July 31, 2020

Value Investor INSIGHT

The Leading Authority on Value Investing

Willfully Open-Minded

While not in vogue in Europe at the time, it made perfect sense to Philip Best to launch the micro- and small-cap focused Argonaut Fund in 2003: "If you've kicked around investing for a while and haven't worked out that most markets are pretty efficient, you're probably in for a nasty surprise," he says. "We just thought there was far more chance of getting an edge if we were looking at companies no one else was bothering with."

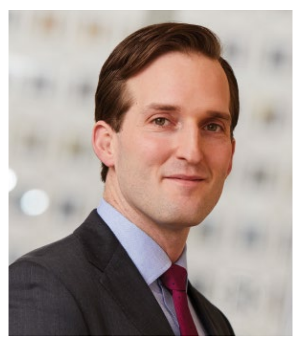
Good call. Since inception the Argonaut Fund has earned a net annualized 11.2%, vs. 6.5% for the Stoxx Europe 600 Index. Today Best and co-manager Marc Saint John Webb are finding unrecognized value in such diverse areas as software, postage meters and cellphone accessories. See page 2

Philip Best, Marc Saint John Webb
Quaero Capital

Inflection Points

It becomes evident early on in speaking with Artisan Partners' Christopher Smith that he's a bit of a stickler when it comes to process. "It's difficult in investing to take subjectivity and emotion out of your decision-making and just allow your research to drive what you do," he says. "We try to quantify our process at every step of the way and stay focused on what matters most in the end: Do we have a variant view on the company's earnings power?"

Smith launched the Artisan Thematic strategy in 2017, targeting companies benefiting from accelerating industry profit cycles. Among the areas of opportunity he sees today: payments processing, analog semiconductors, insurance brokerage, wireless services and life sciences. See page 8



Christopher Smith
Artisan Partners

Enduring Appeal

Joseph Shaposhnik credits his real-estate-developer father with his early business education, delivered through countless hours helping his dad analyze, acquire and develop commercial properties in Southern California. "In the end I can't say I was that interested in real estate," he says, "but I loved the investing part of the business."

Finding a greater affinity for investing in stocks, today Shaposhnik manages TCW Group's New Americas Premier Equities strategy, which since its mid-2015 launch has earned a net 17.1% per year, vs. 10.5% for the S&P 500. Targeting consistent cash-flow generators trading at unchallenging prices, he's finding upside in such areas as credit bureaus, enterprise software and data analytics. See page 15

Joseph Shaposhnik
TCW Group

Inside this Issue

FEATURES

INVESTMENT HIGHLIGHTS

Other companies in this issue:

Investor Insight: Philip Best

Philip Best and Marc Saint John Webb of Geneva-based Quaero Capital describe how they try to stay "willfully open-minded," how they sift through Europe's small-company universe to find undiscovered gems, how their portfolio companies have held up since February, and why they're seeing unrecognized value in Cegedim, Quadient and Cellularline.

Has the opportunity set evolved from what you first saw in starting the Argonaut Fund in 2003?

Philip Best: The idea starting off in 2003 was to focus on companies in western Europe that were too small to interest institutional investors, where information circulation was bad, broker coverage was poor to non-existent, and the valuation indicated that maybe the market wasn't doing its job. I would say on the whole that companies have gotten far better at putting information out there and making the effort to meet investors, but the institutional investment community is still pretty deaf to it. Investing in small- and micro-cap companies isn't a particularly scalable business, so for much of the investor community there isn't a lot of practical interest. The opportunity we saw seventeen years ago is still very much there.

We now have other funds as well, but for Argonaut we track about 1,000 companies with market caps generally between €40 million and €300 million. Europe is not the technological powerhouse the U.S. is, so the sectorial layout is rather different, which in our end of the market means more industrial. Europe, despite high-cost labor and some problematic currencies, is quite good at industrial production. It's not all that we find interesting, but overall the industrial base in Europe is of quite high quality, with even small companies that have surprisingly global footprints.

We tend to focus on markets that are deep and wide enough to have orphaned and badly followed stocks, such as in France, Germany and the U.K. It's more difficult to find off-the-radar stocks in Spain, for example, where there are maybe 15 brokerage firms and only 130 or so listed companies. You'd think a market like Slovenia's would be under the radar, but there's really quite a lot of analyst coverage there for not that many stocks.

You describe your investing mindset as "willfully open-minded." What do you mean by that?

Marc Saint John Webb: It's our way of saying we're contrarian. We hope we're not knee-jerk contrarian – "let's short Tesla because everyone loves it" – but we naturally gravitate toward what is objectively out of favor. But we don't want to just buy bad businesses that are cheap. We're rather looking to invest in a good business when the market, due to short-term issues, has wrongly concluded it's a bad business. If we're right that the issues are temporary, we expect to sell it three or four or five years later when the market suddenly recognizes it's a good business after all and deserves a higher multiple.

Brokers love the fact that when we get invited to investing conferences we always try to meet with companies no one else wants to see. To give an example that also illustrates our process, we had met in 2007 with management of Sarantis [Athens: SAR], which you could call a very-mini version of Procter & Gamble that's based in Greece. It sells consumer staples like dishwashing liquid, paper towels and dog food and has successfully expanded outside of Greece as well. When we first met them we thought, great company, but not cheap enough for us. We visited them again in 2009, but the stock still wasn't enough of a bargain. Then in 2012, the depths of the Euro crisis and with Greece at the center of all that, we saw Sarantis on the list of attendees at a conference and we were one of the very few investors who wanted to spend any time with them at all. That time we ended up buying the shares, which worked out very well for us.

How do you tend to generate ideas?

PB: We do a lot of screening, primarily looking at good old-fashioned value cri-

Philip Best, Marc Saint John Webb

What Comes Naturally

Fresh from Oxford University with a degree in modern history in 1982, Philip Best didn't find his true calling in finance right away. Of his first job as a fixed-income analyst at asset manager Schroders: "I absolutely hated it," he says. "Watching bonds move up and down in response to interest rates didn't fire my imagination at all." He switched to equities and after stints as an analyst, broker and brokerage-firm executive, he founded Quaero Capital in Geneva in 2005. While its main focus remains value-priced micro- and small-cap stocks in Europe, Quaero – which means "I seek" in Latin – now manages €1.8 billion in assets across multiple strategies.

Marc Saint John Webb, who joined Quaero in 2006, describes the value orientation set down from Best from the firm's origination: "You can come to value investing because you studied it and intellectually decided it was the best way to make money. Another way to come to it is if you apply to buying financial assets the same process you apply to buying any personal asset, like buying Christmas cards in January when they're on sale. We have this natural instinct to buy things when we believe they're bargains. That's how we are – we also happen to apply it to investing."

teria like price-to-book and price-to-earnings. We like looking at price to peak earnings, to look through the prism of what the company has done in the past. That focuses us on trying to figure out if that's possible again or if something structural has changed and it isn't.

We also look carefully at gearing. We're prepared to be bottom-feeders, looking at those ugly fish you find at the bottom of the sea, but we're quite demanding about the viability of the balance sheet. Our portfolio companies as a whole have zero net debt. That's probably a difference you'd find in Europe, where leverage – particularly in our end of the market – isn't nearly as prevalent as it is in the U.S. You could say we're willfully open-minded about everything except the balance sheet.

Finally, we look for stocks that are on sale, so our weekly screening shows price movement over one week, one month, three months, six months, one year and three years. We come up with a heat map of sorts and want to focus on companies showing a nice bright green on price-to-book and price-to-earnings, a nice bright green on the balance sheet, and lots of rosy red signifying a share-price decline.

MSJW: However we've come across a potentially interesting idea, one of our first steps is to understand the negatives reflected in the market's assessment of the stock. We'll try to speak with any analysts who follow it and people in the network we've built over the years who might have some experience with it. If we think we understand what the market is saying and have explored all the negatives, and if a kick-the-tires valuation indicates there might be a big difference between value and price, if we're still interested then we'll likely visit the company and go from there.

In our research we believe in boots on the ground. While the information flow is better than it was, in smaller companies we need to be more proactive to get complete information. If you go on Bloomberg and type "CN" for company news on a U.S. or European large-cap company, you're going to get pages of results. For our companies you often type CN and there's nothing there, except maybe a dividend notice and the last earnings release. We have to proactively get all the information we need, which means being out in the market and talking to people, especially across different levels in the company.

How would something like current holding Rapala [Helsinki: RAP1V], which is based in Finland and sells fishing tackle, get on your radar screen?

MSJW: This is a company we've known going back probably 15 years, when it bought the fish-hook business of a French company we were invested in called Lisi. It showed up on our screens a couple of years ago after a dive in the share price, which reflected a number of issues, including factory problems in Indonesia and working through a transition to more online selling in the U.S. Our research gave us confidence that the company's strong brand made it a long-term winner as sales channels evolve, and that new management was doing the right things to address temporary issues and generally restructure operations in a way that can generate much higher profits when we get beyond the current economic impacts of the coronavirus. [*Note*: Around €4 per share three years ago, after falling as low as €2.15 in March, Rapala's shares currently trade at €2.70.]

ON LEVERAGE:

We're prepared to be bottom-feeders, but we're quite demanding about the viability of the balance sheet.

You've said that many of your companies, like Rapala, are working to "structurally improve profitability through self-help measures." Can you give another recent example of that?

MSJW: We're nearing the end of what has been a very positive investment story for us in Volex [London: VLX], a U.K.-based company that makes power cords and cable assemblies. When we first got interested in it in 2016, the company's share price over a number of years had been divided by 10. It had lost some big supply deals, its manufacturing plant was generally substandard, and it was increasingly exposed to the lower-value-add end of the market.

That all attracted the attention of banking-dynasty scion Nat Rothschild, who has basically driven a transformation of the company from a me-too producer of commodity power cords to one more focused on value-added complex cable assemblies sold into higher-growth areas like medical technology, electric vehicles and data centers. They have also reengineered the manufacturing footprint, installing lean-manufacturing principles that have significantly improved profitability and earnings power. We got into the stock at around 30 pence when the market considered it a "bad" company. After a lot of self-help and with the shares now closer to £1.30, the market now thinks it's actually pretty good.

Do you ever take a more "activist" approach yourselves when you believe the situation warrants?

PB: I wouldn't say we wear the activist hat, but we're quite prepared to weigh in with our opinions when we're a significant shareholder, which is often. That's another reason we want to get to know management well, so we can be heard when we do have something to say.

MSJW: One current holding in which we've been quite vocal over the past two years is Bigben Interactive [Paris: BIG]. We often like to value companies on a sum of the parts, and when we originally did that here it appeared to us that the company's business mix – which included smartphone accessories, videogame accessories, videogame production and a business trading mobile phones – wasn't well understood by the market and that there were steps to take that would better crystallize value.

With our encouragement, management has taken a number of those steps, most importantly spinning off the higher-margin videogames business in March of this year under the name Nacon [Paris: NACON]. We've done very well in Bigben, but still own it because the value of its 78% stake in Nacon is now worth more than Bigben's entire market cap. That means the market is attributing no value to what is now a smartphone-accessory business that is the market leader in France. There's no reason that should be the case.

How did the Argonaut Fund portfolio hold up in February and March?

PB: Historically our drawdown capture is low compared to the index – on the order of 70% – which to me is what value investing is all about. This year our performance is pretty much in line with our small-company index, but given our emphasis on our companies' financial resilience, we've seen little if any of what I would consider permanent capital impairment.

For the vast majority of our companies, when we stress-test earnings for various scenarios of revenue decline they are unlikely to see more than a 10% drop in annual profit for this year. With the markets not having come back as far in Europe as they have in the U.S., the price-to-book valuation of the portfolio today is almost as low as it's ever been, at less than 0.8x. And there hasn't been that wave of trading equity capital for debt through share buybacks that you've had in the U.S., so book values are pretty solid.

Did you have cash to put to work during the worst of it all?

PB: We did a little bargain-hunting where possible, but unfortunately whenever there's a panic we have a certain amount of money going out of the portfolio. We had maybe 5% of cash going into the crisis and through it all we're still about at that level.

Describe your investment case for French software provider Cegedim [Paris: CGM].

MSJW: The company primarily supplies software and services to the healthcare industry, including practice management systems for doctors and pharmacies and payments-processing systems linking patients, pharmacies, doctors and insurance companies. They have another business as well providing human-resources systems for corporate customers like Michelin, Henkel, L'Oréal and Canon. The company has been around for 50 years, has large market shares in France, and its systems tend to be deeply ingrained into customers' work flows.

We like investing in family-owned companies like this one, which generally take a long-term view and are willing to make the investments necessary to secure a long-term future. Cegedim, for example, is coming off a big investment phase over the past four years that focused on transforming its business model to be more subscription-based, on making its systems more software-driven than just data-driven, and on developing its online medical-consultations service. That said, management has not been nearly as focused on improving the profitability of the

INVESTMENT SNAPSHOT

Cegedim
(Paris: CGM)

Business: Provider of data-management and business-process systems and software targeting customers in the life sciences, healthcare and health insurance end markets.

Share Information
(@7/30/20, Exchange Rate: $1 = €0.84):

Price	**€26.50**
52-Week Range	€19.12 – €33.20
Dividend Yield	0.0%
Market Cap	€370.9 million

Financials (TTM):

Revenue	€503.7 million
Operating Profit Margin	6.9%
Net Profit Margin	0.5%

Valuation Metrics
(@7/30/20):

	CGM	S&P 500
P/E (TTM)	162.5	30.6
Forward P/E (Est.)	24.4	25.5

Largest Institutional Owners
(@3/31/20 or latest filing):

Company	% Owned
Fidelity Mgmt & Research	7.7%
DNCA Finance	3.4%
Ennismore Fund Mgmt	3.2%
Norges Bank Inv Mgmt	1.4%
Quaero Capital	1.2%

Short Interest (as of 7/15/20):

Shares Short/Float	n/a

CGM PRICE HISTORY

THE BOTTOM LINE

The company tends to invest well for the future, but it has not been nearly as focused as it should be on improving the profitability of its individual businesses, says Marc Saint John Webb. Applying what he believes are reasonable multiples to each piece of the business even at its current level of performance, he estimates the fair value of the shares at €52.

Sources: Company reports, other publicly available information

individual businesses, to the point where the performance of each one lags fairly significantly relative to peers. That's why we think the stock is as poorly regarded as it is.

How poorly is the stock regarded at today's price of €26.50?

MSJW: We value the company on a sum of the parts, using what we think are reasonable multiples on each business segment, including those serving health insurers, corporate human-resources departments and doctor/pharmacy offices, as well as an e-commerce division and one that provides videoconferencing for doctors. The company is not very transparent in giving detail on all of these different businesses, but we can make reasonable estimates of their revenues and profitability.

In our base-case valuation we arrive at a fair-value estimate of €52 per share, applying reasonable multiples to each piece of the business at its current level of performance. If we apply those same multiples but assume that each business earns the margins of its peers – say a private-equity firm took over and set about optimizing profitability – we arrive at a target price of closer to €95 per share. Just for fun, we assume profitability is optimized and the earnings multiples on each business are at the same current level of peers, which in software businesses can be very high. Here it gets a bit crazy, with a target price of €165.

Are you making the case for change here?

MSJW: We're working on it at the moment with the Labrune family, who still own more than 50% of the outstanding shares. We're engaging quite a lot with Investor Relations to try to help them communicate the story more effectively, but we are going to need to persuade the founder/chairman and his son, who is the current CEO, to engage more positively with large investors.

In the meantime, the business is well positioned in a healthy industry, with a lot of potential upside from increasing profitability over time. We have heard that every two years or so the leading peer company in Europe, Germany's Compugroup Medical [Xetra: COP], makes an offer to buy Cegedim. It could pay a significant premium and still have the acquisition be very accretive. Compugroup today is roughly twice the size of Cegedim in terms of revenues, but the market cap is nearly 9x higher. We have also heard that they have received interest in other smaller parts of the business.

Turning to an industry with little wind at its back, describe the investment potential you see in French supplier of postal equipment Quadient [Paris: QDT].

PB: The company recently changed its name from Neopost and operates pretty much in a duopoly with Pitney Bowes [PBI] of the U.S. in providing postage meters and related services to business and enterprise customers. It's obviously a declining market – everybody knows that – we just don't happen to believe that disqualifies it as a potentially interesting area for investment.

There are different ways to play the hand the company has been dealt. Pitney Bowes, as far as we understand, is milking the core business for all it can, not investing in much else and giving as much back to shareholders as possible. Another alternative would be to take every euro you make in the traditional business and invest it aggressively in hopefully related businesses with better growth profiles and where you can have some reasonable expectation of success. We think Quadient is sort of in between those two approaches. It still generates high margins – until recently EBIT margins were around 18% – and good cash flow, which it has reinvested back into its franking business and to a degree in higher-potential businesses related to parcels, logistics services and business-process outsourcing. We also think it has the ability to return a lot more capital to investors.

Under CEO Geoffrey Godet, who took over in early 2018, the company has taken on the motto of "grow, improve or exit" and applied it to each one of its businesses. That's meant focusing the geographic scope to markets where they have strong positions, in the U.S. and most European countries. It's meant some investment in the postage-meter business, where they've taken market share from Pitney Bowes. It's meant investment in certain of the diversifying businesses showing promise, but also exiting those that haven't gained much traction. While this year will be thrown off by the pandemic, we believe earnings power can actually increase in 2021 and beyond. Based on how the shares trade, we don't think the market is contemplating that at all.

What potential upside are you contemplating in the stock from today's price of just around €12.50?

MSJW: We're estimating that with EBIT margins of around 12.5%, the company can earn at least €2 per share next year, rising to €2.50 or so in 2022. So we're at a roughly 6x multiple on our 2021 numbers and at 5x on 2022. As the diversification efforts take better hold, we think earnings can increase 20 to 30 cents per share annually from there.

In addition to believing that earnings-growth profile warrants a better than single-digit P/E, we also think the company can reinstate a significantly higher dividend than the one currently paid. It may not get there right away, but we think the capacity is there to get back to the €1.70 per share dividend paid out as recently as 2018. Even without earnings growth and valuation upside, that would provide a 13.5% yield on today's share price.

From postage meters to smartphone accessories, explain the upside you see in Cellularline [Milan: CELL].

MSJW: The company sells a variety of add-on products for smartphones, including covers, screen protectors, chargers, auxiliary batteries, earphones and speakers. It's the market leader in Italy, with roughly 60% market share, is among the leaders in Switzerland, Austria and Germany, and also has footholds in a number of other European countries.

While we wouldn't say we love this business in general, we like Cellularline's prospects in it. Driven by the strong market share in Italy and low-cost production in Asia, it earns 15% operating margins. This is a business where scale matters, making for more efficient distribution and better ability to service and add value to clients. The company overall is the biggest player in Europe and we think has considerable potential to grow through acquisition and consolidate its positions in other key countries. Earlier this month, for example, they announced the acquisition of a company that specializes in adapters for different electrical sockets around the world. We've actually introduced them to a company we know well in the space as a potential buy.

PB: To the question of why something like this might be mispriced, one issue here has been that the company came public just over three years ago through a SPAC [special purpose acquisition company], which is becoming more popular in the U.S. but

INVESTMENT SNAPSHOT

Quadient
(Paris: QDT)

Business: Provider to small and midsize businesses of document-management products and services, including postage meters, shipping and tracking systems and parcel lockers.

Share Information
(@7/30/20, Exchange Rate: $1 = €0.84):

Price	**€12.55**
52-Week Range	€10.67 – €24.30
Dividend Yield	2.8%
Market Cap	€433.8 million

Financials (TTM):

Revenue	€1.14 billion
Operating Profit Margin	15.6%
Net Profit Margin	1.2%

Valuation Metrics
(@7/30/20):

	QTD	S&P 500
P/E (TTM)	86.5	30.6
Forward P/E (Est.)	5.8	25.5

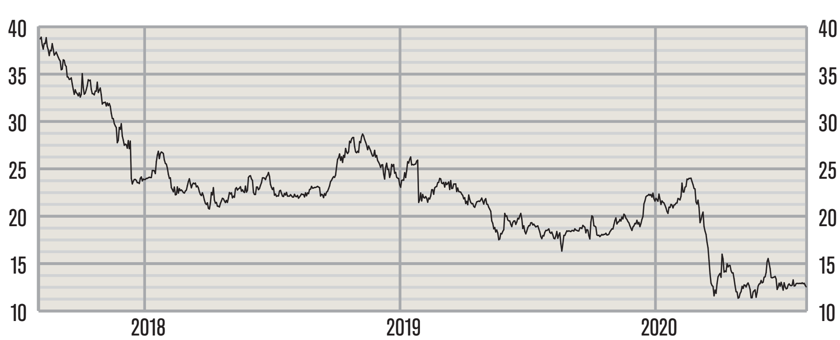
Largest Institutional Owners
(@3/31/20 or latest filing):

Company	% Owned
Teleios Capital Partners	10.9%
Norges Bank Inv Mgmt	4.8%
Marathon Asset Mgmt	4.4%
Dimensional Fund Adv	4.1%
BWM AG	3.7%

Short Interest (as of 7/15/20):

Shares Short/Float	n/a

QDT PRICE HISTORY



THE BOTTOM LINE

Its traditional franchise is in long secular decline, but Philip Best believes the company's "grow, improve or exit" approach to all of its businesses can actually lead to a resumption of earnings growth and a much higher dividend payout starting in 2021. The market as yet is unconvinced, pricing the company's shares at only 5x his 2022 earnings estimate.

Sources: Company reports, other publicly available information

is still rare and not particularly well regarded in Europe. It also listed initially on a secondary market in Italy, called AIM Italia, which has a reputation for lax oversight and some rather sketchy companies.

The stock has since shifted from AIM Italia to another segment of the market, called STAR, which is more demanding on reporting standards and generally has a better reputation, and the company is starting to improve in how it communicates with investors. But to a lot of investors, the history of how it came public and where it traded made it uninteresting right off the bat. That doesn't wear off quickly.

Is this something you bought into prior to the pandemic?

MSJW: We started looking closely when the shares were around €7 and took a small stake then. When the pandemic hit and took the share price below €5, we added to the position. It's recovered somewhat, but at the current share price [of around €5.10], it trades at a P/E of only 5x our 2021 EPS estimate and at roughly 50% of book value.

What do you think the stock is more reasonably worth?

MSJW: We think the industry will continue to increasingly favor the larger players, as retailers look to consolidate the accessories they sell and have them better stocked and presented in stores. That will also spur further consolidation, again likely to the benefit of those with the strongest market positions. Through organic market-share gains and bolt-on acquisitions, we expect Cellularline to increase its top line at better than 10% a year. Operating leverage should drive profit growth even better than that.

If we're right about the growth prospects, we think the shares could trade at twice the current P/E and at book value. That would give us 100% upside, probably over the next two to three years. There's also a very nice dividend here – the current yield is 6.5% – not because the payout ratio is so high, but because the market cap is so low relative to the company's earnings power.

Has the investing game changed in any ways that make it harder for you to enjoy?

PB: Given our strategy, I worry about the kind of prolonged lack of investor interest in the small-cap-value end of the market in Europe. Even before Covid, it's fair to say we've been operating in a style that's out of fashion, in a sector of the market that's out of fashion, and in a geographical area that's out of fashion. Of course we don't think any of those things are permanent and that money will find its way back, but it's been a bit like running into the wind.

As for me personally, this is a just a way of life. My house is a value house, and while it's not Omaha, it's in an unfashionable part of Geneva. I drive an unfashionable car. Investing is also the only thing I really know how to do and I still very much enjoy doing it. I imagine I'm pretty much in for the duration. VII

INVESTMENT SNAPSHOT

Cellularline
(Milan: CELL)

Business: Italy-based designer, manufacturer and distributor of mobile-phone accessories, including cases, screen protectors, battery chargers, powerbanks and earphones.

Share Information
(@7/30/20, Exchange Rate: $1 = €0.84):

Price	**€5.10**
52-Week Range	€3.97 – €7.40
Dividend Yield	6.5%
Market Cap	€110.5 million

Financials (TTM):

Revenue	€139.8 million
Operating Profit Margin	15.2%
Net Profit Margin	12.9%

Valuation Metrics
(@7/30/20):

	CELL	S&P 500
P/E (TTM)	5.7	30.6
Forward P/E (Est.)	n/a	25.5

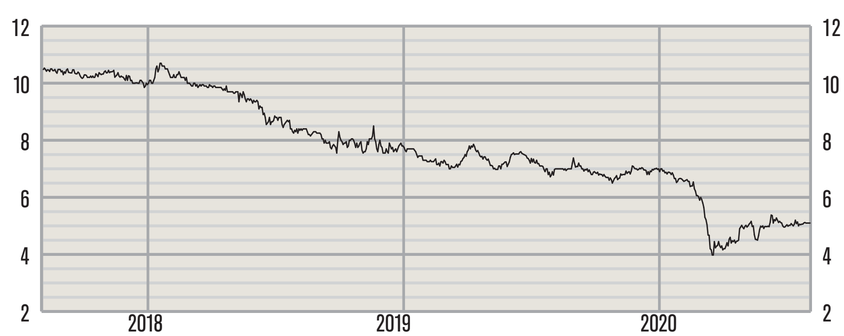
Largest Institutional Owners
(@3/31/20 or latest filing):

Company	% Owned
Intesa Sanpaolo	4.8%
Quaero Capital	2.4%
Norges Bank Inv Mgmt	2.1%
Kairos Partners	1.6%
Carthesio SA	1.2%

Short Interest (as of 7/15/20):

Shares Short/Float	n/a

CELL PRICE HISTORY



THE BOTTOM LINE

Marc Saint John Webb believes the company can capitalize on a natural consolidation in its market, driven by its retailer customers favoring suppliers providing one-stop shopping and more value-added service. If he's right that it can profitably increase its top line at 10% per year, he would expect the shares to double over the next two to three years.

Sources: Company reports, other publicly available information