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INVESTMENT NOTE **30 MARCH 2015**

HERMES: FIVE UNDER-THE-RADAR EUROPEAN GROWTH GEMS

Martin Todd, Co-Manager of Hermes Sourcecap European Alpha, chooses five of his favourite stocks for long-term growth in 'triple zero' Europe.

European equities have been in the sweet spot so far in 2015, with the asset class supported by a number of tailwinds – such as the falling euro, lower oil price and the implementation of QE.

What we are seeing at company level is positive, with 55% of companies so far meeting or beating forecasts during the current European earnings season. However, in this 'triple-zero' economy we have in the eurozone – zero growth, zero rates and zero inflation – growth is a scarce asset and companies able to deliver it should command a much higher premium.

In this environment, we prefer structural growth plays and those companies taking destiny into their own hands through restructuring. While many eyes are on Europe's household names, we believe there are a number of under-the-radar stocks showing strong long-term growth potential.

Aena
Aena owns and operates most of the airports in Spain, in addition to some in Mexico and Latin America. This industry has huge barriers to entry – it is neither easy nor cheap to build a competing airport. It effectively has a monopoly on Spanish air travel, which is a business growing at a rate of around 2.5x GDP historically.

At the same time, macro tailwinds are augmenting the underlying structural investment case for Aena. There is potential for the Spanish economy to pick up further in the near future, which bodes well for Spain's tourism industry – which is the third-largest globally. Falling oil prices have also made it cheaper for airlines to operate, which should filter through to consumers and boost the appeal of air travel.

Aryzta
Aryzta is the world's largest speciality baker – supplying to the likes of MacDonald's, Starbucks and Subway. Not relying on a branded model to drive profitability, it instead operates in a contracted 'cost-plus' world. As global multinationals get bigger, these companies increasingly rely on a smaller number of suppliers able to provide products to the specifications needed. Aryzta is one of the few companies capable of delivering the quality, quantity and consistency the larger chains demand, meaning it is entrenched in the supply chain.

This company is what we refer to as a true consumer staple, offering stable underlying growth. The strong cash-flow generation is used to acquire smaller 'mom-and-pop bakeries', which boosts the top line. Management has an excellent track record of acquiring contracts by consolidating smaller bakeries and improving operating efficiency, and at less than 14x P/E the shares represent good value.

Wirecard
Though not yet a household name, German electronic payment processing service Wirecard is the preeminent operator across the entire value chain of e-product and mobile payments in

Europe. While safety is one of the main inhibitors to retailers and consumers in the online and mobile payment world, Wirecard has the sophisticated fraud prevention tools and security software needed to differentiate the company from competitors.

The company is already expanding beyond Europe into Southeast Asia, where e-commerce is exploding, and may look to the US. Wirecard has a profitable and leverageable business model, as every additional customer is incremental profit on a per-transaction basis. As a result, there is potential for double-digit revenue growth on a very scalable platform.

Gamesa
We have not been interested in renewables in the past, due to intensive capital costs and heavy reliance on government subsidies. However, wind energy has effectively achieved parity with conventional energy sources over the last few years. Spanish group Gamesa, which is seeing strong demand from Brazil and India, is consistently winning contracts and generating attractive revenues. Gamesa trades on a forward P/E of 15x, with just below 20% earnings growth. While it has suffered from indiscriminate selling due to falling energy prices and Spanish economic weakness, we still see strong upside.

Telecom Italia
Several European countries have already seen mobile consolidation – including the UK, Germany, Netherlands, Ireland and Austria. The Italian market is made up of four operators, with the smaller two significantly lagging the leaders and remaining unprofitable. A combination of these two would result in a rational three-player market, where all participants would be profitable. This deal makes a lot of sense and Telecom Italia would be the biggest beneficiary of it.

We invest via the saver shares for additional value. The savers have the same economic value as the ordinary shares but don't carry a vote. As a result they trade at a 20% discount to the ordinary shares and only 13x P/E on current market forecasts.

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Notes to Editors:

Hermes Investment Management
Hermes is focused on delivering superior, sustainable, risk adjusted returns for our clients – responsibly.

Hermes manages assets on behalf of more than 200 clients* across equities, fixed income, alternatives and real estate, with £28.6 billion* assets under management. In Hermes EOS, we have the industry's leading engagement resource, advising on more than £134.0 billion* of assets.

We believe in **Excellence**, **Responsibility** and **Innovation**

- **Excellence:** We aspire to excellence in everything we do. This manifests itself most visibly in our investment performance. We will only offer products to our clients where we believe there is a strong investment thesis and where we can deliver sustainable alpha.

- **Responsibility:** We believe it is our responsibility to lead discussion and debate about the fiduciary responsibilities of fund managers to our clients, their stakeholders and, ultimately, society at large. We have always sought positive engagement with the firms in which we invest.

- **Innovation**: We have the entrepreneurial culture to identify forward-looking products that meet those needs, along with the resources and speed-to-market mentality to develop them rapidly.

Our structure gives clients globally the benefit of access to a broad range of specialist, high conviction investment teams operating within an established and robust operating platform.

Hermes' investment solutions include:

- **Equities**: Global, Emerging Markets, Small & Mid Cap, Europe, Asia Ex Japan, Greater China
- **Fixed Income**: Inflation-Linked, Government Bonds, Investment Grade, High Yield
- **Real Estate**: Segregated, Unitised, Debt, UK, US Residential, European, UK PRS
- **Alternatives**: Multi Asset, Infrastructure, Private Equity

*Please note the total AuM figure includes £3.7bn of assets managed or under an advisory agreement by Hermes GPE LLP ("HGPE"), a joint venture between Hermes Fund Managers ("HFM") and GPE Partner Limited. HGPE is an independent entity and not part of the Hermes group. £0.4bn of total group AuM figure represents HFM mandates under advice. Source: Hermes as at 31 December 2014.