

Ennismore European Smaller Companies Fund

Investor Newsletter for the month of September 2018

Issued on 4 October 2018

Fund Details

Daily dealing UCITS and Irish Central Bank regulated open-ended investment company with Financial Conduct Authority recognition and registered in Ireland. The Fund size was GBP 390m as at 28th September. Total assets under management by Ennismore Fund Management were GBP 688m. Our funds are hard closed to new investment with the number of shares in issue capped and we have a waiting list of clients that want to invest as and when capacity becomes available through redemptions. If you would like to be included on this please call Eleanor Scott on +44 (0) 20 7368 4219 or email subs@ennismorefunds.com. Redemptions can be made through the Administrator in the usual way.

The Fund is managed as an absolute return fund with the objective of generating positive returns irrespective of market conditions rather than performing relative to any benchmark index. Index data is provided in the following table as a guide to general equity market conditions.

Performance as at 28 September 2018

	Share Class ²					HSBC Index ³		MSCI Index ⁴
	GBP A £	GBP A €	GBP B	EUR A	EUR B	GBP	EUR	(local)
NAV per Share¹	130.94	147.01	22.12	21.19	21.26			
Period	% Change					% Change		
September 18	0.3	0.8	0.3	0.7	0.7	-1.8	-1.2	0.3
August 18	1.1	0.8	1.1	0.8	0.8	0.1	-0.3	-2.4
July 18	0.3	-0.6	0.3	-0.4	-0.4	2.1	1.3	3.3
June 18	2.0	1.2	2.0	1.1	1.2	-0.4	-1.1	-0.3
May 18	0.9	0.9	0.9	1.0	0.9	1.8	1.9	-0.5
April 18	0.7	0.6	0.7	0.6	0.6	3.7	3.7	4.9
March 18	0.0	1.0	0.0	1.0	1.0	-2.6	-1.9	-1.9
February 18	-0.8	-1.8	-0.8	-1.8	-1.8	-2.0	-3.2	-3.5
January 18	-2.0	-0.7	-2.0	-0.7	-0.7	0.5	2.0	1.1
2018 to date	2.5	2.2	2.5	2.2	2.3	1.3	1.1	0.7
Annualised return⁵	14.1	12.7	10.9	10.3	10.3	10.1	8.7	4.2
Since launch⁵	1234.1	943.9	121.2	111.9	112.6	558.4	413.5	126.5
	Discrete 12 Month Rolling Performance - % Change							
To 30 September 18	4.3	3.2	4.3	3.3	3.4	3.7	2.7	2.0
To 30 September 17	8.9	6.9	8.9	7.4	7.4	23.0	20.8	17.7
To 30 September 16	18.9	1.3	18.9	4.4	4.4	24.5	6.3	7.0
To 30 September 15	7.3	13.5	7.3	12.2	12.2	8.1	13.9	-0.3
To 30 September 14	11.8	19.9	11.8	18.6	18.5	5.2	13.0	10.9

¹Source: Administrator, Net Asset Value. ²Source: Administrator, Net Asset Value, net income reinvested. ³Source: Bloomberg, Euromoney (formerly HSBC) Smaller European Total Return Index. ⁴Source: Bloomberg, MSCI Europe Index, local currencies, total return. ⁵Since inception of GBP A share class on 27/01/99 to date, GBP B share class on 19/01/11 to date, EUR A and EUR B share classes on 31/01/11 to date. Note: All performance figures net of fees. Past performance is not a guide to future returns.

Comments below on performance refer to GBP NAV per share unless otherwise stated, exclude cash returns and are prior to expenses.

The Fund's NAV increased by 0.3% in September. Our long book cost 1.7% while the Fund's short exposure contributed 2.3%. Our short position in a UK semiconductor company was the largest contributor in the month adding 0.4%. The biggest detractor was JD Sports which cost 0.8% despite good half-year results. In addition, Cegedim and our short position in a European food services company both cost 0.4%.

METRO - German wholesale retailer (3.2% NAV)

METRO is a wholesale retailer which started its cash & carry business in Germany back in 1964. Today, METRO is active in 25 countries with revenues of around EUR 37bn and earnings before interest, tax, depreciation and amortisation of EUR 1.6bn. Unfortunately, the huge success in its first three decades somewhat masked the inefficiencies created by the original complex corporate structure, resulting in the company being ignorant to the need for major structural change. It was only in 2012 when the new CEO Olaf Koch took over, that significant steps commenced to reverse this by focussing on the core business. Developments in the shareholder structure may prove to be an important catalyst, with Czech billionaire Daniel Křetínský and his partner Patrik Tkáč recently acquiring 10.9% and holding options on a further 20.6% of the share capital following an agreement with Ceconomy and Haniel. We were initially drawn to the investment idea after the 2017 spin-off of the electronic retailer chains Media Markt and Saturn, which allowed METRO to deconsolidate EUR 22bn of revenues in a much-challenged space with high price transparency and strong online penetration. The spin-off enabled the company to focus on its wholesale business with its attractive customer base of hotels, restaurants and caterers. This, in combination with the underlying property portfolio and 4% dividend yield, led us to build an initial position last year. Unfortunately, we were negatively surprised by the Russian business which has been witnessing an escalating price war among the key grocery retail chains. This, together with the failed negotiations with the unions in Germany to lower the historically high personnel costs at its food retailer Real, brought the share price down to a level we thought provided enough margin of safety to make it one of our largest positions in the fund. After years of delay, we

think that METRO's turnaround has begun. We believe the business can be transformed to a pure play wholesale food service provider without injecting additional cash, thanks to the strong asset backing of its owned property portfolio. We feel that Mr Koch, who was at private equity firm Permira, is set well for this transformation but could still do more if the company is taken private, enabling him to accelerate actions that may not prove popular with short-term equity investors. We believe METRO's portfolio includes both bad and good operating assets. Real, the German hypermarket chain, has been deemed unsaleable by some market participants, with revenues of EUR 7.2bn. Given the very concentrated nature of the German grocery market, we think it might appeal to a player like Amazon if it decides to enter this space. METRO's Benelux business is also a problem child with EUR 1.9bn of revenues and a negative operating profit, but we think a divestment is not unlikely. Looking at the more attractive assets, we like the French business where METRO is the market leader and achieves one of the highest margins within the group, although all properties are leased. We think it could fetch a valuation more in line with pure play companies Sligro and Marr, of circa EUR 3bn. The Russian business is an interesting asset given all locations are owned with many in the Moscow and St. Petersburg area. Finally, in China, where METRO still owns 50% of their locations, urbanisation trends play into its hands. From a valuation perspective, we think the current share price reflects the fair value of the underlying properties only, in other words, the operating business comes for free. We think there are more businesses like the French one that are sustainable even leasing 100% of their locations. Given METRO never re-valued its properties, we see the book value adjusted for depreciation of EUR 9.2bn as a conservative measure for fair value. Deducting finance lease properties of EUR 0.8bn and net debt of EUR 3.1bn leaves a net asset value of EUR 5.3bn, compared to a current market capitalisation of EUR 5bn. Based on last full year results, METRO trades on an undemanding ten times enterprise value to operating profit and should not deviate much from its current year results. With the new shareholders on board and the timeframe imposed by their option structure, we think there is more than 30% upside in the next 12 months.

Top Five Long Holdings as at 28 September 2018

Company	Country	Sector	% of NAV
1 Jd Sports	United Kingdom	Consumer Discretionary	7.3
2 Costain	United Kingdom	Industrials	4.1
3 METRO	Germany	Consumer Staples	3.2
4 Renk	Germany	Consumer Discretionary	2.9
5 Tracsis	United Kingdom	Information Technology	2.9
			20.4

Exposures as at 28 September 2018

Longs %	Shorts %	Gross Exposure %	Net Exposure %
77.3 (78.0)	45.8 (49.7)	123.1 (127.7)	31.5 (28.3)

Figures in brackets refer to previous month end.

Exposures by Country, Market Cap & Sector as % NAV and Positions as at 28 September 2018

Country	Gross%	Net%	Market Cap	Gross%	Net%	Sector	Gross%	Net%
Australia	0.9	0.7	>£2bn	37.3	10.2	Consumer Discretionary	35.8	12.9
Austria	3.1	0.3	£700m - £2bn	18.0	-14.7	Consumer Staples	5.5	4.2
Belgium	1.3	0.6	£200m - £700m	50.0	21.8	Energy	0.0	0.0
France	5.2	1.7	<£200m	17.8	14.2	Financials	10.4	1.7
Germany	30.4	10.7				Health Care	6.2	0.7
Hong Kong	1.3	-1.3				Industrials	22.1	9.0
Italy	4.2	2.7				Information Technology	28.3	-5.4
Luxembourg	1.7	1.7				Materials	4.1	3.2
Netherlands	1.6	0.8				Real Estate	8.0	3.6
Norway	6.0	6.0				Telecommunication	2.7	1.6
Sweden	1.7	-0.3				Utilities	0.0	0.0
Switzerland	5.9	-5.9				Other	0.0	0.0
UK	49.3	17.3						
US	7.5	-3.0						
Other	3.0	-0.5						

Geographic analysis relates to country of incorporation or listing. This may not represent the underlying economic exposure of the operating business.

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