Ennismore European Smaller Companies Fund

Investor Newsletter for the month of June 2023

Issued on 6 July 2023

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 292m as at 30th June. Total assets under management by Ennismore Fund Management were GBP 467m. The Fund continues to limit capacity by capping the maximum number of units in issue, there is currently a small amount of capacity available due to the natural rate of investor turnover. If you would like to invest please contact Adam Sullivan on +44 (0) 20 7368 4224 or email subs@ennismorefunds.com. 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.

Performance as at 30 June 2023

	Share Class[1]				
	GBP A £	**GBP A €**	**GBP B**	**EUR A**	**EUR B**
NAV per Share[2]	152.71	177.95	25.81	25.57	25.69
	% Change				
June 23	-2.6	-2.3	-2.6	-2.3	-2.4
2023 to date	-5.9	-2.7	-5.9	-2.7	-2.7
Annualised return[3]	11.9	10.9	7.9	7.9	7.9
Since launch[3]	1455.9	1163.6	158.1	155.7	156.9

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 decreased by 2.6% in June. The long book contributed 0.1% while the short book cost 2.6% of NAV.

There was no news flow on many of our largest detractors, including the biggest whose share price rose over 40% costing us 0.7%. The Swiss online short position cost us 0.5% as the stock reacted to the expectation that government regulations may be getting closer to helping their business. tinyBuild, a small UK listed game developer we had in the fund cost us 0.4% after it fell heavily post an extremely disappointing profit warning. Clearly, although the company does have a big pipeline of future games and a net cash balance, the position is highly likely to lead to a permanent loss in capital.

Overall, June was a quieter month news flow wise for the fund. Novem Group reported solid 1st quarter numbers and then backed that up with a generous dividend pay out for the previous financial year giving it a yield of over 11%, the stock reacted positively up 15% in the month contributing 0.3%. Cakebox reported numbers in line with expectations and they seem to have good momentum going into the next financial year. SThree also gave a solid half year trading update, given the slowdown in the labour market, with net fees down 2%. Our long position in SoftwareOne contributed 0.3% as the company received an indicative non-binding offer from Bain Capital at CHF 18.5 per share.

Performance in the month was disappointing as it has been for the first half of the year overall. Year to date the poor negative performance has been due to the short book with negative 5.3% of contribution. There have undoubtedly been errors in the short book but although the market doesn't agree right now, we believe there is significant overvaluation in many of our short positions versus their sustainable earnings potential. On the contrary our long book we feel has many unsustainably low valuations especially in our UK listed holdings which seem to be particularly cheap.

[1]Source: Administrator, Net Asset Value, net income reinvested.
[2]Source: Administrator, Net Asset Value.
[3]Since 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.

Top Five Contributors and Detractors for June 2023

Contributors	MTD (bp)
SoftwareONE Holding AG	32
Novem Group SA	29
UK building products distributor	27
Swedish software company	26
Mobilezone Holding AG	24

Detractors	MTD (bp)
US listed Chinese aerospace company	-67
US listed Chinese education company	-49
Swiss online retailer	-49
STO SE & Co KGaA	-45
tinyBuild LLC	-38

Top Five Long Holdings as at 30 June 2023

Company	Country	Sector	% of NAV
STO SE & Co KGaA	Germany	Materials	4.3
Vossloh AG	Germany	Industrials	3.6
IG Group Holdings Plc	United Kingdom	Financials	3.4
EVS Broadcast Equipment SA	Belgium	Information Technology	3.4
Mobilezone Holding AG	Switzerland	Consumer Discretionary	3.1
			17.7

Exposures as at 30 June 2023

Longs%	Shorts%	Gross Exposure%	Net Exposure%
87.1 (87.3)	49.7 (49.5)	136.8 (136.8)	37.4 (37.7)

Figures in brackets refer to previous month end. All exposures are calculated on a delta adjusted basis. All calculations are subject to the impact of rounding.

Exposures by Country, Market Cap & Sector as % NAV and Positions as at 30 June 2023

Country	Gross%	Net%
United Kingdom	42.1	22.4
Germany	34.8	20.3
Switzerland	12.7	-0.6
Sweden	12.1	-5.4
Italy	7.6	0.9
United States	7.6	-6.4
France	4.5	3.3
Belgium	3.4	3.4
Norway	3.2	-1.5
Austria	2.9	1.2
Netherlands	1.5	0.9
Portugal	1.1	1.1
Finland	1.0	-1.0
Spain	1.0	0.3
Other	1.5	-1.5

Market Cap	Gross%	Net%
>£2bn	31.2	-3.6
£700m-£2bn	39.2	10.2
£200m-£700m	46.9	17.1
<£200m	19.4	13.7

Positions	Jun	May
Long	71	78
Short	79	89
Longs Opened	1	2
Longs Closed	8	2
Shorts Opened	5	8
Shorts Closed	15	7

Sector	Gross%	Net%
Communication Services	5.3	-2.7
Consumer Discretionary	33.4	10.0
Consumer Staples	4.5	-2.3
Energy	0.0	0.0
Financials	11.1	11.1
Health Care	3.6	1.1
Industrials	34.8	8.1
Information Technology	25.6	-1.5
Materials	13.1	8.3
Real Estate	5.3	5.3
Utilities	0.0	0.0
Other	0.0	0.0

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

Morgan Advanced Materials Plc – UK industrial manufacturing company (1.9% of NAV)

Morgan Advanced Materials Plc (MAM) is a GBP 780m market capitalised UK business, founded in 1856, which sells material, components and systems globally across many industries and end markets. We think the company offers a resilient cash and earnings profile partly due to circa half of revenue being exposed to consumable-like products alongside many strong market positions. The business generates solid double digit post-tax returns on invested capital and operating margins with fundamentally strong cash generation. We believe the stock is trading on an extremely low valuation for a business of its quality.

MAM has five product segments totalling GBP 1.1bn of sales in 2022: Ceramics, Thermal and Technical, account for almost two-thirds of revenue (38% and 27% respectively). The rest consists of Electrical Carbon (17%), Seals & Bearings (13%) and Molten Metal Systems (5%). All segments showed strong profit growth in 2022 except Seals & Bearings. Overall profits grew organically at constant currency by around 15%. All segments have double digit operating margins.

MAM has many strong market positions across its business segments. It's the No.1 player in Thermal Ceramics with a 25% global share ex China (which have lower quality suppliers and local demand). In Technical Ceramics they are exposed to many sectors so market shares can range from 5% to 40% in small niches. In Electrical Carbon and Seals & Bearings they have the same peers with MAM being one of 4 global sensible competitors sharing 60% of the market. Finally, they are No.1 in Molten Metal Systems with 25% of the global market.

As mentioned around 50% of revenues are in products which need replacing regularly, such as carbon and ceramic components. The replacement period can range from less than a year to every few years, overall, this leads to a strong base of demand for MAM's products. The relatively mild constant currency organic fall of 11% in 2020 followed by this snapping back up 10% in 2021 would seem to be testament to this resilience.

Due to its wide range of end markets MAM has very low customer concentration (largest is 2%), helped by the fact 80% of sales are direct with only 20% via distributors. The company has done well in increasing operating margins in 2022 to 13%, based on our calculations, more than covering cost inflationary pressures mainly via price increases but also efficiency gains. This would seem to indicate good pricing power.

The business generated circa 16% post-tax return on invested capital last year. Over 25% of invested capital is intangibles linked to prior acquisitions so return on capital employed sits higher. Trade working capital sits at around 16% of revenues, and we wouldn't expect this to change much given the inventory needed for their range of products and customers.

In January 2023 MAM's IT systems were maliciously compromised leading to a need for external help to contain and remedy the situation. This also temporarily affected the operational efficiency of the business. Overall, we think this will impact stated operating profits by around GBP 35m this year. The one silver lining being that the company is likely to come out of this with a stronger cyber-secured IT environment.

Over the past 5 years there has been cumulatively zero organic growth as the management have been more focussed on the operational efficiency of the company, profits have grown by over 20%, putting them in a stronger stance for growth in the future. Going forward, although 80% of revenue is to the core sectors in the economy such as industrial, metals and petrochemical, MAM also has 20% exposure to faster growth areas such as semiconductors and healthcare so overall we expect the company to grow at a rate stronger than the economic cycle in the medium term, around 5% per annum. Clearly management needs to prove the company can structurally grow through the cycle while maintaining operating margins. In the first half sales were up 2% although this was held back by lost revenue from the cybersecurity incident. The company still expects growth of 2-4% for the year.

In the last 5 years net bank debt has fallen by GBP 33m to GBP 148m after cumulative dividends of circa GBP 120m. However, they have also made circa GBP 160m of deficit pension payments, including a lump sum of GBP 67m in 2022, on top of the regular GBP 17m deficit payment. This implies over GBP 60m per annum of cash generation. This pension cash drain now looks to be permanently solved with minimal deficit payments expected going forward, a material positive for free cash flow generation. However, over the next two years cash generation will be held back by a step up in capex as well as the cybersecurity incident of 2023. The step up in capex is much to do with increasing capacity and all capex is done on the basis of hitting a pre-tax return on investment of close to 20%, so we see this as a positive. In 2024 we expect cash generation of circa GBP 40m.

Overall debt levels are comfortable, especially given the business's relative stability, sitting at the low end of their targeted range. Around 40% of debt at year end is exposed to interest rate movements on our calculation. We think that given this low financial leverage they can support the current dividend yield of more than 4% while having more options via bolt on acquisitions or buying out minority interests. We are pleased to see management's incentive plans include return on invested capital with regards to the risk of overpaying for acquisitions, as well as their reticence to increase leverage with the current economic uncertainties.

MAM's CEO, Peter Raby, has been in place since 2015 and since then he has done a good job in rationalising the business to enhance profitability as well as increasing focus on higher growth market segments. The next chapter will be more focussed on growth in our opinion.

Overall, Morgan Advanced Material is a business which we feel now has a much better platform for organic growth, with lower financial leverage and no pension cash drain. This isn't being appreciated by the stock market with the company trading on around 9.5 times enterprise value to after-tax operating profit adjusted for minority interests (around 10% of earnings). Given the strong resilience and good return on invested capital, we think we are conservative putting the stock on 12.5 times which gives upside of over 40% to the end of 2024.

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Historical Monthly Percentage Return for the GBP A Shares

Year	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD
2023	-2.8	-0.1	-0.4	2.9	-3.0	-2.6							**-5.9**
2022	1.1	-2.6	0.2	1.4	-0.9	0.7	-3.1	1.9	-1.2	2.2	3.0	1.0	**3.7**
2021	-5.2	1.7	4.5	4.7	3.4	1.0	2.8	0.7	-0.1	-1.8	1.8	1.5	**15.8**
2020	-2.4	-2.8	-5.7	-0.8	-1.6	4.0	-3.8	-2.5	0.8	-3.1	9.6	4.5	**-4.8**
2019	1.4	-0.2	1.5	0.7	2.2	-0.7	0.6	0.6	0.6	0.2	-1.4	1.2	**6.9**
2018	-2.0	-0.8	0.0	0.7	0.9	2.0	0.3	1.1	0.3	-1.0	2.3	0.2	**4.0**
2017	1.2	-0.2	0.9	1.0	2.2	-0.6	2.7	1.5	-1.2	-1.2	0.4	2.6	**9.6**
2016	2.2	2.8	0.9	0.4	-1.2	2.3	1.3	2.3	1.6	1.9	-2.7	1.9	**14.5**
2015	-0.7	-3.1	0.0	2.2	2.2	0.8	1.9	0.8	0.5	0.5	0.7	3.8	**9.7**
2014	1.1	0.5	2.9	1.5	-1.4	-2.0	0.2	1.1	-0.2	0.8	2.0	-0.2	**6.4**
2013	6.5	2.7	1.5	-0.9	1.8	-0.9	2.8	1.2	1.6	4.2	1.2	2.3	**26.6**
2012	0.5	2.8	0.0	-1.4	-1.9	1.6	-2.0	2.5	-0.1	2.9	2.6	0.7	**8.4**
2011	2.9	0.5	5.3	0.5	-0.2	4.4	-0.7	-0.2	-0.2	2.9	-4.0	-1.4	**9.8**
2010	0.9	3.0	2.0	1.0	-1.6	-0.3	2.4	-1.5	3.4	2.3	-0.4	6.0	**18.4**
2009	-3.7	-1.6	-2.1	-6.5	4.0	-2.5	0.3	4.5	7.0	-1.1	2.0	-0.9	**-1.6**
2008	-1.4	3.4	0.1	1.8	-0.5	-2.9	-0.2	1.5	-8.5	-7.6	2.1	7.5	**-5.7**
2007	-2.2	1.3	2.4	2.9	0.5	1.5	0.5	-1.5	1.4	-0.3	-0.9	3.4	**9.1**
2006	4.0	2.3	4.8	4.2	-3.9	-4.0	-0.7	-1.4	-0.8	1.4	1.0	1.7	**8.4**
2005	3.2	4.2	0.4	-2.4	2.1	4.7	6.6	3.2	3.3	-5.2	2.5	4.9	**30.4**
2004	2.8	2.7	-0.5	2.1	-1.5	4.6	-0.9	1.5	1.7	1.9	2.8	4.4	**23.5**
2003	-1.5	2.8	1.4	4.9	4.7	0.0	3.3	1.5	2.2	0.9	2.1	3.8	**29.3**
2002	1.3	2.2	3.2	1.5	2.7	-1.0	-5.3	0.6	-4.1	3.3	2.5	-0.5	**6.2**
2001	2.4	0.7	-7.8	2.2	1.4	-0.7	0.4	1.8	-4.6	0.9	2.7	2.8	**1.5**
2000	11.8	20.7	-0.3	-4.6	2.5	1.8	1.0	0.1	-2.5	-3.0	2.6	3.2	**35.7**
1999	-0.3	1.0	0.8	6.6	1.4	3.3	4.6	1.4	-1.8	2.6	8.6	13.4	**49.0**

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