Ennismore European Smaller Companies Fund

Investor Newsletter for the month of December 2012

Issued on 10 January 2013

Fund Details

Daily dealing UCITS and Irish Central Bank 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 210m as at 31st December. Total assets under management by Ennismore Fund Management were GBP 255m. 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 31 December 2012

	Share Class[2]					HSBC Index[3]		MSCI Index[4]
	GBP A £	**GBP A €**	**GBP B**	**EUR A**	**EUR B**	**GBP**	**EUR**	**(local)**
NAV per Share[1]	**68.89**	**84.93**	**11.63**	**11.99**	**12.06**			
Period			**% Change**				**% Change**	
December 12	**0.7**	**0.8**	**0.7**	**0.8**	**0.8**	**4.4**	**4.2**	**1.4**
November 12	2.6	1.7	2.6	1.8	1.8	1.3	0.4	2.5
October 12	2.9	1.9	2.8	2.1	2.1	2.0	1.2	1.1
September 12	-0.1	-0.4	0.0	-0.3	-0.4	3.3	2.7	1.2
August 12	2.5	1.5	2.4	1.6	1.6	3.8	2.9	2.3
July 12	-2.0	0.8	-2.0	0.4	0.4	-0.5	2.2	2.8
2012	**8.4**	**11.6**	**8.3**	**10.8**	**10.9**	**20.2**	**23.6**	**15.6**
Annualised return[5]	**15.0**	**13.8**	**8.1**	**9.9**	**10.3**	**7.9**	**6.7**	**2.4**
Since launch[5]	**601.9**	**503.1**	**16.3**	**19.9**	**20.6**	**189.8**	**147.7**	**38.9**

[1]Source: Administrator, Net Asset Value. [2]Source: Administrator, Net Asset Value, net income reinvested. [3]Source: Bloomberg, HSBC Smaller European Total Return Index. [4]Source: Bloomberg, MSCI Europe Index, local currencies, total return. [5]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.
Note: All performance figures net of fees.

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 0.7% in December. Our long book contributed 2.9% while the Fund's short exposure cost 1.5%.

The main positive contributions came from Home Retail and LSL Property Services, both adding 0.5% to NAV. There was no significant newsflow specific to either company during the month.

The main negative was Hargreaves Services which reported a fraud at its small Belgian subsidiary. The shares fell 17% in December costing the Fund 0.4%. We have discussed this extensively with management and the financial impact seems to be limited, reducing ongoing profit by at most 4% with a one off inventory write down of less than GBP 15m. The nature of the fraud leads us to believe that it is unlikely to be more extensive than currently estimated, or that it will be repeated. The fall in the share price looks like an overreaction and we have been adding to our position.

Portfolio Activity

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

As at 31st December the Fund was invested in 77 (78)* stocks.

Nemetscheck – German software developer (1.2% NAV)

Nemetschek develops software for architects, engineers and construction firms. Their main product (80% of sales) is computer aided design (CAD) software used in creating models of projects. Geographically the company makes 70% of its sales in Europe (in 2011), 16% in the Americas and 13% in the Asia-Pacific region. Although globally Nemetschek is the number two behind Autodesk most competitors are much smaller and in key markets they are the dominant supplier, with a market share of over 60% in Germany and more than 40% in Japan. Because construction markets tend to be quite distinct in each country it is scale at this level that really counts. In the markets where it is dominant Nemetschek's product is more likely to be used at the early stages of an individual's career and, once familiarity is established, the customer base becomes sticky as the product is so essential and the benefits of switching are not significant enough (the downside to this is that it makes it harder to break into other regions like the Americas). This is reflected in 95% annual renewal rates for maintenance revenue (45% of sales). Most of the rest of Nemetchek's sales come from one off license income but this has also proven relatively stable, supported by annual product launches. In recent years management has put renewed focus on increasing the number of new products that have maintenance attached leading to 8% compound annual growth since 2007. We really value the predictability of Nemetschek's revenue stream which in turn has led to consistently high returns on capital. Even in the difficult year of 2009 turnover fell by only 10% and operating profit was little changed as management was able to reduce the cost base to compensate for lower sales. In the medium term the company will need to also offer web-based software-as-a-service products and we feel that their strategy of doing this carefully and on an evolving basis is the correct one.

Nemetschek is conservatively managed for the long term with the founding family, who still own 53% of the shares, represented on the board. The company had sales of EUR 164m in 2011 and grew pre-tax profits at an annual compound rate of 14% in the five years up to 2011. Last year the company again grew the top line at a high single digit rate while profits are expected to be flat. Over the coming years we expect the overall operating margin to trend up due to both operational leverage from increased turnover and the benefit of a higher share of maintenance sales, where the drop through to operating profit on incremental revenue is up to 50%. Overall we expect at least ten per cent annual earnings growth over the next couple of years. Nemetschek also has almost EUR 34m of net cash, around 10% of its market cap. We expect this will be used for bolt-on acquisitions, which they have a good track record of integrating, and perhaps to increase the dividend payout ratio. Based on our forecast for earnings in 2013 the shares are trading on a price to earnings ratio of 11 times, with a free cash flow yield of around 9% (which gives an indication of how attractive the dividend, currently yielding only 2.5%, could become). Valuing the stock at an enterprise value of 13 times forecast 2014 after tax operating profit (excluding goodwill) leads us to expect upside of more than 50% over this time period. Not surprisingly we see the current valuation as compelling for a high quality business and look forward to following its progress over the coming years.

Top Five Holdings as at 31 December 2012

	Company	Country	Sector	% of NAV
1	Howden Joinery	United Kingdom	Consumer Discretionary	5.7
2	Xing	Germany	Information Technology	4.9
3	Vib Vermoegen	Germany	Financials	4.3
4	Sto	Germany	Materials	4.3
5	Home Retail	United Kingdom	Consumer Discretionary	3.6
				22.8

Exposures as at 31 December 2012

Longs %	Shorts %	Gross Exposure %	Net Exposure %
91.0 (91.6)	32.6 (33.0)	123.6 (124.6)	58.4 (58.7)

Figures in brackets refer to previous month end.

Exposures by Country, Market Cap and Sector as % NAV as at 31 December 2012

Country	Gross%	Net%
Austria	1.8	0.9
Belgium	2.4	1.2
Bermuda	1.3	1.3
Denmark	3.0	0.9
France	5.5	4.7
Germany	27.7	23.1
Ireland	3.8	3.8
Italy	4.7	3.4
Jersey	4.5	0.4
Netherlands	1.8	-0.7
Sweden	5.4	-0.4
Switzerland	7.8	0.4
UK	42.2	16.2
US	8.3	0.6
Other	3.4	2.6

Market Cap	Gross%	Net%
>£2bn	3.1	0.7
£700m - £2bn	29.9	9.3
£200m - £700m	44.4	12.2
<£200m	46.2	36.2

Sector	Gross%	Net%
Consumer Discretionary	46.0	18.7
Consumer Staples	1.3	-1.3
Energy	2.0	2.0
Financials	15.1	13.7
Health Care	3.5	0.4
Industrials	12.8	8.5
Information Technology	26.2	9.0
Materials	10.9	10.6
Telecommunication	4.2	-1.6
Utilities	1.6	-1.6
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. Sector analysis is based on the Global Industry Classification Standard ("GICS"). Source: Bloomberg.

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