Ennismore Global Equity Fund

Investor Newsletter for the month of December 2024

Issued on 9th January 2025

Fund Details

Daily dealing UCITS and Irish Central Bank regulated open-ended investment company with Financial Conduct Authority recognition and registered in Ireland, Germany, Italy, Spain and Sweden. The Fund size was GBP 136m as at 31st December. Total assets under management by Ennismore Fund Management were GBP 428m. We currently have capacity available in the Global Equity Fund. If you would like more information or to invest, please contact Margaret Webb on +44 (0) 20 7368 4250 or email clients@ennismorefunds.com.

Performance as at 31st December 2024

	Share Class[1]					
	GBP	**GBP A**	**EUR**	**CHF**	**EUR I**	**USD I**
NAV per Share[2]	14.82	14.74	15.50	13.66	11.19	11.65
	% Change					
December 2024	0.5	0.5	0.9	2.0	0.4	0.5
2024	6.5	6.4	10.7	14.3	6.1	6.4
Annualised return[3]	4.9	4.8	5.5	3.9	1.7	2.6
Since launch[3]	48.2	47.4	55.0	36.6	11.9	16.5
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 GBP A NAV per share increased by +0.5% in December, the long book cost -0.5% while the short book contributed +1.1%.

We are pleased to have delivered another positive return in 2024, marking the Fund's fourth consecutive year of gains, produced across a range of economic and equity market conditions. The GBP A class gained +6.4%, the EUR class gained +10.7%. the CHF class gained 14.3% and the USD I class gained +6.4% over the year. The Fund continued to show its diversifying properties, with correlation & Beta over the year (USD I class) to the MSCI World Index $ realising close to zero at -0.03 & -0.02 respectively. The Fund's realised volatility (USD I class) was 6.4% over the year.

Global equity markets were strong with US stocks outperforming other regions, driven by stronger-than-expected US economic growth, Fed rate cuts and the continuing AI boom. 2024 was a year where political economy reemerged as a major driver of equity performance. In Europe, sluggish growth and political deadlock hampered domestic French & German equities, whilst other countries with better economic performance or more stable political backdrops outperformed (e.g. Spain, Italy, Greece).

Japanese equities posted another solid year, albeit with more volatility in H2 as political and monetary policy uncertainty increased amidst a change in political leadership. After starting the year on a weak footing, Chinese equities rallied sharply in Q3 after Chinese authorities announced significant stimulus measures designed to bolster flagging economic growth. Brazil was a notable underperformer as investors fretted over the government's fiscal policies.

Another major feature of the year was the outperformance of large & mega cap equities versus their small & mid cap peers. This was notable in the US (S&P 500 +25% vs Russell 2000 +11.5%), Europe (MSCI Europe +8.6% vs MSCI Europe SC +5.7%) and Japan (Nikkei 225 19.2% vs Topix Small Cap +11.3%).

Given the above headwinds from market cap & country performance, we were pleased to be able to deliver a positive return, whereby positive stock selection overcame the challenges from geographic and small and mid-cap exposures.

[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.

Indeed, stock selection alpha has been the dominant driver of returns since 2021 (accounting for ca. 70% of gross returns), outweighing style, country and industry factors.

Over the year, on a (100%) normalised dollar gross basis, the long book returned +19.3%, outperforming the MSCI World $ net TR Index (+18.7%), whilst the short book (+12.6%) underperformed both the long book & the Index. This marked the fourth consecutive year of a positive spread between the long & short books (ca. 23% p.a. since Jan 2021), albeit 2024's spread was below our own expectations.

Short contributors included fuboTV (+51bps), Applied Digital (+46bps), and Mondee (+102bps) which is discussed in more detail below.

We typically like to short companies which are unprofitable and fall into our 'deception, challenged business, or over earners' categories. In recent years, particularly in the deception category, some companies (mainly in the US) have been the subject of speculative fervour or so-called 'meme' attention. The short book return would have been more satisfying but for the impact of two such names (AST Spacemobile & Soundhound AI), which detracted -130bps & -207bps respectively. We have improved our short book 'meme' risk monitoring framework and this has helped us avoid other similar speculative shorts which do inevitably come out of our short screening process.

Generating short book alpha is always challenging and many actors have exited the stage in recent years. Despite all the difficulties of shorting at times exuberant / speculative markets (not least in 2024), we are pleased to have added alpha on the short side. Based on this we are confident that when the time comes for shorts to drive portfolio returns, our short process will serve us well.

On the long side, we've written before about how much we like businesses that benefit from network effects, particularly online classifieds. Such businesses tend to be the fulcrum of the value chain they serve, being a habitual, or more often an essential tool for both sides of their networks. This endows them with strong pricing power. They also tend to be extraordinarily capital efficient, such that growth requires next to no incremental capital. Assuming such a business grows, one can pay a surprisingly high multiple of current earnings and still get a very decent outcome over time.

Over the year, 19 long positions in businesses that we classify as beneficiaries of network effects, spread across a variety of sectors, contributed ca. 750bps.

At the year-end we maintain a decent exposure to these businesses, albeit with a different composition than at the start of the year. Then, Schibsted was the Fund's largest holding, as we approached the closing of two business unit disposals and a significant return of capital. Schibsted repriced sharply as the dividend was distributed and we reduced our position size. Now, Auto Trader (which we discussed in our December 2023 letter) is our largest network effect-driven position after a sell-off following a trim to guidance in November. Our thesis is essentially unchanged from a year ago, albeit delivery on the digital retailing opportunity is becoming clearer as the number of cars available to reserve online is almost 80% higher than last year, and management has announced its commission-based pricing model which supports our expectation of almost doubling revenue per car over time.

Another theme that has generated significant value for the Fund this year is special situations, particularly the payment of special dividends at Schibsted and D'Ieteren. A special dividend sounds like a pretty anodyne event, and it should be: company sells assets; company receives and distributes cash; investor receives cash, perhaps net of tax. No change in corporate value, except for any tax leakage. These should not be particularly complex events to analyse. The distribution is telegraphed weeks or months in advance. And yet the stocks traded up over 13% and 20% respectively in the week preceding the ex-dividend date. We had large positions in both stocks approaching the distribution event, and we estimate these events contributed up to 1.5% in 2024. We won't claim to be geniuses for exploiting these situations, but even the most die-hard efficient market zealot would struggle to disagree that these were market inefficiencies, and when free money is being offered in the markets, it's our job to grab as much of it as quickly as we can.

Whilst 2024 has not been a banner year for the short book, we still notched up some successes. One is worth recounting, not only because it is an entertaining story but it is also a demonstration of how our in-depth research process uncovered various red flags. Mondee Holdings was a late vintage SPAC from the post-Covid SPAC boom. The new entity listed in July

2022 and we discovered it in Autumn 2023 via our proprietary tracking of business relationships which raised some red flags. Unusually, it took us a while to work out what the company did, so full were the investor materials of claims about revolutionising travel with a transformative AI travel agent. Eventually we established that the business was in fact one of the most legacy of legacy business models. It was an airline ticket "consolidator" – which means it helps airlines to distribute difficult-to-sell inventory to niche markets at discounted prices. A classic example is acting as intermediary to sell seats on the London-Shanghai route into London's ethnic Chinese community via the local physical Chinatown travel agency. This is a low margin, working capital-intensive business, and a declining market. Travel was one of the first markets to be disrupted by the internet given the absence of a physical product to deliver and social media has made identifying and communicating with small niches much easier, eroding the business logic of the consolidator model.

The SPAC promoters were presumably aware that the market for such a business would be thin, but their attempt at building an exciting narrative to sell to equity investors was not compelling. They resprayed the company with a modern brand image, exaggerated its AI technology features and its total addressable market by taking initial steps into supposedly lucrative new markets. However, the AI exaggeration was transparent when we tested it, whilst the "TAM expansion" initiatives were doomed to failure, leaving Mondee competing with behemoths like Booking.com in hotel distribution for instance. An acquisition spree combined with some disposals and less-than-complete disclosures, made tracking organic growth very difficult and had left the company drowning in debt. Having projected EBITDA of USD 100m in 2023 in its SPAC presentation materials, Mondee delivered a USD 25m of highly adjusted EBITDA, and no cash flow. When we found the company, it already had ca. USD 193m of net debt including preference shares and had been forced to renegotiate its credit agreement multiple times. By mid-2024, the net debt was up to ca. USD 261m. As far as we know, Mondee renegotiated its credit agreement another seven times in 2024, including what one of the promoters claimed was a "game-changing" maturity deferral in August along with its delayed 10Q for the June period. This was the last 10Q the company filed, as it failed to file for its September period and was delisted by the NASDAQ in December.

Outlook

As we enter 2025, from a bottom-up perspective we are very happy with both the upside potential as well as the quality, safety and value mix of our current portfolio. We have confidence in our investment process to continue to deliver alpha on the long side & short side in the years ahead, irrespective of the macro cycle or market environment.

From a top-down perspective, the Fund's overall style & cyclical profile is modest. The Fund carries two notable exposures: a geographic bias towards UK/Europe together with our structural bias towards small & mid cap companies. The European skew is a recurring feature of the Fund's positioning, and likely to remain so, reflecting our location and the background of the underlying PMs. We discussed these at length in our Q3 2024 newsletter, however, it is worth briefly reiterating why, despite these having been headwinds in 2024, we are not shying away from these exposures.

On a global basis, small & mid-caps have underperformed in recent years as capital has flowed into mega cap stocks. This is historically unusual during periods of economic expansion and has led to a large gulf in valuations between mega caps and the mid cap universe, which, we believe, offers a favourable risk reward going forwards.

Following a long period of underperformance, European equities now trade at historically cheap valuation discounts to their US peers, even on a sector normalised basis. The reasons not to like Europe are well known (tariffs, energy costs, politics, lower growth). However, a dovish ECB, historically cheap valuations, Chinese stimulus, UK stability, a cheap Euro (benefiting exporters) and being out of favour provide upside potential. A resolution to the French impasse, a clear German election result or a ceasefire in Ukraine could all unleash a large move in what is a coiled spring.

The Fund has maintained its solid diversification profile, showing low correlation/beta to broader equities. When combined with a large upside potential from the compellingly cheap long book and a continuingly fruitful short-side research process we believe this makes it an interesting proposition for investors seeking a diversified return potential.

Top Five Contributors and Detractors for December 2024

Contributors	bps
Wise Plc	61
D'Ieteren Group SA	38
Nippon Television Holdings Inc	30
Just Group Plc	27
US software company	26

Detractors	bps
French technology company	-47
Phillip Morris International Inc	-30
Auto Trader Group Plc	-28
Baltic Classifieds Group Plc	-27
Becle S.A.B. de C.V.	-19

Top Five Long Holdings as at 31st December 2024

Company	Country	Sector	% of NAV
Admiral Group Plc	United Kingdom	Financials	7.0
D'Ieteren Group SA	Belgium	Consumer Discretionary	4.7
Auto Trader Group Plc	United Kingdom	Communication Services	4.6
Nippon Television Holdings Inc	Japan	Communication Services	3.7
Phillip Morris International Inc	United States	Consumer Staples	3.6
			23.6

Exposures as at 31st December 2024

Longs%	Shorts%	Gross Exposure%	Net Exposure%
107.9 (109.4)	43.8 (44.8)	151.7 (154.2)	64.1 (64.6)

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 31st December 2024

Country	Gross%	Net%
United States	40.8	-6.3
United Kingdom	32.5	29.0
Japan	13.8	12.3
Sweden	7.8	-0.2
Belgium	6.9	6.9
Germany	6.4	2.9
Canada	6.2	5.8
France	4.7	-4.5
Italy	4.6	1.8
Norway	3.4	3.1
Lithuania	2.9	2.9
Ireland	2.3	2.3
Hong Kong	2.2	2.2
Israel	1.6	0.3
Bermuda	1.6	1.6
Spain	1.4	0.9
South Korea	1.3	1.3
Mexico	1.2	1.2
Singapore	1.2	-0.4
Finland	1.2	-1.2
Philippines	1.1	1.1
Switzerland	1.0	-0.5
Taiwan	0.9	0.9
Other	4.7	0.8

Market Cap	Gross%	Net%
>$50bn	16.6	10.6
$20bn - $50bn	7.3	4.3
$2bn - $20bn	75.3	24.7
$500m -$2bn	37.7	13.5
<$500m	14.8	11.0

Positions	Dec	Nov
Long	84	78
Short	92	91
Longs Opened	7	4
Longs Closed	1	11
Shorts Opened	6	15
Shorts Closed	5	12

Sector	Gross%	Net%
Communication Services	24.9	22.3
Consumer Discretionary	21.4	10.7
Consumer Staples	12.3	-1.0
Energy	3.1	2.0
Financials	28.9	21.7
Health Care	7.6	2.3
Industrials	22.1	2.4
Information Technology	19.0	-3.7
Materials	7.9	4.1
Real Estate	3.2	2.4
Utilities	0.2	-0.2
Other	1.1	1.1

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

Video Gaming Industry – The game has changed

The video game industry has some attractive basic characteristics, particularly relative to other segments of the media industry. It remains a growth industry, with hours played growing significantly over the last ten and twenty years in contrast to largely stagnant consumption of television or radio[4,5,6]. Monetisation per hour of consumption is also low relative to television, despite engagement being more intense. It is this intense engagement that is the key to understanding why this divergence has happened. The technological advancements of the past two decades have revolutionised the experience of video games in ways not possible for other media. While music and video entertainment have undergone distribution disruption, the experience of playing video games has transformed on top of the distribution shifts. Video games are not merely software toys or interactive puzzles anymore; they have become something else. To understand what they have become, it helps to see where they have come from.

It is commonly estimated that 80%-90% of music albums fail to cover their upfront costs. A 2004 Nielsen BookScan study of the industry found that 98% of books published in the US sold fewer than 1,000 copies. Historically, video games were similar: hit-driven and short-lived entertainment products funded by high upfront costs in development and marketing with a high proportion of failures. Even if the product was a hit, the process largely repeated with a difficult sequel. This is not a recipe for predictably high returns, but for lumpy revenues and inconsistent (often elusive) profits.

One method of alleviating this capital allocation problem is by creating a more durable and sustained engagement to drive monetisation, and this is where advancing technology has benefited the video games industry relative to its media peers. Digital distribution and online connectivity shifted gameplay from solitary interaction with a computer into a complex and interactive social experience. As software-based and cloud-delivered products, games can change based on how a user interacts with them and be updated by developers, so the product evolves over time, possibilities that are largely inaccessible to other media entertainment. The fan of a minor character in some TV series cannot have that TV series increase the screen time of that minor character, just for them. A fan of an instrumental section of a music single cannot have that instrumental extended and tweaked to their liking while they listen to it. Mechanisms analogous to these are available to game developers, allowing them to drive unrivalled engagement depth and durability. It is no surprise that the monetisation of this engagement in video games has become more sophisticated: changing from almost total reliance on an upfront sale to a complex mixture of upfront, game extensions, in-game purchasing and the beginnings of in-game ads. The combination of this evolving engagement and phased monetisation has allowed some video game businesses to invert the capital allocation problem, spreading costs over a long monetisable life to create sustainable high returns.

Consider the financial performance of Electronic Arts Inc. ("EA") as a demonstrative example of this evolution. Between FY1999 and FY2010 (year-end March), EA's average gross margin was 55%. The group's EBITDA margin went from 16% in 1999 to 4% in 2001, then recovered to 29% in 2004 before steadily declining to 10% in 2010. Revenue almost doubled in two years from 2001 to 2003 but declined by 13% in 2010. The last ten years is a sharp contrast: the average gross margin has been 74%; EA's EBITDA margin has not dropped below 23%; whilst the worst revenue performance was a decline of 4% in 2019. Interestingly, annualised growth in revenue per share has been almost identical at ca. 9.5% during both periods.

As exciting as all this is, many video games remain hit-driven and short-lived entertainment products funded by high upfront costs. Not all businesses have elevated their financial performance in the way EA has. With this in mind, we approach this industry from two perspectives.

First, the 'picks-and-shovels' companies, which act as a royalty on the underlying growth of the industry whilst insulating themselves from the risk of commercial failure. We invested in Keywords Studios plc ("Keywords") earlier this year as an example of this theme. Keywords is the clear market leader in providing outsourced game development services to the premium (AAA) end of the market, where outsourced game development is most necessary. The labour demands during the production of a AAA game can grow from a dozen employees at the start, to hundreds (or more) at peak production only to then collapse at release. As the scale and budgets of games have grown, the range of this labour expansion and contraction has forced AAA publishers to exchange fixed labour costs for variable costs through outsourcing. This has

[4] https://www.bls.gov/news.release/archives/atus_09142004.pdf
[5] https://www.bls.gov/news.release/archives/atus_06182014.pdf
[6] https://www.bls.gov/news.release/atus.t11B.htm

become inescapable for them. To give some context to the rate at which development costs have grown, consider the extreme example of Grand Theft Auto which has historically set new bounds for development budgets. Grand Theft Auto V was released in 2013 with a budget estimated by analysts to be around $250m for development and marketing combined. Grand Theft Auto VI, scheduled for release in Autumn 2025, is estimated to have a budget of as much as $2bn, the largest budget of any video game to date. We believe this release will be successful but the basic mechanics of the game development outsourcing model make for a far more predictable investment. Keywords was bid for by EQT in May 2024 and we exited our position close to the offer price after the bid was recommended by the board.

The second approach is to deepen our understanding of what creates durable engagement in video games and apply that analysis to video game developers and publishers themselves. This means finding companies who can and have exploited the potential to transform games from short-lived hits to long-duration franchises. We believe there are a handful of basic qualities that can facilitate this durable engagement, build competitive moats and achieve high returns. The three we elaborate on here are gaming franchises with high gameplay variation, extendable playable life, and scope for dominating a niche.

High gameplay variation

The myriad of possibilities for variation in gameplay are beyond the scope of this newsletter but its consequences are important. Complex variation gives players freedom and choice. This gives scope for open-ended and imaginative play that increases replayability and game lifetime motivated by the ideas of the player, not just the expensive game designer. An example of this from outside of video games would be Lego. The guided gameplay offered by a Lego blueprint is ultimately an optional introduction to the possible gameplay offered by the Lego pieces. Video games can work similarly but the consequences can be far more significant. Gameplay variation in video games fuels discussion and debate in online communities, facilitating content for streamers, Youtubers, online forums and guides. When players engage with this secondary content, social media platforms will reinforce their immersion in similar content. The power of these secondary network effects was demonstrated over 20 years ago, even before mass adoption of social media, when the developer of the Championship Manager gaming franchise (Sports Interactive) split from its publisher (Eidos Interactive, "Eidos") in late 2003. Eidos retained the brand but Sports Interactive retained its online forums. This was a fatal misjudgement of competitive advantage by Eidos. When Sports Interactive found a new publisher and released Football Manager, a near identical competing product, consumers followed the online community, not the brand. When consumers googled for answers on how to navigate the inherent complexity and variation in the gameplay, or even simply for which game to buy, they found a rich online community for the new rival but not the incumbent. In the 20 years since that split, Sports Interactive has grown revenue at a 15.7% CAGR, while the Championship Manager franchise is dead.

Extendable playable life

There are only a few things a developer can do to extend the life of their video game before developing and releasing an expensive (and risky) sequel. They can (A) change or expand the bounds of the playable area, (B) change the content within those bounds, or (C) change game mechanics/modes of interactivity. Ideally, a video game should be designed with these possible changes in mind and then the developers should remain in touch with consumers to balance new and existing variations. This customer relationship is helped by engaging with online communities but is probably best managed by allowing the consumers to enable these changes within the game themselves, through user-generated content (UGC) and 'modding' support (a process whereby players can access the game's code and make modifications which can then be integrated into the game). For games with an extensive modding community and/or a lot of UGC, the current state of the game is in constant development at minimal cost to the developer. Then as a developer can see which consumer-developed changes are most popular, they can incorporate them into the core game for free or even sell a perfected version as downloadable content. In the context of our primary capital allocation problem, where spreading development expense over the life of a game is preferred, this offers ideal post-release development economics.

Minecraft is the perfect example of a gaming franchise that has achieved this. Minecraft started in 2009 as a simple game that allowed a player to manipulate the small cubes that constituted the Minecraft gaming environment, not unlike a digital Lego. Over years of continuous development with its community, these cubes have become so varied that a 5-year-old can use them for imaginative play and a computer scientist can, for fun, use them to build working models of computer processors. Designing the current state of the game from scratch would be a technically and financially absurd venture, aside from being almost certainly beyond the imagination of a small group of developers. Yet this absurd scenario, almost organically designed through the evolution of community development, is the greatest selling video game of all time by copies sold at over 300 million. Microsoft acquired the development studio responsible for USD 2.5bn in 2014.

Scope for dominating a niche

If a game is high in variation, can repeatedly extend its life and is in a niche that can be dominated, it is well positioned to create a powerful moat. When a game has been able to be in constant development for many years using tight integration with its community, those incremental developments can sum to an unsurmountable upfront cost for a competitor. Even if a competitor chooses to take that risk, it is unlikely to pry customers away from the years of technical, emotional, social or financial costs sunk into the incumbent. A good example of this is how ‘Cities: Skylines’, developed by Colossal Order and published by Paradox Interactive, came to dominate the city-building genre over the 2010s. After a poor 2013 release by SimCity, at that time the leading franchise of the genre, Cities: Skylines was able to take the lead. Through modding support and a stream of downloadable content, this city planning simulator could become richer and more complex in digestible and affordable increments. What resulted was a hugely detailed and profitably developed game. Paradox Interactive eventually released a full sequel, Cities: Skylines 2, in 2023. This release was a relative failure, criticised by its customers for being buggy and unpolished. Despite this, it is unlike the failure of the incumbent in 2013 because the only viable alternative for fans of the genre is Cities: Skylines 1. If anything, it is not unreasonable to say that the barriers to entry created by that game were so high that even its sequel has struggled to overcome them. Thankfully for Paradox Interactive and Colossal Order, there should be time to continue developing the sequel and replace its predecessor.

Evaluating game franchises against these sort of qualitative criteria helps us to judge the durability of a franchise. We believe many investors have failed to fully appreciate the migration of parts of the video game industry to a software-like business model, and as a result we sometimes see robust franchises or groups of franchises treated like commodities on the basis of a weak quarter or other short-term noise. We believe Paradox Interactive fits this profile. After a year or so of noisy financial performance the share price more than halved from the peak. We have followed the company for a few years and established a position in Q4.

ENTER PARADOX

Paradox Interactive AB – Swedish video game publisher (2.0% NAV)

The core Paradox gaming franchises are close to an ideal inversion of the fundamental capital allocation problem of video games. The excellent financial performance of these games is currently disguised by the terrible performance of a failed and now-ending publishing strategy that company undertook under the leadership of its former CEO. This CEO has since been replaced by the founder of Paradox Interactive, Fredrik Wester, who still owns 33% of the company. He has ruthlessly written off most of the failed investments of that publishing strategy, choosing instead to focus on building out the core business. This is the correct strategy in our view. However, it has caused short term losses that depressed the share price in 2024. As these weaker investments tail off, the market has begun to recognise the quality of what remains with the stock up around two thirds from its mid-year lows.

We estimate that between 2016 and 2023, the core Paradox gaming franchises compounded revenue at approximately 22% p.a. and grew monthly active users from approximately two to six million. As the development capex of non-core gaming franchises declines, leaving just the higher return businesses, we believe free cash flow margins can approach 40%.

Paradox leads a niche genre of video game known as ‘grand strategy’, particularly the ‘map painting’ style of grand strategy. Five of the six core Paradox franchises are in this genre. These games evolved from tabletop strategy games that would take hours or days to complete. They require players to learn and operate on complex rule sets and systems, resulting in cognitively challenging gameplay with high psychological reward. As a single game progresses, these rules and systems interact to create an emergent complexity that creates asymptotic skill ceilings and endless replayability. The sixth core franchise is Cities: Skylines, the city-building game we discussed earlier. Although Cities: Skylines is in a different genre, it possesses very similar mechanics.

All bar one of the grand strategy games are simulations of periods of human history. The player begins by taking control of a territory or family dynasty during some historical period and then progresses through that period by balancing domestic and international politics, economics and war while communicating and influencing the AI or human characters controlling the other territories and dynasties. The levers for controlling gameplay that the player possesses depend on the historical period the game relates to. The one non-historical core grand strategy game in this genre (Stellaris) has similar qualities but is set in futuristic outer space. The 'map painting' descriptor of these games comes from the screen displaying a map, with each territory coloured (painted) by its properties. Players will attempt to 'paint' the map according to their desires. The board game 'Risk' is probably the most well-known map painter.

Developing games in this genre is difficult but relatively inexpensive. These are map-based environments after all, not procedurally generated virtual realities with lifelike detail. The upfront cost is approximately $20m but the typical retail price is ca. $50. Considering premium AAA games cost hundreds of millions to develop and will only retail at $70, this is impressive pricing power. Once a base game is released, Paradox aims to monetise and fuel its engaged customers with many years of regular paid downloadable content, the cost of which is modest. What results is a game that covers its upfront costs on release, then generates healthy profits in the years that follow.

As you can imagine, this genre will never have mass appeal. Games primarily designed around cognitive challenge and without short-term rewards are not fun for the average person. Yet for the consumers willing to traverse the steep learning curves and emergent complexity, it's a recipe for extraordinary engagement. The average time spent in these games is in the hundreds of hours but it is common to find players with greater than 1,000 hours of playtime. To contextualise this level of engagement, in one thousand hours a person could watch the entire ten season run of Friends eleven times, watch the eight-part Harry Potter film series fifty times or play over 650 ninety-minute football matches. A thousand hours of engagement in a single entertainment product will make that product a part of a consumer's life and identity. It is important to them. This gives Paradox an extraordinary ability to monetise its games.

The moat possessed by these franchises is peculiar. Replicating Paradox's grand strategy games is very, very difficult. Creating a functioning game based on the complex rule sets is a non-trivial matter, especially when they are of the complexity that Paradox games achieve. This is something only rare minds are capable of. Then making that complex ruleset understandable to a customer requires, among other things, an online community that smooths the learning curve and encourages learning. Paradox has built this community over decades. Even if we assume a competitor overcomes these barriers, product differentiation still remains. Paradox has set a standard for how this genre works. Deviating too much from that standard will be unpalatable to the consumer while not deviating enough will create a game more easily replicated by Paradox. It is simply not a good idea to compete with Paradox Interactive in its core business.

The dominance over this genre and deep engagement not only give pricing power over customers but also an interesting bargaining power over suppliers. By fostering a modding community, the company has a pool of game developer fans who have learned and worked on the game code as a hobby. Paradox can employ development talent who are fans of the games, who already know the company's code, have already created products with it and are already engaged in the community. Given that access to the rare personalities that can make these games is so essential to the business, this is a powerful advantage.

The hangover of the former strategy is affecting Paradox financial statements in two key areas. We estimate the remaining annual development cost of that strategy's projects to have been close to SEK 250m in 2023. The first of those projects was released at the end of 2023 and aggressively written off, the second was cancelled and written off in early 2024, and the third is set for release in 2025. We were informed by management that the third project will not continue as a part of the Paradox strategy regardless of success. The amortisation of these write offs has suppressed profits by almost SEK 500m in the twelve months to Q3 2024 while free cash-flow has been reduced by the tailing-off of this high development spend. These are non-recurring issues that will end soon after the release of that final project. What will remain is a collection of enduring franchises that epitomise the qualities we desire, albeit in a niche.

Our modest volume and pricing growth assumptions (well below historical performance) for the existing franchises combined with an exit multiple close to Paradox's historic lows generate a mid-teen IRR over the next four years. This leaves a healthy foundation for the potential of new or rejuvenated franchises to add to the potential upside.

The key risks to this outcome are sequel failure, limited market size and the concentrated importance of Paradox's human capital. Cities: Skylines 2 has demonstrated that sequels to these dominant franchises will not always meet with immediate success. The business model provides some insulation for existing franchises but the possible poor execution of sequels and new franchises nevertheless creates risk. The total addressable market for these games is unknown, although we estimate headroom for growth in the medium term despite their niche characteristics.

Team Update

We are pleased to announce the addition of two portfolio managers to the Global Equity Fund team: Mike Dymond and Henry Rayner. Both portfolio managers are existing analysts who are already fully embedded into our team. They have both greatly contributed to our investment process in recent years and we are confident they will add expertise and fresh ideas to the Global Fund. They begin with a low single digit allocation of the Fund.

Full biographies of all team members can be found on our website.

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
2024	3.3	-3.1	1.9	1.1	2.7	-0.9	0.7	1.5	-1.4	-0.3	0.4	0.5	**6.4**
2023	0.7	0.8	0.1	3.4	-1.7	-0.9	0.8	2.5	4.9	0.9	-0.4	-0.1	**11.4**
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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