Ennismore European Smaller Companies Fund

Investor Newsletter for the month of March 2022

Issued on 7 April 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 GBP 337m as at 31st March. Total assets under management by Ennismore Fund Management were GBP 551m. The fund continues to limit capacity by capping the maximum number of units in issue, there is currently a small amount of capacity available due to the natural rate of investor turnover. If you would like to invest when capacity is available through redemptions, please contact Adam Sullivan on +44 (0) 20 7368 4224 or email subs@ennismorefunds.com.

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

Performance as at 31 March 2022

	Share Class[2]				
	GBP A £	**GBP A €**	**GBP B**	**EUR A**	**EUR B**
NAV per Share[1]	**154.55**	**182.89**	**26.12**	**26.05**	**26.17**
Period	% Change				
March 22	**0.2**	**-0.8**	**0.2**	**-0.8**	**-0.8**
February 22	-2.6	-2.7	-2.5	-2.6	-2.6
January 22	1.1	1.6	1.1	1.5	1.5
December 21	1.5	2.9	1.5	2.6	2.7
November 21	1.8	1.0	1.8	1.2	1.2
October 21	-1.8	0.0	-1.8	-0.4	-0.4
2022 to date	**-1.3**	**-1.9**	**-1.3**	**-1.9**	**-1.9**
Annualised return[3]	**12.6**	**11.7**	**9.0**	**9.0**	**9.0**
Since launch[3]	**1474.7**	**1198.7**	**161.2**	**160.5**	**161.7**
	Discrete 12 Month Rolling Performance - % Change				
To 31 March 22	13.3	14.3	13.4	14.1	14.1
To 31 March 21	7.3	11.5	7.3	11.5	11.5
To 31 March 20	-6.9	-9.3	-6.9	-9.7	-9.6
To 31 March 19	9.8	11.8	9.9	11.1	11.1
To 31 March 18	4.6	2.1	4.6	2.8	2.8

[1]Source: Administrator, Net Asset Value. [2]Source: Administrator, Net Asset Value, net income reinvested. [3]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.

The Fund's NAV increased by 0.2% in March. Our long book contributed 0.8% while the Fund's short exposure cost 0.4%.

Top 5 Contributors and Detractors for March 2022

Contributors	MTD (bp)
Mobilezone Holding AG	46
Cegedim SA	45
Coats Group Plc	27
BioNTech SE	20
Norwegian energy machinery supplier	20

Detractors	MTD (bp)
UP Global Sourcing Holdings Plc	-77
US media company	-29
UK retailer	-28
UK online retailer	-27
UK online retailer	-26

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

Costain Group Plc – UK engineering and construction company (2.1% NAV)

We have written twice on Costain previously. However, as the saying goes, 'If at first you don't succeed, try, try, again'. On a more serious note, we are more convinced than ever that the share price is completely mispriced with a potential upside of more than 300% over the medium term. Costain seems to be truly in the doghouse when it comes to the stock market. However, we think the huge changes that have been made, in the background, by the new senior management team over the last 18 months to improve the business's operational fundamentals and to significantly de-risk the company, are being ignored.

Since we last wrote about Costain, in the July 2019 newsletter, a lot has happened. Costain had to take sizeable provisions on two major contracts in 2020 which ended up totalling GBP 128m and was forced to raise GBP 80m of equity at GBp 60 per share due to the impact on the company's capital. This has all led to the share price falling circa 75%. We overestimated the quality of Costain's internal controls and reporting at that time. Moreover, contractual terms were shown periodically to have made Costain responsible for some uncontrollable risks. It also appears that too many contracts were bid for based on having to beat their cost estimates to make them economic. This increased the risk of future provisions substantially. These legacy problems have been very painful, but we now feel that they have been substantially worked through within the order backlog of GBP 3.4bn.

A new CFO, Helen Willis, has been in place now for over a year and she, alongside CEO Alex Vaughan, is making some long overdue changes to the risk culture and internal reporting of the business. These changes, we believe, have put the business on a much surer footing, and more in line with how it was presented in the past - a low-risk construction entity plus a higher margin revenue stream. This should generate a 5-6% margin over the next 3-5 years. The changes included i) ensuring that contracts are written so that Costain is legally protected from uncontrollable risks, ii) internal reporting which puts a much larger focus on downside risks for project bidding and execution, alongside cash generation, and iii) biddings at a 3-5% margin, assuming no gain on cost estimates. This year the company plans to strengthen these changes by investing in digital processes, which we'd expect will give a long-term payback to the group in terms of efficiency and further strengthening controls.

Excluding the one-offs related to provisions mentioned earlier, operating profits have now been rebased to GBP 30m for 2021 on a revenue base of GBP 1.2bn. With the combined beneficial timing of framework spend and the implementation of the changes made by management, profits are expected to grow by 20% in 2022. Costain remains very much focussed on infrastructure and regulated sectors, especially in Transportation i.e. mainly road and rail (73% of 2021 revenue) with the remainder in Natural Resources i.e. Water, Energy, and Defence. They have a strong bias to open book framework contracts, which should theoretically lead to stable margins overall. To get to the 5-6% medium term operating margin target, the management assumes 3-5% in the construction business plus margins of over 5% in consultancy and digital services work, which may be bundled into project work. We think these targets are very attainable, although, for higher value-added type work, we would expect Costain to achieve high single-digit margins, as a minimum. It's hard to calculate how much of Costain's current revenue is in this higher margin stream due to the bundling mentioned, however, at least 10% of revenue in 2021 was in pure consultancy, to give some context.

Clearly a major risk currently is inflation. The management is mindful of this with most contracts having inflation protection, and any risk from this is included in their regular provisioning policy. Costain often has the ability to change the raw material aspects of a contract which can help mitigate any particularly inflationary bottlenecks. It also shouldn't be forgotten that cost-plus, open-book type contracts, if negotiated properly, should have less inflation risk compared to fixed-price contracts prevalent in construction.

Costain's balance sheet has net cash of GBP 76m at year end 2021, adjusted for the GBP 43m cash required to satisfy a settlement linked to the provisions mentioned earlier. However, they still have a pension deficit which has a GBP 10m annual cash requirement, although recent increases in bond yields could reduce this requirement over the coming years. Post-tax return on capital was 15% last year and we would expect this to increase substantially as profits grow over the coming years.

In terms of alignment, the executive directors' long-term incentive plans kick in at a minimum net income of an average of GBP 26m over 2021 to 2023. This compares favourably to its GBP 116m market capitalisation. Overall, we think the perception of Costain will change significantly over the coming years as they execute on their strategy. If they do indeed hit the midway of their medium-term target, then this would imply circa GBP 51m of earnings and a ridiculous earnings ratio of around two times. We value the stock at a multiple of nine times our forecasted 2023 earnings of GBP 30m, giving an upside of 130% over the next 21 months.

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Top Five Long Holdings as at 31 March 2022

Company	Country	Sector	% of NAV
STO SE & Co KGaA	Germany	Materials	8.4
IG Group Holdings Plc	United Kingdom	Financials	3.7
Vossloh AG	Germany	Industrials	2.9
UP Global Sourcing Holdings Plc	United Kingdom	Consumer Discretionary	2.6
Mobilezone Holding AG	Switzerland	Consumer Discretionary	2.5
			20.2

Exposures as at 31 March 2022

Longs%	Shorts%	Gross Exposure%	Net Exposure%
75.5(67.2)	40.5(34.5)	116.0(101.7)	35.0(32.7)

Figures in brackets refer to previous month end. All calculations are subject to the impact of rounding

Exposures by Country, Market Cap & Sector as % NAV and Positions as at 31 March 2022

Country	Gross%	Net%
Austria	3.5	2.8
Belgium	2.5	2.5
Finland	1.0	-0.7
France	3.9	2.7
Germany	26.1	17.6
Italy	2.3	1.3
Netherlands	2.9	2.6
Norway	5.4	-3.0
Other	1.8	-0.6
Poland	0.9	0.9
Spain	1.2	1.0
Sweden	10.3	-3.7
Switzerland	6.7	1.6
United Kingdom	41.3	13.3
United States	6.4	-3.2

Market Cap	Gross%	Net%
>£2bn	24.6	-2.8
£700m - £2bn	31.1	6.1
£200m - £700m	42.1	15.8
<£200m	18.2	16.0

Positions	Mar	Feb
Long	77	68
Short	88	75
Longs Opened	13	3
Longs Closed	4	0
Shorts Opened	20	14
Shorts Closed	7	9

Sector	Gross%	Net%
Communication Services	3.9	0.2
Consumer Discretionary	34.1	4.7
Consumer Staples	7.5	-2.0
Energy	0.0	0.0
Financials	8.3	7.7
Health Care	5.0	1.8
Industrials	25.0	9.2
Information Technology	17.8	0.7
Materials	12.1	10.4
Real Estate	2.3	2.3
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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