Ennismore Global Equity Fund

Investor Newsletter for the month of March 2017

Issued on 13 April 2017

Fund Details

Daily dealing UCITS and Irish Central Bank regulated open-ended investment company with Financial Conduct Authority recognition and registration in Ireland. The Fund size was USD 200m as at 31st March. Total assets under management by Ennismore Fund Management were USD 768m. 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.

Performance as at 31 March 2017

	Share Class			
	GBP	GBP A	EUR	CHF
NAV per Share[1]	**10.32**	**10.3**	**10.50**	**10.34**
Period	**% Change**			
March 17	**-1.1**	**-1.2**	**-1.3**	**-0.7**
February 17	-1.3	-1.4	-0.7	-1.0
January 17	-0.2	-0.1	-0.7	-1.3
December 16	5.2	5.3	4.7	4.0
November 16	-0.8	-0.8	4.1	3.9
October 16	1.6	1.3	-0.9	-1.4
2017 to date	**-2.6**	**-2.6**	**-2.8**	**-2.9**
Since launch[2]	**3.2**	**3.0**	**5.0**	**3.4**

[1]Source: Administrator, Net Asset Value. [2]Since inception on 03/10/16. Note: All performance figures net of fees.
Past performance is not a guide to future returns.

Quarterly Attribution

Attribution %		GBP	EUR	CHF
Long	Q1 17	3.8	4.0	3.7
	Q4 16	5.4	8.6	7.1
Short	Q1 17	-5.5	-5.3	-5.3
	Q4 16	2.7	2.6	2.6

Attribution figures exclude cash returns and are prior to expenses

Top Five Holdings as at 31 March 2017

	Company	Country	Sector	% of NAV
1	Mtu Aero Engines Gmbh	Germany	Industrials	6.9
2	Inmarsat Plc	United Kingdom	Telecommunication Services	6.4
3	Etsy Inc	United States	Consumer Discretionary	5.5
4	Spectris Plc	United Kingdom	Information Technology	4.8
5	TripAdvisor Inc	United States	Consumer Discretionary	4.5
				28.1

Exposures as at 31 March 2017

Longs %	Shorts %	Gross Exposure %	Net Exposure %
79.5 (74.3)	46.0 (45.3)	125.5 (119.6)	33.5 (29.0)

Figures in brackets refer to previous month end.

Exposures by Country, Market Cap & Sector as % NAV and Positions as at 31 March 2017

Country	Gross%	Net%
United Kingdom	35.5	21.2
United States	34.2	-1.5
Germany	20.2	9.3
Canada	7.0	3.7
Netherlands	4.9	0.1
Belgium	3.5	1.5
Norway	3.4	3.4
Sweden	3.2	-0.7
Australia	3.0	0.3
Luxembourg	2.7	2.0
Other	7.9	-5.8

Market Cap	Gross%	Net%
>$10bn	15.6	2.9
$5bn-$10bn	32.6	22.0
$1bn-$5bn	55.9	20.6
<$1bn	21.4	-12.0

Positions	Mar	Feb
Long	36	37
Opened	2	1
Closed	3	0
Short	46	50
Opened	1	0
Closed	5	1

Sector	Gross%	Net%
Consumer Discretionary	30.8	18.6
Consumer Staples	10.4	-1.5
Energy	0.8	-0.8
Financials	4.8	1.7
Healthcare	1.5	-0.2
Industrials	22.5	13.1
Information Technology	29.3	1.7
Materials	8.8	-0.2
Telco Services	14.8	2.9
Utilities	1.8	-1.8
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.

The Fund's NAV per share declined between two and half and three per cent in Q1, depending on currency. We would of course, in a perfect world, prefer to be up in every period, but we are not fazed when we are not – it is the nature of our business. When we invest in a company, we focus on the destination rather than the journey. If we get the destination right – say that a stock should trade at roughly twice its current price – we don't really care about the journey. We know there will be ups and downs along the way. In general, we welcome this bumpy ride – it is just Mr. Market at work. And it is Mr. Market that throws up opportunities along the way.

If we get the destination right, the Fund will compound at solid returns over many years. At the same time, we will always be ready to take advantage of a bear market. We believe the right investment process will lead to good returns in the long run. It is just a matter of being patient.

The long book contributed positively in the quarter, adding around 4% to NAV despite a relatively low average long exposure of 75% over the period. In this letter we have written on the worst performer, Etsy Inc, partly because we prefer to focus on what has gone wrong (it cost the Fund half a per cent in the quarter) but mostly because we think it is a great business that will prove to be a fantastic investment over the long run.

The performance of the short book was more eye-catching, but not in a good way. It cost the Fund around 5.5%. The implied return, with an average short exposure of 43%, was into double digits.

It will almost certainly cost us more in April after Straight Path Communications Inc, which we were short, was acquired by AT&T Inc. Straight Path owns radio spectrum assets, high frequencies that currently have no significant commercial application. Earlier in the year it had been fined and ordered by the FCC to sell these assets after it emerged the company had for years misled the FCC by falsely claiming to deploy and maintain a service over the spectrum. Supposed transmitters just did not exist. The short was relatively large for us, a little less than 2% of NAV, but the premium – at over 150% – was way above comparable transactions for this kind of asset, even when there was not a forced seller like there was in this case. Clearly we got our assessment of this risk wrong. We also suspect someone in AT&T has got their analysis wrong, perhaps grossly so. This is a further reminder that our strategy to keep each short position relatively small is the right one, no matter our conviction.

Portfolio construction

So why do we short? Our answer has two parts. First, we short to make money. Since the Fund launched at the end of September the return from the short book performance is better, but it has still cost us overall. The Fund does not have a longer track record yet but the team managing it does. Over the longer term the short book has contributed positively to Ennismore's funds and we expect the same for this fund.

Secondly, the short book is not there just to act as a hedge against market risk but it naturally does. Even if it added nothing to returns over the cycle it would still be valuable because a low net exposure will help us preserve capital in a downturn. In a market correction we expect the short book to go down much more than our long investments because we focus on shorting what we call the bottom end of the equity market. These are suspected accounting frauds or anomalies, stock promotions, fads and obsolete business models. Ideally they are companies burning cash or heavily in debt (but not usually where the equity is a stub of enterprise value). In a rising market, raising more capital is not so hard for many of these. This is especially true in a world of near zero interest rates. It may be dilutive but the show goes on. A downturn often brings the final curtain.

If the short book does its job the Fund's NAV can be maintained in the not uncommon but (we think) largely unpredictable event of a bear market. This would give us a fantastic opportunity. We can, to quote investor Warren Buffett, be "greedy when others are fearful" (we find it harder the other way as people seem greedy most of the time). In a hypothetical crash where the market is down 20% and we are invested 100% long and 50% short, if the long book goes down with the market we need the short book to, on average, fall twice as much. If we deliver the Fund's capital is preserved; NAV is unchanged. Our net exposure is also unchanged but we now have 20% of NAV in cash available to invest closer to the bottom of the market. That's exactly what we will do. And that is where running the short book can reward us handsomely for a second time.

This approach to portfolio construction is partly down to our view on the macro economy. Or, really, our lack of a view. We have never had enough confidence in a short run macro forecast to make it the reason for an investment. We are not into market timing as we have no edge there. Our approach to portfolio construction is informed by this inability (and unwillingness) to predict the big picture, except in the longer term. If we could see into the future we would obviously want to hold cash going into a cyclical downturn. Sadly, we can't, and for us real life investing is closer to economist Paul

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Samuelson's joke that "Wall Street indexes predicted nine out of the last five recessions". We think we would hold too much cash, too often and for too long if we tried to manage the Fund this way. We would lose out too much in the years a downturn didn't happen then we would gain in the odd down year.

As the Fund's investments are and will be highly liquid we do not have a significant preference for cash. Instead our approach will normally be to stay close to fully invested on the long side provided we can find reasonably priced shares in quality companies to own. This will almost always mean that our long book will be down when stock markets correct significantly. But we do not plan to lose money when this happens. The difference will be our short book.

Etsy Inc

Etsy Inc ("Etsy") is an online marketplace for unique goods; a sort of anti-Amazon. Most of the sellers on the site are self-employed and work from home. They make clothing, jewellery, homewares, artwork, toys. It is a niche and Etsy totally dominates it with gross merchandise sales ("GMS") of USD 2.8bn last year. Today there are 33 million items listed on the site. Compare that to Amazon's Handmade, which has about 750,000. There are some stronger national competitors - in the UK, for example, Notonthehighstreet has over 2 million items. But even here we estimate Etsy has now taken the lead in UK GMS and it is now their second largest market. Like all successful marketplaces, there are powerful network effects at work – sellers want to list on as few sites as possible to save money; buyers want to find huge choice in one or a few places to save them time. The network effect of Etsy's success is particularly powerful for its sellers and for many it is their only significant sales outlet. Their level of buy-in is higher than for businesses selling on Amazon, where sellers tend to be larger. You can see this in Etsy's ancillary services. Nearly half of its customers use its Direct Checkout merchant acquiring service rather than having their own relationship with a payment platform, much more than would be the case at Amazon. With a relatively fixed cost base, other than the option to boost growth with marketing, scale should naturally lead to a high return on capital because the switching costs for its customers (the sellers) are high compared to the benefits of listing their products on Etsy.

So, Etsy is the clear market leader and has substantial scale. It must be very profitable already? Not quite. Costs other than marketing have shown the expected operating leverage, dropping from 87% of sales in 2012 to 71% in 2016. But management has chosen to reinvest most of that into marketing spend so the current profit margin is only single digit. What gives us the confidence to say this increase in spend is optional? In 2016 only one in ten visits to the site came from paid advertising. We think it is right for management to try to maximise the brand's reach early on in its development by marketing to potential buyers that might not otherwise think of visiting Etsy. We also think the company could spend very little on it and still grow revenue at a double digit rate for many years. If they did the current operating margin could be close to 20%. This would probably be bad for shareholders longer term - the overall revenue base would not be as big so soon – and we don't want the business run this way. But we do think it is a good indication of the margin Etsy will be able to achieve in future.

Etsy is a beach stock for us. We think we can go away for five years and come back to a business that will be in really good shape. It launched in 2005 and revenue has been growing fast ever since, up by one third (largely organically) in 2016 to USD 365m. We expect the company to deliver on its guidance of at least mid-teens top line growth for many years to come and see a medium term margin of around 20% (we view this as conservative in the long run). That would mean us coming back to revenue of over USD 750m and operating profit of close to USD 150m, with perhaps a generation of good growth beyond that as retail continues to migrate online and the brand becomes better and better known outside and within the US. Etsy's current market cap is USD 1.2bn with almost USD 300m in net cash. The management have a significant personal stake (the CEO has c. 0.7% of the shares, for instance). We were also not surprised when Burda became the largest investor in the company. In 2012, Ennismore and Burda Digital were the two largest shareholders in Xing, another platform business. Burda is also invested in Notonthehighstreet. The share price is down about 10% so far this year with all of that decline (and then some) coming on the back of fourth quarter results where revenue grew ahead of management's already raised guidance. The disappointment (for the market, not us) came from their decision to continue to invest more in advertising this year, including Etsy's first really significant brand campaign. Looking even further back, the shares are down around 65% from its peak in early 2015, despite growing sales organically by over 30% in each of the last two years. To put it mildly we think the market's reaction is short sighted and we have recently added to our position.

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