

# Italian Mid/Small Caps Monthly

## Attractive Valuations But Rotation Likely to Be Gradual

by Intermonte Research Team

Italian Equity Market

- **Performance (+).** The Italian equity market (prices as at 15 April 2024) has posted a positive 0.1% performance in the last month and is up 11.2% YtD. The FTSE Italy Mid-Cap index (-0.1%) has underperformed the main index by 0.2% in the last month (-5.8% YtD on a relative basis), with the FTSE Italy Small Caps index (+2.7%) performing 2.6% above the market, but still -13.5% on a relative basis since the beginning of 2024. The recent announcement of voluntary tender offers on two stocks supported the Small Cap index performance.
- **Estimates (=).** Since the beginning of 2024, we have implemented a +1.7%/+0.3% revision to our 2024/2025 EPS estimates; however, focusing on our mid/small cap coverage, we have reduced our 2024/2025 EPS by -1.0%/-1.4%. Notably, the large cap estimate revision has been positive in the last month (+1.0%/+0.5% on 2024/25 EPS) while the same metrics remained almost unchanged for our mid/small cap coverage (+0.5%/+0.1%).
- **Valuations (+).** If we compare performance YtD to the change in FY24 estimates over the same period, we see that FTSE MIB stocks have recorded a 10.0% re-rating YtD (the same metric was +11.0% one month ago); mid-caps have re-rated by 5.8%, while small caps have re-rated by 7.3%. On a P/E basis, our panel is trading at a 27% premium to large caps, above the historical average premium (17%) but slightly below the level one month ago (30%).
- **Liquidity (+).** Looking at official Italian index trends, we note that liquidity for large caps in the last month (measured by multiplying average volumes by average prices in a specific period) is 26.1% higher than in the corresponding period one year ago and is up 13.7% from a YtD perspective. The picture is similar for mid/small caps: specifically, YtD liquidity is up 19.8% YoY for mid-caps and 8.2% for small caps. Notably, liquidity has particularly improved in the last month, up 45% YoY.
- **Investment strategy.** Policymakers are trying to strike a delicate balance as they contemplate how to respond to the economic situation. Central bankers want to avoid cutting borrowing costs too early or too much, which could prod the economy to re-accelerate and inflation to take even firmer root. In this scenario, amid increasing global tensions, large caps are likely to remain more favoured compared to mid/small caps, but we still think a rotation from value to growth should start in June. Having said that, we continue to recommend keeping a selective approach on mid/small cap portfolios with a focus on quality stocks. Exposure to the USA, which is proving very resilient, or attractive investment themes (infra, defence, digitalization) in the current uncertain scenario could be a plus. Italian stocks are on the verge of distributing ~€30bn in dividends in the coming months and part of this liquidity could be diverted towards mid/small caps, although the competition from government bonds remains high with a new, unexpected issuance of BTP Valore taking place in early May, draining retail assets further.
- **Changes to our recommended portfolio.** Looking at our mid-cap portfolio, we are implementing no changes to our selection. Among small caps, we are taking out Civitanavi Systems (Honeywell launched a voluntary tender offer at Eu6.3 per share on March 27<sup>th</sup>) while we are adding Unidata (attractive entry point after a recent weak share performance). **Our top calls for the current month are** Reply, Media For Europe and Mondadori among mid-caps and Txt E-Solutions and Omer among small caps.

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- Comparison with market peers, using the most appropriate methods for the individual company analysed: among the main ratios used for industrial sectors are price/ earnings (P/E), EV/EBITDA, EV/EBIT, price /sales.
- Return on capital and multiples of adjusted net book value are the main methods used for banking sector stocks, while for insurance sector stocks return on allocated capital and multiples on net book value and embedded portfolio value are used
- For the utilities sector comparisons are made between expected returns and the return on the regulatory asset base (RAB)

Some of the parameters used in evaluations, such as the risk-free rate and risk premium, are the same for all companies covered, and are updated to reflect market conditions. Currently a risk-free rate of 4.0% and a risk premium of 5.5% are being used.

Frequency of research: quarterly.

Reports on all companies listed on the S&PMB40 Index, most of those on the MIBEX Index and the main small caps (regular coverage) are published at least once per quarter to comment on results and important newsflow.

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BUY: stock expected to outperform the market by over 25% over a 12 month period;

OUTPERFORM: stock expected to outperform the market by between 10% and 25% over a 12 month period;

NEUTRAL: stock performance expected at between +10% and -10% compared to the market over a 12 month period;

UNDERPERFORM: stock expected to underperform the market by between -10% and -25% over a 12 month period;

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Prices: The prices reported in the research refer to the price at the close of the previous day of trading

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OUTPERFORM:	46.22 %
NEUTRAL:	27.73 %
UNDERPERFORM	00.84 %
SELL:	00.00 %

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