# Ennismore European Smaller Companies Fund

## Investor Newsletter for the month of December 2013

**Issued on 15 January 2014**

### Fund Details

Daily dealing UCITS and Irish Central Bank regulated open-ended investment company with Financial Conduct Authority recognition, registered in Ireland and listed on the Irish Stock Exchange. The Fund size was GBP 269m as at 31st December. Total assets under management by Ennismore Fund Management were GBP 328m. 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 2013

| | 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]** | **87.22** | **104.84** | **14.73** | **14.91** | **14.97** | | | |
| **Period** | **% Change** | | | | | **% Change** | | |
| **December 13** | **2.3** | **2.2** | **2.4** | **2.3** | **2.3** | **1.6** | **1.4** | **1.0** |
| November 13 | 1.2 | 3.1 | 1.2 | 2.8 | 2.7 | -0.1 | 2.0 | 0.5 |
| October 13 | 4.2 | 2.9 | 4.2 | 3.2 | 3.2 | 6.1 | 4.7 | 4.4 |
| September 13 | 1.6 | 3.6 | 1.6 | 3.2 | 3.2 | 3.6 | 5.7 | 3.6 |
| August 13 | 1.2 | 4.0 | 1.2 | 3.5 | 3.4 | -1.3 | 1.2 | -1.5 |
| July 13 | 2.8 | 0.6 | 2.8 | 0.9 | 1.0 | 8.1 | 5.8 | 5.9 |
| June 13 | -0.9 | -1.2 | -0.8 | -1.1 | -1.1 | -3.6 | -3.8 | -5.0 |
| May 13 | 1.8 | 0.9 | 1.8 | 1.1 | 1.1 | 4.2 | 3.2 | 2.5 |
| April 13 | -0.9 | -1.1 | -0.9 | -1.0 | -1.1 | 1.7 | 1.4 | 1.9 |
| March 13 | 1.5 | 3.4 | 1.5 | 3.0 | 3.0 | -1.8 | 0.2 | 0.9 |
| February 13 | 2.7 | 2.1 | 2.7 | 2.2 | 2.2 | 3.5 | 2.8 | 0.9 |
| January 13 | 6.5 | 0.9 | 6.5 | 2.0 | 2.0 | 9.7 | 4.2 | 5.1 |
| **2013** | **26.6** | **23.4** | **26.7** | **24.4** | **24.1** | **35.5** | **32.2** | **21.6** |
| **Annualised return[5]** | **15.8** | **14.4** | **14.0** | **14.7** | **14.8** | **9.6** | **8.3** | **3.6** |
| **Since launch[5]** | **788.7** | **644.5** | **47.3** | **49.1** | **49.7** | **292.7** | **227.6** | **68.9** |

[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 2.3% in December. Our long and short books contributed 1.8% and 1.3% respectively.
On the long side the most significant contributions were from construction machinery manufacturer Somero Enterprises and chemicals manufacturer AZ Electronic Materials, both adding 0.3% to NAV. AZ received a takeover bid from Merck at a 50% premium to its share price at the start of December.
The largest attribution of 0.8% came from our short position in online sports media rights agency Perform Group, which issued its third and largest profit warning of 2013. The share price halved in December. Our short in iodine producer Iofina also contributed positively (0.4%) after the company confirmed that it had failed to sell any iodine in 2013.

### 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 (80)* stocks.

### Kongsberg Automotive – Norwegian auto components manufacturer (2.0% NAV)

Kongsberg Automotive is a niche, global supplier of components to the passenger car (c.55% of its EUR 1bn turnover) and commercial vehicle (45%) industries. Half of sales come in Europe and a third in North America. The group has strong market positions, normally being one of the top two suppliers with market shares often more than 25% in Europe. Customer concentration is reasonable with the largest customer accounting for less than 10% of sales and the top five around a third. Kongsberg has been a company in transition since the poorly timed, overpriced acquisition of Global Motion Systems (GMS) at the end of 2007. This more than doubled the size of the group and increased its exposure to passenger car sales and Southern Europe going into the downturn. A new CEO, Hans Peter Havdal, came in early 2010 and was tasked with sorting out some of the legacies of this acquisition such as unprofitable long-term contracts and an over-leveraged balance sheet. He also started on a plan to increase the efficiency of the group - savings from this in 2013 were over EUR 9m with the number of production sites now reduced by more than a third and suppliers by a quarter - with further significant cost reductions still to come. Management are targeting a return on capital employed (pre-tax and amortisation of acquisition intangibles) of around 18%, from the 15% expected in 2013, and we think they will achieve this in 2015.
Kongsberg has four divisions: Driveline (28% of sales), Interior (30%), Driver Controls (23%) and Fluid Transfer (19%). As end customers are more focussed on the economic return on vehicles as opposed to price per se, the company earns higher, double-digit operating margins from the divisions supplying commercial vehicles - Driver Controls (e.g. gearshift systems, pedals, steering columns) and Fluid Transfer (e.g. brake & fuel systems). Interior (e.g. lumbar support & seat heating) margins are also

pretty solid at around nine percent as seat comfort is a key factor in consumers' choice of car, but the problem child Driveline (gear shifters, gear selectors & shift cables) is expected to achieve only a lowly two percent margin for 2013. Driveline is one of only two global suppliers in this segment of the market, but still has a market share of only 10%, and although they try to focus on high-end components in reality much of its sales are to the competitive, mass market end of the industry. Despite this there is a lot of potential for self-help and management are looking to at least double the division margin as unprofitable contracts begin to roll off this year and are replaced with better pricing terms. New contracts typically take two to three years to translate into sales as customers plan new models well ahead of launch, but once they start they often run for several years giving good visibility for management's turnaround plan.

For 2013 we expect Kongsberg's turnover to be slightly down due to the continued focus on profitability in the Driveline segment (with sales about 10% lower in this division), but underlying operating profit to increase by over 35% to c.EUR 70m as Driveline turns profitable and margins across the rest of the group increase due to the productivity improvements made. Recent orders suggest future sales growth is likely to be led by emerging markets trading up and we expect operating profit to grow by at least a mid-single digit percentage each year. We also forecast free cashflow of at least EUR 40m a year from 2014 onwards. Management's first priority for this is to reduce net debt further, from EUR 280m at the end of Q3 13, towards a target of less than two times operating profit before depreciation. It seems likely they will reach this level in the course of 2014 and at this point we would also expect them to consider paying a dividend again. The negative consequences of making large acquisitions still loom large and mean management are only looking at bolt on acquisitions in the longer term to add extra competences; we see this as much lower risk. Kongsberg's strong focus on cash generation, good operational momentum and the potential for further help from an improving European economy this year make it an attractive investment for us. At its current market cap of EUR 275m Kongsberg shares trade at an enterprise value to operating profit after tax (NOPAT) and a price to earnings multiple of nine and six times respectively for 2014, which we see as materially undervaluing the earnings power of the business. Valuing the stock on a multiple of eleven times NOPAT leads us to expect upside of more than 60% over the next two years.

## Top Five Holdings as at 31 December 2013

| | Company | Country | Sector | % of NAV |
|---|---|---|---|---|
| 1 | Xing | Germany | Information Technology | 5.0 |
| 2 | Vib Vermoegen | Germany | Financials | 4.6 |
| 3 | Sto | Germany | Materials | 4.3 |
| 4 | Jd Sports | United Kingdom | Consumer Discretionary | 4.1 |
| 5 | Oslo Bors | Norway | Financials | 3.7 |
| | | | | **21.7** |

## Exposures as at 31 December 2013

| Longs % | Shorts % | Gross Exposure % | Net Exposure % |
|---|---|---|---|
| 78.3 (82.1) | 32.9 (34.2) | 111.2 (116.3) | 45.4 (47.8) |

Figures in brackets refer to previous month end.

## Exposures by Country, Market Cap and Sector as % NAV as at 31 December 2013

| Country | Gross% | Net% |
|---|---|---|
| Belgium | 1.9 | 0.7 |
| Bermuda | 1.7 | 0.6 |
| Canada | 1.9 | -1.5 |
| Denmark | 1.1 | 0.9 |
| France | 5.1 | 4.3 |
| Germany | 28.4 | 22.3 |
| Ireland | 1.3 | 1.3 |
| Italy | 5.8 | 2.4 |
| Norway | 5.7 | 5.7 |
| Spain | 2.1 | -2.1 |
| Sweden | 2.3 | -0.4 |
| Switzerland | 7.4 | 0.3 |
| UK | 35.6 | 11.8 |
| US | 5.3 | -0.4 |
| Other | 5.6 | -0.5 |

| Market Cap | Gross% | Net% |
|---|---|---|
| >£2bn | 4.9 | 0.9 |
| £700m - £2bn | 30.2 | 5.6 |
| £200m - £700m | 47.8 | 16.9 |
| <£200m | 28.3 | 22.0 |

| Sector | Gross% | Net% |
|---|---|---|
| Consumer Discretionary | 35.7 | 17.8 |
| Consumer Staples | 1.6 | -1.6 |
| Energy | 2.5 | 0.3 |
| Financials | 13.9 | 9.9 |
| Health Care | 2.5 | 0.8 |
| Industrials | 15.4 | 5.2 |
| Information Technology | 26.4 | 7.3 |
| Materials | 8.3 | 8.3 |
| Telecommunication | 3.3 | -1.0 |
| 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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|---|---|---|---|
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