Ennismore European Smaller Companies Fund

Investor Newsletter for the month of April 2017

Issued on 10 May 2017

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 375m as at 28th April. Total assets under management by Ennismore Fund Management were GBP 614m. 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 28 April 2017

	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]	**119.91**	**142.46**	**20.26**	**20.33**	**20.39**			
Period			% Change				% Change	
April 17	**1.0**	**2.7**	**1.0**	**2.4**	**2.4**	**3.1**	**4.5**	**1.5**
March 17	0.9	0.7	0.9	0.8	0.7	2.3	2.5	3.5
February 17	-0.2	0.4	-0.2	0.3	0.3	2.5	3.0	2.8
January 17	1.2	0.6	1.2	0.7	0.7	1.8	1.4	-0.3
December 16	1.9	1.4	2.0	1.6	1.5	6.0	5.2	5.8
November 16	-2.7	3.1	-2.7	2.3	2.3	-4.1	1.3	-0.6
2017 to date	**2.9**	**4.4**	**2.9**	**4.1**	**4.1**	**10.2**	**11.8**	**7.6**
Annualised return[5]	**14.7**	**13.5**	**11.9**	**12.0**	**12.1**	**10.2**	**9.0**	**4.3**
Since launch[5]	**1121.7**	**911.6**	**102.6**	**103.3**	**103.9**	**484.9**	**382.5**	**113.9**
	Discrete 12 Month Rolling Performance - % Change							
To 30 April 17	10.7	2.8	10.7	4.4	4.4	29.4	20.2	19.5
To 30 April 16	18.7	10.7	18.7	11.8	11.7	4.3	-2.4	-9.6
To 30 April 15	-1.4	11.1	-1.3	9.0	9.0	4.7	17.7	13.2
To 30 April 14	22.0	25.9	22.0	25.4	25.3	26.0	29.8	15.5
To 30 April 13	17.0	12.5	16.9	13.4	13.4	23.4	18.7	20.1

[1]Source: Administrator, Net Asset Value. [2]Source: Administrator, Net Asset Value, net income reinvested. [3]Source: Bloomberg, Euromoney (formerly 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. **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 increased by 1.0% in April. Our long book contributed 4.6% while the Fund's short exposure cost 2.7%. JD Sports contributed 1.1% to NAV after the company issued strong full year results, beating market expectations. Market Tech Holdings added 0.7% following a bid from its majority shareholder LabTech at a 30% premium, which we think undervalues the company. Our short positon in a US company which received a takeover offer detracted 0.8% of NAV.

DFS Furniture – UK Retail (0.5% of NAV)

DFS is a furniture retailer in the UK. Furniture retail is perhaps an unexpected place to find a high quality business, and UK retail is not exactly popular in the wake of Brexit. But dig into DFS and we have found a surprisingly strong and resilient business model, at what we think is a bargain price.

DFS is the dominant player in the UK sofa market. With net sales of GBP 750m, it has a market share of 28%, over three times the size of the closest competitor. It uses this scale to great advantage – it buys its sofas for less (it represents 50% of sales for most of its suppliers) and delivers items cheaper and faster. It passes these scale-economies back to its customers by offering low prices, 4-year interest free loans and better customer service (value investors: if in the market for a sofa, take note). On top of this, DFS spends £80-90m on marketing every year, making it one of the top 10 advertisers in the UK. You may not notice the ubiquity of its advertising – but as we recently discovered, if you're shopping for a sofa, you'll see it everywhere you turn. We estimate its share of voice is around 60% - far higher than its market share. This leads to constant market share growth, which has expanded almost every year of its 47 year history. Its sales per square foot are amongst the highest out of any retailer in the country, and are twice that of its closest competitor and three times that of the number three player. This makes it a good place to be a commission-based sales rep, leading to better retention. These virtuous circles only get better as DFS grows.

Retail is confronted with a seismic channel shift to online. Combine that with large lease liabilities, and we suspect there will be much pain ahead for the industry. Furniture retail is also cyclical, falling 25% peak to trough during the last downturn, and it still remains nearly 20% below its peak. Despite this, we like DFS's chances in navigating these challenges. Some people prefer to see and sit on sofas before buying them, especially if spending over £500. This results in online penetration of just 10% for sofas, well below that of other categories. Notwithstanding this, DFS has a higher market share in its online channel than it does in its traditional bricks and mortar channel and because it already delivers direct to home, the incremental costs online are marginal, unlike in many other retail categories. This means DFS actually benefits from the shift to online. It has far more scale than any online-only players in a market where scale is crucial. Made.com, its biggest online-only competitor, spends three times more (as a percentage of sales) on distribution, and it has been forced to open showrooms because people want to see their sofas before buying them. Superior profitability means DFS should be the last man standing during a recession: today its operating margins are 10%, compared to less than 3% for most of its competitors. This is despite DFS spending 8-9% of sales on marketing, double what most competitors spend and paying above-market rents. In the last major downturn several of DFS's competitors went out of business, while its sales fell just 6% and its profits expanded as marketing became cheaper. Their performance during downturns demonstrates the DFS formula works.

DFS sales have compounded at 9% over 20 years in a market that grew in-line with GDP. Over the last decade, EBITDAR margins have increased from 17% to 20%. Capitalising leases at eight times rent, its pre-tax return on net operating assets is over 30%. Leverage of GBP 130m is manageable compared to operating profit of GBP 76m, even when considering its leases. With a market cap of GBP 580m, DFS trades at an 11% free cash flow yield (excluding growth capex). Last summer, we were buying it at a 14% FCF yield. We expect it to pay out all of its free cash flow to shareholders, and this year the dividend yield will be double-digits. While the UK consumer faces headwinds, and DFS's earnings may fall over the next couple of years as a result, we think its competitive position – and long-term earnings power – will remain strong. We think investors willing to look far enough into the future will be well rewarded.

Top Five Holdings as at 28 April 2017

	Company	Country	Sector	% of NAV
1	Jd Sports	United Kingdom	Consumer Discretionary	7.3
2	Vib Vermoegen	Germany	Real Estate	4.1
3	Conviviality	United Kingdom	Consumer Staples	3.2
4	Oslo Bors	Norway	Financials	3.0
5	Cello Group	United Kingdom	Consumer Discretionary	2.8
				20.4

Exposures as at 28 April 2017

Longs %	Shorts %	Gross Exposure %	Net Exposure %
84.6 (83.5)	46.3 (42.7)	130.9 (126.2)	38.3 (40.8)

Figures in brackets refer to previous month end.

Exposures by Country, Market Cap & Sector as % NAV and Positions as at 28 April 2017

Country	Gross%	Net%
Austria	2.9	1.4
Belgium	1.9	0.2
Canada	1.5	0.8
Finland	1.1	-1.1
France	5.6	5.5
Germany	30.0	8.3
Italy	3.9	1.9
Netherlands	3.8	-2.6
Norway	5.8	5.8
Spain	1.9	-1.9
Sweden	1.2	-0.4
Switzerland	5.6	-5.1
UK	54.3	27.4
US	8.8	-3.0
Other	2.6	1.1

Market Cap	Gross%	Net%
>£2bn	37.5	4.0
£700m - £2bn	26.6	-4.3
£200m - £700m	47.6	21.6
<£200m	19.2	17.0

Positions	Apr	Mar
Long	94	93
Short	81	78
Longs Opened	2	5
Longs Closed	1	5
Shorts Opened	8	8
Shorts Closed	5	4

Sector	Gross%	Net%
Consumer Discretionary	37.7	17.3
Consumer Staples	10.7	-2.5
Energy	0.2	-0.2
Financials	6.7	1.7
Health Care	5.6	3.1
Industrials	21.0	7.4
Information Technology	25.4	1.6
Materials	5.3	3.8
Real Estate	11.3	7.7
Telecommunication	6.1	-0.7
Utilities	0.9	-0.9
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.

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