Ennismore European Smaller Companies Fund

Investor Newsletter for the month of January 2008

Issued on 5 February 2008

Important Notice

The number of shares in the Fund is currently limited to 3.85m. Further investments will only be accepted if shares become available through redemptions. Ennismore Fund Management is keeping a waiting list for investors wishing to subscribe for shares in the event of any redemptions. To be included on this list call Emily Allen on +44 (0) 20 7368 4218. Redemptions can be made through the administrator in the usual way.

Fund Details

Daily dealing UCITS and Irish Financial Services Regulatory Authority regulated open-ended investment company with Financial Services Authority approval, registered in Ireland and listed on the Irish Stock Exchange. The Fund size was GBP 167.3m as at 31st January. 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 31 January 2008

	GBP			EUR			
Period	**Fund NAV[1]**	**Fund NAV[2] % Change**	**HSBC Index[3] % Change**	**Fund NAV[1]**	**Fund NAV[2] % Change**	**HSBC Index[3] % Change**	**MSCI Index[4] % Change**
January 08	**51.93**	**-1.4**	**-11.0**	**69.73**	**-2.8**	**-12.5**	**-11.4**
December 07	52.67	3.4	0.4	71.71	0.5	-2.8	-0.5
November 07	50.96	-0.9	-6.9	71.38	-3.3	-8.8	-3.8
October 07	51.43	-0.3	3.8	73.85	-0.1	3.8	2.9
September 07	51.61	1.4	-0.2	73.94	-1.8	-3.2	1.7
August 07	50.89	-1.5	-3.0	75.30	-1.8	-3.3	-0.5
July 07	51.66	0.5	-1.6	76.69	0.5	-1.5	-3.5
June 07	51.39	1.5	-3.3	76.34	2.6	-2.5	-0.7
Launch (27/01/99)	10.00			14.35			
1999	14.90	49.0	27.2	23.71	65.2	42.1	29.8
2000	20.21	35.7	-3.2	31.84	34.3	-4.7	-2.2
2001	20.52	1.5	-18.3	33.54	5.3	-15.6	-16.4
2002	21.49	6.2	-19.8	32.98	-0.3	-24.7	-29.4
2003	27.65	29.3	48.8	39.25	19.6	37.5	19.8
2004	34.15	23.5	24.6	48.24	22.9	24.4	12.2
2005	44.54	30.4	32.6	64.82	34.4	36.3	24.9
2006	48.28	8.4	30.5	71.66	10.6	33.2	19.1
2007	52.67	9.1	3.1	71.71	0.1	-5.5	6.0
2008 to date	**51.93**	**-1.4**	**-11.0**	**69.73**	**-2.8**	**-12.5**	**-11.4**
Annualised return[5]		**20.3**	**10.1**		**19.4**	**9.2**	**3.9**
Since launch (27/01/99)		**429.1**	**137.7**		**395.1**	**120.7**	**40.9**

Comments below on Performance are prior to expenses, exclude cash returns and refer to £ Sterling unless otherwise stated.

The Fund's NAV decreased by 1.4% in January. The long portfolio cost 9.0% and the short book contributed 8.0%, while the HSBC index fell 11.0%.

Our shorts in the renewable energy sector performed well in January but the most significant contribution came from our short of a games software developer, adding 1.1% to the Fund. This was a longstanding position. Our main concerns were:

- This is a hit-driven industry, comparable to the movie business, which requires significant upfront investment in game development. The company is a relatively small player with limited resources relative to its main competitors and therefore lacks a well diversified portfolio of titles to mitigate this risk. This problem has been exacerbated by the high demands, and even higher consumer expectations, of 'third generation' consoles (Microsoft's Xbox 360, the Nintendo Wii and Sony's PS3), requiring significantly higher spend per game.
- The big hardware success of 2007 was the Wii, which has so far massively outsold the PS3. Because Nintendo is much more vertically integrated than its competitors, with a long history in game development and a very high share of software sales on its platforms, this leaves less room for third party developers than in previous cycles.
- The company is highly dependent on licensed third party intellectual property (IP) – we estimate these titles account for all of its operating cashflow and there is a high risk of these contracts being lost when they expire. Two of the three main licensors have recently invested significantly in in-house game development and the third is in a protracted legal dispute over its contract.

Towards the end of 2007 we significantly increased our position, making it one of our largest shorts, for four main reasons. Firstly, channel checking and industry reviews suggested their own IP titles were performing poorly. Secondly, capitalisation of development costs became increasingly aggressive as the year progressed. Thirdly, a member of the senior management resigned. Finally, significant insider selling resumed at prices well below those where insiders had sold earlier in the year.

In January management announced massive development cost write offs including scrapping two of its most prominent own IP franchises due to poor sales. As a result, the business has generated no operating cashflow over the last four years and is more exposed than ever to its licensed titles. The share price fell 36% on the month. Were it not for a cash pile on the balance sheet we would question whether this company was worth anything at all.

Hellenic Duty Free – Greek duty free retail operator

Hellenic Duty Free's core business is operating travel retail shops. It has the exclusive concession to operate duty free shops in the Greek market for the next 50 years and has locations at all the key airports, ports and border crossings. This is an attractive market for two reasons - a captive audience (particularly in airports, where passengers spend a significant amount of time in departure lounges) and structural growth (the total number of passengers passing through the company's locations has grown by 35% in the last 6 years).

Sales in the core business grew by an average of 10% p.a from 1999 to 2006. 2007 has been a year of transition due to the closure of two fuel stations at the border crossings and the EU accession of Bulgaria and Romania. Approximately 35% of the business at these border crossings was from duty free tobacco sales. Excluding these one-offs, underlying sales growth remained around the 10% historic average and we expect to see continued strong growth driven by increasing passenger traffic and improvements in spend-per-passenger. In addition, we expect an increased focus on costs to drive an improvement in margins and hence a faster growth in profits.

The core business generates a significant amount of cash which management have used to diversify the business away from travel retail, but focussing on complementary activities. We therefore believe the execution risk in their strategy is relatively limited. Links of London, a UK-based branded jewellery retailer, was acquired in 2006 for EUR 60m. The business is currently experiencing like-for-like growth of 25% and looks to be on target to deliver operating profit of more than EUR 6m in 2007. With scope to roll the brand out into Asia in the next few years, the purchase increasingly appears to have been a bargain. Hellenic Duty Free is now in the process of acquiring Elmec Sport, which operates department and factory outlet stores in Greece. Based on initial discussions with management and a recent trip to Greece, we believe that the purchase price is relatively attractive and expect the acquisition to add value to the group as a whole. Importantly, the company owns most of the shops it operates, giving substantial asset-backing to the price paid.

Excluding Elmec Sport, Hellenic Duty Free has a current market cap of EUR 580m and is debt free. We estimate operating profit will be around EUR 70m in 2008, implying the business trades on approximately 11 times net operating profit after tax. Given the strong competitive position and steady growth of the core business and rapid growth of Links, we believe Hellenic Duty Free is substantially undervalued and expect the shares to appreciate by at least 50% in the next 12 - 18 months.

Top Five Holdings as at 31 January 2008

	Company	Country	Sector	% of NAV
1	Trader Media East	Netherlands	Media	8.8
2	Atlantia	Italy	Transport	4.4
3	TGS Nopec	Norway	Services	4.3
4	Sto	Germany	Construction	2.9
5	Eniro	Sweden	Media	2.7
				23.1

Exposures as at 31 January 2008

Longs %	Shorts %	Gross Exposure %	Net Exposure %
89.1 (91.0)	49.8 (50.2)	139.0 (141.2)	39.3 (40.7)

Figures in brackets refer to previous month end.

Exposures by Country, Market Cap and Sector as % NAV as at 31 January 2008

Country	Gross%	Net%
Austria	1.7	-1.7
Denmark	3.2	-1.0
Finland	2.2	-2.2
France	3.4	2.2
Germany	18.3	6.2
Greece	1.0	1.0
Italy	10.2	8.1
Luxembourg	0.8	0.8
Netherlands	10.8	7.3
Norway	22.3	12.1
Sweden	9.7	3.5
Switzerland	8.7	-0.9
UK	30.1	7.1
US	9.1	-6.1
Other	7.5	2.9

Market Cap	Gross%	Net%
>£2bn	22.9	-1.4
£700m - £2bn	18.9	-5.8
£200m - £700m	57.3	16.0
<£200m	39.9	30.5

Sector	Gross%	Net%
Construction	10.0	6.3
Consumer	5.8	-0.6
Energy	18.6	8.2
Engineering	1.2	1.2
Financial	11.0	-6.3
Manufacturing	3.9	2.2
Media	25.7	20.1
Mining	0.3	0.3
Property	5.5	2.9
Retail	10.2	4.8
Semiconductors	0.9	-0.9
Services	8.4	5.5
Technology	10.9	0.1
Transport	8.7	3.4
Other	17.9	-7.9

Portfolio Activity

Figures in brackets refer to previous month end; * = positions >0.5% of NAV.

As at 31 January the Fund was invested in 85 (87)* stocks.

Outlook

We are seeing an increasing number of good long investment opportunities in smaller companies, where prices have often corrected massively, but also believe significant opportunities remain on the short side, where valuations are still reflecting over-optimistic expectations of sustainable future earnings. As always, we will stick closely to our philosophy and investment process. We are excited about the prospects for the Fund in 2008.

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