Ennismore Global Equity Fund

Investor Newsletter for the month of March 2019

Issued on 8 April 2019

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 449m as at 29th March. Total assets under management by Ennismore Fund Management were USD 1,089m. The Fund is currently open. Please contact Eleanor Scott on +44 (0) 20 7368 4219 or email subs@ennismorefunds.com if you would like more information or to make an investment in the Fund. Redemptions can be made through the Administrator in the usual way.

Top Five Long Holdings as at 29 March 2019

Company	Country	Sector	% of NAV
METRO AG	Germany	Consumer Staples	7.7
Naspers Ltd	South Africa	Consumer Discretionary	6.0
SES SA	Luxembourg	Consumer Discretionary	5.8
Ryanair Holdings PLC	Ireland	Industrials	5.6
Bayer AG	Germany	Health Care	5.2
			30.3

Exposures as at 29 March 2019

Longs %	Shorts %	Gross Exposure %	Net Exposure %
92.8 (91.2)	61.0 (55.2)	153.8 (146.4)	31.8 (36.0)

Figures in brackets refer to previous month end. All exposures are calculated on a delta adjusted basis.

Exposures by Country, Market Cap & Sector as % NAV and Positions as at 29 March 2019

Country	Gross%	Net%
United States	36.3	-9.3
United Kingdom	26.8	13.0
Germany	24.1	9.8
France	10.0	4.0
Cayman Islands	8.7	-7.7
South Africa	6.6	5.4
Netherlands	6.0	5.5
Luxembourg	6.1	6.1
Ireland	5.6	5.6
Norway	4.7	4.6
Italy	3.6	0.2
Other	15.3	-5.4

Market Cap	Gross%	Net%
>$10bn	60.4	15.6
$5bn-$10bn	32.6	23.3
$1bn-$5bn	46.0	0.3
<$1bn	14.8	-7.4

Positions	Mar	Feb
Long	47	47
Opened	1	2
Closed	1	1
Short	96	96
Opened	4	3
Closed	4	1

Sector	Gross%	Net%
Consumer Discretionary	36.1	22.3
Consumer Staples	12.0	9.8
Energy	0.6	-0.6
Financials	6.2	2.8
Health Care	12.5	-1.5
Industrials	20.2	5.2
Information Technology	44.0	-13.3
Materials	3.7	-3.7
Real Estate	2.4	-2.4
Telecommunication	15.8	13.5
Utilities	0.3	-0.3
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 March 2019

	Share Class					
	GBP	GBP A	EUR	CHF	EUR I	USD I
NAV per share[1]	**13.29**	**13.25**	**13.43**	**13.68**	**10.90**	**10.45**
Period	**% Change**					
March 19	**0.3**	**0.3**	**-0.2**	**-1.4**	**0.2**	**0.4**
February 19	1.0	1.0	2.5	2.3	0.9	**1.1**
January 19	3.0	2.9	5.4	6.2	2.8	3.0
2019 to date	**4.3**	**4.2**	**7.8**	**7.0**	**3.9**	**4.5**
Annualised return[2]	**12.1**	**12.0**	**12.6**	**13.4**	**-**	**-**
Since launch[2]	**32.9**	**32.5**	**34.3**	**36.8**	**9.0**	**4.5**
	Discrete 12 Month Rolling Performance					
To 31 March 19	**23.4**	**23.3**	**25.2**	**19.8**	**-**	**-**
To 31 March 18	**4.4**	**4.4**	**2.2**	**10.4**	**-**	**-**

[1]Source: Administrator, Net Asset Value. [2]Since inception of GBP, GBP A, EUR and CHF share classes on 03/10/16, EUR I share class on 03/07/18, USD I share class on 02/01/19. Note: All performance figures net of fees. **Past performance is not a guide to future returns.**

Attribution %		GBP	EUR	CHF
Long	Q1 19	12.7	17.0	16.3
	Q4 18	-10.1	-11.0	-12.0
	Q3 18	8.1	7.4	6.1
	Q2 18	20.4	19.4	17.9
Short	Q1 19	-6.3	-6.6	-6.5
	Q4 18	9.2	9.2	9.2
	Q3 18	1.3	1.3	1.3
	Q2 18	-3.9	-3.9	-3.9

Attribution figures exclude cash returns and are prior to expenses

Top 5 Contributors and Detractors for March 2019

Contributors	MTD (bp)
Inmarsat Plc	189
Electronic Arts Inc	49
Naspers Ltd	35
Jd Sports Fashion Plc	31
Wirecard AG	28

Detractors	MTD (bp)
SES SA	-152
Bayer AG	-108
US software company	-42
SMA Solar Technology AG	-36
Tencent Holdings Ltd	-36

Individual stock attributions relate to GBP A shares and are gross of fees and expenses (including financing/stock borrowing costs).

The Fund's NAV increased between 3.9% and 7.8% in Q1, depending on currency.

For the quarter, longs added 12.7% to NAV (in the sterling share class). Most positions increased in value.

The largest positive contribution came from Inmarsat PLC, which added 2.1% to NAV. The Board accepted a takeover bid from a private equity consortium. We don't think that the price offered is particularly attractive. In fact it is only marginally higher than the offer made by Echostar Corporation halfway through last year, which the same Board dismissed because it "very significantly undervalued" the company. One big difference may be that with this offer management will probably get to keep their jobs. Unfortunately the deal is quite likely to go through as no other suitor has emerged yet.

The other major positive contributors in Q1 were Asos PLC (1.8%), recovering from a heavy sell off in December that allowed us to make it a large position in the Fund, Etsy Inc (1.5%) and JD Sports Fashion PLC (1.4%). All three gave trading updates. We sold our position in Etsy Inc during the quarter as it traded close to our estimate of fair value.

Our position in SES SA cost us 1.5% of NAV. As a quick reminder, our investment case is largely based on a proposed sale of C-band radio spectrum in the United States. We view this as something close to a free option, with the core business fairly valued. During the quarter some US lawmakers voiced opposition to the proposed spectrum sale on the grounds that it represents a potential windfall of tens of billions of dollars. We are surprised that the shares sold off so much. There is no other option on the table that will quickly make the spectrum available for telcos to deploy 5G and we always expected a compromise where a share of sale proceeds goes back to the US government.

The short book cost 6.3% of NAV in Q1.

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Through the looking-glass

We try to have as much as possible of the Fund's short book exposed to companies that we think are being misrepresented to investors. In particular, as a firm, we have had some success over the years betting against companies that have subsequently had to materially restate financial reports. If management is telling us it bought a company for one price, and the sellers are saying they sold for another, then there's not really much grey area. Someone isn't telling the truth, the only issue is who? (see, for example, case number HCMA01-046365-2019 against Wirecard AG in the High Court in Chennai; you can find some relevant background to this case in our December 2017 letter). That kind of question has a right answer that is binary and potentially knowable. If we find that answer it can give us a very high level of conviction. Compare that to the long book where, no matter how strong a competitive position may seem, for example, there are often plenty of significant unknowns that it is impossible to answer categorically. To take just one, Amazon Marketplace has an incredible moat today and it is hard to see it getting competed away. But it may also all face much tougher antitrust legislation before too long. We are not saying it will. We can see good social arguments for it, but we really have no idea about the political economy of legislation (or enforcement). That's the point, we can have way more conviction when we find accounting issues or misstated facts.

You might think high conviction should translate into concentrated positions. The opposite is often true for our shorts. If we take the most extreme case, where there is outright fraud, a management able and willing to make up 10 million of profit, say, can almost as easily make that 100 million. The numbers can be pretty much whatever they want, particularly when the company is relatively small. We assume any short might go against us before it works out, and if it is a fraud it might go against us a lot. If it does, the important thing is that the Fund's exposure is still relatively small so we don't have to reduce the position at a loss. We size accordingly. That's why we currently have going on a hundred individual short positions with an average weight of not much more than half a percent of NAV.

You can always promise jam tomorrow but getting money for jam is not so easy. In the end companies light on real business tend to fail because they run out of people willing to give them more cash. Many of the positions in our short book are not self-financing and we expect they will go this way too. There is no guarantee though. Even if a company is deliberately misleading its equity still might not end up being worth a lot less. If management can persuade investors to bid up the shares enough they could use that paper as currency to buy real assets, or they might convince another company to buy them out (Hewlett Packard Enterprise Company may have a view on this). Most of the time, though, these businesses fail. Not for the people running them, who tend to walk away a lot better off. It is the investors who back them that end up holding the bag.

Our short book is built on a process that allows us to get a high level of conviction relatively quickly. If it wasn't we wouldn't be able to run the number of names we need to manage the volatility that comes with shorting this kind of company. Not all of the positions in our book are ones where we believe the success of the business is being over-stated, but our process works much the same even when they're not. We are looking for information that is significant enough on its own to justify a position, with a lower level of more general due diligence than we could ever accept on the long side. To give you a flavour of how this works in practice we've included three examples in this letter. In each case we are giving you only a small piece of the investment thesis. In each case it was enough for us to seriously consider shorting the company.

"The idea of it is to dance as wildly, as noisily, as furiously as you can"

Remark Holdings Inc. ("Remark") is a textbook demonstration of why we size these positions small. We first shorted the stock back in 2016 at around USD 4.50 a share, in part because we doubted several claims management was making about its new KanKan platform. This was first promoted by the company in 2015 as an app that would allow users to link all major Chinese social media networks "from a front end and back end perspective". Think about how likely that was for a second. In practice KanKan appeared to do little more than scrape whatever information it could from the public pages of social networks. It did not seem to have a significant number of users, to put it mildly.

Over the course of 2016 Remark made several statements about its relationship with Alibaba Group Holding Limited ("Alibaba"), including claiming it had a data integration partnership allowing "access to the data of all transactions made through Alibaba", access to its internet gateway into China that bypassed the "greatest firewall" between it and the United States, and that KanKan was one of the largest customers of Alibaba Cloud Services. We didn't think there was much substance to any of these claims. For example, the only way to bypass the Chinese state firewall we know of is through a virtual private network, and that is illegal. Alibaba Cloud Services had revenue of USD 224m in the third quarter of calendar 2016. Remark's total cost base for its Chinese business was, at most, USD 2.8m for the whole of 2016.

In 2017 KanKan was completely reinvented, first as a big data platform and then as market leading facial recognition software. Remark had invested less than USD 10m in this world-beating technology but its applications seemed endless. Several multi-million dollar contracts to provide ID checks for Chinese lenders followed, along with a deal to install cameras in hundreds of restaurant

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kitchens in Shanghai. Management forecast 2018 revenue of USD 30m for the KanKan platform, from nothing in 2016. The stock soared 400% in two months.

Remark delivered its 2018 results on April Fools' Day. Reported KanKan revenue was only USD 8m. The company burnt through USD 18m of cash (even after paying USD 13m of salaries in stock) and breached its banking covenants (again). To remain a going concern it has agreed to sell travel website Vegas.com to its creditors. The site accounted for 87% of Remark's revenue in 2018, so KanKan is basically all that's left. Last year it reported an adjusted actual earnings before depreciation and amortisation ("EBITDA") loss of USD 11m, before net central costs of over USD 15m. Remark's share price is now around USD 1.50 and we still think it is 100% over-valued.

Fool's gold

On 17th December 2018 Upland Software Inc. ("Upland") announced it was acquiring Adestra Limited ("Adestra") for USD 60m. The purchase price got our attention because it is a lot higher than the GBP 11m valuation Adestra issued equity at about a year earlier, which was roughly the same price paid by Business Growth Fund PLC to buy a controlling stake in the company in January 2016. We won't dwell on that. We are interested in the following statement:

> "The acquisition is within Upland's target range of 5-8x pro forma Adjusted EBITDA and will generate at least USD 8m in Adjusted EBITDA annually once fully integrated."

For the year to March 2018 Adestra reported an operating loss of GBP 1.5m and depreciation of GBP 0.3m. That is, actual EBITDA was about minus USD 1.6m (the previous year that was about minus USD 2m). We were curious to see how Upland might translate this into over USD 8m of *adjusted* EBITDA. How could they go from an EBITDA margin of minus c.10% to one over 50% almost overnight?

The same press release gave revenue guidance that implies steady but not spectacular growth, so the improvement almost all has to come from taking out cost. Here is a rough breakdown of Adestra's expenses as a percentage of sales:

Cost of goods sold	8%
Rent	3%
Staff	59%
Directors	11%
Other	29%

To get to Upland's number over 40% of these need to go. We start by assuming they can scrap Directors' fees entirely. There isn't much information in Adestra's accounts on what other expenses are, but we can infer something from the cost base of listed peer Dotdigital Group PLC. Below the gross profit line the only significant expenses it has besides staff are spend on IT, rent and travel. Even if we assume Upland can take a third of these out we are still left with payroll costs needing to be cut a similar amount.

Adestra had about 150 staff before Upland bought it. One way to reduce salary expense would be to let a lot of them go, but looking at LinkedIn suggests that if anything the number of employees has gone up. Given that it's almost impossible to drastically reduce nominal wages, staff costs just can't have fallen by much. The philosopher's stone here is, we assume, stock-based compensation (another angle, capitalising expenses, doesn't seem to be taken advantage of by Upland). Pay part of your employees' wages in stock and you can exclude the cost from adjusted EBITDA, even though the expense doesn't really change. Why would it? In principle there's not much difference between paper issued by a company and paper issued by a government.

We are not unaware that a lot of listed companies, especially US tech, use this trick. In aggregate it might be the biggest accounting adjustment ever made. But the size of the implied adjustment here really caught our eye. Back in the real world the economics of the business haven't changed. Upland just paid four times sales for a loss-making email marketing firm. That seems fitting really, Upland as a whole loses money (on an unadjusted basis obviously) and only generates any cash at all by paying a large part of its wage bill in shares.

Plastic fantastic

There is, rightly we think, a lot of focus today on reducing plastic waste. If you weren't moved by last year's Blue Planet II documentary series we can only assume that's because you haven't seen it (and if you haven't, you should). As luck would have it Bio-On SpA's ("Bio-On") CEO Marco Astorri claims to have a solution – his company's biodegradable plastic (polyhydroxyalkanoate, or "PHA"). Amazingly Bio-On seem to state that they are able to make PHAs at a tenth of the cost of other producers, which would easily be low enough to make them commercially viable. We may come back to the science in a later letter, for now let's look at the numbers.

Bio-On listed in 2014 and reported cumulative revenue of EUR 25m up to the end of 2017. EBITDA was EUR 11.7m, a 47% margin. The company was able to achieve this because a large part of its reported sales were deals to license its technology. However operating cashflow over the same period adds up to an outflow of EUR 5.2m. Management has done a much better job of announcing deals than

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it has collecting on them. For example, in July 2015 it gave details of a license deal with French sugar co-operative Cristal Union, although the tie-up was in fact with a joint venture ("JV") between the two companies named B-Plastic SAS. Bio-On's 2015 accounts show it booked EUR 3.25m license revenue from this JV but collected none of it in cash. By the end of 2017 EUR 2.75m was still due from B-Plastic but the accounts for the joint venture show no liability, or cash to pay it with. Curiously Bio-On accounted for its stake in the JV with a EUR 1m book value at the end of 2015 but then removed this item the following year, writing off the investment but not re-stating its 2015 accounts (the entry just disappears). That is, Bio-On appears to have invested EUR 1m in the JV, written that investment off while collecting, at most, half of that license fees from it.

Other announced license deals appear to have been just as hard to consummate. An entity called Moore Capital in Brazil (no relation to Louis Bacon's firm Moore Capital Management LP) was due to pay EUR 5.5m in September 2015. Bio-On's accounts show it collected EUR 0.2m at most. A third deal with Maccaferri SpA in December 2015, again through a JV (Sebiplast SpA), has a license fee element of EUR 4m. Again little, if any, of this had been collected by the end of 2017. In all three cases no plant has been built. In all three cases the joint venture that would build it has very little capital, implying Bio-On would need to contribute tens of millions of euros for this to happen.

Having failed to find a partner willing to actually invest in a plant, Bio-On has instead been putting up one of its own, funded by an equity raise in 2017 (we say it is building advisedly as, although the company said it would be finished by the end of last year, recent visits to the site show a work clearly still in progress). Management made some very big claims about the company's production processes to justify this investment. They need to be right. Whatever proprietary knowledge Bio-On does have, the product itself is not new. The material was first isolated in the 1920s. ICI PLC, Zeneca Inc., Monsanto Company and The Procter & Gamble Company all spent decades trying to commercialise PHAs and failed. More recently PHA specialist Metabolix Inc. sold for only USD 10m.

Bio-On has a market cap of EUR 1bn. If that valuation is justified it is reported to be largely down to the work of head of biology, Simone Begotti, according to a *Wired* article published only a little more than a year after he joined the firm. If so, this would have been a remarkable achievement for a scientist that the company's founders found on the internet; one that hasn't published an academic paper since his Masters thesis in 1994, doesn't seem to have a PhD, worked for many years as a schoolteacher and then as the marketing officer for a biotech firm that went into liquidation, and has not ever officially registered to work as either a biologist or a chemist in Italy – even though the relevant trade bodies stated to us that this was required.

A few days ago Bio-On announced its preliminary 2018 results. There's not much detail in this set of numbers but revenue was a stunning EUR 51m – with just the EUR 49m remaining to be collected out of receivables. It appears that most of these sales were licenses granted to JVs with combined losses of well over EUR 30m (which is the share accounted for by Bio-On). Revenue from these "special purpose vehicles" is speculative, at best, as many are so far inactive. For example, on 27th December Bio-On announced a EUR 6.5m license sale to its subsidiary ELOXEL SpA, with furniture retailer and Bio-On shareholder Kartell SpA taking a 50% stake in it at the same time. The Italian company register shows this JV is still dormant today. The very next day another JV, ZEROPACK SpA (this one is with Rivoira Giovanni & Figli SpA, a loss-making fruit and veg producer) bought a EUR 10m license from Bio-On. Similarly, on 31st May 2018 Bio-On announced an 80/20 JV in AMT Labs SpA with GimaTT SpA; GimaTT's annual report shows the JV remained inactive at the end of the year. In total very little cash appears to have been invested in any of the JVs so far. We look forward to reading the accounts for each of these related entities, as and when they are eventually filed. In the meantime, Bio-On, which went from a net cash position at the end 2017 to net debt of EUR 23m a year later, could really do with generating some meaningful cashflow from selling actual product to real customers.

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