Ennismore European Smaller Companies Fund

Investor Newsletter for the month of July 2019

Issued on 6 August 2019

Fund Details

Daily dealing UCITS and Irish Central Bank regulated open-ended investment company with Financial Conduct Authority recognition and registered in Ireland. The Fund size was GBP 410m as at 31st July. Total assets under management by Ennismore Fund Management were GBP 904m. Our smaller companies funds are hard closed to new investment with the number of shares in issue capped and we have a waiting list of clients that want to invest as and when capacity becomes available through redemptions. If you would like to be included on this please call Eleanor Scott on +44 (0) 20 7368 4219 or email subs@ennismorefunds.com. Redemptions can be made through the Administrator in the usual way.

The Fund is managed as an absolute return fund with the objective of generating positive returns irrespective of market conditions rather than performing relative to any benchmark index. Index data is provided in the following table as a guide to general equity market conditions.

Performance as at 31 July 2019

	Share Class[2]					HSBC Index[3]		MSCI Index[4]
	GBP A £	**GBP A €**	**GBP B**	**EUR A**	**EUR B**	**GBP**	**EUR**	**(local)**
NAV per Share[1]	**140.33**	**154.33**	**23.71**	**22.29**	**22.40**			
Period	% Change					% Change		
July 19	**0.6**	**-1.0**	**0.6**	**-0.7**	**-0.7**	**1.1**	**-0.6**	**0.7**
June 19	-0.7	-1.9	-0.7	-1.8	-1.7	4.8	3.5	4.6
May 19	2.2	-0.6	2.2	-0.1	-0.1	-2.4	-5.1	-4.5
April 19	0.7	1.0	0.7	0.9	0.9	4.3	4.3	4.1
March 19	1.5	0.8	1.5	0.9	1.0	1.0	0.7	2.0
February 19	-0.2	1.7	-0.2	1.3	1.3	1.3	3.1	3.6
January 19	1.4	4.3	1.4	3.8	3.7	5.6	8.7	5.6
2019 to date	**5.7**	**4.3**	**5.7**	**4.4**	**4.5**	**16.5**	**14.9**	**16.8**
Annualised return[5]	**13.9**	**12.4**	**10.7**	**9.9**	**10.0**	**9.6**	**8.2**	**4.3**
Since launch[5]	**1329.8**	**995.9**	**137.1**	**122.9**	**124.0**	**556.8**	**400.6**	**134.9**
	Discrete 12 Month Rolling Performance - % Change							
To 31 July 19	8.7	6.6	8.7	6.8	6.9	-1.9	-4.0	1.6
To 31 July 18	3.1	3.4	3.1	3.3	3.4	7.5	7.9	7.1
To 31 July 17	12.9	6.3	12.9	8.1	8.0	27.1	19.7	16.3
To 31 July 16	15.9	-2.6	15.8	0.1	0.2	13.2	-5.5	-6.2
To 31 July 15	7.0	19.8	7.0	17.3	17.2	10.2	24.0	13.8

[1]Source: Administrator, Net Asset Value. [2]Source: Administrator, Net Asset Value, net income reinvested. [3]Source: Bloomberg, Euromoney (formerly HSBC) Smaller European Total Return Index. [4]Source: Bloomberg, MSCI Europe Index, local currencies, total return. [5]Since inception of GBP A share class on 27/01/99 to date, GBP B share class on 19/01/11 to date, EUR A and EUR B share classes on 31/01/11 to date. Note: All performance figures net of fees. **Past performance is not a guide to future returns.**

Comments below on performance refer to GBP NAV per share unless otherwise stated, exclude cash returns and are prior to expenses.

Top 5 Contributors and Detractors for July 2019

Contributors	MTD (bp)
UK auto company	67
Jd Sports Fashion Plc	49
Vossloh AG	32
Dialight Plc	29
Cello Health Plc	24

Detractors	MTD (bp)
METRO AG	-37
Costain Group Plc	-36
UK technology company	-34
United States energy company	-21
Just Group Plc	-17

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

The Fund's NAV rose by 0.6% in July. Our long and short books contributed 0.4% and 0.5% respectively.

Costain – UK engineering and construction company (2.8% NAV)

We last wrote about Costain in the October 2017 newsletter but we wanted to write again due to the extreme value we see in the stock. We believe the share price reaction to the recent trading update was overly harsh: Costain now has a market capitalisation of GBP 165m despite having a net cash position and expected turnover this year of circa GBP 1.2bn, which would lead to operating profit after tax of around GBP 30m and tangible equity of over GBP 130m by the year end.

Operationally in 2018 the business had progressed a little worse than we were expecting when we wrote last, by around 5 percent lower at profit level, with more cash flow absorption to speed up supplier payment than expected. However, the recent trading update reduced estimates by over 30 percent for 2019 and led to the share price to falling by around 40%. As at 5 August 2019 the price was 152p compared to a price of 425p in October 2017. We added substantially to our position following the update as we don't believe the long-term value of the stock has materially changed.

The reduction in estimates was very frustrating but was due to various large highway and railway contracts being delayed, and one being cancelled, rather than provisions for losses on existing contracts which would be much more worrying for us. The company did also disappointingly have to take a GBP 10m charge for an arbitration award for the cost of remedial works on a very old contract where a subcontractor had gone bankrupt but, from speaking to management, we believe this was exceptional. There are still worries that the new UK government may delay projects further such as the second section of the high-speed rail project which would reduce profits in 2020 on our calculations by circa 20%. However, from recent comments regarding other potential projects we believe that if anything the new government could be a positive for infrastructure spending over time.

The company has not really changed since we last wrote, the main differences being the recent change of CEO, with one of the previous divisional heads being promoted to that role, and some changing of divisional allocation. It still has substantial long-term visibility with an order book of GBP 4.2bn and remains focussed on infrastructure within highways, rail, aviation, water, energy and defence. The new CEO, Alex Vaughan, has recently further emphasised the strategy to increase their focus on higher value-added turnover such as consultancy and the digital solutions attached to the projects they are involved with, as opposed to the low margin pure construction element. This longer term would lead to an operating margin over six percent, versus the four to five percent target historically, with the majority of profits coming from higher value-added revenue. This strategy is logical to us and would further differentiate them from some of their peers. The struggles of other construction companies such as Kier and Carillion do seem to be weighing on Costain's share price although Costain's business model of cost reimbursement, as opposed to lump sum contracts, together with net cash on the balance sheet and strong tangible equity backing makes it look very different to those two.

Even with the disappointing news the return on invested capital after tax is still around 35 percent and average net cash for the year is expected to be around GBP 55m, which helps to sustain a generous expected dividend yield of around six and a half percent. This is another factor in our weighting of Costain in the fund. Overall, with the business on what we think is close to trough earnings, applying a lowly 10 times multiple to forecast 2020 operating profit after tax and adjusting for net cash and pension deficit would give a potential total return of over 100 percent to the end of next year.

Top Five Long Holdings as at 31 July 2019

	Company	Country	Sector	% of NAV
1	Jd Sports	United Kingdom	Consumer Discretionary	5.0
2	Sto	Germany	Materials	3.2
3	Vossloh	Germany	Industrials	3.1
4	METRO	Germany	Consumer Staples	2.8
5	Costain	United Kingdom	Industrials	2.8
				16.9

Exposures as at 31 July 2019

Longs %	Shorts %	Gross Exposure %	Net Exposure %
70.5 (72.3)	48.7 (47.9)	119.2 (120.2)	21.8 (24.4)

Figures in brackets refer to previous month end.

Exposures by Country, Market Cap & Sector as % NAV and Positions as at 31 July 2019

Country	Gross%	Net%
Austria	2.5	0.6
Belgium	1.1	1.1
France	6.2	2.3
Germany	30.6	5.2
Hong Kong	1.5	-1.5
Ireland	1.7	1.7
Italy	4.7	2.5
Luxembourg	1.0	0.9
Netherlands	2.0	0.8
Norway	3.7	-0.3
Sweden	2.0	-0.6
Switzerland	4.4	-4.4
UK	46.0	18.0
US	8.4	-3.2
Other	3.4	-1.3

Market Cap	Gross%	Net%
>£2bn	38.8	3.5
£700m - £2bn	17.6	-12.6
£200m - £700m	42.5	15.9
<£200m	20.3	15.0

Positions	Jul	Jun
Long	79	78
Short	90	89
Longs Opened	4	2
Longs Closed	3	3
Shorts Opened	5	1
Shorts Closed	4	4

Sector	Gross%	Net%
Consumer Discretionary	33.0	8.1
Consumer Staples	5.5	2.9
Energy	0.6	0.4
Financials	8.9	7.2
Health Care	7.6	-0.9
Industrials	18.0	8.6
Information Technology	31.5	-13.6
Materials	4.6	4.5
Real Estate	5.0	1.9
Telecommunication	4.5	2.7
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.

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