Ennismore European Smaller Companies Fund

Investor Newsletter for the month of September 2019

Issued on 7 October 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 414m as at 30th September. Total assets under management by Ennismore Fund Management were GBP 981m. 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 30 September 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]	**142.05**	**160.57**	**24.00**	**23.08**	**23.19**			
Period			% Change				% Change	
September 19	**0.6**	**2.9**	**0.6**	**2.4**	**2.4**	**0.9**	**2.7**	**3.1**
August 19	0.6	1.2	0.6	1.1	1.1	-2.3	-1.5	-1.7
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	**6.9**	**8.5**	**7.0**	**8.1**	**8.2**	**14.8**	**16.3**	**18.4**
Annualised return[5]	**13.8**	**12.5**	**10.6**	**10.1**	**10.2**	**9.5**	**8.2**	**4.3**
Since launch[5]	**1347.3**	**1040.2**	**140.0**	**130.8**	**131.9**	**547.0**	**406.5**	**138.1**
	Discrete 12 Month Rolling Performance - % Change							
To 30 September 19	8.5	9.2	8.5	8.9	9.1	-1.7	-1.4	5.1
To 30 September 18	4.3	3.2	4.3	3.3	3.4	3.7	2.7	2.0
To 30 September 17	8.9	6.9	8.9	7.4	7.4	23.0	20.8	17.7
To 30 September 16	18.9	1.3	18.9	4.4	4.4	24.5	6.3	7.0
To 30 September 15	7.3	13.5	7.3	12.2	12.2	8.1	13.9	-0.3

[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 September 2019

Contributors	MTD (bp)
JD Sports Fashion Plc	105
IG Group Holdings Plc	31
Vossloh AG	20
Costain Group Plc	19
U and I Group Plc	17

Detractors	MTD (bp)
Swiss electronics manufacturer	-31
IQE Plc	-27
UK healthcare company	-17
Dutch online retailer	-13
Cegedim SA	-12

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 by 0.6% in September. Our long book contributed 2.5% while the Fund's short exposure cost 1.1%.

Cello Health Plc – UK healthcare services company (2.5% NAV)

We last wrote on Cello Health (then named Cello Plc, the new name reflecting that it is now very much a healthcare services business) in our February 2016 newsletter. Since that comment the stock has delivered a total return of about 60% but we consider this disappointing given the execution of its strategy which has resulted in improving profit quality, larger scale and a stronger balance sheet. We expect the business to generate operating profit of around GBP 13.5m for 2019 compared to around GBP 9m in 2015.Cello raised GBP 15m of equity in February 2017 to acquire Defined Health Inc in the USA for c.USD 9m, and to strengthen the balance sheet for further acquisitions such as that of Advantage Healthcare Inc later that year. Organically the company has operationally performed roughly as we expected in our previous Cello stock comment.

Now with a market cap of around GBP 135m Cello Health is predominantly a business offering scientific commercial services to the pharmaceutical and health industry, which account for around 80% of the group's total divisional operating profit of around GBP 18m. In reality around 35% of Cello's sales are pass-through e.g. paper and printing, and therefore we believe profitability should be considered relative to the company's net revenue of over GBP 110m. Overall on this basis we expect Cello Health to generate a margin of circa 12% post central costs this year.

The Health division provides market research, consulting and communication services. The company can be involved at various stages of a drug's lifetime from pre-clinical all the way to post launch, providing a broad range of services to help maximise the likelihood of a drug's commercial success. This segment has a strong international bias with 80% of its net revenue from clients located

outside the UK, with the USA accounting for over 50%. The company has various offices mainly on the East and West coast of USA as well as the UK and mainland Europe. Cello's Health division is therefore now a global platform offering a range of services to the industry with 24 of the top 25 global pharmaceutical companies as clients of which 15 have been clients for the last five years. Organic net revenue growth has continued to be solid, we estimate at around 7% a year since we last wrote, continuing to be helped by the structural growth in health spending. In the first half 2019 this was running at over 8% with some operational leverage leading to 15% profit growth and a margin on net revenue approaching 19%. This organic growth continues to be bolstered by acquisitions such as ISS, a New Jersey based scientific consulting firm acquired in August for a total potential USD 10.5m outlay at a multiple of six times profits before tax. This is an example of the company being disciplined about the price it is willing to pay for acquisitions.
The Signal segment is a very UK-focussed business and only has around 15% of its net revenue in health-related work. It is also in a more competitive space with a large proportion of revenue being more traditional marketing services. This has been reflected in its low growth which has not been helped by a weak economic environment. This division has struggled to achieve double digit margins, however, following the recently announced disposal of loss-making subsidiary Pulsar for GBP 4.5m of the acquiror's equity, the operating margin should increase to a credible double digit level. This division is likely to reduce in significance due to its lower organic growth and lack of acquisition focus.

The business continues to require little capital to grow organically and we expect the dividend, still at over a three percent yield, to have grown by over 40% from 2015 to this year. The return on gross invested capital pre-tax is only around 12%, primarily held back by the weakness in the Signal division. For the health division, which is the key focus going forward, we calculate healthy returns of over 30% pre tax.
Staff are well aligned with shareholders with around 20% of pre bonus profits typically paid out as bonuses as well as there being a long-term incentive plan in place.
Given the amount of private equity interest looking to consolidate the healthcare services space, we are a little surprised that the company has remained independent and wonder whether this will continue to be the case if the valuation stays at current levels.
As of June, Cello Health had GBP 2m of net cash which we would expect to grow to over GBP 5m by the year end. Adjusting for average debt and deferred consideration leads to an Enterprise Value of around GBP 137m. We value Cello's two divisions separately, with Health deserving a premium at a multiple of 17 times operating profit after tax compared to the Signal division at 10 times due to its structural growth, greater specialisation, international diversification and increasing scale. Finally, we deduct central costs applying a 13 times multiple. This leads us to expect a total return of over forty percent to the end of 2020.

Top Five Long Holdings as at 30 September 2019

	Company	Country	Sector	% of NAV
1	Jd Sports	United Kingdom	Consumer Discretionary	5.8
2	METRO	Germany	Consumer Staples	3.7
3	Sto	Germany	Materials	3.2
4	Vossloh	Germany	Industrials	3.1
5	Costain	United Kingdom	Industrials	2.8
				18.6

Exposures as at 30 September 2019

Longs %	Shorts %	Gross Exposure %	Net Exposure %
72.2 (68.9)	45.7 (45.8)	117.9 (114.7)	26.5 (23.1)

Figures in brackets refer to previous month end.

Exposures by Country, Market Cap & Sector as % NAV and Positions as at 30 September 2019

Country	Gross%	Net%
Austria	2.0	1.0
Belgium	1.3	1.0
France	5.9	1.9
Germany	30.6	7.3
Hong Kong	1.2	-1.2
Ireland	2.1	2.1
Italy	5.3	3.2
Luxembourg	1.5	1.4
Netherlands	3.1	-0.4
Norway	2.4	0.1
Sweden	2.2	-0.2
Switzerland	5.2	-5.2
UK	44.0	19.4
US	7.2	-2.8
Other	3.9	-1.1

Market Cap	Gross%	Net%
>£2bn	42.7	8.5
£700m - £2bn	17.1	-7.2
£200m - £700m	36.6	8.3
<£200m	21.5	16.9

Positions	Sep	Aug
Long	76	75
Short	91	90
Longs Opened	5	2
Longs Closed	4	6
Shorts Opened	4	2
Shorts Closed	3	2

Sector	Gross%	Net%
Consumer Discretionary	33.6	11.0
Consumer Staples	5.9	3.7
Energy	0.5	0.4
Financials	8.6	8.3
Health Care	8.0	-0.6
Industrials	18.4	9.4
Information Technology	29.2	-15.4
Materials	5.4	5.3
Real Estate	4.4	2.0
Telecommunication	3.9	2.4
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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