Ennismore Global Equity Fund

Investor Newsletter for the month of September 2017

Issued on 12 October 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 218m as at 29th September. Total assets under management by Ennismore Fund Management were USD 860m. 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 29 September 2017

	Share Class			
	GBP	**GBP A**	**EUR**	**CHF**
NAV per Share[1]	**10.17**	**10.15**	**10.04**	**10.56**
Period	**% Change**			
September 17	**-2.8**	**-2.8**	**1.8**	**1.9**
August 17	3.2	3.2	0.0	0.4
July 17	1.0	1.0	-0.9	3.2
2017 to date	**-4.1**	**-4.1**	**-7.0**	**-0.8**
Since launch[2]	**1.7**	**1.5**	**0.4**	**5.6**

[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.**

Attribution %		**GBP**	**EUR**	**CHF**
Long	Q3 17	2.4	2.0	6.0
	Q2 17	2.6	0.3	2.2
	Q1 17	3.8	4.0	3.8
	Q4 16	5.4	8.6	7.1
Short	Q3 17	0.0	0.1	0.0
	Q2 17	-4.7	-4.6	-4.7
	Q1 17	-5.7	-5.6	-5.5
	Q4 16	2.7	2.6	2.6

Attribution figures exclude cash returns and are prior to expenses

Top Five Long Holdings as at 29 September 2017

	Company	**Country**	**Sector**	**% of NAV**
1	Etsy Inc	United States	Consumer Discretionary	8.0
2	Mtu Aero Engines Gmbh	Germany	Industrials	7.8
3	Inmarsat Plc	United Kingdom	Telecommunication Services	6.1
4	Schibsted ASA	Norway	Consumer Discretionary	5.5
5	TripAdvisor Inc	United States	Consumer Discretionary	5.1
				32.5

Exposures as at 29 September 2017

Longs %	**Shorts %**	**Gross Exposure %**	**Net Exposure %**
85.1 (81.0)	49.1 (48.8)	134.2 (129.8)	36.0 (32.2)

Figures in brackets refer to previous month end.

Exposures by Country, Market Cap & Sector as % NAV and Positions as at 29 September 2017

Country	**Gross%**	**Net%**
United States	44.1	9.1
United Kingdom	32.1	12.1
Germany	23.5	6.9
Australia	8.2	5.2
Norway	5.5	5.5
Netherlands	4.5	-0.4
Hong Kong	3.2	-3.2
Canada	2.8	-0.7
Switzerland	2.2	-1.9
Italy	1.5	1.5
Luxembourg	1.5	1.5
Other	5.1	0.4

Market Cap	**Gross%**	**Net%**
>$10bn	19.0	-5.3
$5bn-$10bn	33.0	29.8
$1bn-$5bn	65.8	20.3
<$1bn	16.4	-8.8

Positions	**Sep**	**Aug**
Long	37	35
Opened	3	2
Closed	1	5
Short	55	59
Opened	1	4
Closed	5	3

Sector	**Gross%**	**Net%**
Consumer Discretionary	43.7	21.8
Consumer Staples	15.9	4.5
Energy	0.0	0.0
Financials	5.1	1.8
Health Care	2.1	-0.5
Industrials	18.8	14.3
Information Technology	29.5	-9.0
Materials	1.5	-1.5
Real Estate	2.1	-2.1
Telecommunication Servic	14.4	7.8
Utilities	1.1	-1.1
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 increased between 0.9% and 5.6% in Q3, depending on currency, with the return in Swiss francs materially higher than in the other share classes.

For the quarter, long positions added around 2.4% to NAV (in the sterling share class). The main positives were our largest positions, MTU Aero Engines AG and Etsy Inc, with both adding 0.7% to NAV. We wrote up our investment cases for these positions in previous quarterly letters and our long-term views have not changed.

SMA Solar Technology AG ("SMA") also contributed 0.7% to NAV. The company manufactures inverters for solar panels, to convert direct into alternating electrical current. It is a good example of a company where the share price is, we think, much more volatile than the underlying value. Put simply, our approach is to own companies when they are priced at a significant discount to underlying value, so long as we are confident we can estimate it. SMA shares mostly traded between EUR 20 and EUR 40 over the last five years, often swinging quickly from one extreme to the other, and we have been able to buy it more than once. The shares re-rated in Q3 after management issued better than expected guidance and we sold our position. We would not be surprised if we end up owning it again.

We also sold our position in PotashCorp. It has been a reasonably good investment for the Fund and added 0.6% to NAV in the quarter. Our investment case was mostly based on its concentrated exposure to potash mining where global supply is controlled by a handful of companies. PotashCorp is now in the process of merging with Agrium Inc, which is more exposed to the retail end of the value chain. When the facts change, we change our mind. The merger made us less certain of fair value and so we sold.

The other significant positive on the long side was Boston Beer Company Inc, brewer of Sam Adams lager in the US. It added 0.6% to NAV and was our largest new position in the quarter. The largest negatives were Inmarsat PLC (costing 0.8% of NAV), which we have written up in detail later in this letter, and TPG Telecom Limited (0.7%), a broadband provider in Australia.

The short book was flat in the quarter. This was disappointing because we had our first significant contributor of the year, with Telit Communications PLC adding 1.4% to NAV. We have included a brief update on it below, partly because the story provides some light relief. This positive was offset by the continued rise in the Wirecard AG share price, costing 1.5%. We covered this company in detail in our last letter and have yet to hear anyone offer a benign explanation of the concerns we highlighted. For momentum investors, though, the stock has been a dream.

One Year Review

The Fund has been up and running for a year now. Since launch NAV per share is up 1.7% in sterling, 0.4% in euro and 5.6% in Swiss francs. We are not in this business to produce single digit returns. We don't expect to in the long run. That said, we focus on the inputs – our investment process and stock selection – which have delivered for us in the past. We are happy with the Fund's portfolio and believe our approach will yield a very good return for our investors.

We expect our long positions to compound value at double digit rates over our typical holding period, which is measured in years not months. So far, they have, contributing 14.6% (based on the sterling share class) for the year to the end of September. The implied return, based on an average exposure of 81%, was around 18%.

Our short book has performed poorly, costing the Fund 8.1% of NAV so far. Based on average short exposure of 45%, the implied return was again around 18%. Most of this loss is unrealised because for most of our shorts we have not seen anything that has changed our minds. We expect these positions will contribute significantly to future returns.

Foreign Exchange Risk

The Fund's currency exposure comes mostly from long positions and cash balances (shorts are held through contracts-for-difference priced against the local currency share price and so foreign exchange risk only applies to the unrealised profit or loss on these, which is usually a small rolling balance). We provide a breakdown of this exposure on a monthly basis for any investors that require it.

We have no edge predicting foreign exchange markets. Few do. We assume developed market currencies are as likely to go up as down, relative to each other. Over the long run the ups and downs should cancel out. To the extent that they do not, we don't think we can profit from it – long run moves are largely predicted by structural inflation, which is reflected in interest rates.

We could hedge the Fund's foreign exchange risk ourselves but we choose not to. We do not think it is worth the cost to our investors. Hedging based on the currency in which a share is quoted can give a misleading appearance of risk management as it fails to capture the underlying exposure of owning a business. To give an example from our portfolio, Inmarsat PLC bills most of its revenue in US dollars. A large part of its expenses is dollar based too, but as a UK PLC it has a relatively high exposure to sterling costs. Its shares are priced in sterling. To hedge out the real, underlying currency exposure on this position is not straightforward.

Telit Communications PLC

Early this year we added the following question to the recruitment page of our website:

"In 2016 a police investigation of the collapse of a business closed with a public prosecutor recommending more than a dozen individuals be charged with fraud. One of those named as a suspect is the CEO of a UK PLC with a current market capitalisation of several hundred million. A formal indictment could be handed down any day. Name the company."

Finding management with colourful pasts is one way we source short ideas. We maintain a database of people involved in past stock promotions and frauds and these often lead us to new ones. For example, in 2015 Avigdor Kelner, founder and former Chairman of Telit Communications PLC ("Telit"), was sentenced to two years in jail for bribing politicians in Israel. He had previously been arrested in 2007 in relation to alleged insider trading involving several investments made by Polar Investments Limited ("Polar"), including Telit, although no charges were brought.

As you may have already guessed, Telit was the answer to our question. The investigation had been covered in local Italian press but not, as far as we were able to identify, mentioned at all either by the company or in sell-side research. In 2016 the public prosecutor in Monza recommended fraud charges be brought against 13 people connected to the collapse of Italian company Bartolini After Market Electronic Services Srl ("BAMES"). One of them was Telit CEO Oozi Cats. We are not aware of the details of the proposed charge. We note that BAMES made a EUR 16m investment to acquire 10% of a Telit subsidiary at a time when the whole of Telit had an enterprise value of less than EUR 10m. The investment was subsequently unwound with BAMES taking a loss of c.EUR 13.5m. A final decision on indictment remains outstanding at the time of writing.

This August Telit issued a press release in which it noted that the recommendations of the public prosecutor might be an issue for the company. The main subject of the announcement, however, was the departure of Oozi Cats. A few days earlier Italian newspaper Il Fatto Quotidiano had published a story claiming that Cats and his wife Ruth had outstanding indictments for wire fraud in the USA. The press release, dated 14th August, went on to state that it was "a source of considerable anger to the Board that the historical indictment […] was never disclosed to them or previous members of the Board".

Finance Director Yosi Fait has stepped up to become interim CEO of Telit. We understand Yosi and Oozi have known each other since childhood. Both attended university in Haifa and they have business connections going back decades. For example, in 2001 Telit signed an agreement to supply Israeli mobile network Pele-Phone Communications Limited ("Pele-Phone"). Fait was CEO of Pele-Phone until March 2002. In 2003, he was appointed CFO of Israeli tile manufacturer Alony Marble Limited. Polar took two Board seats at the same time, with Avigdor Kelner becoming Chairman. At IPO in 2005 Telit's main subsidiary was Dai Telecom Limited ("Dai Israel"), founded in 2000 by Kelner and Cats. Kelner resigned from the Telit Board in April 2007 and was arrested a month later on suspicion of insider trading. In July of the same year Telit announced it was selling Dai Israel to a group of investors led by Yosi Fait. The deal was never consummated but Fait still became a Director of the subsidiary. Finally, in 2011, he was made Finance Director of Telit.

At the start of August this year Telit announced a profit warning – after burning through USD 28m of cash in the first half it breached a banking covenant at the end June. The share price fell 41.5% on the day. The market was shocked, we think, because the company had said as recently as the end of April that it was trading "in line with the Board's expectations" and, a few days later, had raised USD 51m in new equity. On 24th May, only a month before the end of the period, Cats sold shares worth GBP 24m. In early July, further sales by Directors were announced. Chairman Enrico (Chicco) Testa sold 134,354 shares (c.GBP 0.4m), Cats another 429,129 (c.GBP 1.3m) and Yosi Fait sold 815,000 shares worth around GBP 2.6m. These transactions all took place right at the end of the trading period. Telit reported sales of USD 178m in the first half of 2017. Adjusting for the limited disclosure given on acquisitions it appears that organic growth was close to zero.

The revenue miss was USD 12m. As the company was reportedly trading in line at the end of April we assume the underperformance came in the last two months of the period. The timing of the Board's share sales would worry us if we were shareholders.

We have outlined a number of concerns with Telit and its Board but our short position is based much more on discrepancies in the company's statements. To begin with it has not been able to generate free cashflow over any meaningful period, despite often reporting very healthy profit margins. The difference is largely down to very large investments made into intangible assets – essentially capitalised labour costs. Management has repeatedly guided for these to decline as a proportion of revenue. It has failed to deliver. Intangible investments were equal to 9.3% of sales over the last twelve months compared to only 5.2% in 2012.

Also worrying to us, was the fact that we were unable to establish that a number of distributors that the company claimed to use were in business in any meaningful way. Websites were incomplete or did not work. Phone calls and emails went unanswered. Since this issue was made public some of the claimed distributors (for example, Aviv Mobile in Israel and Eddas HG in Peru) have disappeared from the Telit website. Others have seen their websites come back to life after months offline. Many others still do not seem to list any Telit products. This is all quite unusual in our experience.

Our main concerns, though, relate to Telit's accounts. We cannot reconcile reported Asia-Pacific ("APAC") revenue to the numbers filed by its main subsidiary in the region ("Telit Korea"). For several years APAC revenue has been significantly higher than Telit Korea revenue, which has been steadily falling, and the gap is getting wider. We have seen a sell-side comment suggesting that this is explained by Telit's Hong Kong subsidiary whose accounts are not publicly available, but we still find a discrepancy of about USD 18m even in 2011 when the Hong Kong entity was not actively trading (and there were no other subsidiaries in the region). Telit Korea also had a significant minority investor until 2014 making a simple inter-company accounting explanation unlikely.

We also cannot reconcile the cost of inventory disclosed in Cypriot, Italian and Korean subsidiary accounts to the number reported at group level. These three subsidiaries combined report that they bought more stock from third party suppliers than the whole company did in 2015 - about USD 30m more. We also note the Cyprus report was not filed until the end of 2016, almost a year after the group accounts were signed off. We would like to know what the position was last year but we are still waiting for those Cyprus accounts to be filed.

The Board assured shareholders in its press release announcing Oozi's departure that, despite market speculation, it had full confidence in the integrity of Telit's accounts. A further update in September revealed they have now appointed a third-party accounting firm to perform a review of certain elements of the group's financial statements. Another banking covenant waiver was also taken for the end of the quarter. We remain short Telit shares, which still value the company at around USD 260m.

Inmarsat PLC

Inmarsat PLC ("Inmarsat") owns satellites that provide telecommunications to mobile assets such as ships and aeroplanes. It was founded in the 1970s as an intergovernmental organisation to provide connectivity to the shipping industry and, later, to aviation. These have been attractive markets to serve because competition is limited. Most capacity is aimed at fixed, land-based customers. Inmarsat was privatised in the 1990s and listed in 2005. It has two global networks, one operating in the L-band of radio spectrum and a new one in the Ka-band, and is also launching a smaller one in the S-band covering Europe. Although the end customer base is similar for each, the economics and competitive positions are different. This makes it a difficult company to analyse and, we think, misunderstood by the market. We have tried to outline the investment case relatively simply in this letter. Inmarsat is not a straightforward business to value and we like to give our investors more detail rather than less. Briefly, though, the pitch is this: we estimate close to half of Inmarsat's investment today is for one new business line, in-flight connectivity (broadband for passenger aircraft cabins). Either this investment will pay off, in which case the company is worth a lot more than its current share price. Or it won't, the investment will stop, and the company is worth a lot more than its current share price. In the latter scenario shareholders are left with a mature L-band network with only one significant competitor and a new Ka-band constellation that will provide good growth for several years to come. We estimate free cashflow from these operations will reach nearly USD 400m by 2021. Inmarsat's market capitalisation today is less than USD 4bn. Beyond this, there are three developments – effectively free options – that could mean the upside is much greater. The first is, of course, that the USD 200-300m a year investment into in-flight connectivity pays off. The second is that Inmarsat's S-band network in Europe, which mostly uses cellular towers to supply aircraft cabins, becomes something close to a monopoly in the region. There are some good reasons for thinking this may happen. Thirdly, it is possible that Ligado Networks Inc. ("Ligado") will get regulatory approval to use L-band spectrum in the USA for a new terrestrial network. If they do, rental payments of c.USD 120m a year to Inmarsat will then continue in perpetuity. It is unlikely that all three options work out, and possible that none will, but we believe Inmarsat's core business on its own is worth significantly more than the current share price. The rest of this letter explains – perhaps in a little too much detail - why we are confident of this assessment.

We start with Inmarsat's established business in L-band connectivity. This is low frequency spectrum of 1-2 gigahertz ("GHz"). It has a relatively long wavelength so the number of waves per second is lower (all electromagnetic waves travel at the speed of light). The advantages of using this part of the spectrum are that a signal on a longer wavelength is easier to pick up with relatively small, cheap equipment and, most importantly, the connection is very reliable. Inmarsat has provided communications over the L-band to and from ships since the 1970s and aeroplane cockpits since the 1980s. Where reliability is the most important consideration, such as maritime mayday procedures, there is no real alternative. Although the market is mature we expect these characteristics will mean that overall demand is relatively stable.

Two factors make L-band connections to ships and planes close to a monopoly for the company. One is that there is a fixed amount of radio spectrum and you cannot re-use it without causing interference. Specific frequencies are allocated by governments for dedicated uses. A lot of the L-band is used for mobile phones, for example, other parts for the global positioning system ("GPS"). It is not easy for a new entrant to come in and launch a competing global L-band satellite network today because there isn't enough spectrum available to do it on. There is already one other network with global coverage, operated by Iridium Communications Inc. ("Iridium"). Iridium demonstrates clearly the other major barrier to entry. It launched its first constellation of satellites in the late 1990s and filed for bankruptcy before the end of the decade. Another global L-band network would not be economically viable and so we think it is fair to assume that the supply side will not look very different for the foreseeable future. Iridium will remain the only significant competitor. Today it mostly provides a satellite phone service because its existing constellation has not been reliable or fast enough to compete seriously in other uses. The replacement, Iridium NEXT ("NEXT"), is now being launched and will be more comparable to Inmarsat's. NEXT is not yet fully funded but we assume here it will be completed by 2019 (so far 30 of the 75 satellites making up the constellation are in orbit). That is, we look at the worst-case scenario for Inmarsat.

Inmarsat's main mobile L-band service today is FleetBroadband. More than 37,000 ships use it and it accounts for nearly two thirds of the Maritime division's revenue (USD 368m in 2016). Iridium management are explicit that they plan to target this customer base by under-cutting on pricing so an Inmarsat investor has to estimate how successful they will be. On the face of it, they may have a comparable, perhaps even better product, by the end of 2019. Why wouldn't a FleetBroadband customer switch for a discount? The main reason we do not think that this will happen often is that Inmarsat's own replacement constellation ("i-6") begins to go up in 2020. This will offer much faster download speeds (they suggest at least 2-3 Mbps, increasing to 8Mbps over the decade, compared to less than 1Mbps claimed for NEXT) which again puts Iridium at a significant disadvantage. That leaves only two or three years for them to take market share. Many customers will not even have to make a decision as contracts typically run for three to five years. For those that do switching costs will be important in the calculation. The cost of a new terminal, which a customer who switches will need to buy, is around USD 5,000. A 20% saving on FleetBroadband for 3 years adds up to about USD 6,000. For most it probably makes more sense to wait rather than switch although we expect Inmarsat to offer discounts to make sure. We assume Iridium will take limited share but cause a decline in pricing of perhaps 10% over this period. In Aviation, we think Inmarsat's L-band proposition is less threatened. One product, Classic Aero, is used by virtually all planes flying over the oceans to connect the flight deck. Switching costs are extremely high. The cost to ground an aircraft and replace this system is prohibitive and airlines are unlikely to use more than one supplier. The other product, SwiftBroadband, provides cabin connectivity to small planes. Iridium will target this customer base but the same switching costs apply and it is a smaller market than FleetBroadband. Overall, we expect them to have only a modest impact on Inmarsat's Aviation division, in part because overall demand is growing due to a larger global fleet and increasing use of connectivity.

Inmarsat's plan for a higher frequency constellation, which is much better suited to high data throughput, was first unveiled in 2010. The spectrum typically used for this type of service is Ku-band (12-18 GHz) and, more recently, Ka-band (26.5-40 GHz).[1] There are differences in the properties of the two bands but we believe they are insignificant enough to ignore in many applications. However, ecosystems can build up that make it difficult to simply substitute one for the other. A relevant example for Inmarsat is the use of Ka-band by the military. While this operates on a separate part of the

[1] The bit in the middle, between 18 and 26.5 GHz, is the K-band. This suffers from attenuation by water vapour so is not viable for long distance communication.

band to commercial satellites, the same terminal can easily be used to connect to both, but not to Ku-band. This is significant because the US military is the largest satellite communications ("satcom") customer in the world. The downside of Ka-band, as a supplier, is that there is not a significant constraint on the amount of available spectrum. A lot of satellite capacity is planned for launch over the next few years. The risk of over-supply is one of the reasons the market has become so sceptical of Inmarsat but the threat is very different depending on which part of its GX business you look at. The good news is that we think there are enough areas where competitive supply will be limited to generate a good return on the original investment.

GX was designed as a three-satellite network providing global coverage and a true broadband service. The total system cost USD 1.2bn and was completed in 2016. Significant demand is coming from ships needing connection speeds that are not available over L-band (this is known as very-small-aperture terminal, or "VSAT", service) and from a defence sector that has become increasingly dependent on satcom. We think this GX was, and is, a good business that can generate high returns for Inmarsat. Mobile VSAT is a secondary revenue stream for Ku-band satellites. It is a nice incremental use of capacity but it is never going to be large enough for another dedicated network so over supply is not likely to be a huge issue over the oceans or in remote regions. This has always been one of Inmarsat's key strengths: its core customer base needs something close to global coverage and it has the best capacity in the market to serve this need. This is as true for GX as it is for L-band. If we depreciate the original GX constellation over a typical 15 year lifetime this equates to USD 80m a year. Very crudely, then, annual EBITDA of over USD 300m would deliver a good, high teens pre-tax return on the investment. Inmarsat should get to that easily from VSAT and government customers. In fact, the economics are probably better now than that back of the envelope calculation implies. Inmarsat's i-6s, which are going up to replace the L-band constellation, include Ka-band payloads as well. These double its Ka-band capacity at a fraction of the original cost. We think Inmarsat's original GX plan was, and is, a good business.

Inmarsat's largest division is Maritime. We expect it to grow over the next few years as GX VSAT customers ramp up and more than offset a modest decline in the L-band revenue base. Subscriber numbers for FleetBroadband, the L-band service, have been falling because more and more ships require a service speed that can only be delivered over VSAT. We assume this continues, along with a steady but limited fall in pricing, until Inmarsat has replacement satellites up in 2021. We estimate they lose about 5,000 FleetBroadband customers and USD 80m in run rate revenue up to then. At that point, the large step change in service level should return the product to modest growth. Of course, the main reason Inmarsat launched its GX constellation was to meet the demand for VSAT broadband from its shipping customers. Prior to the service being ready it built up c.USD 100m in revenue from nearly 3,000 customers using capacity leased from other satellite networks. On top of this resellers have committed to convert 7,000 more to the GX service on a wholesale basis. These will add over USD 150m revenue by the end of 2021. VSAT retail revenue - the c.3,000 customers where Inmarsat own the end relationship – provides a more immediate dividend. As these are transferred to Inmarsat's own network the leasing cost to serve them falls away. The company has guided for a saving of USD 30m (which looks very conservative to us). The final part of estimating Inmarsat's future Maritime profit is a bucket of around USD 100m other revenue. Much of this is expected to go away but is relatively low margin, so direct costs go with it. Inmarsat is trying to replace it with a low-end service for large fleets of small vessels (e.g. fishing boats) but we don't assume much for this, leaving about USD 35m of recurring other revenue. Altogether, net revenue for Inmarsat's Maritime division should grow from USD 576m in 2016 to about USD 620m by 2021. Costs should fall by at least USD 20m over the period so EBITDA grows from USD 455m to more like USD 525m.

For Aviation, we look at the existing L-band business separately from the planned GX and S-band services (which we discuss later in this note). Total revenue was USD 141m in 2016. Subscriber numbers and average revenue per user are delivering high single digit revenue growth and this should continue for several years. The number of planes needing connectivity and, more importantly, the level of data they expect to consume is only going up. On a per bit basis pricing will, of course, decline but not as fast as the cost of delivering it decreases. Key to this is the fact that Inmarsat's replacement L-band constellation will cost about as much the previous one but deliver several times the capacity (the same change that we expect to drive FleetBroadband growth from 2021). For Aviation, the overall outlook is better because Inmarsat's products in this division are not open to substitution by VSAT and, we believe, face less intense competition from Iridium in the meantime. Division EBITDA was USD 97m in 2016 but this understates the L-band contribution. The cost base included significant investment of close to USD 40m in operating costs to support the in-flight connectivity proposition over GX. Stripping this out we estimate L-band Aviation EBITDA of over USD 130m. We expect this to grow to USD 170m by 2021.

For Inmarsat's Government division, and to a lesser extent its smaller Enterprise unit, it is harder to separate out the future L-band business from GX. The Ka-band constellation is driving good growth in the Government division which delivered USD 244m EBITDA in 2016. This year will be closer to USD 300m and we think USD 400m is a reasonable medium-term target. The most important single customer here is the US military. It operates its own satellites but extra capacity is often needed and Inmarsat may be the main or even only available Ka-band supplier in a given location. Revenue can be lumpy – there were material one off contracts in each of the last three quarters. This makes it less predictable than a subscription business in the short term but we don't think it is less profitable. For the Enterprise division, we assume EBITDA declines to USD 70m, from over USD 100m in 2016, as we expect a lot of the customer base in the energy sector to shift to other communications networks.

If we value Inmarsat on this scope – excluding investment in and returns from in-flight connectivity – we think it is clearly undervalued. We estimate 2021 EBITDA of nearly USD 900m (we assume central costs can be held at the 2016 level if in-flight connectivity is excluded). The biggest unknown is what level of capex is needed to sustain this business. We approached this question a variety of ways and think the easiest and most accurate assessment is to exclude capex for in-flight connectivity. We estimate this is running at over USD 200m a year (we explain this calculation further below), which suggests the rest of the business could be maintained and replaced for about USD 300m p.a. That implies 2021 operating cashflow of c.USD 600m and free cashflow of close to USD 400m. For us Inmarsat's current market capitalisation of USD 4bn is simply too cheap for a business that is able to generate this level of cashflow protected by high barriers to entry.

There are also three options for further significant upside. The first is that Inmarsat is in fact able to deliver a good return on its investment in in-flight connectivity over GX. The constellation has increasingly become a vehicle for the company to try and establish itself in this market. The allure is obvious. A little over 6,000 passenger aircraft were connected in 2016. This is expected to more than double in 5 years and could double again from there as Wi-Fi becomes standard on most flights. Revenue per plane is currently low – about USD 150,000 a year for competitor GoGo Inc. ("GoGo") – but then service levels are poor in comparison. Most of GoGo's fleet is served over its air-to-ground network in the US which is very capacity constrained and therefore often offers something less than a real broadband service. With a good connection at a reasonable price it may not be unreasonable to expect revenue per plane to go much higher. If we assume USD 300,000, based on c.USD 1 per passenger as part of the ticket price, the market size could be USD 7bn a decade from now. It is not a surprise that Inmarsat is taking this opportunity seriously. It is also not a given that it won't be nicely profitable for them in the long run. Unfortunately, though, we think the odds are not in their favour and don't justify the level of capital investment and operating expenses that management is putting into the business.

The fundamental problem is that Ka-band is not likely to be capacity constrained over the main aviation routes and hubs for the foreseeable future. For example, ViaSat Inc. ("ViaSat") has just launched its second-generation satellite over the Americas. This has several times the capacity of the satellite it is replacing. A third generation is planned in the next five years that will also cover Europe and potentially Asia as well, with several times the capacity of the second generation. ViaSat's primary target market is residential broadband but there is a significant risk that, as rural terrestrial networks improve, there is not enough demand there to soak up this capacity. In the US ViaSat offers a far superior service to GoGo for, we believe, much the same level of revenue per plane. GoGo's response has been to launch a satellite service of its own over leased Ku-capacity but the results for its Rest of the World division (which is only served over satellite) show how unprofitable this is – in the last quarter gross margin per plane was negative to the tune of about USD 100,000 a year. So far Inmarsat has avoided (or been unable to win) in-flight connectivity customers in North America. We think that makes sense given current pricing but if ViaSat-3 gets built and launched the same may become true everywhere until the end of life for that constellation, around twenty years from now!

ViaSat rightly stresses that it takes very high capacity over key airports to serve this market. GX was not designed for this. It was meant to provide an even supply globally because that is a more efficient way to serve the end markets it was originally targeting. To quote Inmarsat CEO Rupert Pearce, the original GX constellation was only "table stakes" to supply in-flight connectivity. To deliver a broadband service to say 100 planes in one location requires adding high throughput capacity aimed at where this demand is focussed. And Inmarsat are adding a lot of additional capacity. First came a fourth GX satellite. This was the backup in case one of the three needed for global coverage failed but it is now likely to be used in large part for in-flight connectivity. That cost USD 400m. In 2016, they leased another Ka-band satellite, Thor-7, from Telenor. The economics of this deal have not been disclosed but we assume it is equivalent to another c.USD 100m in capex (Thor-7 cost Telenor about NOK 1bn). A further GX satellite, this time with a high throughput design focussed on a narrow area, was announced in June this year for 2019 launch. That will cost c.USD

200m. And then there is the Ka-band capacity on i-6s, most of which is not really necessary to serve the core business. On top of this you have investment into equipment on the planes, some of which is being born by Inmarsat rather than the airline. Overall, we think the company is having to make capital investments at a run rate of about USD 200m a year to play in the in-flight connectivity market. They are also adding significant operating expenses to support this business line. Guidance suggests these might peak at USD 100m a year. To get a return on all of this will require a very large revenue base. We estimate a network costing c.USD 3bn in total (that is, capitalising USD 200m of annualised capex) would need to generate revenue of around one billion dollars – more than 3,000 planes on our numbers – to earn a mid-teens pre-tax return on capital. So far Inmarsat has announced contracts to supply about 1,000 planes over GX.

The more interesting in-flight connectivity option is, we believe, Inmarsat's European Aviation Network ("EAN"). We think Inmarsat management agree as they chose to invest in it after GX (which underlines our concern about that part of the business). EAN is a hybrid network that mostly uses cellular towers to supply air-to-ground connectivity to planes. Here Inmarsat owns the spectrum license in the S-band but most of the capacity is rented from Deutsche Telekom AG, which has built about 300 towers specifically to supply planes (there is also a smaller satellite component owned by Inmarsat). In many ways, this is a very attractive way of supplying this market given how uncertain the future economics are. The capital cost is low and capacity is easier to vary as it mostly depends on adding more cell towers rather than launching whole satellites. S-band is low frequency and so requires cheaper, smaller and lighter terminal equipment on board, making it more fuel efficient. International Consolidated Airlines Group SA ("IAG") has already signed up most of its short-haul fleet, over 300 planes. Deutsche Lufthansa AG will trial it too and Air France KLM SA is currently in the process of deciding what technology it will use. It is possible that EAN becomes the de facto standard in the region within a few years. ViaSat is currently challenging the European Commission in court over their decision to allow it, having failed to persuade regulators that it goes beyond the scope of the original spectrum license (by relying too much on a cellular network). Discussing this, ViaSat's COO Rick Baldridge actually makes a good business case for EAN, pointing out that "the low-cost install [is] pretty attractive to the buyer. Once they get on, they have this stranglehold on the consumer" giving Inmarsat "a natural monopoly with major Pan-European business advantages". If EAN does manage to dominate the European short-haul market it will be very profitable in absolute terms (even though the margin will be lower than for a model where Inmarsat provides the capacity via satellite). The main issue is that it will not match the bandwidth of ViaSat-3 when that eventually launches over Europe. The critical service here is video streaming. Inmarsat believe it can get around any bottleneck by housing popular products like the Netflix Inc. library on the plane. This may be right. If so it is not difficult to see EAN generating EBITDA of EUR 200m, with little capex, within 5 years. The commercial launch is due before the end of this year.

The other profit line that we assume nothing for in the medium term is rental payments from Ligado, which pays annual fees of c.USD 120m to Inmarsat for use of some of its L-band spectrum in the USA. The company, originally known as LightSquared Inc., wants to use it along with its own spectrum to provide a terrestrial network. The problem is it does not have permission to do this from the regulator, the Federal Communications Commission ("FCC"), and may never get it because of concern that its spectrum is too close to – and will interfere with – the GPS network. This is likely to be resolved one way or another within the next year. Although the current US administration is probably the most favourable Ligado could wish for, we still think it is more likely that permission does not come. If it does the immediate upside is obviously very significant for Inmarsat.

We have explained in some detail why we think Inmarsat's core business is undervalued by the market. We also think there is nothing in the share price for the potential upside from GX in-flight connectivity, EAN or Ligado. Investors are, we think, overly focused on the negative: the committed investment into in-flight connectivity. We think they are also sceptical that current management will change course. GX is CEO Rupert Pearce's baby. He has been in charge of it since 2008. He probably cannot admit failure and keep his job. On the 2015 results conference call Pearce said:

> "So will we be talking about year after year of transition? No. 2015 is the final year of transition for us, which is about bringing through GX, and now GX has got to pay off in the years to come."

Inmarsat's shares at the time were worth USD 13 each. Today the price is about USD 8.20, well below where it was when GX was unveiled in 2010. The reason is, we believe, pretty simple. 2016 and 2017 both turned out to be more years of transition. Operating profit has not grown for the best part of a decade as depreciation catches up with ever higher investment. We think the company needs to stop and take stock, and to announce clearly that this is what it is doing. It should not commit any more capital to in-flight connectivity over GX until it can provide real visibility on future profitability. If that change in strategy doesn't happen sooner it will happen later. It cannot go on forever investing in a venture if it turns out to be loss-making, which is what sell-side consensus now seems to assume. When that changes, either because Inmarsat demonstrates its solution is viable or because it accepts that it is not, the value of the core business will still be there. One or two other things may have turned out well for them too. Taken together, all of this makes Inmarsat shares a very attractive investment for us today.

For further information please contact:	Eleanor Scott, Ennismore Fund Management	+44 (0) 20 7368 4219	subs@ennismorefunds.com
For dealing please contact:	Northern Trust International Fund Administration Services (Ireland) Ltd	+353 (0) 1 434 5103	Ennismore_TA_Queries@ntrs.com

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For further information please contact:	Eleanor Scott, Ennismore Fund Management	+44 (0) 20 7368 4219	subs@ennismorefunds.com
For dealing please contact:	Northern Trust International Fund Administration Services (Ireland) Ltd	+353 (0) 1 434 5103	Ennismore_TA_Queries@ntrs.com