GEHLEN
BRÄUTIGAM

CAPITAL

Gehlen Bräutigam Capital GmbH
Kurfuerstendamm 11
10719 Berlin

+49 30 42141851
info@gbcvalue.com
www.gbcvalue.com

Letter to Partners #8

Q2 2020 *(1st April 2020 – 30th June 2020)*

23rd July 2020

Dear partner,

On the occasion of our two-year fund anniversary, we would like to take a brief look back at the developments to date. Our fund has had a **performance of -3.0%** since inception. Even if this development is **more than 5% above that of our reference index** (the MSCI Europe Small & Micro Cap), a negative development is not satisfactory and is **far from our goal (a double-digit net return per year)**.

However, another development is much more important to us. In our opinion, the **intrinsic value** of the portfolio has **increased significantly** since the fund was launched, despite the challenging economic environment (especially considering the current pandemic situation). There are two reasons for this: the values of the companies in our portfolio are higher than the purchase price, or we have realized some of them (e.g. Volvere, Telepizza or DO & CO) and the money has been re-allocated. In addition, especially in the current crisis, we have added some new companies to the portfolio that we believe are even more undervalued.

From today's perspective, we estimate the intrinsic value per share to be at least €170. The focus of our work is to further increase this value over time. **We are confident that the price of the fund shares will approach this value over time**.

In recent weeks, there has been an increasing number of observers in the stock markets who are concerned that the upside of an investment in the market is limited at the present time. In their opinion, the stock market does not sufficiently reflect the major economic challenges and risks of the current crisis.

It is important to note that the stock market is not an image of the entire economy. It would surely be on a different level if it consisted mainly of small companies, who are suffering more in the current time and will continue to do so during the aftermath. The development of popular indices also overshadows the various development of different sectors. The current stock market rally is particularly driven by certain sectors, such as technology and healthcare.

Mega caps such as Apple, Amazon or Microsoft in the USA are likely to benefit from the current crisis and have been in positive territory since the beginning of the year. Due to their size, they are heavily weighted and have a significant impact on the development of the indices. However, many stocks continue to trade near their lows.

In the past few years, future growth has become more and more valuable due to the sharp drop in interest rates, which are likely to remain at a very low level for a long time to come. Today, investors are willing to pay very high prices for "safe growth". Some companies are now valued at 20 or 30 times **their sales**. These reviews leave little room for disappointment as the whole value is in a very positive future development. Should the growth level off, the price paid today would be too high.

We do not want to say that the market fundamentally overestimates these companies. The large technology companies in particular are characterized by exceptional market positions and their future prospects remain very positive. Under these conditions, the prices called for today do not seem crazy, even if valuations have risen sharply in recent years. With some review, however, we scratch our heads. "Story stocks" such as Tesla, Shopify or Lemonade have to do extraordinary things to justify the advance laurels of the stock market.

In the current market environment, we found that companies that do not offer such high "secure" growth and cannot necessarily tell the most exciting stories (à la Microsoft, Tesla or Zoom Video Communications), are sometimes neglected and act on exceptionally low valuations.

We already mentioned in our Q3 letter last year that the relative valuation of "value" - compared to "growth" stocks - is seldom low. In 2020, "value" stocks have had the worst relative performance since 1999. The valuation difference between "value" and "growth" stocks is greater than ever before, and even higher than at the time of the dotcom bubble.

Our approach is not to rely on quantitative theses about the broad market. There are certainly some good reasons for higher valuation differences (e.g. the increasingly rapid disruption). However, we would be very surprised if this phenomenon does not also offer opportunities at the individual title level. We are confident that we have identified companies that are not only superficially cheap on the surface, but also have a positive future and where the **current discount is absolutely not justified**. Therefore, a particularly important part of our work will consist of being patient and "sitting on our hands".

"The single greatest edge an investor can have is a long-term orientation." - Seth Klarman

We do not have a strong opinion about the future development of the markets in general and consequently about the timing of an investment in the broad market. **However, we are convinced that there has hardly been a better time to invest in our funds since our inception, admittedly for a very short time**.

We mentioned earlier that we believe the intrinsic value of our portfolio has increased since it was launched. The price didn't do that. So today we see a very big difference between the two. **Based on our estimate of the intrinsic value per share of €170, an investor would get a discount of more than 40% (or more than 70% upside) at today's price**.

We are also confident that the companies in our portfolio, often run by owners, can and will significantly increase this value. In our previous Letter to Partners, we reported on the possible opportunities of the current crisis and the positioning of some of our core holdings.

We received confirmation last week that we are not alone in our views. The founders of one of our portfolio companies, the people who should know the company best, made a takeover offer for our shares after the end of the quarter. Despite the uncertainties caused by Corona, they are prepared to pay a clear premium for the company at the current exchange rate...

In this case, it is **Devoteam**. On July 9th, the founders, managing directors and currently largest shareholders (they hold approx. 26% of the shares) - Godefroy and Stanislas de Bentzmann - together with the private equity investor KKR, made an offer for the outstanding shares.

We started to build up a position in the French company at the end of last year and have expanded it slightly again in the past few weeks. In our opinion, Devoteam is one of the best positioned IT service providers. The company was geared towards future technologies by the founders very early, during a difficult phase 7-8 years ago, and today has a particularly strong position in the fast-growing cloud area. The positive orientation for future trends and the positioning with the right partners were confirmed to us in discussions with some specialists from the industry before we invested.

Nevertheless, Devoteam was also one of the cheapest IT service companies on the stock market. We paid an amount for our shares that hardly priced in growth. In contrast, the "digital" business (with almost an 80% share of sales for the company) has grown by over 10% per year in recent years.

The uncertainties in the pandemic situation lead to a short-term slowdown in growth. In the medium term, however, the current situation could even turn out to be a tailwind as companies' experience with decentralized work and home office solutions leads to an increased implementation of cloud solutions.

Although we were able to achieve a considerable return (approx. +23%) with Devoteam in a very short time, there is a drop of bitterness. We have to conclude that the offered price of €98 per share is, in our view, more advantageous for the buyers than for us as minority shareholders. We estimate the intrinsic value of the company to be significantly higher. If this were not the case, the founders would not be willing to pay the premium. It is the second company in our portfolio to receive a takeover offer from private equity investor KKR (you might remember Telepizza).

Still, we don't want to complain. Right now - at a time when we see very attractive alternatives - we have already sold some shares and invested the income elsewhere in what we consider to be an equally attractive investment.

Below you will find a detailed description of an investment that we made in the second quarter. As a fitness studio chain, Basic-Fit is undoubtedly “in the eye of the storm.” We are convinced that the company will master the current challenges with flying colors and that it will not be any worse after the crisis than before.

Finally, you will find an overview of the performance since inception and the current portfolio.

We thank you very much for your trust and support. Please feel free to contact us at any time with questions or comments. As always, we look forward to your feedback.

With kind regards,

Daniel Gehlen *Marc-Lennart Braeutigam*

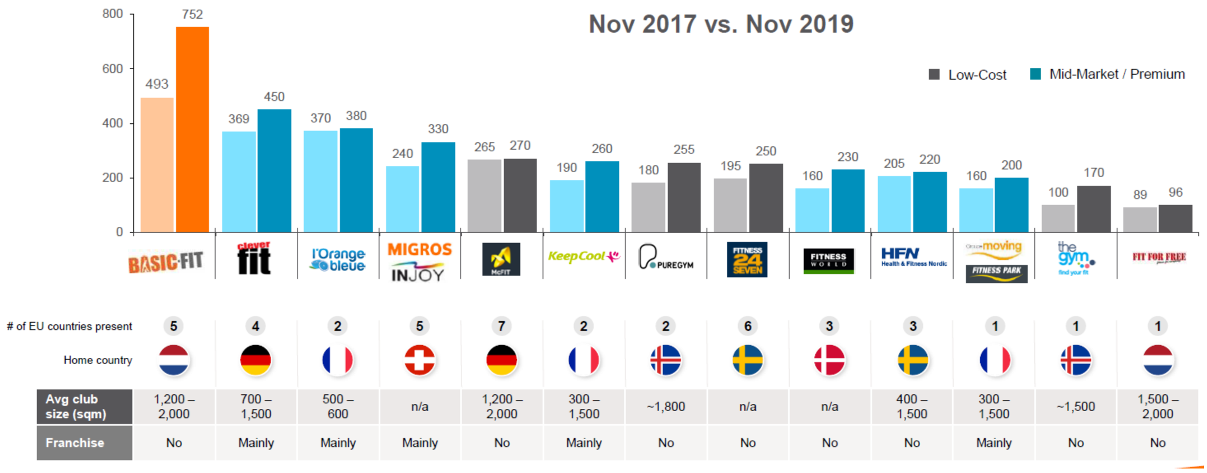
Follow us:

Basic-Fit
With more than 800 gyms and over 2 million members, Basic-Fit is the largest fitness studio chain in Europe and one of the largest worldwide. The company operates studios in Holland, Belgium, France and Spain. Basic-Fit has had to close all of these studios over the past few months. In order to lose as few members as possible, the contributions were frozen, meaning the turnover has been almost eliminated. As of today, all gyms have reopened.

In addition to the basic investment case, we primarily analyzed the short-term and possible long-term effects of the Covid-19 pandemic on the company and collected available data points from local and international competitors and discussed our theses with numerous users and industry insiders, as well as other investors and bankers.

About the company: The founder Rene Moos was a professional tennis player in the 80s. After his career, he opened his first fitness studio in 1984, the premium studio HealthCity. In 2010, he acquired 28 Basic-Fit Clubs with HealthCity. Rene quickly realized that the low-price strategy would have long-term advantages. Therefore, in 2013 he decided to put the full focus on the expansion of Basic-Fit together with the private equity investor 3i as a partner.

Rene still holds approximately 15% of the shares. He also sold very few shares in the IPO four years ago. Basic-Fit is now the largest and one of the fastest growing fitness studio chains in Europe.



The Discount Model
Before the fitness industry, some other industries were conquered by players who focus on reducing costs as much as possible. You are probably familiar with a few examples:

Like the companies above, Basic-Fit has thought about what customers really expect from a gym. The main criteria for the selection of the gym is the cost and the location. For some, it is the opening hours (e.g. for shift workers, but especially young people). In contrast, only relatively few users attach great importance to a pool or a café in their gym.

Basic-Fit has taken this to heart and doesn't offer costly amenities such as pools, saunas, tennis courts, cafes, and childcare in its clubs. The focus, however, is on high quality exercise equipment. Thanks to its size, Basic-Fit is able to buy the devices cheaper. By using technology, 24/7 opening hours can also be offered without having to hire more staff. On average, a studio with an average of over 3,000 members is operated by fewer than three permanent employees. If customers are interested in personal training, they can book this flexibly.

Since Basic-Fit has removed the expensive services from its range, it can offer membership at significantly lower prices than its competitors. The contribution for the use of all (!) Basic-Fit Studios is €20 per month. On the other hand, customers at other gyms quickly pay €50-60 per month. Premium providers are significantly more expensive (>€100).

With a higher number of members per gym (which are only offset by very low additional costs), Basic-Fit also manages to be significantly more profitable than most of its competitors. While many small gyms are just barely profitable, Basic-Fit achieves an EBITDA* margin of 40% and a return on investment of 20-30% for "mature" clubs (those that have gone through the start-up phase).

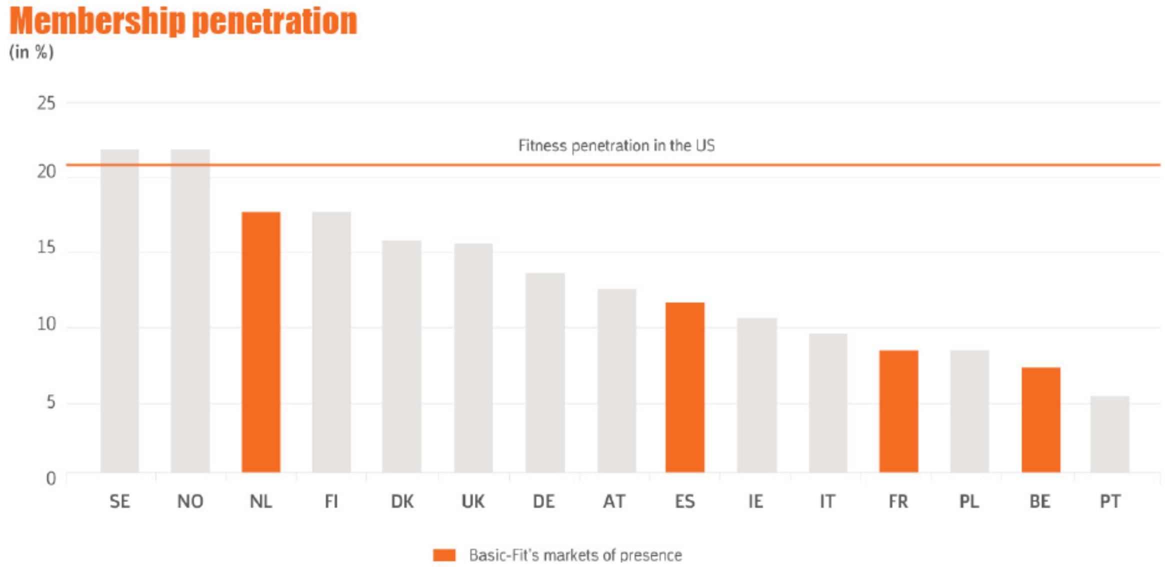
We particularly like the fact that management also focuses on profitability, not pure growth, when setting up new clubs. There is a clearly defined goal for each new club, a (pre-tax) return on investment of 30%. The company bases its analysis on a large database. This significantly reduces the greatest risk of rapid growth, which is choosing the wrong location.

**EBITDA = Earnings Before Interest, Taxes, Depreciation and Amortization*

Mega-trend fitness - unstoppable, not even with Corona!
While fitness training used to be a niche sport and was viewed more as a “sport for body builders”, it has now reached the general population. In Germany, the proportion of people who registered in a gym almost doubled from 7% in 2008 to just under 14% in 2019.

Thanks to increasing health awareness among the population and an expansion of offers, a further increase in fitness can be expected in the future. The proportion of fitness studio goers is higher, especially in the younger generations. In addition to a higher level of health awareness, growing up with the presence of social networks (e.g. Instagram) also plays a role here.

The possibility for future growth can be seen, among other things, from the rather lower fitness studio penetration in Basic-Fit’s core markets. The penetration in the USA, a much more advanced market, and in the Scandinavian countries, is over 20% (and continues to grow). By contrast, penetration in Belgium and France is still below 10% today. France, in particular, is a very large market with huge potential.



We estimate that Basic-Fit can at least double, but rather triple, the number of gyms in its four core markets. There is further potential in opening up new countries, although the existing competition naturally plays a major role. We see Germany, for example, as a rather mature market that is unattractive, especially since two large low-price providers (McFit and FitX) are already represented here. In addition, competition between these providers is very aggressive and not always rational, which leads to lower profitability.

The graphic above offers another interesting observation. The penetration is particularly high in the countries in which discount providers were active early on: in the USA (many, e.g. Planet Fitness), NL (Basic Fit), UK (PureGym and The Gym Group) and DE (McFit and FitX). In fact, the market growth is particularly driven by fitness chains, and especially those in the discount area. We expect low-price providers to continue to lead growth and expand their market shares significantly in the coming years.

Gyms in the middle segment, on the other hand, have a hard time. The differentiation from low-price providers is often not high enough. Increasingly fewer customers are willing to pay €60-70 per month for a gym with a pool or a little more intensive care if they also get a membership in a studio with high-quality equipment and 24/7 opening hours for €20.

We expect the market to be streamlined over a longer period of time, in which some studios, especially those in the mid-price segment, will continue to disappear from the market. Basic-Fit, on the other hand, should be able to gain additional market share. The current pandemic and the challenges it poses, particularly for smaller gyms, could accelerate this transformation considerably.

We see Basic-Fit's market position as exceptionally positive compared to other chains. The company is not only the dominant player in its markets - in Belgium the market share is around 50%, in Holland it is almost 20% and in France Basic-Fit has just risen to #1 – but it also offers significantly cheaper prices than the other four players in the top 5. There is also no major discount provider active in the countries of Basic-Fit (apart from McFit with a few studios in Spain), and, at the moment, nobody is planning to expand into these regions.

In addition to opening new studios, we see considerable potential in the offer of additional products and services. So far, just 2-3% of revenues come from sources other than membership fees. In our view, the potential to offer additional services to more than 2 million members should be significantly greater. Beyond very obvious products, e.g. diet or personal training, the fitness-oriented target group of Basic-Fit can also be very valuable for advertisers or researchers. A very interesting project in this area is The Mirai in Oberhausen - McFit is investing a huge sum (supposedly up to € 150 million) in the construction of the largest fitness studio in the world, but membership fees would be waived.

A few years ago, Basic-Fit integrated an app into its offering that provides members additional services (incidentally included in the monthly fee). It is now used by a large number of the members. The closer link with the customers and the data that Basic-Fit receives from using the app has considerable value. The topic of "omni-channel" will also become increasingly important in the future of the fitness industry.

The current situation could accelerate this development. Precisely because of its size and the advantage that costs are distributed among a large number of members, in addition to easy access to its fitness studios, Basic-Fit can offer a significantly better service for members online. For example, the first HOME GYM DAY was organized during the closing of the studios on April 4th. According to the company, an incredible 800,000 sports enthusiasts attended this event.

In addition to the opportunity to generate revenue by selling additional offers via this channel (it is noteworthy what customers sometimes pay for other providers), the use of multiple services should also strengthen the loyalty of the members. Ultimately, Basic-Fit could further expand its competitive advantages in this way and increase the entry barriers for new competitors.

The valuation - not so sporty

In order to be able to evaluate Basic-Fit, it is important to identify and understand the business model and the key financial indicators. For this we now take a look from a quantitative lens at the key figures of a "typical" fitness studio.

Building a new Basic-Fit gym requires a large initial investment of around €1.15 million. After a (less profitable) start-up phase of two years, a fitness studio has an average of 3,300 members and thus generates annual sales of almost €800 thousand. "Club EBITDA" amounts to €395 thousand. After deducting some central costs, the EBITDA is approx. €320 thousand.

Incidentally, Basic-Fit can break even with just over half of the members. In contrast, many competitors with 10% fewer members will come under great pressure. If the number of members does not normalize according to our expectations after the Corona period, Basic-Fit will probably benefit from less competition.

Due to the high initial investments and the associated high depreciation, which are far above the actual maintenance costs of the fitness studios, the profits of the company subsequently shown do not correspond to the actual cash flows. Therefore, a simple evaluation scale such as a P/E ratio is misleading.

As already described, it takes about two years after opening a fitness studio until the full number of members is reached. Due to the rapid growth in recent years, just over half of the clubs are currently in the mature stage. Before Corona, we would have expected EBITDA to increase by 70% over the next two years without opening new gyms.

For the following evaluation we assume that all clubs have reached the mature status. We also take into account the difference between depreciation and lower maintenance investments. We bought the shares in our fund at an **average price of around €18**. If the number of members returns to the numbers before the Corona crisis, this price corresponds to a **double-digit free cash flow return**.

We find this valuation far too low for the non-cyclical business model of Basic-Fit. In our view, the profitability of the current studios alone is worth over €30 per share. The growth is not priced in at all. However, Basic-Fit plans to open 150 new gyms per year in the next few years. With the current base of around 800 fitness studios, this corresponds to growth of almost 20%. And this growth is highly profitable.

The problems of the retail sector, which will increase sharply due to a change from the current situation to online retail, are likely to lead to a large number of open spaces in attractive locations. The landlords will desperately search for reliably paying new tenants for these spaces. However, there are few nowadays. Basic-Fit will take on an exceptional situation as one of the few very popular tenants. We expect that the company will not only be offered very attractive space, but also extremely attractive leases. Thanks to a successful capital increase in June, Basic-Fit also has the necessary money to take advantage of the opportunities that are available.

Even with a conservative inclusion of the growth potential, the fair value, in our view, is over €60 per share, and thus over 150% above today's price. We also see considerable further potential, e.g. from the successful development of the offer of further products and services. With its base of over 2 million members, and an app with a correspondingly large number of users, Basic-Fit is as promising in this area as any other fitness companies.

Corona Risks

Of course, an investment in a fitness studio chain is associated with risks today. In the past few months, especially shortly before the studios were closed or the contributions frozen, some members have canceled their membership. In contrast, Basic-Fit had almost no opportunity to recruit new members while the gyms were closed.

Our assessment shown above assumes that the existing Basic-Fit studios will return to the number of members before Corona in the next few years. At first glance, there are good reasons for not doing so. A lot of people kept fit at home while the studios were closing. The number of hits from YouTube stars such as Pamela Reif, Mady Morrison or Sascha Huber is booming, as are the orders for home training equipment. In addition, more and more startups with alternative offers are entering the market (e.g. Peloton or Mirror).

However, we do not expect these offerings to completely replace gym memberships, at least not for a large portion of the population. Even if some people decide to continue doing yoga twice a week at home in the future, many will still want to take advantage of the opportunities of using a gym 1-2 days a week. We see the positioning in the discount area as a great advantage. Some people will wonder if they are still willing to pay €60 if they use their gym less often. However, €20 still seems reasonable.

The first dates since reopening have been positive. The competitor PureGym reported in May that the number of members in the previously open clubs in Switzerland is already over 90% (and has increased since it opened). Basic-Fit itself reported in early June that after the clubs opened in France, they were able to win more new customers than they had to accept layoffs.

Even in times of economic crisis, fitness enthusiasts tend not to give up their gym membership entirely. During the financial crisis, the number of members in Germany had grown at impressive rates. An analysis of the McFit figures shows that even during this time, discount providers in particular grew significantly above the market. We believe positioning in the low-price segment offers protection, as some people may switch to a cheaper provider when money becomes scarcer or uncertainty about the future increases.

Overall, we estimate that Basic-Fit has lost about 10-15% of its members since March. We expect that they will be able to regain the majority of members after normalization. In a positive scenario, the current situation could even further raise health awareness (the strongest defense against the virus is a fit body) and increase fitness penetration in the medium term.

Ultimately, the price we paid offers a very high margin of safety. Should - contrary to the previous data points - significantly fewer people return to the gyms in the medium term, then even when considering the large operating lever (Basic-Fit can hardly save costs and therefore the results of falling sales are hit particularly hard), we have not paid too much.

All three tranches of our fund are currently open for investment:
The -S- tranche is closed to new investors. Existing investors can order additional fund units from a minimum investment of EUR 10,000. You can invest in the -R- tranche without a minimum investment. For the -I- tranche, the minimum investment for new investors is EUR 200,000. Existing investors in the -I- tranche can order additional fund units without a minimum amount.
You can find the respective tranche using the following **security identification numbers**:

-S- Tranche: A2JF8Z **-R- Tranche: A2JQHQ** **-I- Tranche: A2N811**

Net performance figures (including distribution), after deduction of all costs, the -S-, -R- and -I- tranches:

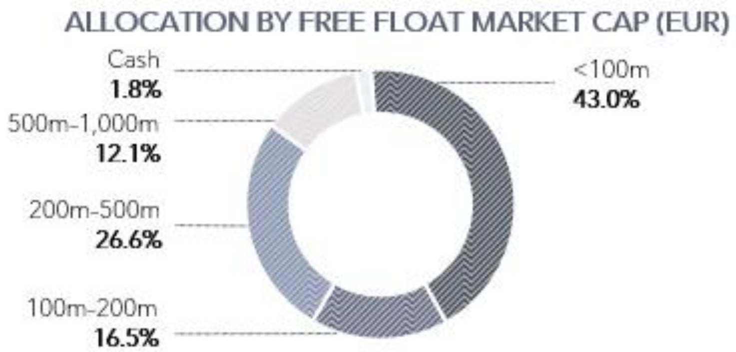
	-S- Tranche	-R- Tranche	-I- Tranche	MSCI Europe S&M Cap
2018	-2.9%*	-2.5%**	-	-17.2%*
2019	+10.3%	+9.2%	+8.3%***	+30.6%
2020 H1	-9.5%	-10.0%	-9.8%	-15.3%
Since inception	**-3.0%**	**-4.0%**	**-2.3%**	**-8.4%***

* Since the -S- tranche was launched on July 2nd, 2018 until the end of 2018 (approx. 6 months). ** Since the -R- tranche was issued on September 7th, 2018 until the end of 2018 (approx. 4 months). *** Since the launch of the -I- tranche on January 2nd, 2019 until the end of 2019.
Note: Due to the uneven starting times and fee structures, there may be deviations in the performance of the individual tranches.

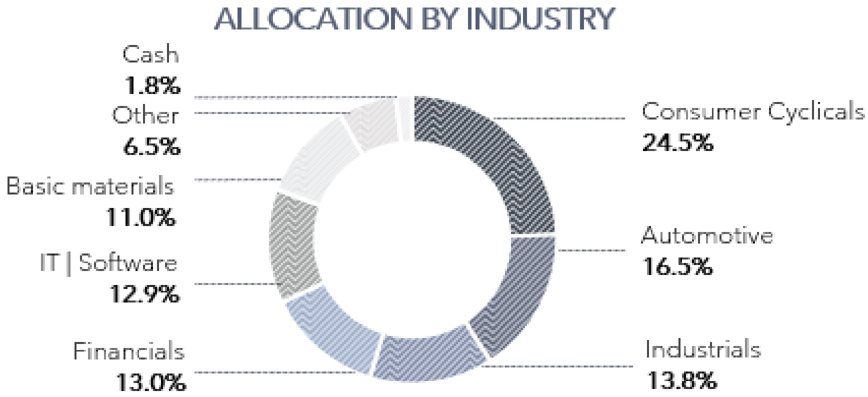
Top 10 positions with respective weightings as of June 30, 2020:

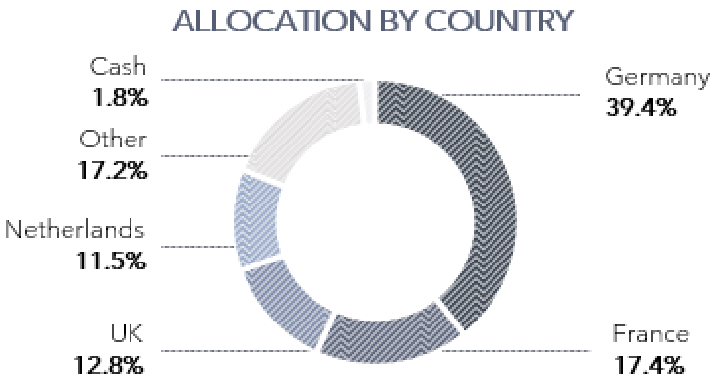
1	Akwel	8.9%	6	Tick Trading Software	4.2%
2	Sto	7.4%	7	Serviceware	4.1%
3	Basic-Fit	6.8%	8	Italian Wine Brands	3.8%
4	Gamesys	5.3%	9	Koenig & Bauer	3.7%
5	Ferronordic	5.3%	10	Traumhaus	3.6%

Allocation by free float market capitalization (EUR) as of June 30th, 2020:



Allocation by country and industry as of June 30th, 2020:





Disclaimer/Imprint