and shareholder structure. Because of our engagement with their management team, and in turn management's willingness to work with us, we have assisted with activities such as spinning off non-core divisions to focus capital allocation on the core business and introducing new analysts to cover the company by encouraging management to increase investor roadshows.



Main KPI's	2012	2016	2022
EPS (€)	0.5	1.2	2.5
Market cap (€m)	c. 600	c.1,800	c.2,800
EV/EBITDA	7.3X	10.2X	8.2X
Liquidity (€m)	0.2m	3.5m	2.2m



Washtec AG

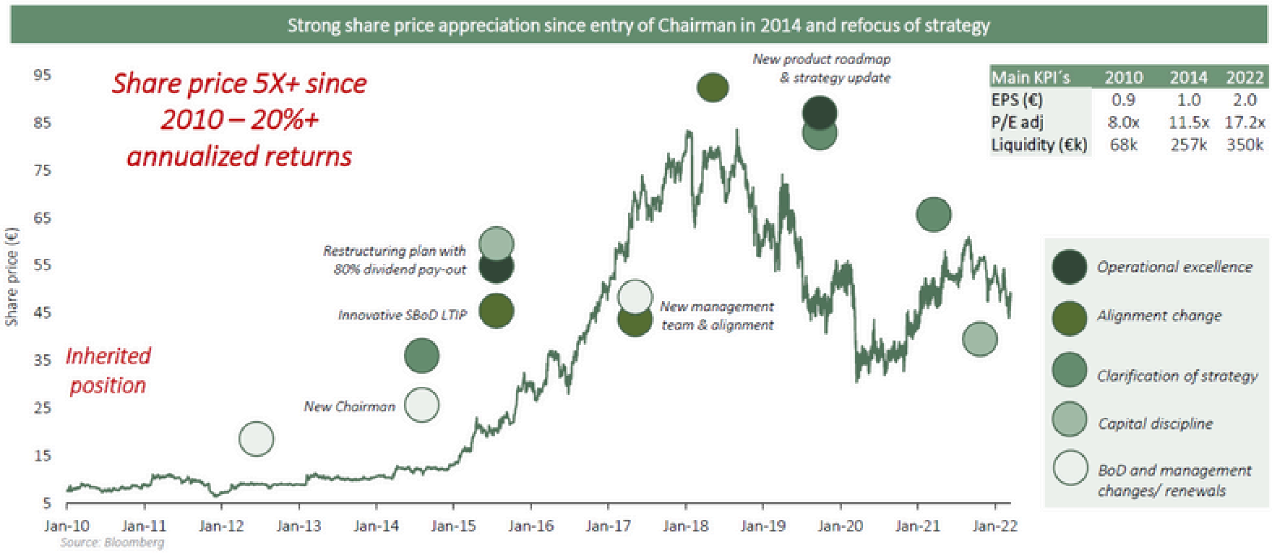
This company is based in Augsburg, Germany and produces, markets and services a complete range of car wash systems for cars and commercial vehicles, including rollover, wash tunnel conveyor systems and jet washes.

In early 2024, Michael Drolshagen was appointed CEO. He came with a strong operational track record and aftermarket experience at Porsche and ThyssenKrupp, which we believe makes him an adequate replacement for the previous CEO.

The new CEO, senior board of directors and a reinforced management team have backed a new low-risk strategy with a focus on core markets, something we have promoted and encouraged. Aligning management and board of director quality has been part of our ESG engagement with this company.

Its recent Long Term Incentive Plan programme for the senior board of directors represented a milestone in Germany and improved capital discipline has meant that €180 million has been returned to owners in dividends and buybacks since 2014.

All these changes, along with a focus on product excellence, have resulted in market share gains in the US and China and an estimated return on capital employed for 2024 of 24 per cent.



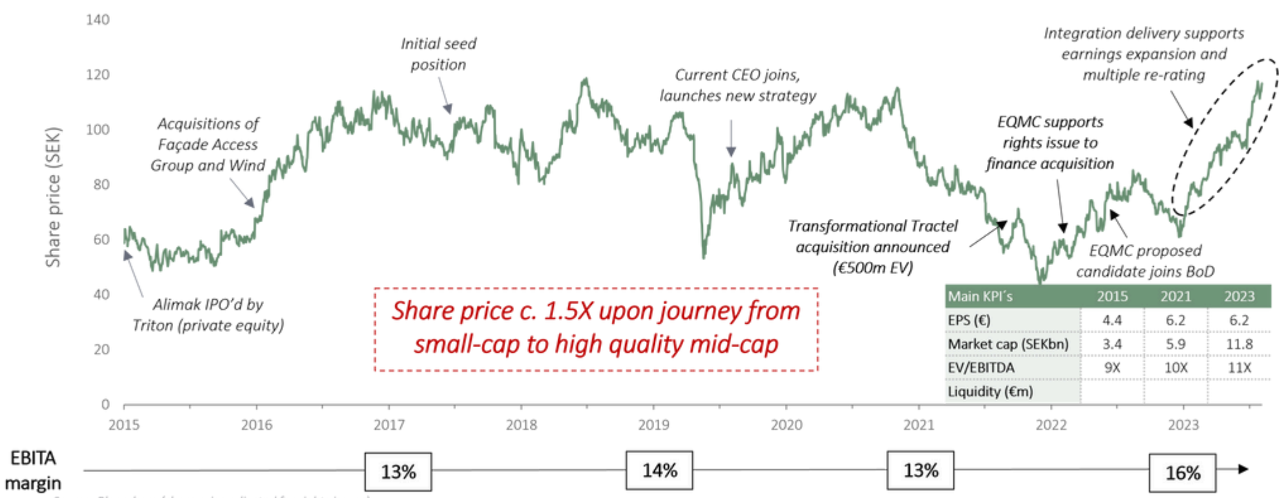
Alimak

This Swedish company is the global leader and industry standard in vertical access solutions, including lifts, hoists, and related equipment, catering to the industrial, wind, building maintenance, and construction sectors. In total, 34 per cent of its sales are from the Americas, 22 per cent from Asia and 43 per cent from Europe.

Our involvement with Alimak culminated in 2022 when we played an instrumental role, together with top-owner Latour and a few others, in securing additional funding for the transformational acquisition of Tractel, its largest competitor. This acquisition, which we had advocated for over several years, marked a significant turning point for the company.

The strategic merger created a highly profitable and dominant market leader, unlocking substantial cost and revenue synergies. The increased scale of the business is also likely to attract greater investor interest and improved analyst coverage, resulting in enhanced liquidity and higher valuation multiples.

Engagement and transformational M&A driving journey from small cap to high quality mid cap



Main KPI´s	2015	2021	2023
EPS (€)	4.4	6.2	6.2
Market cap (SEKbn)	3.4	5.9	11.8
EV/EBITDA	9X	10X	11X
Liquidity (€m)			

Source: Bloomberg (share price adjusted for rights issues).

The bottom line

There are many opportunities to be found by looking outside the box and taking advantage of cheaper prices to buy outstanding companies.

European small-cap stocks are currently trading at a substantial discount compared to both their historical averages and their large-cap counterparts. Brexit, the war in Ukraine and the general political turmoil in Europe have exacerbated this discount, as investors have broadly devalued European assets without distinguishing between companies focused on domestic markets and those with significant global operations.

A private-equity style investment approach to listed companies and 'friendly' activism can also reap benefits for those willing to take the time to engage with company management and encourage and foster reform.

By focusing on quality assets exposed to global markets that meet strict value metrics, with management teams open to improving shareholder returns in the medium to long-term, EQMC has become one of the best performing funds of its kind.

About Alantra

Alantra is an international financial services firm with over 600 professionals representing 35 nationalities across 24 offices.

Founded in 2001, Alantra provides alternative asset management, private capital and financial advisory services to companies, families and investors operating in the mid-market segment.

The firm's listed partnership model ensures accountability and responsibility, which influences everything it does... from decisions on deals, to the companies it invests in, to how the firm supports its clients and team members. Both Alantra and its executives invest in its products alongside clients, creating a strong alignment of interests.

Alantra has detailed environmental, sustainability, social & governance (ESG) and responsible investment policies and is a member of the Principles of Responsible Investing (PRI), the world's leading proponent of responsible investment.

Our active funds take a unique approach to serving investors looking to invest in European and Iberian assets. We hold relevant minority positions in small and mid-cap listed companies in Europe and take a hands-on approach, providing the companies we invest in with support from our most senior managers along the way. We focus on quality assets exposed to global markets. Our investments meet strict value metrics, present opportunities for value enhancement and have management teams typically open to improving shareholder returns in the medium to long-term.

EQMC is the leading, award-winning active investor in the European, listed small and mid-cap space, one of the best performing funds of its kind. It has an active ownership strategy which has achieved 15% net annualized returns since its inception in January 2010. The fund has outperformed indexes by 170% to 220%+ as well as most hedge funds, with controlled risks while typically holding a small net cash position with no leverage.

About the authors

Jacobo Llanza | Executive Chairman of Alantra Asset Management

Jacobo Llanza holds a degree in Economics and Business Administration by the Université de Paris. He started his professional career in 1989 at the Equity Capital Markets Division of Bancapital (Grupo Mercapital). In 1991 he moved to Mexico as a founding partner and Head of Research at AB Asesores Moneda, a Latin-American financial service company. In 1995 he became Managing Director and lead the expansion of this Group in Mexico, Brazil, Argentina and Chile. In 1999, after the acquisition of AB Asesores by MSDW, he moved to New York as Managing Director and Head of Equities of Dresdner Kleinwort Wasserstein for Latam & EMEA. Finally, returned to Madrid in 2002 to re-join his partners of AB Asesores at Alantra , where he has been involved in the development of the Asset Management (Active Funds, Private Equity, Infrastructure, Real Estate, Debt) and Capital Raising activities.

Francisco de Juan | Managing Partner & EQMC CIO

Francisco De Juan is an active investor in European public equities. He is the CIO of the EQMC Fund since its 2010 inception and Managing Partner of Alantra EQMC Asset Management. With over 25 years of cross-disciplinary experience, De Juan combines extensive expertise in active investing in public equities with his background as a top-ranked equity research analyst (Cheuvreux), investment banker (Lehman Brothers) and a small-time as an auditor.

De Juan is a strong believer of deep-dive fundamental analysis and holds a vast experience constructively engaging with European small/ mid-caps. The EQMC fund has been granted multiple international awards under his watch in recent years due to its top performance. He holds a double degree in Law & Business in ICADE (E-3), Madrid (Spain). He collaborates as a lecturer at the IE Business School teaching his course on "creating value through active ownership". He has participated in several nomination committees for EQMC's portfolio companies. He currently serves as a board member at Guala Closures.

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