PM duo reveals dos and don’ts for investing in European micro caps

By Jessica Beard 01 Jun, 2018

Investing in small and micro caps in Europe can be an attractive playing field for those looking for less well-researched gems, but there are some pitfalls to avoid.

Quaero Capital portfolio managers Philip Best and Marc Saint John Webb tell *Citywire Selector* about the tricks and pitfalls of investing in companies below the €300 million cap threshold.

1. Don't invest in companies that need your money

The first rule of small- and micro-cap investing is to target companies that are already successful, survivors and cash-generative, the duo said.

‘If you are going to invest in a small company without pushing your risk profile too high, you have to invest in "small but solid".’

If the company happens to be small and cash-burning, the combination means that the investor would be taking a lot more risk in their investment decision, they added.

‘We've done it once recently and it went quite against the grain because this company needed an injection of cash as it's a turnaround situation.’

2. Look at a company as if you’re going to buy 100% of it

There is real opportunity for doing deep, fundamental, bottom-up research on small-cap companies where you will get easier access to top-level management, the duo said.

‘For large companies it's difficult to grasp all the different parts of the business, whereas with smaller companies you get to understand them. We buy stocks that are on sale in the market and try to understand what the market is saying about the company.’

3. Don’t follow brokers’ advice

Former brokers themselves, the two portfolio managers were adamant that brokers aren’t to be trusted because they are commercially driven.

‘We don't want to get our ideas from people who are selling ideas at us, we want to get them for ourselves.’

4. Don’t be seduced by a charismatic CEO

Most challenging of all when choosing the next investment is being on guard against the strong presentation skills of CEOs, Saint John Webb said.

This particularly applies to UK chief executives, who often see selling the company and communicating with investors as part of their job.

‘In the UK you get the company pushed at you, whereas if you go to Germany they are much more reticent. They don't see their job as being defined by the need to communicate with the stock market. They tend to give you the story as it is.’

The managers also jokingly warned against listening to chief executives wearing leather jackets and gold wrist bangles. ‘We've had a couple of those where they roll up to your office in crocodile shoes and the whole thing turns out to be a fraud.’

One CEO fitting this description paid a visit to the two managers and they decided not to invest. ‘Four months later, he was shot by a professional sniper on his boat in the south of France and they never discovered who it was. The company share price went more or less to zero.

‘In the world of small caps you do come across some exotic companies.’

Over the past three years to the end of May 2018, the Quaero Capital Funds (Lux) – Argonaut A EUR fund run by the two managers has returned 56.42% in euro terms, while its Citywire-assigned benchmark MSCI EMU Small Cap TR EUR has returned 32.45% over the same period.

http://citywireselector.com/news/pm-duo-reveals-dos-and-don-ts-for-investing-in-european-micro-caps/a1125075?ref=citywire_global_latest_news_list