Ennismore Global Equity Fund

Investor Newsletter for the month of December 2017

Issued on 16th January 2018

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 226m as at 29th December. Total assets under management by Ennismore Fund Management were USD 879m.

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.

Top Five Long Holdings as at 29 December 2017

	Company	Country	Sector	% of NAV
1	Etsy Inc	United States	Information Technology	9.4
2	Mtu Aero Engines Gmbh	Germany	Industrials	6.9
3	TPG Telecom Ltd	Australia	Telecommunication Services	6.2
4	Under Armour Inc	United States	Consumer Discretionary	6.0
5	Schibsted ASA	Norway	Consumer Discretionary	5.9
				34.4

Exposures as at 29 December 2017

Longs %	Shorts %	Gross Exposure %	Net Exposure %
88.7 (87.4)	43.4 (45.4)	132.1 (132.8)	45.3 (42.0)

Figures in brackets refer to previous month end.

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

Country	Gross%	Net%
United States	46.9	18.6
United Kingdom	28.0	11.2
Germany	21.2	5.2
Australia	10.1	5.5
Norway	5.9	5.9
Netherlands	3.1	1.7
Canada	3.0	-0.8
Hong Kong	2.3	-2.3
Switzerland	2.3	-2.3
Sweden	1.4	1.1
Belgium	1.3	0.2
Other	6.6	1.3

Market Cap	Gross%	Net%
>$10bn	19.2	-4.7
$5bn-$10bn	32.7	29.6
$1bn-$5bn	64.0	28.1
<$1bn	16.2	-7.7

Positions	Dec	Nov
Long	35	37
Opened	1	1
Closed	3	1
Short	53	51
Opened	3	3
Closed	1	4

Sector	Gross%	Net%
Consumer Discretionary	37.1	23.2
Consumer Staples	14.7	3.9
Energy	0.4	-0.4
Financials	4.8	2.1
Health Care	1.6	0.0
Industrials	17.7	9.4
Information Technology	39.3	2.0
Materials	2.1	-2.1
Real Estate	2.3	-2.3
Telecommunication Servic	12.1	9.5
Utilities	0.0	0.0
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.

Performance as at 29 December 2017

	Share Class			
	GBP	GBP A	EUR	CHF
NAV per Share[1]	**10.74**	**10.72**	**10.56**	**11.22**
Period	**% Change**			
December 17	**5.5**	**5.5**	**5.1**	**4.0**
November 17	-1.2	-1.2	-1.6	-0.6
October 17	1.3	1.3	1.7	2.8
2017	**1.3**	**1.3**	**-2.2**	**5.4**
Since launch[2]	**7.4**	**7.2**	**5.6**	**12.2**

[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	Q4 17	6.6	5.8	7.8
	Q3 17	2.4	2.0	6.0
	Q2 17	2.6	0.3	2.2
	Q1 17	3.8	4.0	3.8
Short	Q4 17	0.9	0.9	0.8
	Q3 17	0.0	0.1	0.0
	Q2 17	-4.7	-4.6	-4.7
	Q1 17	-5.7	-5.6	-5.5

Attribution figures exclude cash returns and are prior to expenses

The Fund's NAV per share increased between 5.1% and 6.2% in Q4, depending on currency.

For the quarter, long positions added around 6.6% to NAV (in the sterling share class). There were several major positives and a couple of material negative performers.

The largest contribution came from social media network Twitter Inc, adding 1.7% to NAV. Although we get asked about this position a lot, and not usually in a flattering light, it has been a good investment for the Fund. We will save a full write-up for another letter but the business appears to be performing better and remains significantly under-valued in our view. Other positives were TPG Telecom Ltd (1.6%), Etsy Inc (1.6%), Boston Beer Company Inc (0.9%), MTU Aero Engines Gmbh (0.8%) and chemicals distributor Brenntag AG (0.6%). Schibsted ASA also added 0.6% to NAV. We have written up our investment case for this company later in this letter.

Etsy remained the Fund's largest holding at 9.4% of NAV. It has contributed strongly to performance over the past year and our long-term view of the quality of this investment remains the same.

Our largest new position in the quarter was sports apparel brand Under Armour Inc. We have long admired the company, which has grown consistently for two decades. It is the only brand that, in our view, challenges Nike and adidas. It has delivered in the US, where it is now a similar size to adidas, but we think it has enormous potential in the rest of the world where Under Armour is much less well known. In 2017 the company saw sales decline in the US for the first time in its history and the stock de-rated massively. Trading is likely to remain tough in 2018 but we do not believe the brand is anywhere close to being done growing, even in its home market. We were able to buy a position at an enterprise value to sales multiple of only a little more than one times, which we think is a very attractive entry point. As always, we have no strong view on timing although so far, we have been right (or lucky). The position contributed 0.9% to NAV in the quarter.

Against this, Inmarsat PLC and travel website TripAdvisor Inc cost the Fund 1.5% and 0.8% respectively. We wrote about Inmarsat in the Fund's previous quarterly letter. We saw nothing in the Q3 numbers that fundamentally contradicted our views but continue to monitor the business closely.

The short book added 0.9% to NAV. Our short positions in Eros International PLC, Steinhoff International Holdings NV and Telit Communications PLC contributed 1.2%, 0.8% and 0.6% respectively.

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Steinhoff admitted in December that its accounts for several previous years were unreliable and senior management have now gone. While its origin was in furniture, under then-CEO Markus Jooste the company grew in recent years using leverage to acquire disparate retail assets. The nature of their acquisition strategy – they were prepared to buy anything from electronics retailers to pound shops – caught our eye. It strongly suggested to us that the driving force for this strategy was financial engineering. A number of off-balance sheet transactions raised further, significant red flags. That said, we were (and are) unclear on the full extent of the overstatement. Given the high level of leverage, we think it is very possible that equity holders will get nothing. However, we could not be sure of this and so it was only a normal-size short position for us, at a little over 1% of NAV.

Telit continues to struggle. A trading statement in mid-December downgraded profit guidance again and, perhaps more significantly, no longer stated that the company would generate cash in the second half. Further waivers from lenders were required at year end to avoid multiple covenant breaches. The business is, we think, in a terminal condition. Its financial statements can no longer hide this.

Wirecard AG was, again, the main negative on the short side. It cost the Fund 0.9% in the quarter. We have included a brief but important update on our investment case here.

Wirecard AG

In June last year we wrote up some of our concerns about Wirecard. Specifically, we don't believe its accounts make sense. Since then, the stock is up by a half. It is now a EUR 13bn market cap company. Understandably our investors have asked us more about this company than any other. Our position is based on the facts we see and we have seen nothing that has reduced our conviction. The best we can do is share some of these with you and so we have included one example below of facts that lead us to be short Wirecard.

Acquisition of the Payments Business of Great Indian Retail Group

Wirecard announced it would acquire "the payments business of Great Indian (GI) Retail Group" on 27th October 2015 for up to EUR 340m, of which EUR 230m would be paid up front. The acquisition closed on 1st March 2016. According to Wirecard's 2015 annual report this transaction involved acquiring three entities outright - Hermes I Tickets Pte. Ltd. ("Hermes") and its subsidiary GI Philippines Corp. ("GI Philippines"), and Star Global Currency Exchange Pte. Ltd ("Star Global"). Wirecard also injected new capital into another entity, GI Technology Private Limited ("GI Tech"), in return for a 60% stake. The latter investment totalled EUR 15m, according to filings by Wirecard and GI Tech. As part of the transaction both Hermes and Star Global were acquired by Mauritian entities and sold on to Wirecard. Indian foreign direct investment ("FDI") filings show that the Mauritian entities acquired Hermes for USD 39m and Star Global for USD 0.7m.

The price tag of at least EUR 215m (and potentially as much as EUR 324m) for Hermes and Star Global is surprising to us for a number of reasons. Firstly, for the year to March 2015 Hermes reported sales of c.EUR 35m, almost all classified as low margin "Airline Ticket Sales", and only c.EUR 2m net profit. Star Global was loss making and we do not believe it was a significant part of the transaction given that it was not mentioned in Wirecard's 18th November 2015 presentation, which set out the rationale for the Indian acquisitions. Secondly, Hermes was reportedly up for sale in September 2014, a year before Wirecard acquired it. We have been told that the investment bank pitch book suggested a EUR 40-50m valuation for the business. Thirdly, parent company GI Retail's accounts show that it in fact received only EUR 37m from the disposal of subsidiaries in the year to March 2016.

In summary, two sources – the parent company filing and Indian FDI disclosures – state that Hermes was in fact sold by GI Retail for c.EUR 35-40m, not over EUR 200m. These are consistent with a failed sales process in September 2014, where the asking price was rumoured to be EUR 40-50m. Interestingly, on 6th October 2017 Sanjay Chandi, EAGM Ventures (India) Private Ltd. and Prashant Manek filed a commercial fraud claim in the UK's Commercial Court. They were minority shareholders in Hermes when it was sold. Their claim is against a UK subsidiary of India Infoline Ltd., the company which appears to have incorporated the Mauritian entities that acquired Hermes, and Ramu and Palaniyapan Ramasamy, the majority shareholders of GI Retail Group. We believe that minority shareholders in Hermes may be pursuing a claim relating to the sale process, given the huge discrepancy between what GI Retail actually received and Wirecard's reported cost of its Indian acquisitions.

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Return on Capital

The maths of investing is pretty basic. We are buying future cash flow, discounted to the present. Ignoring special situations, a good investment requires some combination of growing cash flows and a relatively low initial multiple. As your time horizon extends, the growth component becomes more and more important, but not all growth is the same. Most companies grow by investing a decent chunk of their cash flow back into their business. To borrow a quote from a well-known investor, "after ten years… a CEO whose company retains earnings equal to 10% of net worth will have been responsible for the deployment of more than 60% of all capital at work in the business". We spend most of our time trying to assess the return those future investments will make.

Many of the companies we own are high return on capital businesses. Evidence suggests that the market often under-prices companies that generate high returns, which implies that these returns tend to be more persistent than expected. One reason may be heuristics. Common valuation rules of thumb, like comparing the price to earnings ratio to growth, do not capture differences in return on capital. Consider two companies, both growing at 5%, one valued at 11 times earnings and the other at 19 times. It seems obvious that the stock on the lower multiple is a more attractive investment. In fact, this call isn't possible without understanding the cost of delivering growth. If the low multiple company can only deploy capital at a 10% return and the high multiple one at 50%, the first company will have to retain a much larger proportion of its earnings to grow at 5%. It should be valued at a lower multiple. In fact, at a 10% discount rate, both companies in our example are fairly valued.

In most industries, most of the time, high returns will attract new investment that dilutes returns. In general, then, investor shortcuts like price to earnings multiples may be reasonable. It is also true, however, that many businesses are able to sustain a high return on capital for a very long time. This is because they are protected by barriers to entry that make it hard for new investors to come in. The barrier might be the economies of scale and customer switching costs associated with aircraft engine manufacturing, or the brand and distribution model of a large brewer. Or it might be the network effect of a successful marketplace, which we discuss at length below. These are the kind of high return on capital businesses we like to invest in.

Our two-company example does make one big assumption - that they cannot reinvest all of their surplus cashflow at the current rate of return. If they could, the valuation difference would be even greater, because growth would be much higher for the company with the higher return on capital. Which leads us to our favourite sort of investment: the protected, high return on capital business that has the opportunity to invest. In this letter, we discuss Schibsted, an online classifieds business. This is one of those rare businesses that can grow with barely any capital. However, Schibsted also has a track record of successfully deploying the free cash flow it has generated, both in launching new businesses from scratch and making acquisitions. It is a great example of a high return business that deserves a premium valuation.

Online Classifieds

Marketplaces often tend to be natural monopolies. Buyers and sellers all benefit from only having to transact in one venue. Liquidity matters. This is a powerful network effect that makes it almost impossible to displace an established incumbent. With costs relatively fixed, a mature marketplace can earn an extremely high return on capital. The Fund's largest holding, Etsy Inc, is a marketplace for handmade goods which we wrote about in a previous letter. Probably the best examples of this type of barrier to entry are the online classified advertising businesses, which account for around 10% of the Fund's long book. Schibsted is the largest of these holdings, but we are also invested in Carsales.com Ltd. in Australia, Auto Trader Group PLC in the UK and Scout24 AG in Germany. We begin by discussing why we find these businesses so attractive before moving on to a more detailed discussion of Schibsted, which we think shows how these great businesses can become unloved and under-priced.

Establishing a marketplace is tough. It's a classic chicken and egg problem – how do you get sellers to a marketplace without any buyers and vice versa? The main goods and services traded using classified ads are homes, cars and jobs. They are, by necessity, local marketplaces. People buy a home mostly because of where it is and won't often move far for a job. The margin on used cars is usually too low to ship them long distances (this is even more important for lower value items) and, of course, the buyer has to go and see the goods before they buy (or interview for the job). The local nature of these markets meant that, before the internet, classifieds were dominated by newspapers which often had a monopoly in their city or region. Today, most of the brands are national but the marketplaces remain local. The shift to the internet provided a one-off (or, at most, a once in several generations) opportunity for new entrants. To take an example we know well, in the UK the local newspapers were mainly owned by four competing groups. When it came to shifting online they tried to co-operate, pooling their inventory on the Fish4 websites, and to compete, starting their own national brands. This was a disaster as no brand benefitted from the full support of their advertising budgets. In the property segment, the four leading estate agency brands instead launched a competing site. Despite controlling a relatively small proportion of total UK inventory their focus meant that it was this site – Rightmove – that came to dominate, with audience share of around 90%. Even today, with a large competitor that carries essentially the same houses for sale, its dominance is largely untouched.

Once an incumbent classified advertising site is well established, it is extremely difficult for a new entrant to get any traction. Unlike most businesses, the very fact that an incumbent is larger is a crucial part of its value proposition to its users. In a marketplace, liquidity is the crucial competitive driver: sellers want to shift their inventory quickly at the best possible price, and if they can do that in one venue why pay for another? Similarly, buyers are looking for breadth and depth of inventory, preferably being able to compare the whole market in one place. To use Auto Trader as an example, UK consumers can choose from 450,000 different cars on the site, around four times as many as the closest competitor. Car dealers advertising on Auto Trader are selling to an audience that is many times larger than any competitor – over 80% of time online looking for a used car in the UK is spent on its website. Any new competitor is certain to have an inferior product. Innovation on other elements of the proposition (e.g. more sophisticated search functionality, better user interface) cannot easily overcome such a disadvantage. When innovations do come, incumbents just replicate them. US player CarGurus launched in the UK late in 2015 and its feature incorporating price advice into its adverts gained some popularity. Auto Trader just copied it. Today CarGurus is irrelevant in the UK market.

Incumbent sites also benefit from brand awareness and affinity built over years and, frankly, from inertia. If the incumbent has virtually all the inventory in the market for free, what incentive is there for a buyer to duplicate their effort looking elsewhere? For Carsales, the Australian equivalent to Auto Trader, the vast majority of its traffic is brand-driven – that is, users browsing on an app, typing the URL directly into their browser, or using a search term including the word "Carsales". On top of this habitual behaviour, many users will have custom searches built into their user profile within the app or website, or have email alerts or push notifications set to notify them if a car matching their criteria pops up on the site. Persuading a user to go elsewhere is a tough ask. Many have tried over the years, without any real success.

A lot of the cost base of a classified advertising site creates long-term value. If we continue with Carsales as our example, around half of its costs are product development and brand investment. The same is true for Auto Trader. These are expensed but many of the benefits remain for years. We estimate Carsales has spent over AUD 200m in marketing over the last ten years, helping to build its brand. When News Corp entered the market in 2011 its c.AUD 100m total investment, of which a small portion went into marketing, didn't have any lasting effect on Australian car buyers. News Corp exited the market in 2016. If anything, the stickiness of the brand may be even more true for property sites, where there is often a number two player that is able to list virtually all of the inventory in the market. Even so, where the incumbent has a dominant audience share it is almost impossible for agents advertising on it to do without the site. Estate agents and car dealers are just too fragmented to be able to go it alone. The impact on their business would be many times greater than the lost revenue for the classifieds website.

When a classified advertising business is able to emerge as the clear market leader it can dominate its sector for years, while new entrants flounder and disappear. Many well financed companies with their own advantages, from News Corp to Google to Facebook, have tried and failed to compete with these incumbents. Although most of the companies that have successful online classifieds businesses only started when the internet took off, the business model is largely a reincarnation of the best part (financially speaking) of the local newspaper industry. For decades, this business model has proved to be extremely resilient in the face of new entrants.

Warren Buffett was an investor in newspaper businesses at least as far back as 1973, when he bought stock in the Washington Post. He acquired the Buffalo Evening News, a local paper in upstate New York, in 1977. Local newspapers tended towards monopolies in each district giving them strong pricing power, as explained in Berkshire Hathaway's 2012 chairman's letter to shareholders:

> "As long as a newspaper was the only one in its community, its profits were certain to be extraordinary; whether it was managed well or poorly made little difference… Over the years, almost all cities became one-newspaper towns (or harbored two competing papers that joined forces to operate as a single economic unit). This

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> contraction was inevitable because most people wished to read and pay for only one paper. When competition existed, the paper that gained a significant lead in circulation almost automatically received the most ads. That left ads drawing readers and readers drawing ads. This symbiotic process spelled doom for the weaker paper and became known as "survival of the fattest.""

As Buffett notes, the key driver of success for a paper was circulation, and newspapers competed for readers with their content. Given that much of a newspaper's cost base was fixed, whilst both ads and circulation revenues scaled with the number of readers, a circulation advantage would quickly translate into a higher profit margin. This meant a larger newspaper could invest in better content, attracting more readers and more advertisers. For some readers, the local ads were a valuable part of the content, leading again to increased readership for larger newspapers. There was a virtuous circle.

Rupert Murdoch built his media empire on the foundation of newspaper classifieds, which he famously described as "rivers of gold". As he later noted wryly, "sometimes rivers dry up". Print media has obviously been disrupted by the internet over the last 15 years, but we believe the business model just moved to the digital medium. Classified advertising websites are heirs to the fortunes newspapers delivered to generations past. Hence Murdoch's repeated, and largely unsuccessful, attempts to launch online classifieds businesses.

Comparing online classifieds websites to their print predecessors illustrates our point. Berkshire Hathaway's disclosures from the 1980s and 1990s show that Buffalo News generated operating margins in the 30-40% range. In the online world, many of the newspaper's costs disappear: there is no physical product to distribute, and next to no content that needs to be produced, apart from the listings themselves. But the value to advertisers – which is driven by the number of buyers and sellers interacting on the platform – remains at least as strong. In fact, online platforms offer a host of capabilities that newspapers couldn't, such as precise targeting of ads and video content.

How would Buffalo News have looked with just a classifieds business and none of those additional costs? We estimate that if you stripped out circulation revenue (25% of total sales) and all the direct costs associated with the physical product (around 65% of total costs), you would be left with a 70% margin business – in line with what the best online classifieds sites earn today. Their monopoly-like positions are just as strong as the local newspapers once were.

Local newspapers didn't always manage to achieve anything like a monopoly in their area. When Buffett first bought Buffalo News it was competing against the similar-sized Buffalo Courier-Express. Neither of them were making much money. The same is true for online classifieds. In some countries, no monopoly site has emerged. In the United States, for example, several sites – cars.com, cargurus.com and autotrader.com – are fighting it out in the auto classifieds segment of the market. In other countries, though, the same network effects that led to dominant local newspapers in the past have created incumbent websites that are at least as strong. The UK, Norway, France and Australia markets all fit this description.

Schibsted ASA

Schibsted is one of the only newspaper companies we know that successfully transitioned its classified advertising business from print to online. Its history in newspapers goes back to 1839 and it still owns some national titles in its home markets in Scandinavia. But today, despite 58% of its EUR 1.8bn of sales still coming from newspapers, online classifieds make up three quarters of its EUR 360m EBITDA (pre-investments) and almost all of its free cashflow. Online classifieds revenue grew at c.15% p.a. over the last five years, most of which was organic. Given the differences in growth rate and margin, we view the print business as largely irrelevant.

Schibsted's online classifieds business began in 1999 when the company started a website, Finn, which took all the classified adverts from the largest regional newspapers in Norway and put them online. Finn became the default place to look for a new house or car. But what really stands out is Schibsted's track record of establishing and growing strong businesses outside of its home market. In 2003, it bought a nascent online marketplace in Sweden called Blocket, which it developed into the market leader in the auto and generalist segments. It went on to launch several start-ups on the same model in other countries, most successfully Leboncoin in France. The key to their strategy was recognising that what mattered early on in the shift from print to online was building up dominance in liquidity. That meant spending on marketing to attract buyers and offering the service free to sellers. Fees and profitability would follow.

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Given this heritage, it is not surprising that Schibsted's various online classifieds businesses are at different stages of development. It is a market leader not only in France (29% of its classified advertising revenue), Norway (23%) and Sweden (17%), but also in a number of other, smaller markets. It has also acquired a position in Spain (15%) and an emerging business which may well become a market leader in Brazil. Most recently it bought the mobile app Shpock, providing a way into the UK and German markets. Finn in Norway is the most mature of Schibsted's brands and it grew revenue at over 10% in the first nine months of 2017. Blocket in Sweden is similar although it still has some revenue from general merchandise adverts which we expect to become free of charge, holding back the top line for a couple of years. In France Leboncoin is dominant in auto and increasingly strong in property too, but it has a lot of opportunity to add revenue. For example, it only just started charging for job listings, of which there are 300,000 on the site. Schibsted is also beginning to monetise the significant investment it has made in OLX in Brazil, which is in a hyper-growth phase. Shpock, on the other hand, is a pure cost item at the moment as they try to build up the network around it, with no revenue stream to speak of.

Overall, we expect Schibsted's online classifieds revenue to grow by double digits percentages for many years ahead. The competitive position of most of the businesses is very strong and we believe management has not used pricing as aggressively as incumbents in other markets, meaning there is untapped pricing power. In the markets where we have access to good data, classified advertising revenue is significantly below what it was in the heyday of print. This suggests there's plenty more room for growth even in the most developed markets. Over the last ten years we estimate that spend on classified advertising has fallen by as much as half in real terms in Australia, the UK and Germany. In some cases, this has contributed to higher margins at customers - we understand that German estate agents are generating peak margins, for example. The key property portals in Germany, Scout24 and Axel Springer's Immowelt / Immonet, Rightmove in the UK and REA Group in Australia, continue to grow average revenue per agent by double digit percentages. The same is true for Schibsted in France but from a much lower base. We think Schibsted management should also be more aggressive with pricing in Norway too.

For the car market, the situation is a bit more complex, but we still believe there is plenty of growth ahead. Taking the UK as an example, car dealer margins have been flat despite the decline in classified advertising spend. This is because having listings available online has led to greater price transparency and hence a lower average gross margin. But we believe that Auto Trader still has plenty of pricing power in the UK. It is the source of such a large chunk – we estimate over half - of all industry leads. The customer base is fragmented and any dealer that drops Auto Trader suffers a large drop in sales and inventory turnover, which is exacerbated by the fixed cost base. Dealers that spend more with Auto Trader end up with higher operating margins, a sure sign of its value. When we compare Schibsted's overall average revenue per car dealer, it is only a small fraction of the level Auto Trader achieves in the UK, again suggesting it may have very significant pricing power remaining in its key markets.

Last year, we hired half a dozen students as temps to call car dealers and property agents across Europe. We found consistently that Schibsted's sites were considered great value compared to their competitors. This pricing power should also deliver further margin expansion over time. Finn, for example, currently reports an EBITDA margin of only a little over 40%, way below comparably dominant sites in other markets. This may be partly down to how central costs are allocated but we believe it has significant potential to improve this. So does Leboncoin. While its margin is higher at c.60% this is below its 2011 level of 70%, as it is investing more today. Overall, we think Schibsted's online classifieds EBITDA margin will end up well above 50%.

Employing Capital

You could be forgiven for taking Schibsted's success with Finn in Norway for granted, given they had so much inventory in their newspapers to put on the site at the outset. But the experience of publishers in other countries shows that winning the market online was not a given. That said, what is really impressive is the returns they achieved by investing in markets outside their home country, not once but repeatedly over the last 15 years. First was Blocket in Sweden in 2003. It cost c. EUR 20m and was already profitable. In 2016, it made EBITDA of about EUR 60m.

What came next is almost more remarkable. In 2006 Schibsted partnered with publishing house Ouest-France to launch Leboncoin, a Blocket replica in France (the two already published free newspapers together in the country). Today it is Schibsted's most valuable asset with EBITDA of c.EUR 150m. It is the clear market leader in the auto segment, and in property outside of Paris, but it still has a long way to go. As mentioned above, it only recently began monetising job listings. In property, it is growing faster than competitor SeLoger as it closes the gap in pricing. It is not simply the case that Schibsted was lucky, or early, in France. 2006 was quite late for an online classifieds business to be starting up. In 2010, with the brand well established, they shrewdly bought out their joint venture partner for only EUR 200m (with EUR 60m of this a payment in kind - a 50% share in the auto classifieds site LaCentrale - which Leboncoin has subsequently gone on to make almost irrelevant).

Not all of Schibsted's online classifieds investments have been successful. They bought the Spanish, Italian and Latin American assets of Trader Media Group and most of these have not established dominance in the same way as Schibsted's main websites. More recently management issued equity without an obvious use for the capital raised. Overall, though, we think the track record speaks for itself and, most importantly, some current investments could pay off handsomely in future. In aggregate, it's 'New Ventures' cost about EUR 100m a year at the EBITDA level. To put that in context, group EBITDA would have been 35% higher in 2016 if management chose to cut these investments. We don't think they should. In particular OLX, Schibsted's Brazilian subsidiary, has huge potential. When it started selling premium listings in July 2016, revenue quadrupled compared to the previous six months. It has only just started the journey to profit. It has 40m monthly visitors to its cars vertical; competitor Webmotors has 9m. While OLX generates little revenue from car ads, Webmotors makes EUR 35m in sales. At the same revenue per visitor, OLX would generate EUR 150m revenue, just from car dealers. This won't come soon, but the patient investor is usually rewarded. OLX is currently loss-making and most research analysts simply value the company using a multiple applied to earnings that include these losses. They, in effect, treat OLX as a liability. However, Schibsted valued its 50% stake at c.EUR 700m when it bought out Telenor Group in May last year. OLX is hardly a liability.

The largest current investment is in Shpock, Schibsted's mobile-only generalist site. In the last twelve months, it lost around EUR 50m. Most of this is marketing spend and if Schibsted were to conclude that the return is poor, it could turn off this investment immediately. For the time being we expect it to continue. The app is partly defensive, preventing other mobile-only start-ups from gaining traction as they have in, for example, Spain. It is also an option on new, large markets in the UK and Germany where Schibsted wasn't previously a player. But in the medium term Shpock, along with OLX and any other investments, will have to deliver or disappear.

Potential Issues

Schibsted is not a takeover target as a trust controls the voting shares. We don't mind that if the capital allocation remains good. We're not in this for a quick buck, although we do worry Schibsted would continue to run its newspaper business even if it became unprofitable. This part of the business is stable at the moment, with a lot of digital revenue, and management has been quick to reduce costs. This could change. Against this, the advantage of the trust's ownership is that Schibsted's time horizon is many years further out than a typical listed company, and we like this very much. How else could it have built such a great classifieds business?

A bigger concern is that in some markets mobile-only apps have been able to establish themselves as new entrants. This has been the case in Spain, for example, where Schibsted had not been able to build a really dominant position. That risk is probably balanced by the potential for Shpock to work for them in a big market like the UK. Then there is an almighty new entrant in Facebook, which is pushing its 'Marketplace'. It already has a huge user base so it can market this offering cheaply. So could Google when it tried, several times, to break into online classifieds. It is less clear that either has anything to tempt users away from strong incumbents. So far Facebook hasn't made much of an impact, and it failed once before – few remember that this is not its first attempt. Facebook's 'Marketplace' has been in action longest in New Zealand and the dominant site there, Trade Me, reports little impact so far. Schibsted even less, but it's a risk we watch closely. Facebook only needs to succeed once.

Valuation

It is no secret that dominant online classifieds websites are good businesses. Relatively high valuation multiples reflect this. Nevertheless, we think the market underestimates the remaining growth potential of many of these businesses, doesn't fully appreciate the strength of their competitive positions and undervalues their high cash generation. In the case of Schibsted, significant investment in less mature markets, one of its key attractions for us, masks the margin potential. In particular, the acquisition of Shpock has meant that the level of investment declined less quickly than expected over the last couple of years. We think this is the main reason that the shares still trade about 25% below their late 2015 peak.

Even if all of its current investments fail, Schibsted is not expensive. It has a market capitalization of EUR 5.8bn with net debt around EUR 0.2bn at the end of 2017, giving it an enterprise value of EUR 6bn. We estimate that its marketplace

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division (online classifieds and price comparison site, Lendo) will generate EUR 250m of free cash flow in 2018. This excludes investments in 'New Ventures', which may be around EUR 50m (the actual level depends a lot on how management choose to develop Shpock). We estimate print will generate around EUR 10-15m of cash (these estimates fully load group costs into each division and assume interest is serviced by the marketplace division). On this basis, Schibsted's shares trade at 23 times free cash flow from its profitable online classifieds businesses, which we expect to deliver high teens growth for many years to come. Giving a modest valuation to the 'New Ventures' division of c.EUR 0.9bn, roughly equal to cumulative investment in it to date, implies that the established online classifieds are in fact trading at more like 19-20 times free cash flow. We expect our investment to compound in the mid-teens on the back of Schibsted's earnings growth, topped up by attractive returns on the capital it reinvests.

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