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CAPITAL

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Letter to Partners #11

Q1 2021 *(01/01/2021 - 03/31/2021)*

April 19th, 2021

Dear Partner,

In the first quarter of 2021, our fund gained +19.3%, which ranks first among 136 comparable funds (Equities - Europe Small & Mid Cap) according to Citywire. The start to the year could hardly have been better.

Since the lows in March 2020, our fund has achieved positive performance in every quarter. **In the past four quarters, it has risen >100%**. Over the last 12 months, we finished as #3 out of 135 comparable funds.

EUR 100.00 invested at the start of the fund in mid-2018 was worth EUR 156.42 at the end of the quarter. The **overall gain since inception is +56.4%** and the **compounded annual gain is +17.6%** (compared to +26.0% or +8.8% p.a. for our reference index).

Portfolio

The final results of the past year have been significantly better for many of our companies than we could have expected a few months ago.

Italian Wine Brands, as a beneficiary of the stay-at-home policy, was able to close a strong year with growth of almost 30%. In our view, the accelerated growth was not only driven by positive one-off effects. IWB is gaining market share in the B2B business with supermarkets with both existing and new brands. Sales via its own website are also developing positively. At the end of last year, the company also launched Svinando in Germany. We have already tested the online shop a few times. After the (quite usual) initial difficulties, the service is working increasingly better according to our personal experiences.
The outlook for the next few years is also promising. The CEO and largest shareholder, Alessandro Mutinelli, has a grand vision. He wants to create the leading independent wine group in Italy. Against this background, we are also looking forward to possible acquisitions in the coming months. We see a good chance that the success story of Italian Wine Brands has just begun.

Sto, the specialist for external wall insulation systems and paints, was able to increase turnover slightly and the operating result by 40% (!) despite the pandemic in 2020. Especially against the background of the announcements of massive subsidies for energy-efficient renovation in Europe and the USA, we are also very positive about the next few years. In the course of the European Green Deal, the EU has set itself the goal of doubling the renovation rate by 2030 and has promised correspondingly gigantic subsidies. In the USA, an infrastructure package of over USD 2 trillion is being launched. A key objective here is also to increase renovation activities. Insulation in particular makes a very positive contribution to reducing harmful emissions. In our view, these long-term tailwinds are still not nearly reflected by a valuation that, even after last year's share price increase, hardly prices in growth – especially in light of the fact that Sto has continuously grown faster than the market in recent years.

Particularly in the case of business models that are dependent on economic cycles, we review the track record of the company and its management in crises such as the financial crisis of 2008/09. An analysis of how profitability and liquidity have developed helps to draw conclusions for future crises, if necessary. Good companies are not only able to successfully master crises, but to emerge even stronger from them.

"History doesn't repeat itself, but it often rhymes" – Mark Twain.

In fact, our cyclical investments, such as **Akwel**, **JOST Werke** or **SAF-Holland**, behaved similarly robustly last year as in previous crises. We would like to highlight **Akwel** in particular at this point. In our Letter to Partners #4, we emphasised the management's long-term view at the beginning of the case study. In the years leading up to the Corona crisis, there was heavy investment in the automation of production processes to "shore up profitability in a challenging environment".

In the crisis year of 2020, resulting in a decline in sales of approximately -15%, the company was able to reduce investments in its own business and **achieve a higher margin than in the previous year and an unprecedented cash flow generation**. Chapeau! The stock price unsurprisingly jumped sharply on the day of the announcement. The shares of the other cyclical stocks also reported encouraging and confirming news and contributed to our fund performance.

We are very pleased with our decision to have significantly increased our position in Akwel in the midst of the Corona crisis at prices of around EUR 10. At that time, the market valued the company at a market capitalisation of around EUR 270 million. In contrast, Akwel was able to generate a free cash flow of EUR 128 million last year! The stock is currently trading above EUR 30. Even though cash generation was exceptionally high last year, we believe it is still very cheap at this level.

In the latest release, the company had given a cautious outlook for 2021. No surprise there, knowing the management. From a financial perspective, we see Akwel in an excellent position to grow organically and especially inorganically in the coming years. What makes us particularly confident is that the management does not attach great importance to size in acquisitions, but rather to the price as well as the profitability and technological know-how of the target company.

At the end of March, we received a takeover bid for **Gamesys**. The price of GBP 18.50 offers only a 14% premium to the last share price. Even though we have seen a gain of over 150% since our entry, it, unfortunately, does not value the full potential of the company in our view. Although Gamesys certainly qualifies as a "Covid winner", the price also shows how highly undervalued the company was when we entered. Overall, our engagement was nevertheless very successful despite the slightly unsatisfactory conclusion.

In the following section, we look at one of the crucial aspects in the analysis and selection of potential investments. We then present how our most successful investment last year, **SAF-Holland**, came about. On the last pages, you will find further information on our performance and the portfolio.

We thank you very much for your trust and ongoing support. Please feel free to contact us at any time with questions or comments.

Sincerely, Yours,

Daniel Gehlen *Marc-Lennart Bräutigam*

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***Moats* – the essence of high-quality businesses**

There are different types of value styles and approaches out there – the ones that are closer to Benjamin Graham's traditional 'cigar buts' approach and the more modern Buffett & Munger types. While the former is more focused on finding investments where the shares trade at a deep discount to the value of the company's current assets on its balance sheet, the latter seek high-quality businesses with substantial growth runways (also often referred to as 'compounders').

While we understand that favourable returns can be achieved with both approaches, we remain open to either and seek the best ideas at any given time.

In our definition, a high-quality business is one with high returns on capital and opportunities to redeploy capital at attractive rates. Investing in such businesses sounds like a smart strategy in general. However, one must be careful. We think that terrible investments can be made by buying profitable companies which are not able to defend their profitability in the medium- to long-term. Especially when paying high prices for that profitability, one can easily get trapped on the wrong side of the transaction.

After all, high profitability attracts new competitors and most of the time gets competed away. Very few businesses can generate high profitability over a long period of time. Nevertheless, some businesses can do so for much longer than others. But why?

"In business, I look for economic castles protected by unbreachable 'moats'." – Warren Buffett

Buffett uses the word *moat* to describe the characteristic of a company which allows it to fend off new competitors and continue to generate high returns on new investments. In our analyses, we carefully assess the quality of future earnings by analysing the durability of a company's moat. In this regard, it is easy to talk oneself into believing that companies are special, but very few really are.

Someone who took on the challenge of outlining the different types and degrees of moats in digestible pieces is Pat Dorsey, author of *The Little Book that Builds Wealth*. Below you find an extract of the main ideas of the book, which are also reflected in our internal Due Diligence list. Besides moats, we believe, there are other *qualitative factors* that are important for the success of a company, such as internal processes, the culture and management's ability to allocate capital – but let's save these for another time…

Examples of stronger moats:

Network economics: Does the value of the product or service increase with the number of users?

Customer switching costs: Is the benefit of switching from company A's product to company B's product smaller than the cost of doing so?

- How tightly integrated is the product or service into the customer's ecosystem?
- How high are retention rates?
- Is quality a factor and how significant would a quality failure be for the end product?

Examples of weaker moats:

Intangible assets:

- Brands:
  - Pricing power: Are customers paying a premium for the brand?
  - Repeat business: Does the brand lower search costs?
- Patents:
  - Has the company demonstrated a track record of innovation that you're truly confident can continue, as well as a wide variety of patented products?
- Licenses:
  - Does the company need (regulatory) approval to operate in a market but is not subject to economic oversight with regard to how it prices its product?
  - Other licenses

Cost advantages: Is the company using the lowest-cost inputs available compared to its peers?

- Does it have greater scale in an industry where scale matters?
  - Distribution: e.g., think of a large or dense distribution network. Once the fixed costs are covered, the variable cost of delivering an additional package is almost zero

    - Manufacturing: e.g., think of higher throughput and lower incremental costs to produce additional parts
    - Does access to more data allow the company to improve the product or increase efficiencies?
    - Niche markets: does it make economic sense for a new entrant to enter the market?
- Access to a unique asset (e.g. cement plants, mines, data, etc.)
- Better locations: Think of transportation or logistics costs for example

In order to make this theoretical framework a bit more practical, we would like to give three examples of different types of moats from our existing portfolio:

We believe a great example for a company that enjoys *network effects* is **Gamesys**. The more players are active on its Bingo platform, the better is the user experience and the higher the likelihood of a player to join and stay (underlined by low churn rates). A new entrant would require a lot of time and effort to replicate the experience, which is also characterized by the social element – much more than other gambling verticals. This gives Gamesys a strong and defendable moat (in its Bingo business). By keeping a strong focus on the product and experience, the company can keep competition away, compound its invested capital at high rates and thereby create a huge amount of value for its shareholders.

Endor, in our view, is an excellent example for a business with a fantastic *brand* and very loyal customers. In addition, the company's position is well protected by its portfolio of *license contracts*. The company enjoys long-standing and strong relationships with console manufacturers (Xbox and PlayStation), car OEMs (Porsche, BMW, etc.) as well as race series operators such as F1, NASCAR and GT. Thanks to exclusive contracts, competitors simply are not allowed to put the F1 or Porsche logos on their product and therefore cannot match the company's reputation for excellence and quality.

The third example we would like to share is **SAF-Holland**. SAF's products are *safety-critical* and could cause severe damage and casualties if they don't function well. Its *brands* have enjoyed a great reputation for many decades. Producing components at scale and serving its customers (through a dense network of third-party workshops) in the aftermarket on (inter-)national scale makes it especially hard for new entrants to gain a foothold in this industry *(network effects)*. A truck components manufacturer may not sound like one of the hot stocks these days, but as we outline in the following case study, it can very well be a great investment.

SAF-Holland – a truck supplier becomes a multibagger

In our Letter to Partners #5, we presented our investment in the truck supplier JOST Werke. In the course of analysing JOST, we also took a closer look at its competitor SAF-Holland, which is also listed. At the time, we decided to invest in JOST because we felt that the company was significantly better managed.

However, we have always kept a very close eye on SAF – also due to our position in JOST, of course. SAF's profitability has come under pressure since the end of 2017. The main reason for this was an unlucky decision made regarding its US subsidiary – admittedly at a very unfortunate time. SAF merged its production facilities in anticipation of a weaker market. However, this decision was immediately followed by a boom in the American market. SAF found itself struggling to meet the unexpectedly high demand in the midst of the restructuring. In order not to upset customers, the company accepted large additional costs.

Even beyond that, it was not only the comparison with JOST that indicated to us that the company was not exploiting its full potential and that many inefficiencies existed in the company. Nevertheless, or perhaps precisely because of this, we have always considered SAF as a potential investment. The business model itself is very attractive and profitable even at lower margins due to the low capital intensity. SAF was also – rightly at the time – valued lower than JOST.

Against this background, we read with great interest that Alexander Geis was appointed as the new CEO in February 2019. He was previously responsible for the EMEA region (mainly Europe), which was the only one of the three large regions to develop successfully in previous years. In the previous months, as well as in the following year, a large part of the senior management was replaced. We particularly like the strong focus on cash flow management of the new CFO Inka Koljonen, who had already successfully demonstrated her expertise in previous positions.

Of course, nothing is achieved with a management change alone. Subsequently, however, we could already see the first signs of improvement. The figures in Europe, along with initial improvements in America, were still very satisfactory, which overall protected the value on the downside.

Despite these changes, SAF-Holland's share price had declined further. In March of last year, the share price fell sharply once again. One reason for this was certainly the material debt on the balance sheet. In connection with the cyclicality and the probable implications of the lockdowns for the global economy, this was certainly not a pleasant situation for many investors.

Source: Yahoo Finance. Note: JOST Werke rebased to SAF-Holland (EUR).

However, from our past analyses of JOST and SAF, we knew that the business models are much more stable than those of a typical cyclical company and probably also than their perception in the capital market. We have already written more about this and the general attractiveness of the business model (and the 'moat') in our JOST case study. The reduction in working capital also has a positive effect on the cash flow in bad times, further easing the financial situation.

Last but not least, the existing debt has been almost completely refinanced. We could hardly believe that the planned promissory note loan ('Schuldscheindarlehen') was increased from an original target of over EUR 100 million to EUR 250 million on March 9th, 2020 due to strong investors' demand. At that time Corona had already arrived in Europe and the capital markets were in panic mode. However, following the issuance of this loan SAF's financial situation was secured for the time being.

Our view: We were very confident that SAF would survive the Corona pandemic with a very high probability. And in this case, the shares were too cheap in almost every conceivable scenario, and significantly too cheap in most.

On March 19th, 2020, Mr. Geis, as CEO, bought shares in his own company for more than EUR 800,000. From our point of view, this was a strong sign and confirmed our assessment of the situation. The next day we started to build up our position.

To date, the shares have almost quadrupled in value compared to our entry price. This performance is also justified by the partly unexpected positive developments. Even after the strong increase, we still believe that the current valuation does not do justice to the quality of the company. Especially the internal improvements – which lead to higher margins in the US and allow for more efficient use of capital – are not yet fully appreciated by the market.

In our investment in SAF, however, we made one significant mistake. We bought too few shares. Of course, this is easy to say in retrospect. It was also not easy to buy shares in a cyclical company at a time when the world was

virtually at a standstill and the economic outlook was very uncertain and probably miserable. It becomes all the more difficult when other investors (with more experience) advise caution.

Ultimately, however, we were convinced that our analysis of the situation was robust and that is most important. Investment opportunities as attractive as SAF last March do not come around often. Even if it seems difficult, in the future we will try to act even more independently in such situations, rely even more on our own analysis and build larger positions.

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 with a minimum investment of EUR 10,000. The -R- tranche can be invested in without a minimum investment amount. In the -I- tranche, the minimum investment amount for new investors is EUR 200,000. Existing investors in the -I- tranche can order additional fund shares without a minimum amount.

You can find the respective tranche using the following **ISINs**:

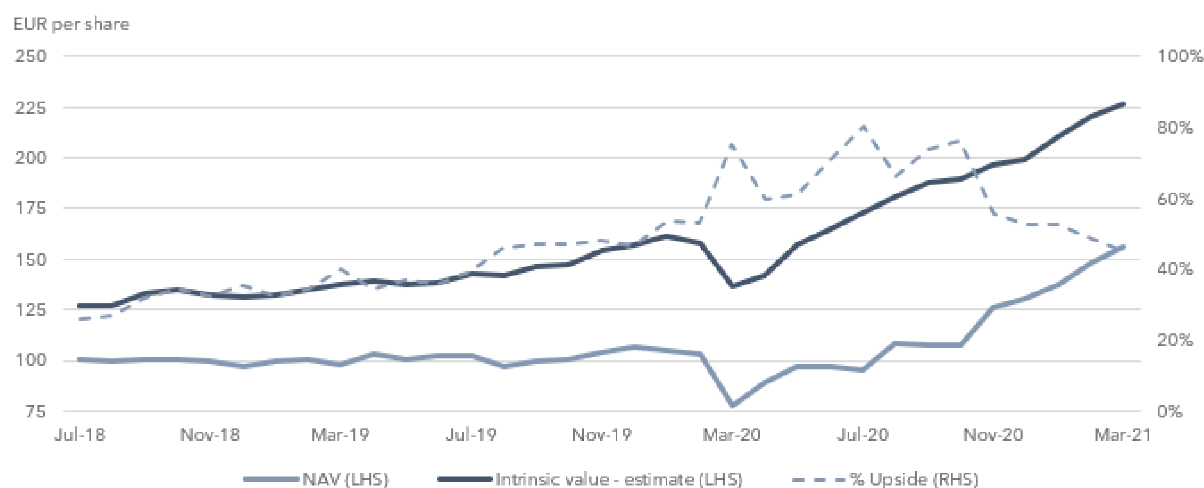
-S- Tranche: **DE000A2JF8Z7** **-R- Tranche**: **DE000A2JQHQ2** **-I- Tranche: DE000A2N8119**

Net performance figures (including distribution), after deducting 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	+22.3%	+20.9%	+21.3%	+5.8%
2021	+19.3%	+19.2%	+19.5%	+10.2%
Overall gain	**+56.4%**	**+53.7%**	**+57.0%**	**+26.0%***
Compounded annual gain	**+17.6%**	**+16.9%**	**+17.8%**	**+8.8%***

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

Development of the intrinsic value determined by us in comparison to the development of the current price of a unit (NAV) since inception:



Source: Gehlen Braeutigam Capital, as of March 31st, 2021.

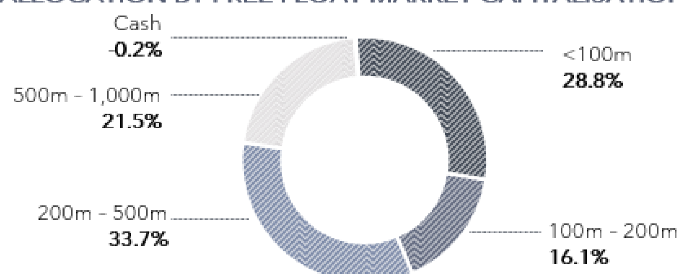
Portfolio overview

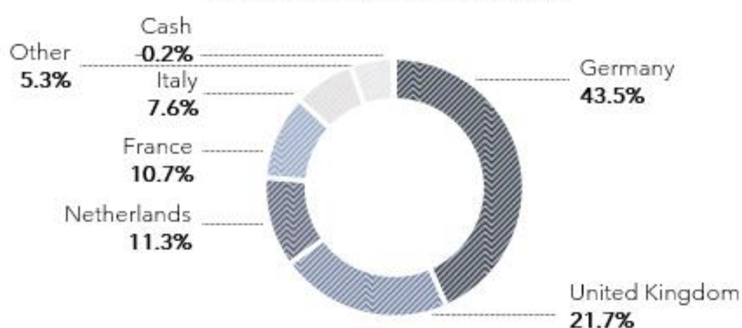
Top 10 positions with respective weightings as of March 31st, 2021:

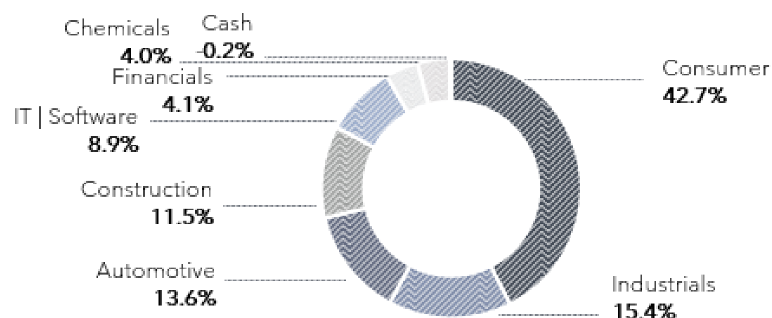
1	Endor	7.7%	6	Muehlhan	4.7%
2	Sto	7.6%	7	Gamesys	4.6%
3	The Gym Group	7.6%	8	Italian Wine Brands	4.3%
4	Akwel	7.5%	9	Basic-Fit	4.2%
5	Naked Wines	6.7%	10	Ferronordic	4.1%

Source: HANSAINVEST.

Allocations as of March 31st, 2021:







Source: HANSAINVEST.

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