Ennismore European Smaller Companies Fund

Investor Newsletter for the month of August 2022

Issued on 7 September 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 331m as at 31st August. Total assets under management by Ennismore Fund Management were GBP 492m. 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 August 2022

	Share Class[2]				
	GBP A £	**GBP A €**	**GBP B**	**EUR A**	**EUR B**
NAV per Share[1]	**154.38**	**178.65**	**26.09**	**25.44**	**25.56**
Period	% Change				
August 22	**1.8**	**-1.2**	**1.9**	**-1.2**	**-1.2**
July 22	-3.1	-0.5	-3.1	-0.5	-0.5
June 22	0.7	-0.6	0.7	-0.5	-0.5
May 22	-0.9	-2.0	-0.9	-2.0	-2.1
April 22	1.4	2.0	1.4	2.0	2.0
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
2022 to date	**-1.4**	**-4.2**	**-1.4**	**-4.2**	**-4.2**
Annualised return[3]	**12.4**	**11.4**	**8.6**	**8.4**	**8.4**
Since launch[3]	**1473.0**	**1168.6**	**160.9**	**154.4**	**155.6**
	Discrete 12 Month Rolling Performance - % Change				
To 31 August 22	0.0	-0.8	0.0	-1.2	-1.2
To 31 August 21	27.7	32.8	27.7	33.2	33.2
To 31 August 20	-14.3	-13.2	-14.3	-14.2	-14.2
To 31 August 19	8.1	7.0	8.1	7.0	7.2
To 31 August 18	2.7	5.9	2.7	5.3	5.2

[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 1.8% in August. Our long book cost 1.7% while the Fund's short exposure contributed 3.6%.

Top 5 Contributors and Detractors for August 2022

Contributors	MTD (bp)
Swedish software company	83
Semcon AB	59
UK online retailer	50
Swiss online retailer	44
STO SE & Co KGaA	38

Detractors	MTD (bp)
Secure Trust Bank Plc	-62
Lumi Gruppen AS	-45
Cake Box Holdings Plc	-40
Dr. Martens Plc	-32
Coats Group Plc	-31

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

Deutsche Wohnen SE– German real estate company (1.4% NAV)

Founded in 1998 as a subsidiary of Deutsche Bank AG, Deutsche Wohnen is the dominant residential landlord in Berlin with more than 100,000 apartments and an additional 40,000 units located across Frankfurt, Leipzig, Dresden, and Hannover. We were initially attracted by the fierce share price correction since Vonovia, the largest residential owner in Germany, finally succeeded with its bid at EUR 53 last year which reflected the reported net asset value. One year later the shares are down over 50% and there is still about 12% in free float of the total market cap of EUR 9bn. We find Deutsche Wohnen particularly attractive given its low leverage and the fact that its core assets are in Berlin. The leverage – we calculate a 25% loan to value – which was triggered by the take-over is, in hindsight, perfectly timed given increasing Central Bank interest rates. We also expect Deutsche Wohnen to beat this year's guidance of around EUR 490m funds from operations. The net operating cash flow from renting out its apartments translates into a current yield of 5.5% of which 65% has been paid out through dividends historically. We think markets have priced in the new interest rate environment but not the quality and long-term potential of the underlying assets as well as the significantly decreased leverage.

Over the last ten to fifteen years Berlin has seen a significant transformation from being "arm, aber sexy" (poor but sexy) into an economic powerhouse within Germany and Europe. Though rental prices have increased strongly in Berlin over the years, the average asking price on rent is around EUR 11 per sqm (for a 60sqm flat) which is still quite low compared to other major capitals across the world. In this context, Deutsche Wohnen's assets are particularly attractive as they are very scarce: apartments that are affordable. The average rent of its Berlin portfolio is around EUR 7.40 per sqm, multiplied by the average size of 60sqm, which equals a net rent of approximately EUR 450 per month. This alone looks cheap, but key is the affordability for its inhabitants - the new German minimum wage equates to after tax income of about EUR 1,500 for a single earner or EUR 1,700 for a family with one child. In both cases, the monthly rent of EUR 450 is still very affordable, especially compared to rental prices in London or Paris. Risk of competitively priced new supply is low due to the price of land and construction costs.

The discouraging of new builds by local government, especially build-to-hold projects, has also exacerbated the already tight supply situation in Berlin. In 2020 a local government experiment called "Mietendeckel" that forced even pre-existing rents to go down was put to an end by the federal constitutional court in April as of last year and rents that have been reduced were due to reverse. Furthermore, last year there was a referendum to expropriate Deutsche Wohnen and other large landlords to lower all rents to below EUR 4 per sqm. Naturally, this won a majority among Berliners, but we are highly doubtful that this attempt to expropriate property will go through, as it is highly unconstitutional and not economically feasible. That said, these regulations and referendums have had an impact on how Deutsche Wohnen is acting in Berlin. Together with Vonovia, they have committed to only increase rents by 1% for this and the next two years and only by a maximum of the rate of inflation for the following two years. Both companies have also offered to sell back apartments to the communal landlords in Berlin and Deutsche Wohnen sold close to 11k apartments at book value for EUR 1.66bn as of September 2021. We find it very generous to offer a rent freeze in real terms, and we think it will calm the market down in Berlin in the medium term.

Eventually though, rents will need to increase, and if higher inflation stays for longer, they will increase quite substantially. Looking at the current share price of EUR 22.50, we estimate its residential properties are valued at below EUR 2,000 per square meter vs. above EUR 3,100 at fair value. The share price seems to be pricing in a large house price correction. Although so far they are stable with high-end luxury flats under more pressure for obvious reasons. Furthermore, the German government has neglected social housing for a very long-time hindering supply further which provides a big cushion for valuation as we expect demand to continue to grow, especially in Berlin.

In the long run, we are confident that Vonovia will squeeze out the minority shareholders. Given the transparency of the underlying assets, this will need to be at a fair valuation, and the latest reported net asset value per share of EUR 57.45 implies an upside of 150%. Moreover, Vonovia limited its take-over offer to just below 90% of all outstanding shares to avoid the risk of paying real estate transfer tax. However, recent changes in tax law mean we believe they now won't be liable to any transfer tax if they do take 100% control. There is a risk that Vonovia will try to take advantage of minority shareholders and with its decision to cancel the dividend it seems it is trying to make the shares less attractive for now. With higher interest costs and leverage very much in investors' focus, it is also interesting to see that Deutsche Wohnen gives a very conservative loan to value figure. As of June 2022, Deutsche Wohnen reported a financial debt of EUR 9.3bn with a 7-year duration, with the vast majority fixed at an average of 1.4%. Their reported loan to value was 27.9%. Down from 38% a year ago. However, having spoken to the company we calculate the underlying loan to value is circa 25%. Furthermore, the company is still engaged in nursing homes and if it disposed of this segment, it would reduce its loan to value to around 23%. Therefore, even in an environment of increasing interest yields, government regulations, and social pressures, we feel very confident about the margin of safety embedded in Deutsche Wohnen due to its high-quality assets and low leverage at attractive interest rates. Currently trading at more than 50% discount to its book value, we find the underlying return on its equity of 2.7% attractive as a bond type investment with an increasing coupon as an inflation hedge. As mentioned, we see significant upside in the longer term as we think Vonovia will eventually try to take out the minority. In the meantime, over the next twelve months, we expect the market to better reflect the quality of its assets as well as its low-risk capital structure. Putting the shares to trade on a fairer FFO yield of 4% would give upside of 35%.

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Top Five Long Holdings as at 31 August 2022

Company	Country	Sector	% of NAV
STO SE & Co KGaA	Germany	Materials	6.6
IG Group Holdings Plc	United Kingdom	Financials	3.4
Dr. Martens Plc	United Kingdom	Consumer Discretionary	3.2
Mobilezone Holding AG	Switzerland	Consumer Discretionary	3.2
EVS Broadcast Equipment SA	Belgium	Information Technology	3.1
			19.5

Exposures as at 31 August 2022

Longs%	Shorts%	Gross Exposure%	Net Exposure%
81.8(84.1)	41.2(44.4)	123.0(128.5)	40.6(39.7)

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 August 2022

Country	Gross%	Net%
Austria	3.1	2.1
Belgium	3.1	3.1
Finland	1.5	-0.8
France	4.2	2.8
Germany	29.0	16.8
Italy	5.3	1.3
Luxembourg	1.5	-1.5
Netherlands	2.9	1.9
Norway	4.4	-2.0
Other	2.1	0.4
Spain	1.1	0.8
Sweden	10.6	-3.0
Switzerland	10.0	2.0
United Kingdom	36.6	21.1
United States	7.5	-4.6

Market Cap	Gross%	Net%
>£2bn	23.0	6.9
£700m - £2bn	37.2	4.0
£200m - £700m	44.4	16.0
<£200m	18.4	13.7

Positions	Aug	Jul
Long	83	85
Short	92	95
Longs Opened	0	3
Longs Closed	2	2
Shorts Opened	3	10
Shorts Closed	6	8

Sector	Gross%	Net%
Communication Services	5.3	-0.1
Consumer Discretionary	33.4	11.0
Consumer Staples	5.0	-2.8
Energy	0.1	-0.1
Financials	8.7	8.2
Health Care	5.3	0.1
Industrials	27.2	9.8
Information Technology	21.6	1.6
Materials	12.5	9.0
Real Estate	3.9	3.9
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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