Ennismore Global Equity Fund

Investor Newsletter for the month of December 2021

Issued on 13 January 2022

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 USD 247m as at 31st December. Total assets under management by Ennismore Fund Management were USD 791m. The number of shares issued by our funds is capped in order to limit the level of assets under management in each strategy. We currently have capacity available in the Ennismore Global Equity Fund. If you would like to invest please contact Adam Sullivan on +44 (0) 20 7368 4224 or email subs@ennismorefunds.com.

Top Five Long Holdings as at 31 December 2021

Company	Country	Sector	% of NAV
Royal Mail PLC	United Kingdom	Industrials	8.1
Buzzi Unicem SpA	Italy	Materials	6.3
Schibsted ASA	Norway	Communication Services	4.5
Vivendi SA	France	Communication Services	4.1
Nordic Entertainment Group AB	Sweden	Communication Services	3.9
			27.0

Exposures as at 31 December 2021

Longs%	Shorts%	Gross Exposure%	Net Exposure%
85.0(83.9)	33.8(33.3)	118.7(117.2)	51.2(50.7)

Figures in brackets refer to previous month end. All exposures are calculated on a delta adjusted basis. All calculations are subject to the impact of rounding

Exposures by Country, Market Cap & Sector as % NAV and Positions as 31 December 2021

Country	Gross%	Net%
United States	45.2	-4.2
United Kingdom	17.0	15.8
Germany	13.2	9.4
Norway	8.3	4.6
Sweden	8.1	8.1
Italy	6.8	5.7
France	4.2	4.1
Netherlands	3.9	3.9
Ireland	2.3	2.3
Japan	1.6	1.1
Spain	1.4	0.6
Other	6.7	-0.3

Market Cap	Gross%	Net%
>$10bn	44.7	22.8
$5bn - $10bn	22.4	16.1
$1bn - $5bn	34.7	17.4
<$1bn	16.2	-4.3

Positions	Dec	Nov
Long	40	43
Opened	5	1
Closed	8	5
Short	95	97
Opened	9	11
Closed	11	9

Sector	Gross%	Net%
Communication Services	29.5	22.8
Consumer Discretionary	11.4	1.6
Consumer Staples	12.4	9.0
Energy	1.0	1.0
Financials	9.5	5.7
Health Care	5.4	-3.5
Industrials	19.0	7.8
Information Technology	17.7	-0.6
Materials	11.3	9.0
Real Estate	0.0	0.0
Utilities	0.7	-0.7
Other	0.8	-0.8

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 2021

	Share Class					
	GBP	GBP A	EUR	CHF	EUR I	USD I
NAV per share[1]	**11.87**	**11.81**	**12.28**	**11.68**	**9.35**	**9.32**
Period	% Change					
December 21	**2.2**	**2.3**	**3.6**	**3.1**	**2.2**	**2.3**
November 21	1.8	1.8	0.9	-0.6	1.6	1.7
October 21	-4.0	-3.9	-2.2	-4.3	-3.9	-4.0
2021	**10.0**	**10.0**	**17.3**	**12.3**	**8.7**	**9.6**
Annualised return[2]	**3.3**	**3.2**	**4.0**	**3.0**	**-1.9**	**-2.3**
Since launch[2]	**18.7**	**18.1**	**22.8**	**16.8**	**-6.5**	**-6.8**
	Discrete 12 Month Rolling Performance					
To 31 December 21	**10.0**	**10.0**	**17.3**	**12.3**	**8.7**	**9.6**
To 31 December 20	**-21.4**	**-21.3**	**-25.5**	**-25.7**	**-22.6**	**-21.5**
To 31 December 19	**7.7**	**7.3**	**12.8**	**9.5**	**5.9**	**-**

[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 21	-2.3	-0.4	-3.6
	Q3 21	0.5	0.4	-0.7
	Q2 21	6.3	5.5	4.8
	Q1 21	7.1	11.2	12.9
Short	Q4 21	3.3	3.4	3.2
	Q3 21	5.8	5.8	5.8
	Q2 21	-2.6	-2.6	-2.5
	Q1 21	-4.2	-4.3	-4.4

Top 5 Contributors and Detractors for December 2021

Contributors	MTD (bp)
Royal Mail PLC	50
Flutter Entertainment PLC	48
GoDaddy Inc	45
Austrian technology company	27
Enphase Energy	22

Detractors	MTD (bp)
Everbridge Inc	-66
Schibsted ASA	-53
Pinterest Inc	-44
METRO AG	-26
Ascential PLC	-19

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

The fund's NAV changed by between -1.9% and 2.3% in the quarter, depending on currency. In sterling, long positions cost us 2.3% but the short book added 3.3% to NAV. For the year the returns were pretty much in line with what we expect to deliver on average – 10.0% in Sterling, 17.3% in Euros and 12.3% in Swiss Francs. Sterling appreciated against European currencies in 2021, essentially reversing its relative weakness in 2020 – over two years, the share class returns are relatively similar to one another. Again in Sterling, the long book contributed 11.6% in 2021 and the short book 2.9%, despite index put options (which mostly expired in Q1) costing 1.4%. We are particularly pleased with the returns from the short book this year, where we generated alpha of 27.9% despite volatile and sometimes hostile market conditions (where we refer to alpha in this letter, we are measuring performance relative to the MSCI World index unless stated otherwise). We continue to see a historically exceptional opportunity set on the short side, which we discuss more later.

Our long book modestly underperformed in 2021. We are obviously not satisfied with this, but looking further back, long performance since inception has been very good. The indices presented an unusually challenging benchmark in 2021 given the extremely strong performance of the largest companies in both the US and Europe, which we have very modest exposure to. More importantly for you now, we are very happy with the long portfolio today, which is a healthy mix of deeply out of favour but strongly performing businesses such as Royal Mail and Buzzi Unicem – we have written up our thesis on this one in this letter – and a broad mix of very profitable, growing businesses at reasonable valuations.

The postman delivered again in the fourth quarter with Royal Mail adding 1.8% to NAV. Results were good and a capital return was announced. Etsy performed well again too (contributing 0.5%). We sold the position as it reached the top end of what we consider fair value.

The main negatives on the long side were Pinterest (costing 1.2%), Everbridge (1.0%) and Metro (0.7%). Pinterest shares declined along with a broad sell off in US tech, despite good results and a reported bid approach from PayPal (subsequently aborted) at roughly double the current price. User numbers have fallen back a little, giving up much of the boost from people stuck at home in lockdowns, but we don't think this really changes the long-term value of the platform. We see Pinterest as the best search engine for images and possibly the most natural advertising platform of any online media.

Everbridge is another US tech company that fell sharply, but in this case this was compounded by the unscheduled departure of its CEO after just two years and an accompanying cut to revenue guidance. This is disappointing. After relatively weak sales in the immediate aftermath of the pandemic, results in the first half of 2021 had been strong and the company won several important nationwide emergency alerting contracts in Europe. However, the company had been increasingly acquisitive, and in hindsight we gave management too much benefit of the doubt for opaque disclosure of the contributions of those acquisitions. After several years of growth above 30%, 2022 revenue guidance implies roughly mid-teens organic growth. Such a sharp deceleration alongside a suspicious CEO departure leaves us lacking confidence in the eventual scale of the critical event management franchise, so we sold the position for an overall loss of 0.6% since inception.

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Metro also gave weak guidance for 2022. New management argues it is investing for growth, and revenue forecasts are higher, but we have no way of separating that from higher costs due to increased competition and the structural shift to delivery. We have sold this position too for now.

On the short side there were nearly a hundred positive contributors, despite a bounce in promotional names in October. Overall, the book has been working well for the fund since the meme stock mania hit in January and February. But risk is still massively elevated relative to any period we can find in living memory.

Between late afternoon (US time) one Friday and pre-market the following Monday Remark Holdings saw its share price go up nearly 10-fold – there was no news, just a picture of some of its execs with Trump associates. The spike was short-lived, but so is our tolerance for this kind of exposure right now. Even though the share price quickly fell back to where it started, covering the position meant realising a 1.2% loss in the quarter. Before 2020 this kind of move on no real information was so rare it was almost unheard of outside of OTC stocks. This just doesn't happen in normal equity markets.

Until conditions do normalise, we will continue to very actively manage our exposure to any positions that start to trade in this way. Doing so has meant we were able to deliver good returns from the short book as a whole, both for the quarter and the year. We believe we have an appropriate balance of risk and reward to suit this market right now.

What did we say we would do?

A little over five years ago we said we could take Ennismore's investment culture and make it work for a fund with a global mandate that still provided daily liquidity to you. We believed that because the things that have allowed Ennismore to deliver good returns are not specific to any market or asset class. We described what we think the keys to success have been in some detail in our September 2019 letter. A quick summary would be independence, a long-term mindset, detailed due diligence, focus on valuation and aligned incentives.

We didn't just wake up one day and decide that a global mandate made sense. The data from the previous decade showed that returns from our more liquid positions in Ennismore's small cap fund, and from positions outside of Europe, had been better than average. And material. This formed the backbone of our pre-launch presentation.

We said this fund would be able to find under-valued companies with wide competitive moats – the fuel for high returns on capital. We said we would look anywhere, and we have. But the focus has been developed markets, principally Europe and north America, because we think we understand the risks there better than in developing markets. We have maintained a very high level of liquidity, confident that we can exit any position within the 10 day settlement terms of the fund without having to distort market prices materially.

We also said the book would be well diversified and generalist, with no significant skew by industry or by company size (other than avoiding speculative sectors like biotech or mineral exploration). And it is. The long book has averaged around 45 names. Returns have been well spread across a number of sectors. Perhaps the most intuitive way to see this is by looking at the mix of the largest contributors. It includes online marketplaces like Etsy and Schibsted and consumer brands Under Armour and Fevertree Drinks, alongside last mile distributor Royal Mail and capital goods manufacturer MTU Aero Engines. There's an even an asset play in there, the rapidly dismantling Thyssenkrupp conglomerate.

We said we expected this long book to deliver mid-teens annual returns, on average and over time. So far we have lived up to that, averaging 17% (in Sterling), for alpha of 4.8%. Ennismore's core geographic focus historically was the UK and Germany. They have been important for the global fund too, accounting for 18.9% and 14.9% of average exposure and delivering returns very much in line with what we expected (20% and 15% on average respectively). The rest of Europe has also been good for the fund. But the real standout has been north America (mostly the US, obviously), at 22.2% of average exposure and a very satisfying 26% average return on capital.

Overall long book returns have obviously benefited from benign financial conditions, particularly lower discount rates. We still don't have a strong view on anything macro but, given where we are today, a similar tailwind seems a lot less likely over the coming years. We are convinced our approach to finding individual companies that are under-valued will still deliver in that environment. We might have to work a lot harder to stand still but, if anything, we suspect we will find it easier to deliver alpha in a more discriminating equity market. By way of example we write up cement manufacturer Buzzi Unicem later in this letter.

When we launched the fund we also said it would run a relatively low net exposure – we have averaged so far at 37.2%. We expected the short book to provide a natural hedge, but first and foremost to be a profit centre in its own right. We said we would bet against companies where the business case or financials were materially mis-stated or misunderstood. And that the book would be highly diversified over many stock specific positions. Overall this book was expected to deliver positive absolute returns over a market cycle.

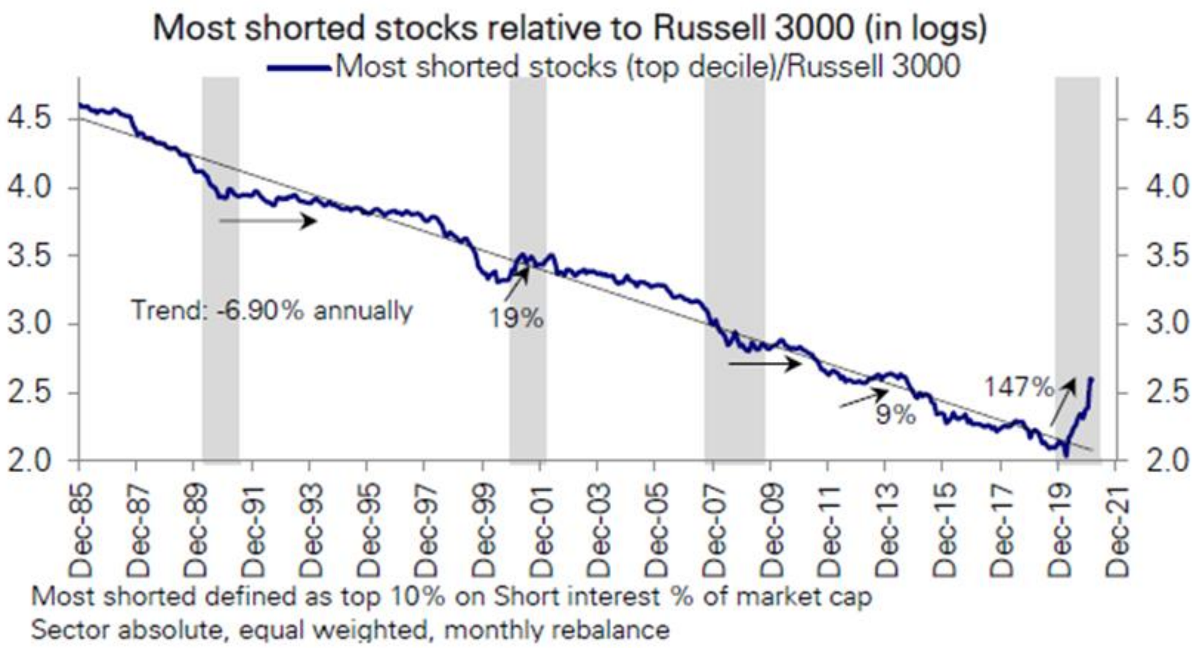
Of course, we haven't been through a full market cycle yet, but so far the short book has performed significantly worse than we expected. That's despite decent returns from positions in Europe, particularly the UK where we have averaged c.12% implied return on capital (for short alpha of 14%, against the FTSE All Share index) and a long-short spread of 33%. And some success spotting high profile frauds. It is, for example, well reported that we were the first to really document the work of fiction that was Wirecard's accounts. Bio-On and Evergrande were similar successes. We have got a lot right - and still let you down.

The simple fact is that almost all of the underperformance relative to our expectations has been skewed to one market, the US. And materially all of that is down to one period – calendar year 2020. If we could leave that year to one side we think the return from the short book has been satisfactory, with average annual alpha of a little under 10%. That's similar to Ennismore's record in the years before we launched the global fund, and we hope to meet or beat this in the coming years as well.

Obviously we can't and won't put 2020 to one side but it is helpful to have context. The fund's long book has worked well and consistently. The short book has been ok in most places and most years too. What happened to our US short exposure in 2020 exposed some serious flaws in our risk management. It meant we needed to make some fundamental changes. But it does not mean that our approach to finding near worthless businesses is broken. We are confident of that because of the returns we have delivered in other markets and other periods.

So what the hell happened in 2020?

In many ways the US equity market in 2020 was truly exceptional. Anecdotally this is obvious. There are no European meme stocks, for example. And it is also true relative to prior years, even the dot com bubble. There has never been another period where the highly shorted stocks outperformed in anything like the way they did in 2020:



Source : Compustat, Haver, Deutsche Bank Asset Allocation

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Many of the individual share price moves underlying this were outright crazy. Consider Ontrak (formerly Catasys, formerly Hythiam) for instance. We wrote it up in our June 2020 letter because its CEO has one of the wildest CVs we have ever seen at a public company. Going into 2020 the company appeared to be insolvent, burning cash on top of a pile of debt, and surviving on covenant waivers tied to completely unrealistic revenue forecasts. The share price was around $16, a market cap of about $250m. But this was 2020. So, of course, being an obvious bankruptcy candidate, the stock price went up 6.5 times to peak just under $100 (making the market cap $2 billion). It is pretty much impossible to make money from a short that does this, even if the thesis is right. At a portfolio level the odd position behaving this way is manageable, provided it is small enough to start with. In fact we highlighted this with Remark Holdings specifically back in our December 2019 letter. But when several positions act like this at the same time we have a problem. In 2020 we had a real problem.

It is no consolation to point out that, in the case of Ontrak (or Remark for that matter), it looks like the thesis was right. Or that the share price is now under $5, down over two thirds from what it was at the start of 2020. It is no consolation because in the meantime the risk management policies we had in place let you down. And we let you down by not intervening faster once they had. Investing is a people business and it was people not policies that made these mistakes. There's no hiding from what we got wrong (it is also right to emphasise that some of the team performed very well in 2020 too). We compounded our problems by letting short exposure run too high, particularly to the momentum factor. This was human error made under intense pressure. We can't control what conditions we are faced with in future, but you can be sure we will deal with them differently.

Sitting here today, it is nice that we can say that we learned enough to deliver our best year so far for short alpha in 2021, despite market conditions being in some ways even more hostile to fundamental short selling. But more than that we are confident that 2020 won't happen to us again even if (when) similarly exceptional conditions do happen again. We need you to be confident of that too.

We have made a number of changes to make sure of this. The most significant is being quicker to take losses on underperforming short positions. Specifically we have introduced an annual loss budget of 1% of NAV on a rolling 12 month basis for each individual short, which in practice acts as a stop loss. In extreme cases we will allow ourselves additional exposure through put options given the certainty we have over how much capital is then at risk . It is much too crude to say that, all other things being equal, having this in place would have reduced the fund's drawdown in 2020 well into single digits. All other things are never equal. But the size of the benefit would clearly have been very large.

There is no such thing as a free lunch either. There is always an opportunity cost. This policy means we will realise losses faster than in the past. Sometimes that will be more expensive than letting positions run, as it was with Remark Holdings in the last quarter. Before 2020 nothing in the data told us that wasn't a risk worth taking with the odd name in a very well diversified book. We know different now.

They say every cloud has a silver lining. In this case we think that's true. The inevitable consequence of runaway capital markets in the US over the last couple of years is the best opportunity set we are ever likely to see on the short side. There are dozens if not hundreds of listed companies valued at over a billion dollars that we think will be worth at least an order of magnitude less a few years from now. There are many metrics we could point to highlighting just how far we are from normal right now – volumes traded in OTC stocks in the US, open interest in call options or VC fundraising all show a market operating at levels that dwarf even the dot-com boom. But we only have so much room in this letter so we will just go with flows into equity funds over the last 20 years:

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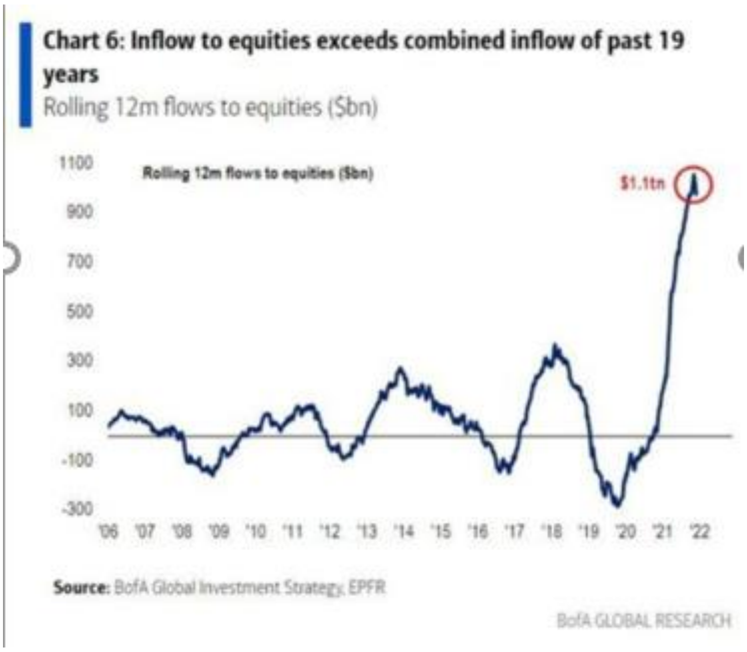

We don't know when this will change. We are not macro experts. But there are signs that crazy actually peaked back in February or March last year (when US fiscal stimulus was at its peak). Whether or not that is right only time will tell. We are ready to profit if it is. The key is a very long list of short positions (and plenty more on the waiting list). In a bear market most will fall a long way. Some will do it quickly. We'll make good returns on these, but they will be limited to something like the starting size of the position. But others will go down more slowly, and these we can add to. That means we can make a lot more money from them. We can't know which these will be in advance but with so many to choose from we are sure to have a lot of opportunity.

There's one other aspect of future returns we want to talk about. We always recognised that this fund's liquidity could allow it scale. And we wanted this benefit to be shared with you by lowering fixed fees. After 2020 we have less scale than we expected at this stage, but more than enough assets for the way we manage money. So we still think it is right to start to reduce the management fee (more so, in fact, as you have stuck by us). As of 2022 we have added a share class for larger investors (over EUR 40m) with a 1% management fee. We plan to add an intermediate one soon too.

Most important of all, though, we are confident that the fund will deliver for all of you over the coming years. And again, we want to say thank you for your support.

Solid foundations – Buzzi Unicem S.p.A.

Last quarter, while discussing Royal Mail, we explained that we often find long ideas by looking at business models in an over simplified way to help clarify what really drives the unit economics. One textbook example we didn't mention is goods that are bulky and low value that can't be shipped profitably a long way over land. Where the supply of these goods is constrained, there is no serious substitute and the customer base fragmented, what you have is a recipe for high returns on capital. The classic case study is sand and gravel pits – a typical grab lorry can carry about 17 tons, which is worth about $250 wholesale at a gross margin of about 50%. You can't drive that more than a few tens of miles before it is outweighed by the cost of a driver, fuel and the vehicle. For a load of cement the value is about 10 times higher but gross margins are bit lower, more like 40%. That makes the viable delivery radius by road wider – maybe up to a few hundred miles with bigger trucks – but still means supply is essentially regional and mostly not international. We also don't mind the fact that, while aggregates producers trade at close to fifty times earnings today, many cement makers are on single digit multiples.

We think the best run listed cement company has for many years been Buzzi Unicem, partly because it avoided over expanding at the peak of the last cycle (Ennismore owned it in other funds in the past). The fact that it is family controlled is likely a big reason for that. Despite its Italian base, by far its most important geography is the United States, accounting for most of its operating profit over the last decade. Pretty much everything about the US market is positive for Buzzi right now.

On the supply side US domestic capacity is sold out and, as in previous cycles, excess demand is being met by imports into the coasts. This is a deliberate strategy controlled by the incumbents to prevent over investment in good times. There hasn't been a new cement plant built in the US since 2011. Environmental regulations mean that may not ever change. The need to reduce CO_2 emissions should instead see modest capacity increases as the market follows Europe in gradually reducing the clinker ratio (the proportion of the end product that is pure cement). The US is currently still mostly a Portland cement market, meaning clinker is over 90% of the mix. In Europe the ratio is now about 20 percentage points lower. The US will not change quickly – US Department of Transportation contracts still mandate Portland – but a gradual shift implies modest capacity increases over the coming years (because clinker is the bottleneck). If it gets to European levels a decade from now, which seems unlikely, implied capacity growth would be 2.5% a year. Incidentally the high US clinker ratio also prevents dumping from China, where there is clearly a risk of a collapse in construction investment as the financing around Evergrande implodes. Chinese product is typically only 60% clinker so can't be sold in the States.

The demand side in the US is also favourable. Housing starts are back to around the long-term average, after a decade of under investment post the financial crisis (which dwarfed the over investment that led to it). The other big leg of cement consumption is infrastructure and that is the key policy of the Biden administration, with a $1 trillion package passed in November. Overall the demand outlook seems likely to be positive for the next few years.

Buzzi management has used good current trading to really strengthen the balance sheet. We estimate net debt was down to zero at the end of 2021. That's way below larger peers, which have tended to show less capital discipline in previous cycles. This might seem like a conservative move but the thinking behind it is partly about exploiting an opportunity to grow market share, and partly to give Buzzi the flexibility to buy in minorities in Brazil and Mexico.

After water, cement is the second most consumed resource on the planet. Modern living depends on it and there's no real substitute. It is also one of the largest sources of CO_2 emissions, about half from the heat used to cook the limestone and half from the calcination reaction which turns it into clinker. Something has to give (and it's unlikely to be consumption going down in a big way). The first part is relatively easy. The energy used for heating will increasingly come from renewable sources. But the second part is essentially what cement is – limestone with CO_2 taken out. Those emissions can't be avoided which means they have to be captured and stored (or, ideally, recycled into fuel used in the production process, creating a closed loop). Capture is possible today and starting to progress beyond test projects. What happens to it then is a problem that doesn't have an answer yet. When the answer comes, cement plants will need significant investment to allow them to capture the carbon they produce. Buzzi management wants to be in the strongest possible position to invest ahead of the competition when this happens.

Higher future investment sounds like it means lower future returns. We don't expect that to be true in this case. Where there's no viable substitute and the supply side is consolidated the incremental capex is most likely to be reflected in higher cement prices. Even if capital intensity doubles that can be offset by mid-single digit product price inflation (which is not uncommon for cement). The key variable influencing whether a cement company has the pricing power to recover its investment outlay is how consolidated the supply side is. And specifically, how consolidated it is locally – because, as we mentioned earlier, the defining feature of high bulk low value goods is that they cannot economically be shipped far (especially over land). In Buzzi's most profitable markets there are usually only two or three large suppliers (for this purpose the US is so big that it is not a single market but several regional ones). This picture mostly hasn't changed much from when Ennismore owned the company in its other funds a decade ago. But there is one notable exception.

Despite obviously favourable competitive dynamics in the US, Buzzi's overall return on capital (in the low teens) is not stellar. The main reason for this is its home market of Italy which accounts for about a quarter of its capacity. The boot of Europe used to have among the highest per head cement consumption in the world (think the opening scenes of The Italian Job) but after the financial crisis volumes have been distinctly average. Neither the market nor Buzzi's Italian operations have turned a profit since and current utilisation is still well under half. That's despite the supply side consolidating from more than ten players to basically three over the last decade. This has reduced the level of losses significantly, but it will need something more to get the industry in Italy back to even a reasonable return on capital. The downside of cement's market structure is that capital is slow to exit too. In the long run plant obsolescence would get it there but the investment needed for carbon capture probably means this will happen sooner. Only capacity that is needed to meet demand will get the necessary upgrades and this should return the market to balance, and good profitability. In effect Buzzi's Italian capacity looks a bit like a relatively low-cost option on supply reducing over time, and something of an extra hedge (along with pricing power) against the investment required for carbon capture.

Today Buzzi shares look extremely cheap on about eight times earnings, even with Italy losing money. The dual share class is gone, as is the net debt. We understand that investment will be higher in future, and that by how much is uncertain. But we cannot see a scenario where the required investment is so large that it cannot be passed on in higher prices as long as the supply side remains consolidated and no viable alternative to cement exists. We could speculate on why the market doesn't agree, but with the valuation where it is we don't think we need to understand that. Cement is unlikely to suit the taste of most ESG investors (although we doubt they would want to live or work in buildings that weren't standing on it). With a double-digit free cash flow yield we don't even need a re-rating to generate good returns, although we definitely expect it.

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