



Global Small Cap Value

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Fund Facts

Strategy	Value Equity
Risk	Medium
ISIN	LU0264925131
Share Class Currency	EUR
Fund Inception	02-Nov-2006
Fund Manager	Kasper Jacobsen
Benchmark	MSCI World Small Cap (net dividends)
Morningstar Category	Global Equity Small/Mid Cap

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Performance

Sparinvest Global Small Cap Value fell by 1.68% in the fourth quarter of 2009, bringing the full-year return to 22.28%. The general small-cap market, as measured by the MSCI World Small Cap Index, gained 4.76% in the quarter and 39.63% over the year. The MSCI World index rose by 6.03% in the quarter and 25.94% over the year, while MSCI World Value increased by 4.15% in the quarter and 22.73% over the year. Growth stocks performed better this year, with a quarterly return of 7.97% and an annual return of 29.12%.

The small-cap market overall ended the year as one of the best performers, but the results vary a lot depending on the region. Our fund continued to lag the index and, despite an absolute return of 22.28%, we are dissatisfied with our performance relative to our benchmark.

The main reason for our disappointing results is our regional allocation. Through the year we have had a big exposure in Japanese small caps which continuously underperformed the rest of the world, ending the year at a measly 2.32% return as measured by MSCI Japan Small Cap. At the same time, MSCI Europe Small Cap returned just under 60%. The negative impact from our Japanese holdings is significant but, as we stress in the Letter to Shareholders, a period of underperformance in a region is not a reason for us to question our holdings there. We are, in fact, encouraged by fundamental developments in our Japanese holdings, despite the performance.

In Europe, our French and German stocks did not perform in line with their European peers. Our Dutch companies, on the other hand, served us well in the quarter – as well as during the year – helped, of course, by the takeover bid mentioned below.

Portfolio Composition

At the end of the quarter, the cash position was 6.1% of assets under management. The fund had 74 holdings and our ten largest positions accounted for 22.34% of the total.

Recent markets have been fairly good hunting grounds for value, and since we last wrote we have made two new investments. We bought shares in Gewiss, an Italian maker of electrical equipment and in Hunter Douglas, a Dutch maker of blinds and other window coverings.

In general rebalancing of the portfolio, we made additional investments in some existing holdings and reduced others. We sold our positions in Danieli, Volcom, Pininfarina and Aska Pharmaceutical, which are discussed below.

For further data on the fund, including complete portfolio holdings, performance and breakdowns by industry and geographical sector, please refer to our website and the latest fund factsheet.

Portfolio Valuation

Despite recent share price increases, valuations of the fund remain attractive. The average price-to-book ratio is only 0.97 times, with an EV/EBITDA of around 5.5 times. In terms of balance sheet health, the average net-debt-to-equity ratio is under 10%. We are convinced that the strength and low pricing of our portfolio will allow us to generate healthy long-term returns.

Individual Positions

Océ

Takeover Bid by Canon.

Océ is a Dutch manufacturer of high-end copiers and printers, which has been a long-term holding in our funds. The group has developed interesting niche businesses in wide-format and high-volume printing, in which it has a strong competitive position in Europe. In recent years it has had a tougher time in standard office printers, where it is a relatively small player, and of course the crisis has hit the entire industry hard.

In November 2009, Canon – obviously a dominant force in the industry – announced a takeover bid for Océ. The offer price of EUR 8.60 per share was a significant premium to recent share price levels of EUR 5. The tender process is ongoing – European Union regulators only cleared the bid in late December – and we are monitoring the situation closely, but naturally we are encouraged to see that industry peers are able to see considerable

long-term value in Océ.

Pininfarina

Sold with loss

Pininfarina is an Italian company, with a history running back to 1930, that designs and builds cars and body parts for brands as diverse as Ferrari, Maserati, Alfa Romeo, Ford and Volvo, to name a few.

Our funds first invested in Pininfarina in mid-2002, paying around EUR 19 a share. The company was cheap on both price-to-earnings and price-to-book multiples, and offered a strong balance sheet with little debt. It had a certain degree of flexibility in its business model, as it produced on a build-to-order basis. In 2003, it was set to see orders for the new Ford Street Ka and the restyled Alfa GTV and Spider.

Like most companies in the automobile sector, Pininfarina had experienced downturns before, but had shown an ability to turn things around on the back of new model launches. In 2005 to 2006, earnings were suffering somewhat, and Pininfarina took on higher levels of debt, primarily to fund production of new models and expansion of its asset base – such as the acquisition of Volvo's Uddevalla plant in Sweden. In light of their track record, we decided to give management the benefit of the doubt. Unfortunately the credit crisis was just around the corner which, of course, made the operating environment far tougher for the entire industry. For Pininfarina, a further sad blow came when the CEO, Andrea Pininfarina, passed away. Both income statement and balance sheet have deteriorated further under his replacement, Paolo Pininfarina, and while the board is doing its best to get things back on track, we determined that our original investment case had gone, and the company's intrinsic value had been eroded.

We therefore decided to sell our holdings, completing the sale in October 2009 with an average sale price of just EUR 3.5. This is clearly a regrettable example of an investment case that did not develop as expected. Despite our focus on financial strength and enduring business models, there will inevitably be a minority of cases which disappoint. This is why, in addition to our disciplined investment process, we invest in a diverse range of companies, and rigorously monitor our existing holdings, to make sure that our portfolios contain quality companies at healthy discounts to their true worth.

Volcom

Reached target

Volcom is a skate and snowboard brand with its main operations in the US, and an expanding presence in Europe and Japan.

We invested in Volcom in March 2009. The downturn was hurting short-term expectations in the sector, and Volcom was no exception. The shares were trading at around USD 7, just below book value. However, the company had a net-cash position equivalent to half of its market capitalisation, and we were impressed by management's disciplined approach to the balance sheet. Unlike many similar companies, Volcom had not burdened itself with large lease liabilities.

Its assets and earnings had expanded rapidly in recent years and, although the brand name was very strong, we were wary of assuming that Volcom could sustain the high profit levels of 2007 and 2008 over the long term. However, we concluded that the stock was trading at a significant discount to intrinsic value, even on the assumption that long-term profit margins would be half recent levels.

By October 2009, the share price had increased considerably and reached our target price. While we remain impressed by Volcom, it is an important part of our process that we remain disciplined and do not stay invested in companies which no longer have a discount to intrinsic value. We sold our position at USD 17.5, two-and-a-half times what we had paid for it.

Aska Pharmaceutical

Sold with a loss

Aska Pharmaceutical is a producer and wholesaler of medical products, with a focus on prescription pharmaceuticals. It has been a long-term holding in our funds, and has been in Sparinvest Global Value Small Cap since inception in late 2006, when we paid around JPY 940 per share, or 0.8x book value. The balance sheet was solid, with a net cash position, and some real estate positions whose book value looked likely to be considerably lower than current market worth.

Since 2006, Aska's revenues have remained reasonably robust, but changes in the sales mix have made profits volatile. Earnings in the fiscal year which ended in March 2009 were weak, and it became clear that Aska was likely to slip into losses over the current fiscal year. The operating environment is tough for businesses around the world, but one would normally expect to see more earnings stability in a pharmaceutical company, and this volatility concerned us.

The balance sheet remains solid, and two years ago management did indeed sell a portion of real estate, unlocking some of hidden value. However, the company has been channelling increasing amounts into R&D and

capital expenditures, but the benefits of this are not yet obvious. We are long-term investors, and are patient with management attempts to improve a company, but naturally when assets are divested, we like to see benefits filtering through to shareholders either via earnings, or more direct means such as dividends.

In late 2009, we concluded that the lack of earnings stability and visibility in Aska had severely damaged our investment case, and therefore we decided to sell our shares. We realised a price of JPY 800, which means that after dividends we lost a total of around 7% on our initial investment.

Danieli

Reached target

Danieli is a manufacturer of steel-making equipment, located in the industrial heart of Northern Italy. Founded in 1914, it has a long history of pulling through hard times. In 2008, sky high oil prices were a headache for Danieli – but this was nothing new. Back in 1976, when the company was run by a granddaughter of the founder, rapid oil price rises and declining capital expenditure by its customers pushed Danieli into its first ever loss, but it battled through. The same Ms Danieli took the company public in the 1980s and became a key driver for major changes in global steel production processes. Her husband is now the chairman and majority shareholder. It's impossible to make generalisations about family-controlled companies, but we considered Danieli a positive example, where family management had delivered a stable track record and, over the years, developed a niche company with leading technologies and a strong competitive position.

In early 2009, the short-term outlook was clearly tough. Steel companies around the world had been spending heavily on new equipment for a few years and, in the face of the crisis, were likely to scale back or postpone their investment programmes. We could not estimate how much demand would fall in the short term - but we liked the long-term picture. Danieli entered the crisis with a very strong balance sheet and a large order backlog. Moreover, steel plant making is an industry with very high barriers of entry: four companies dominate about 70% of the global market and Danieli alone controls around 30%.

The stock was trading at just 0.6x tangible book, with most production assets already depreciated, and had a net-cash position in excess of its market capitalisation. Even assuming earnings at an eight-year low, the stock looked highly undervalued. We invested in March 2009, paying EUR 6 per share.

We always say that we are not market timers and prefer to stick to our process: we buy stocks at a discount to intrinsic value, and don't try to guess exactly when they will attain that value. Sometimes this happens sooner rather than later, and we are the first to admit that our investment in Danieli happened to come just as the general market was turning for the better. By October 2009, the shares had reached our target price and were trading at 1.6x book value. We sold our shares at EUR 18. We are confident that as long as we keep disciplined at all times, our process will lead us to more little treasures like Danieli.

Kasper Billy Jacobsen
Lead Portfolio Manager
8 January 2010

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