Ennismore Global Equity Fund

Investor Newsletter for the month of July 2023

Issued on 8 August 2023

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 124m as at 31st July. Total assets under management by Ennismore Fund Management were GBP 457m. 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 Global Equity Fund. If you would like more information or to invest, please contact Adam Sullivan on +44 (0) 20 7368 4224 or email subs@ennismorefunds.com.

Performance as at 31 July 2023

	Share Class[1]					
	GBP	GBP A	EUR	CHF	EUR I	USD I
NAV per Share[2]	12.90	12.83	13.07	11.47	9.82	10.15
	% Change					
July 23	0.8	0.8	0.9	-1.2	0.5	0.7
2023 to date	3.3	3.2	6.9	3.5	2.1	3.4
Annualised return[3]	3.8	3.7	4.0	2.0	-0.4	0.3
Since launch[3]	29.0	28.3	30.7	14.7	-1.8	1.5
Note: All performance figures net of fees. **Past performance is not a guide to future returns.**						

Comments below on performance refer to GBP A NAV per share unless otherwise stated, exclude fx and interest contributions to cash and are prior to expenses.

The fund's NAV increased by 0.8% in July, with the long book contributing 3.7% and the short book costing 2.8%. Both Schibsted and Wise reported positive sets of results, while International Distributions Services (fka Royal Mail) finally struck a deal with its unions, followed by the head of the entity's better performing GLS subsidiary being appointed as group CEO. The month continued to be tough for our shorts, with the largest detractor being a US financial services company whose shares rose during the first half on no company specific news.

Top Five Contributors and Detractors for July 2023

Contributors	bp
Schibsted ASA	77
International Distributions Services Plc	60
Buzzi Unicem SpA	50
Deliveroo Plc	35
Wise Plc	34

Detractors	bp
US financial services company	-83
US listed Chinese aerospace company	-24
Hong Kong software company	-19
IHS Holding Limited	-18
US electrical equipment company	-16

Top Five Long Holdings as at 31 July 2023

Company	Country	Sector	% of NAV
Admiral Group Plc	United Kingdom	Financials	4.8
Schibsted ASA	Norway	Communication Services	4.5
Buzzi Unicem SpA	Italy	Materials	4.5
D'Ieteren Group SA	Belgium	Consumer Discretionary	3.8
Moneysupermarket.com Group Plc	United Kingdom	Information Technology	3.6
			21.3

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

Exposures as at 31 July 2023

Longs%	Shorts%	Gross Exposure%	Net Exposure%
79.9 (78.9)	41.8 (36.6)	121.7 (115.5)	38.1 (42.3)

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 at 31 July 2023

Country	Gross%	Net%
United States	40.3	-16.7
United Kingdom	28.6	27.8
Germany	8.9	5.6
Norway	7.5	4.8
Sweden	5.7	1.4
Japan	5.5	5.5
Italy	4.9	4.1
Belgium	3.8	3.8
Switzerland	2.0	0.2
Mexico	2.0	2.0
Hong Kong	2.0	-1.3
Israel	1.7	-0.5
Austria	1.7	-0.1
Spain	1.2	0.8
South Korea	1.0	1.0
Ireland	1.0	1.0
Australia	1.0	-1.0
Other	2.8	-0.5

Market Cap	Gross%	Net%
>$10bn	24.5	0.8
$5bn - $10bn	28.3	21.1
$1bn - $5bn	50.2	17.6
<$1bn	18.7	-1.5

Positions	Jul	Jun
Long	58	59
Short	85	77
Longs Opened	2	7
Longs Closed	3	0
Shorts Opened	12	15
Shorts Closed	4	1

Sector	Gross%	Net%
Communication Services	19.2	15.3
Consumer Discretionary	20.7	4.0
Consumer Staples	5.4	2.6
Energy	0.0	0.0
Financials	15.6	11.3
Health Care	4.3	-4.1
Industrials	17.1	-3.3
Information Technology	23.5	2.8
Materials	13.2	8.7
Real Estate	2.2	1.3
Utilities	0.0	0.0
Other	0.5	-0.5

Geographic analysis relates to country of incorporation or listing. This may not represent the underlying economic exposure of the operating business.

Nintendo Co Ltd – Japanese video game company (1.7% NAV)

Nintendo, founded in 1889, is a USD 50 billion market cap Japanese video game company. Nintendo's flagship console, the Switch, has sold nearly 130m devices to date, making it the third most popular console of all time. Nintendo is valued by the market at 14x forward EV/NOPAT (March year-end), which we believe is too low considering Nintendo's intellectual property ("IP"), margin enhancement opportunities by increasing its digital and third-party sales, and potential to substantially increase its annual subscriber base. This is before considering the optionality around increased monetisation of the IP through such channels as theme parks, movies and mobile gaming. We believe the market is overestimating the risks related to its next console, a risk we believe is greatly diminished by Nintendo releasing a follow-up Switch model.

Nintendo's software/IP business is simply fantastic; Nintendo's IP is vast, evergreen and loved globally. Core properties include the Mario Universe, Pokémon (through a 32% stake in the Pokémon Company), the Legend of Zelda, Super Smash Bros, Animal Crossing and Splatoon amongst others. Mario is the greatest selling video game franchise of all time by units, with over 800 million copies sold to date, while Pokémon takes the third spot. The Mario Universe, which has sold over 190 million units on the Switch, represents over 20% of Nintendo's software sales. The latest Pokémon game, Scarlet and Violet, is the fourth best-selling in the series after only 9 months of sales and sold over 10 million copies in the first three days. Several Zelda titles, including Breath of the Wild and Tears of the Kingdom, are ranked by review aggregators OpenCritic and Metacritic as some of the best games of all time, while Breath of the Wild won Game of the Year in 2017. Nintendo's brands also have truly global appeal, with FY23 sales being split 23% in Japan, 44% in the Americas, 25% in Europe and 8% elsewhere. Overall, we are very confident in the longevity of the popularity and depth of Nintendo's catalogue.

Nintendo also designs and sells game consoles - the current generation is the Nintendo Switch, a portable console that can also be "docked" to connect to a TV. The Switch comes in three models: Nintendo Switch, Nintendo Switch Lite, & Nintendo Switch OLED, with the cheapest model, the Lite, retailing for USD 199.99.

Nintendo develops, publishes and sells video games for the Switch both as physical cartridges and digital downloads, based on its own IP. Given it sells games for its own hardware, Nintendo doesn't pay royalties to a console maker nor hefty digital store fees so the incremental margins of selling a game are very high, with variable costs mainly relating to distribution fees. Third-party developers also create games for the Switch, for which Nintendo receives a royalty per game sold, and if sold through the Nintendo eShop, Nintendo takes a 30% commission. These platform-type fees are a highly attractive, high margin revenue stream. Nintendo sells add-ons alongside its games, such as Downloadable Content (DLC), providing extra content in addition to the core games.

Digital sales have better economics, and Nintendo has scope to shift more of its game sales to digital formats. First party physical game revenues are recognised net of the retailer's typical 30% cut, which doesn't exist for digital sales. Digital games also benefit from almost zero cost of goods sold – the only material cost is payment processing. We estimate the gross profit of a digital first party sale is almost twice that achieved on a physical sale of the same title. The largest barrier to digital volumes is arguably the Switch's lack of storage. The standard model comes with 32GB of storage which means a Switch owner realistically has capacity for only 2-3 digital games. One can buy extra storage, such as a microSD card, but many casual gamers simply buy physical cartridges instead. In FY23, JPY 405bn or 48% of software sales were digital, up from JPY 119 billion or 25% in FY19. However, 67% of PlayStation sales are digital, which indicates the potential assuming a new generation console has much larger storage capacity.

Nintendo also offers an online subscription service creatively named "Nintendo Switch Online" ("NSO"). NSO offers access to online multiplayer gaming, cloud backup and complimentary games to its 36 million+ members. The monthly cost for NSO's cheapest tier is currently USD 3.99 in the USA, which we believe constitutes the majority of the subscriber base. We estimate the recurring NSO revenues constitute almost 10% of Nintendo's sales.

The shift to digital distribution has materially improved video game industry economics over the last decade by both reducing costs (cutting out retail middlemen and costs of physical games) and enabling new monetisation tactics, most importantly online subscriptions, and in-game content. Digital sales are higher margin as discussed, but as importantly, have allowed game developers to extend the period over which they can monetise their IP and to smooth the peaks and troughs resulting from large game releases. Perhaps the best example of monetisation over extended periods is Take-Two's Grand Theft Auto V - released in 2013 yet generated over USD 600m in microtransactions in 2021 alone, 8 years after launch! The improvement in economics is evident in the margins of the largest US game publishers, Electronic Arts, Take-Two and Activision, whose average operating margins improved from 6% in 2012 to 18% in 2022, while also being more stable over time.

NSO can provide a powerful growth avenue. Nintendo's player base stands at 116m annual users, up 10% since June 2022. Only launched in September 2018, NSO has already amassed 36 million users, representing 31% of players, and we believe NSO subscriptions account for at least USD 1bn of Nintendo’s revenue. We estimate PlayStation Plus has penetration of c. 45% of the player base, showing scope for further NSO penetration. Additionally, NSO is 67% cheaper per year, on average, than the cheapest PlayStation Plus or Xbox Live annual subscription. The subscriptions offered are not exactly like for like, with the PlayStation & Xbox subscriptions offering complimentary AAA games, and Nintendo has a more casual player base, both of which should slightly hinder Nintendo's ability to raise prices to the level of peers. We believe Nintendo could realistically raise prices 3-7% a year and increase the users by 1-3 million annually, which suggests NSO revenue should grow at a c. 10% CAGR through 2027, at which pace it would become an increasingly large part of total revenues.

We also believe Nintendo has the potential to greatly increase the number of third-party games sold for the Switch, especially blockbuster AAA games. In FY23, 21% of software sales were derived from third-party games. Assuming a 20% cut of the third-party revenue on average implies 57% of games sold on the Switch are third-party games, compared with 84% for PlayStation in FY22. This difference can be attributed to the Switch's relatively low processing power, meaning a power-intensive game made to PS5's specifications cannot easily be migrated to the Switch. A more powerful Switch model would broaden the opportunity for large third-party games. However, with 125m consoles sold, it becomes increasingly difficult for third-party publishers to ignore the large and growing installed base that Nintendo offers for them to sell into. Third-party games have grown rapidly: JPY 176 billion or 21% of software sales in FY23 were from third party games, up from just JPY 53 billion or 15% of software sales in FY18. And major developers have recently announced new third-party games for the Switch. As part of the Activision/Microsoft merger, Activision has guaranteed 10-years of Call of Duty, the world's largest first-person shooting game, for the Switch. This will be the first time Call of Duty features on a Nintendo console since 2013. Unrelatedly, EA Sports has announced that EA FC 24 for the Switch will be made on its Frostbite engine, which will bring more game modes and better gameplay. This is the first time EA has made a concerted effort to bring its flagship game to the Switch. The trend of increasing third-party sales, along with two of the biggest games in the world coming to the Switch, are promising signs.

The IP segment is relatively immature in its attempts to monetise the content franchises outside of traditional console games, such as through movies and theme parks. In 2015, Nintendo partnered with Universal Studios to create Super Nintendo World, with locations already operational in Osaka and Hollywood, and two more to come in Orlando and Singapore. Nintendo is licensing its IP for this business and not accruing any expenses, therefore it will be a very high margin revenue stream. The recent Super Mario Bros movie was a great success, grossing over USD 1.35 billion at the worldwide box office which makes it the second highest grossing animated film of all time, below only Disney's Frozen 2. We believe these avenues offer scope for substantial growth while also deepening and broadening customer relationships with Nintendo's universe. Finally, Nintendo has also had several forays into mobile gaming, releasing c. 10 games to date. Super Mario Run, released in 2016, has had over 250 million lifetime downloads, while Mario Kart Tour, released 2019, has over 200 million lifetime downloads. Currently mobile revenue is not a huge needle-mover for Nintendo, despite mobile commanding a 60% share of the industry's revenue, but it provides optionality - the demand is definitely there, Nintendo just needs to create more games.

Nintendo has previously suffered from stark hardware-driven cyclicality, most memorably the unsuccessful Wii/Wii U transition. We believe a large reason for Nintendo's apparent mispricing in the stock market stems from an exaggerated fear of the risk of another Wii U-style flop. Numerous advancements in gaming consoles reduce the probability of an unsuccessful product. Firstly, we believe Nintendo's usage of tiered models, such as the base Switch, Switch Lite and Switch OLED, indicates a mentality of staying within the same operating system (OS). Nintendo upgrades the same device over time, while retaining the same OS. This would be more akin to the Xbox or PlayStation model of console advancement, with multiple tiers within one generation, such as the PS4 and the PS4 Pro, and then relatively smooth transitions between generations, e.g. from the PS4 to the PS5. The next Nintendo console will likely be an updated version of the Switch, or a "Switch 2". The latest evidence of a new Switch comes from Microsoft vs FTC court documents, which stated "Microsoft's commitment to make Call of Duty available on an in-development Switch model", amidst a myriad of other leaks.

Following on from the Switch offers numerous benefits, not least lower innovation risk. By having a well-understood console, perhaps with better ability to run more complicated games, higher frame rate, better battery, greater storage, and more, one need not re-educate the consumer. Additionally, there is potential for backwards compatibility, meaning games for the past console can be played on the next generation console. This incentivises the user to stay in Nintendo's ecosystem across console generations, given the sunk cost of the existing game library. Furthermore, new games could be sold to both the Switch and the Switch 2, meaning that software sales will be more durable across the transition. Shuntaro Furukawa, in his first earnings call as CEO in 2018, stated "I want to manage the company in a way that keeps us from shifting between joy and despair", demonstrating Nintendo's desire to learn from its mistakes and reduce cyclicality.

Another risk for Nintendo is the potential for industry-wide shifts into nascent technologies, such as virtual reality ("VR") and cloud gaming. Apple's recent foray into VR, and Meta's "Quest", could both become the go to consoles for gaming, offering immersive experiences which Nintendo currently cannot. The impact and potential adoption are currently unclear, but platform shifts are risky for incumbents.

Beyond the long-term case, Nintendo's short-term positioning is promising. The Mario movie's revenues should have a material effect on the top & bottom line, while there is significant evidence of a boost to Mario game sales as well. Nintendo recently announced "Super Mario Bros. Wonder", along with two other games in the Mario universe which should capitalise on the movie-boost. Additionally, the new Legend of Zelda game "Tears of the Kingdom" was released in May, with critics rating it the best game of the year (Nintendo also has the number 2, in Metroid Prime Remastered). Sales did not disappoint either, with 10 million units sold in the first three days!

Nintendo's capital allocation could, and should, be better. Nintendo's policy is to pay out the higher of 33% of operating profit or 50% of net profit as dividends. In FY24, based on management forecasts of 147 yen/share, this should provide a tidy 2.4% dividend yield. Nintendo has engaged in buybacks in the past, but despite this, Nintendo holds over USD 16.6 billion of cash and investments, representing over 30% of its market cap! Although Nintendo is not directly affected by the TSE stock exchange reforms, we are hopeful signs of a wider shift away from cash-hoarding in Japan will prompt change at Nintendo too.

Ultimately, through Nintendo we are buying an incredible IP portfolio, with many options to grow the top line, improve margins & quality of revenues, for just 14x forward EV/NOPAT. We believe in a couple of years' time, Nintendo will have proven its business model to be less cyclical, sport a more diversified revenue base and will receive a meaningful component of its revenues through a recurring stream. We value Nintendo on 18x EV/NOPAT on 2025 year-end earnings, producing over 40% upside in 18 months, before considering larger dividends or buybacks.

Monthly percentage return for the GBP A share class of the Global Equity Fund

Year	Jan (%)	Feb (%)	Mar (%)	Apr (%)	May (%)	Jun (%)	Jul (%)	Aug (%)	Sep (%)	Oct (%)	Nov (%)	Dec (%)	Annual
2023	0.7	0.8	0.1	3.4	-1.7	-0.9	0.8						**3.2**
2022	-1.7	-3.2	-3.3	3.4	0.4	-5.2	4.5	0.4	-0.4	0.5	4.1	6.2	**5.2**
2021	-2.6	1.4	2.7	3.0	0.7	-0.9	2.2	1.2	1.9	-3.9	1.7	2.3	**10.0**
2020	-4.8	-6.6	-5.4	4.6	-1.0	2.2	-4.5	-10.3	5.3	-0.8	-3.6	2.2	**-21.3**
2019	2.9	1.0	0.3	1.7	-0.2	0.5	1.0	1.8	1.9	0.0	-4.5	0.8	**7.3**
2018	-4.4	5.8	-0.9	3.3	2.8	5.9	1.8	4.0	1.0	0.7	0.5	-3.0	**18.6**
2017	-0.1	-1.4	-1.2	-2.9	1.7	-1.5	1.0	3.2	-2.8	1.3	-1.2	5.5	**1.3**
2016										1.3	-0.8	5.3	**5.8**

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