Ennismore Global Equity Fund

Investor Newsletter for the month of December 2019

Issued on 15 January 2020

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 698m as at 31st December. Total assets under management by Ennismore Fund Management were USD 1,339m. The Fund closed to new investment this month but we have reserved some capacity until the end of this quarter. 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 31 December 2019

Company	Country	Sector	% of NAV
1 Bayer AG	Germany	Health Care	6.2
2 Naspers Limited	South Africa	Consumer Discretionary	5.8
3 Etsy Inc	United States	Information Technology	5.7
4 Ryanair Holdings PLC	Ireland	Industrials	5.4
5 Rolls-Royce Holdings PLC	United Kingdom	Industrials	4.8
			27.9

Exposures as at 31 December 2019

Longs %	Shorts %	Gross Exposure %	Net Exposure %
102.7 (102.5)	58.3 (57.3)	161.0 (159.8)	44.4 (45.2)

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 31 December 2019

Country	Gross%	Net%
United States	49.8	7.0
Germany	24.7	5.9
United Kingdom	22.8	10.3
Cayman Islands	10.0	-10.0
Ireland	6.5	6.5
South Africa	6.3	5.4
Norway	5.6	2.0
France	5.5	4.3
Luxembourg	4.9	4.7
Netherlands	4.7	4.5
Finland	4.5	4.5
Other	15.7	-0.7

Market Cap	Gross%	Net%
>$10bn	66.8	25.9
$5bn-$10bn	36.8	22.6
$1bn-$5bn	44.8	4.4
<$1bn	12.6	-8.5

Positions	Dec	Nov
Long	51	48
Opened	5	2
Closed	2	2
Short	98	98
Opened	2	4
Closed	2	1

Sector	Gross%	Net%
Consumer Discretionary	39.3	25.2
Consumer Staples	7.1	3.5
Energy	0.0	0.0
Financials	9.0	7.0
Health Care	11.1	1.5
Industrials	23.8	11.3
Information Technology	34.7	-10.2
Materials	5.0	3.6
Real Estate	2.5	-2.5
Telecommunication Servic	28.0	5.5
Utilities	0.5	-0.5
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 31 December 2019

	Share Class					
	GBP	GBP A	EUR	CHF	EUR I	USD I
NAV per share[1]	**13.72**	**13.64**	**14.06**	**14.00**	**11.11**	**10.83**
Period	% Change					
December 19	**0.8**	**0.7**	**1.2**	**0.1**	**0.5**	**0.7**
November 19	-4.2	-4.4	-3.2	-3.2	-4.3	-4.2
October 19	0.0	0.0	2.1	3.2	-0.1	0.1
2019	**7.7**	**7.3**	**12.8**	**9.5**	**5.9**	**8.3**
Annualised return[2]	**10.2**	**10.0**	**11.1**	**10.9**	**7.3**	**-**
Since launch[2]	**37.2**	**36.4**	**40.6**	**40.0**	**11.1**	**8.3**
	Discrete 12 Month Rolling Performance					
To 31 December 19	**7.7**	**7.3**	**12.8**	**9.5**	**5.9**	**-**
To 31 December 18	**18.6**	**18.6**	**18.0**	**13.9**	**-**	**-**
To 31 December 17	**1.3**	**1.3**	**-2.2**	**5.4**	**-**	**-**

[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	Q4 19	-1.0	3.3	3.0
	Q3 19	4.2	5.2	3.4
	Q2 19	7.4	4.0	3.6
	Q1 19	12.7	17.0	16.3
Short	Q4 19	-2.2	-2.5	-2.5
	Q3 19	2.8	2.7	2.8
	Q2 19	-4.0	-3.8	-3.8
	Q1 19	-6.3	-6.6	-6.5

Attribution figures exclude cash returns and are prior to expenses

Top 5 Contributors and Detractors for December 2019

Contributors	MTD (bp)
Naspers Limited	62
Royal Mail PLC	47
Bayer AG	35
UK healthcare company	34
Wirecard AG	30

Detractors	MTD (bp)
Tencent Holdings Limited	-109
Enphase Energy Inc	-57
CarGurus Inc	-34
The Walt Disney Company	-29
US automotive manufacturer	-27

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

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The fund's NAV declined between 3.4 and 3.9% in the sterling and sterling-hedged share classes in Q4. It increased marginally in other currencies.

For the quarter the long book cost 1.0% of NAV. The main positive was Ryanair Holdings PLC, contributing 1.7%. Rolls-Royce Holdings PLC and TripAdvisor Inc. cost 0.9% and 0.8% of NAV respectively. The most significant story, though, was the decision by the US Federal Communications Commission ("the FCC") to run a public auction of C-band radio spectrum currently used by satellite operators SES S.A. ("SES") and Intelsat S.A. ("Intelsat"). This was a mixed result for the incumbents. On the one hand, a large portion of spectrum rights (280 MHz) will be sold for terrestrial use. And it will be sold relatively quickly, with an auction planned before the end of this year. On the other, the financial benefit of this to them has been left completely unclear. Under a proposal for a private sale by the satellite operators themselves they would have retained about 70% of the sale proceeds, out of which they would have funded the new satellite investment needed to free up the spectrum that is being sold. With a public auction they still need to make this investment, but a share of the proceeds has not been specified. Draft legislation proposing a minimum 50% take for the US taxpayer did not proceed so the decision is likely to be left to the FCC. It has to strike a balance between satisfying some legislators that there is not an inappropriate windfall for the incumbents and providing an incentive for the satellite operators to invest in clearing the spectrum in a relatively short period of time.

The overall pot of sales proceeds from the C-band auction will depend on the price mobile network operators are willing to pay, but a range of USD 15-20bn is probably reasonable. SES and Intelsat own rights to use roughly half the spectrum each and may need to invest as much as USD 1bn a piece to free it up. At a 10-15% share of the proceeds they probably don't gain much from the process. At closer to 50% they might make something like USD 3bn each, net of capex but before tax. Even that is not enough for Intelsat, given its USD 15bn debt pile, so the share price was marked down heavily on the news. Our call options expiring later this month are likely worthless as a result, and that cost the Fund 0.9% of NAV in the quarter.

SES is more complicated because, as we explained after we took the position (in our June 2018 letter), we view the core business as fairly valued – with the proceeds from a spectrum sale potentially providing significant upside within a reasonably clearly defined timescale. Although the position cost 1.9% in the quarter, the total attribution since inception is only slightly negative. In many ways the investment case remains today. The most valuable scenario of a private sale is gone, but the amount of spectrum being sold is much larger than what was being proposed 18 months ago. And the timescale for auction is now set. Given its market cap of c.USD 6.5bn, the upside on a twelve-month view is still potentially material so we have held on to the position.

The short book cost us 2.2% of NAV in Q4, a little over half of which relates to our hedged position in Naspers Limited.

The ugly truth

Studies show that symmetry and perceived beauty in a human face are highly correlated (at least that's what we have been told). In an investment, however, symmetry is dull. With SES, it was the asymmetry of potential outcomes that caught our eye – we saw little to lose in a worst-case scenario for the spectrum sale, with a decent probability of an outsized return within a couple of a years. The upside won't always come through for our investments, but where the risk of loss is relatively small like this it only needs to in a few cases to deliver a good return overall. Asymmetry of investment outcomes can be a beautiful thing.

The expected payoff profile of an investment is driven by the prospective gains or losses in different scenarios, and the probabilities of these taking place. To be attractive either the relative gains and losses, or the probabilities, and ideally both, need to be skewed in our favour. What this means in practice is we are usually looking for two or more of the following:

- A very low probability of material loss
- A high probability of at least a good return (say double digit annualised over a few years)
- Some probability of an extremely high return (given that the most we can lose is 100%)

With this framework in mind, later in this letter we go through our long position in CarGurus, Inc. in some detail. Before that we reflect a little on why shorting is not quite the opposite of investing in this respect.

Short selling is structurally asymmetric, but not in a good way. It has some features which stack the odds against us. It's important to be aware of these, and to have a strategy for managing them. The obvious one is that the highest possible return on a short position is the size you make the position (plus or minus the net cost of borrowing the stock) but the

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downside may be multiples of it. Then there is time. Most capital is invested at least somewhat productively, so betting against it you are swimming against a current (and often two when interest rates are low, because the net interest on the sale proceeds is less than the borrow cost). Less intuitive, until you actually try and run a short book, is that as a position goes the wrong way (i.e. its value increases), the risk reward profile gets better (all other things being equal) but our ability to incrementally benefit from this gets smaller. If a position gets too big we just can't add to it and may even be forced to reduce it, so that we don't have an outsized exposure at the portfolio level. Even worse, in theory we may not be able to control the timing either, if the stock we are borrowing gets recalled (although that hasn't been an issue for this fund so far). All of which means that in some cases we may make a loss overall, even if our thesis is eventually proved right.

One way we manage this risk is to focus on a different kind of asymmetry. We try and find as many zeros as we can - that is, companies we think are worthless because they are destroying capital (at least for shareholders) – by exploiting information asymmetry. Another is to run a highly diversified book of mostly small positions. Small enough that even if they double or triple in value the risk exposure is manageable. This approach brings two big benefits. Firstly, we can get to a level of conviction that is rare in investing. In the framework we gave earlier that means skewing the probabilities way in our favour. Secondly, if we are right, the return on these positions is 100% (less the cost of borrow). We can't usually profit from this by making the positions large – for the reason outlined above – but we can often short more, with basically the same conviction and expected return, even as a share price collapses. That means we can make a lot more than 100% of the capital first committed to a position.

In our March 2019 letter we gave some examples of short positions that came from taking this approach. One was Remark Holdings, Inc. ("Remark"). When we wrote on it, Remark's share price had already fallen by about 60% from where we first shorted it. It is down another 60% since (which is a kind of symmetry that we do find beautiful). But between starting the position and now, it went up (from trough to peak) almost six-fold in late 2017, almost tripled in early 2019 and doubled in the middle of the year. That's been plenty of risk to manage, and opportunities to short more. The position at cost (not value) has never been more than 0.6% of NAV, but it has already contributed more than that to returns.

Unfortunately we can't always profit from our conviction to the same extent. We also wrote on Bio-On SpA in the same letter. It has since collapsed into administration, with a criminal investigation of management ongoing. We would have loved to short more of that beauty but there was no borrow available. There's plenty more fish in the sea, though, and finding them is our day job. The next part of this letter is taken up with one we find particularly convincing, where independent data appears to dramatically contradict the story being told by a company's financial statements.

Fake TAM?

Enphase Energy, Inc. ("Enphase") manufactures inverters used to convert direct current ("DC") from a solar panel to the alternating current ("AC") used domestically and on the grid (for what it's worth, the advantage of AC is mostly that the voltage can be changed easily, so it can be distributed around the country at a very high level – which is more efficient – and converted to a safe level when we use it). Most solar panels are strung together with one inverter used for a whole array of modules. Enphase's solution is different. They supply micro inverters, one for each panel (known as module-level power ("MLP")). This allows better optimisation because not all panels are necessarily receiving a similar amount of sunlight, especially where the site was not custom-designed to house them. Micro inverters are mostly used in residential installations for this reason. In the last quarter 98% of Enphase's sales were of its IQ 7 model, which is specified for domestic use. Its market share of commercial installations is immaterial.

In 2017 about 315,000 homes in the United States added solar panels. Enphase supplied around a quarter of these. In the first nine months of 2019 total installations were about 15 to 20% higher than 2017 levels, but Enphase's reported numbers imply it sold a lot more inverters. In the third quarter its US sales were nearly triple the level of the same period in 2017, with the average selling price little changed, implying its market share had grown to over 60%. It looks like a remarkable success story, with a share price performance to match. The stock went up fivefold in 2019.

Some of Enphase's increased market share is explained by a supply contract with installer SunPower Corporation ("SunPower"), which sold its own micro inverter intellectual property to Enphase in mid-2018 for about USD 78m. Enphase states that it doesn't use SunPower's tech but in return it got a 5-year exclusive supply contract. This added USD 63.1m to its US sales over the first year of the deal, increasing its share of the market by about 5% from Q4 18. That is, if Enphase had not increased its market share organically in the last couple of years, we would expect it to have about 30% of the residential market today as a result of buying SunPower's business.

Enphase's closest competitor supplying MLP products is SolarEdge Technologies, Inc. ("SolarEdge"), although its solution is a little different, with an optimizer on each panel and then one inverter for the whole array. SolarEdge's residential market share in the US back at the start of 2017 was about 35%. On a May 2019 conference call management stated it was now 55.7%. In August it said it was 59.5%. That would imply, combined with Enphase's numbers, that the two companies supplied all of the residential solar installations in the country - and then some! That struck us as an interesting anomaly.

Enphase hasn't disclosed its market share itself since the end of 2016. In response to a request for this information CEO Badrinarayanan Kothandaraman stated on its Q2 19 call:

> "We are not going to give out any market share numbers"

In contrast, SolarEdge CEO Zvi Lando went out of his way to discuss Enphase's market share at the end of his Q2 19 call, even though no-one had brought it up:

> "it hasn't been asked, but I decided to help you a bit and give you the details from the only objective source in the market. So as we said in the past, there is no ability for a company to measure market share of newly installed systems. The only one we do see constantly is Greentech Media. Since Q1 2018, Greentech Media show steady growth of market share [for SolarEdge] in the U.S. residential market from 45.7% in Q1 2018 to 59.5% in Q1 2019. At the same time, Greentech Media again, [reports that] the other MLP company [Enphase's] market share [declined] from 23.1% in Q1 2018 to 17.1% in Q1 2019. As you may know, other MLP company acquired the micro inverter business of SunPower on August 2018. And since this quarter, they also include the sales of SunPower. Even when combining into - taking [this] into the share of the other MLP company, the SunPower microinverter business since Q4 2018, the combined share decreased from 29.2% in Q4 2018 to 26.8% in Q1 2019. Lastly, to those who try to calculate market share from reported shipments, the shipments number are not representing market footprints and these are affected by customer inventory. I hope this will give you the motivation to get into the numbers of market share from Greentech Media rather from the shipment numbers that the companies reported on themselves."

We were more than a little motivated by this invitation to look at the Greentech Media data, which is drawn from a large survey of solar installers (Greentech Media is a subsidiary of Wood Mackenzie, ultimately owned by Verisk Analytics, Inc). As SolarEdge management was at pains to point out, that independent data shows Enphase's market share falling almost every quarter and down significantly year-on-year all the way up to Q1 19. Even combined with SunPower's reported share the total is a little less than 30% in 2019, and broadly stable. That is half the market share implied by Enphase's reported US sales and half the size of competitor SolarEdge. On the ground survey data from distributors suggests they are selling out only half the volume Enphase reports they are buying in from it.

Cash in hand

We explained why we love successful marketplaces - and online classifieds specifically - in our December 2017 letter. We pointed to the fact that the equilibrium is often a winner-takes-most scenario, and that a combination of strong network effects and the ability of a dominant player to integrate itself deeply into its customers' systems and processes provides a highly defensible competitive position. Sitting on top of a largely fixed cost base the end result can be an extremely high return on capital. Two positions the Fund owns (or has owned), Auto Trader Group PLC ("Auto Trader (UK)") in the UK and Carsales.com Ltd ("Carsales") in Australia, with 69% and 43% operating margins respectively, show clearly what can go right. The one we want to talk about today, though, doesn't. At least on the face of it, with a 5% reported margin. That is CarGurus, Inc. ("CarGurus") in the United States.

Why do these three businesses, each of which is the leading used car marketplace in its domestic market, have such different economics? One difference is cosmetic: Auto Trader (UK) operates only in the UK and Carsales' financials are dominated by its Australian business. CarGurus has a profitable US business with a 14% operating margin, plus several international businesses which are currently lossmaking. More significant, though, is the relative position of each compared to domestic peers. Auto Trader (UK) accounts for roughly 75-80% of time spent by consumers on used car marketplaces in the UK. Carsales has a similar position in Australia. In both countries the market leader scoops up the vast majority (perhaps as much as 80-85%) of online classified ad spend as well. CarGurus on the other hand, accounts for just under 50% of time spent on auto marketplaces in the US. This partly reflects its shorter history. The site was started in 2006 and its consumer audience share only overtook the incumbents - Auto Trader (US) (part of Cox Enterprises, Inc., and unrelated to the UK entity) and Cars.com Inc. (Cars.com) – in 2016. Today Auto Trader (US) has a 25-30% audience share, and Cars.com Inc. c.15%. A challenger business will often choose to underprice its product to encourage adoption, planning to exploit latent pricing power once it achieves scale. CarGurus fits this description. The result is that today it takes well below 20% of online classifieds spend despite its large audience share.

That is only part of the picture, though. There is also a big difference in how car dealers spend their advertising budgets in the US, which means the pot available to classified sites is smaller. Calculating industry profit pools is challenging, but we estimate that Auto Trader (UK) accounts for c.6-7% of car dealers' gross profit on used cars (including finance commissions) in its home market, with Carsales a similar proportion in Australia. US car dealers, however, only spend c.3-4% of used car gross profit on online classifieds sites. Some of that difference comes from dealers spending fairly heavily on TV, which is viable because of more localised TV advertising inventory and the larger average size of dealers (compared to the UK). But the biggest difference is online search - effectively Alphabet Inc.'s Google monopoly. This is the single biggest advertising channel for US car dealers, but almost irrelevant in the UK.

In the UK, Auto Trader (UK)'s position as the default venue for most consumers to search for a used car is reflected in its traffic acquisition channels. According to SimilarWeb, in December 2019 55% of traffic to the site came direct (i.e. the url was typed into the browser or, more likely, it was bookmarked). The remainder was mostly search traffic, of which 97% was unpaid. Over 45% of searches included "autotrader", or a variant of it, in the search string. As a result, Auto Trader (UK) is not a big spender on Google, which has only a small role intermediating used car search activity in the UK (meaning car dealers don't spend much on it either). In the US, there are three large car classifieds platforms and several smaller ones. None has (yet) achieved the position of default venue for consumers. The difference in traffic acquisition patterns is telling: on average across the three main sites, 39% of traffic comes direct but 10% of search traffic is paid for and branded searches only account for between 10% and 35% of total search traffic (depending on the site). Google is a far larger player in funnelling used car traffic, which means there are many more consumer eyeballs for car dealers to go after with their own search ads. That means more bidders in Adword auctions, and higher costs per click. The result is that the US market sees much more paid search from the classified sites and dealers themselves - Google takes approximately USD 6-7bn of car dealer advertising spend in the US, about 30% of the total – and that makes the classified sites there structurally less profitable.

CarGurus is a highly shorted company (short interest peaked last summer at over 20% of the free float). From presentations that are publicly available, concern about the sources of its traffic and leakage of economics to Google and other advertisers appear to be the main planks of the short thesis. This seems to us an overly narrow view. There are plenty of companies that spend heavily on Google (and other performance marketing channels) to drive traffic to their sites, but still generate excellent economics that they have been able to defend from competition for years: two obvious ones (as least to us, as they are or have been holdings in the fund) are price comparison site Moneysupermarket.com Group PLC and online travel agent Booking Holdings Inc. Both get less of their traffic from unpaid search than CarGurus (according to SimilarWeb data) but still make operating margins of over 30% and 35% respectively.

If we refer back to our framework for thinking about asymmetry of expected returns, how does CarGurus fit? It is not an investment where we see the risk of material loss as extremely low. Those tend to be backed by more tangible, or at least transferable, assets. But it is also not a business that looks anything like a zero to us. It has net cash on the balance sheet and has been cash flow positive for years, so there's no dependence on capital markets. We can't find any issues with the integrity of its financial or other statements either. High short interest, of itself, doesn't often convey a lot of information. From a risk/reward perspective it is, on average, probably a net positive if you are long but it is rarely material to us (whereas we are generally reluctant to short these companies because of the increased asymmetric risk of borrow availability getting squeezed).

What about the potential for very high returns? Google customers obviously try to sidestep its toll, and some are successful by becoming the default venue for a particular vertical (cutting out the need for a wider search), or by directing a very high proportion of traffic to apps (where only the download is intermediated). That has not happened before for used car sales in the US, but it is obviously what CarGurus is aiming for. Until recently no one site carried all (or nearly all) of dealer inventory. Without that you can't be the default. CarGurus is now close, with 20-30% more inventory than the other main sites. It is also building brand awareness, from a low base (unprompted it is only c.10%), launching its first brand advertising campaign a little over two years ago. The cost of acquiring traffic through search should fall if its brand prominence rises, resulting in higher click-through rates from CarGurus ads, greater authority in organic search rankings, and fewer consumers bouncing off the site without conducting any car searches. The potential for a virtuous circle is there, now that it is clearly the largest platform (by audience and inventory). The odds of CarGurus becoming dominant enough to push Google out of the value chain in the US, which would enable it to match the economics of Auto Trader UK, are still reasonably long. There's a great deal of inertia in consumer (and advertiser) habits. By far the most likely result is that Google will be able to continue to carve off a significant chunk of car dealer advertising budgets and extract a lot of cash directly from CarGurus itself. But the odds are not zero either. There is some option value in this, and the upside is multiples of the current valuation because the economics of being the default venue are so attractive. There is also some option value in CarGurus' international operations, which lost USD 41m over the last twelve months, but are growing quickly and have established number two or three positions in Canada, the UK, and Italy.

Our main thesis is that we see a high probability of CarGurus delivering a very solid double digit return from here. Its share of US online classified spend is way below its share of consumer audience and the volume of leads it provides to car dealers. This means the return on investment for a dealer listing its inventory on CarGurus is much higher than for spend on its peers (we confirmed this with a survey of dealers we ran towards the end of last year). We don't think that is sustainable. CarGurus has significant latent pricing power to increase the cost per lead and still provide good value for money to its customers. We expect its US revenue to at least double over the next five years as a result. Growth should flow through to the bottom line at a fairly high incremental margin. The company discloses a unit margin of over 50% on its core US marketplace revenue, and this is likely to improve as pricing becomes a larger component of revenue growth, as the company focuses more aggressively on driving traffic to its app, and as aggressive expansion of some cost lines (particularly brand advertising spend and technology resources) begins to plateau relative to revenue. We think a 45-50% incremental margin is a reasonable assumption, taking the overall operating margin in the US business to c.33%. In combination with its international operations reaching breakeven, and the interim cash flows the business will generate, this would leave CarGurus with an enterprise value around nine times net operating profit (after tax) five years out. A reasonable multiple of 20 times implies an annualised return of 15%. Because this is only dependent on CarGurus monetising the audience share it already has, bringing its pricing up to a level still somewhat lower than what its peers are already charging, we think something along these lines is very likely what will happen over the next few years.

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The list of winners and losers presented herein has been calculated by including those positions that contributed most significantly, either positively or negatively, to the performance of the Fund's portfolio during the period. This is not meant to be indicative of the performance of all positions contained in the portfolio. Past performance is not indicative of future results.

Additional Information for Recipients in Switzerland

The Fund has not been approved for distribution in or from Switzerland by the Swiss Financial Market Supervisory Authority. As a result, the Fund's shares may only be offered or distributed to qualified investors within the meaning of Swiss law. The Representative of the Fund in Switzerland is Bastions Partners Office SA with registered office at Route de Chêne 61A, 1208 Geneva, Switzerland. The Paying Agent in Switzerland is Banque Heritage, with registered office at Route de Chêne 61, 1208 Geneva, Switzerland. The place of performance and jurisdiction for Shares of the Fund distributed in or from Switzerland are at the registered office of the Representative.

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