

## **The Interview - Willem de Vlugt and Charles Estourgie, EValuation Capital: “The rally this year has made investors wary of possible corrections ahead”**



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### **GFM: What is the background to your company and fund?**

**WdV/CE:** We founded EValuation Capital Management in 2006 in Amsterdam and the investment team now consists of two fund managers and two analysts. Combined, the founding partners have more than 25 years of experience with companies including Kempen & Co, ABN Amro and Merrill Lynch in Amsterdam and London.

EValuation Capital Management manages the EV Smaller Companies Fund, a long/short equity fund that invests in shares of European ‘under-researched’ companies, mostly smaller companies with a market capitalisation of less than EUR2.5bn with a particular focus on the Benelux countries and Germany.

The fund aims to make positive returns regardless of market conditions targets an average return in the medium term (three to five years) of 15 per cent per annum. Within the investment process, a lot of emphasis is put on company visits (about 150 a year) and management contact. The fund manager is looking for companies whose under- or over-valuation we expect to be neutralised within 12 months. The fund runs a concentrated portfolio of between 15 and 30 companies.

The EV Smaller Companies Fund has generated a return since launch in May 2006 of 32 per cent, compared with a decline of 32 per cent in the MSCI Europe Small Cap Index over the same period. The fund is open-ended, not listed and has assets under management exceeding USD55m.

### **GFM: Who are your key service providers?**

**WdV/CE:** Our auditor is Deloitte Accountants, the fund administrator is Fastnet Netherlands and the custodian is Kas Bank.

**GFM: How and where do you distribute the funds? What is the profile of your current client base?**

**WdV/CE:** We have no distribution arrangements; most of our clients have been referred to the fund. Our client base is made up of family offices, high net worth individuals and several smaller institutions. The assets under management are split between 30 per cent institutional and 70 per cent private clients.

**GFM: How would you assess the impact of the recent global financial crisis and economic downturn on your business?**

**WdV/CE:** The global financial crisis had an impact on the performance of the fund as stock markets corrected heavily in 2008, but we feel the fund has lived up to its expectations in terms of risk profile and performance.

Whereas many stock markets more than halved in 2008, the fund managed to limit losses to 12 per cent. Since launch the fund's correlation to the equity markets in positive months has been 70 per cent, while in negative months it has been 30 per cent. We believe we have found a good balance between capital growth and capital preservation. Moreover, the fund has seen no redemptions.

**GFM: What is your investment process?**

**WdV/CE:** The starting point in the investment process is the development of an investment idea, which is followed by a viability study. We conduct our own fundamental company research with particular focus on the business model, prospects for the company, quality and vision of the management and analysis of the external business environment.

We look for confirmation of the under- or over-valuation using own financial models. The identification of possible events that might lead to the disappearance or reduction of the under- or over-valuation within 12 months is an integral part of the investment process, hence the emphasis placed on company visits and management contact.

**GFM: How do you generate ideas for your funds?**

**WdV/CE:** Ideas are generated by us, brokers, research reports, meetings and quant screening exercises.

**GFM: What is your approach to managing risk?**

**WdV/CE:** We put a lot of emphasis on risk management. The fund will only invest in European stock market-quoted companies, and a long or short position in a particular company will amount to no more than 15 per cent of the fund's portfolio. The fund will not own more than 5 per cent of the outstanding shares of any one company.

Each investment's performance is tracked not only on an absolute level but relative to the MSCI Europe Small Cap Index. Should an investment show a 25 per cent relative underperformance then a 'forced exit' takes place and the position is divested, preventing us becoming fixated with an investment at all cost.

We pay close attention to the liquidity of the portfolio. The average market capitalisation of the companies in the portfolio is approximately EUR500m and the portfolio can, if necessary, be liquidated within days.

These restrictions prevent any single position from having an above-average negative impact on the return of the portfolio. Strict risk management in combination with a well-balanced focus on capital growth and capital preservation meant that in 2008, the worst year for equities since the 1930s, the

fund managed to limit losses considerably.

The fund is managed on its net market exposure, which in practice varies between 0 per cent and 70 per cent. During favourable markets the emphasis is on capital growth and the net exposure is increased to allow the fund to participate in the upside with an acceptable risk profile. During unfavourable markets, the focus is on capital preservation and the net exposure is reduced through the addition of short positions. As a result, the fund's net asset value has experienced less volatility.

**GFM: How has your recent performance compared with your expectations and track record?**

**WdV/CE:** The fund's performance has lived up to expectations. In 2008 the fund posted a decline of 12 per cent return as many stock market indices plummeted, and it was up 31.7 per cent over the first 11 months of 2009. Since launch in May 2006) the fund has generated a return of 32 per cent with an average net exposure of 50 per cent.

**GFM: What opportunities are you looking at right now?**

**WdV/CE:** In 2009 stock market performance was driven by high-beta cyclical stocks with in particular balance sheet issues. We believe in a more normal stock market going forward as the gradual recovery continues, albeit with ups and downs, that is increasingly more driven by fundamental factors, creating a more favourable stock-picking environment. We see ample attractively-valued companies with good management, strong balance sheets and excellent market positions, which will emerge stronger from the current crisis.

**GFM: What events do you expect to see in your sector in the year ahead?**

**WdV/CE:** We believe there will be increased M&A activity in the small and mid-cap sector, which in fact has already started.

**GFM: How will these developments affect your own portfolio?**

**WdV/CE:** Our core long portfolio consists of companies that we believe are undervalued, have good management and are in good shape, and that will emerge stronger from the crisis. The investment cases contain clear triggers for share price performance and several companies are also potential takeover targets.

**GFM: How do you assess investors' current expectations?**

**WdV/CE:** Investors have clearly become more realistic on what to expect from hedge funds. We aim for an average 15 per cent annual return over the medium term. Over the past two years we realised an average annual return of 10 per cent, which is somewhat below target, but still managed to please our investors, especially during the extraordinary events of 2008.

**GFM: What differentiates you from other managers in your sector?**

**WdV/CE:** Our approach and background differs from those of other managers. It is important to be very familiar with the companies in one's universe, their history, management and business model. Therefore our geographical focus is limited to companies from the Benelux countries and Germany, rather than chasing opportunities across the whole of Europe.

This also explains our emphasis on company visits and management contact, resulting in a concentrated and actively managed long/short portfolio. We believe that our background as sell-side analysts is another positive differentiating element.

**GFM: How do you view the environment for fundraising over the coming 12 months?**

**WdV/CE:** We see the environment as favourable in particular for long/short funds. The rally this year has made investors wary of possible corrections ahead. The fund managed to limit losses in 2008

and performed very well last year.

We believe the fund has a good proposition to investors and with our three-and-a-half year track record, we see the current environment as favourable. In general terms, in spite of the complaints that hedge funds did not deliver in 2008, our performance was well ahead of long-only funds. The fund is currently enjoying good inflows.

- [Equity Long Short](#)

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