GEHLEN BRÄUTIGAM

CAPITAL

Gehlen Bräutigam Capital GmbH
Kurfürstendamm 11
10719 Berlin

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

Letter to Partners #16

Q2 2022 *(04/01/2022 - 06/30/2022)*

July 25th, 2022

Dear Partner,

In the second quarter of 2022, **our fund returned -18.1%**. The performance in the first half of 2022 amounts to -30.9%. At the end of the quarter, the fund volume stood at EUR 25.1 million. Since the beginning of the year, the fund has received EUR 4.4 million in net inflows.

EUR 100.00 invested at the start of the fund in mid-2018 was worth EUR 122.58 at the end of the quarter. The **overall gain since inception is +22.6%** and the **compounded annual gain is +5.2%** (compared to +9.1% or +2.2% p.a. for our reference index).

Net performance figures (including distributions), after deducting all costs, the -S-, -R- and -I- tranches:

	-S- Tranche	-R- Tranche	-I- Tranche	MSCI Europe S&M Cap
2018	-2.87%*	-2.49%**	-	-17.22%*
2019	+10.36%	+9.40%	+8.31%***	+30.59%
2020	+22.29%	+20.88%	+21.31%	+5.82%
2021	+35.31%	+34.24%	+34.84%	+24.20%
2022 YTD	-30.89%	-31.17%	-31.03%	-23.17%
Since inception	**+22.58%**	**+19.15%**	**+22.19%**	**+9.15%***
Annualized return	**+5.22%**	**+4.70%**	**+5.90%**	**+2.21%***

* 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. Past performance is not an indicator of future performance.
All data according to BVI method, costs at fund level are taken into account. Source: HANSAINVEST.
Note: MSCI Europe Small & Micro Cap index; net-return (EUR).

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** as well as the links below for further information:

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

Portfolio
This quarter was clearly a disappointing one for the fund with inadequate returns on both an absolute and relative basis. Even though a total net return of +22.6% or +5.2% p.a. since inception is better than the performance of our reference index, this return is well below our aspiration and the expectations we had when we started the fund four years ago. We also feel a special obligation to the (new) investors who joined around the recent highs and will do our utmost to generate a pleasing return.

However, it is important to note that such a performance measurement is highly dependent on the timing of the measurement. Today, we are looking at crises prices. Most equity indices have seen one of the worst first half years in their history in 2022. One only has to look back six months to see our (and the market's) returns looked totally different. The shorter the period – four years is still very short – the higher the effect of the timing of the measurement.

You certainly noted that our performance was much better than that of the market in the last two years (2020 and 2021) and is worse this year. These variations should be expected given our concentrated portfolio and independent investing style.

Several companies in which we are invested have experienced high share price losses since the beginning of the year. The stand-out losers are home24 (-69%) and Naked Wines (-74%). Considering the respective weightings, each position has added about four percentage points of negative performance this year.

In the last year, we were willing to take a higher risk when we invested in these two companies which were not yet sustainably profitable. We thought that we were getting paid well for taking the additional risks when looking at the expected returns in our base cases. Since then, the (economic) environment has unfortunately turned out as bad as it possibly could (at least that's our feeling) in most respects for both companies.

Beyond that, Naked has performed worse than we would have expected in such a challenging environment. The company has low flexibility to redirect its marketing dollars. The increase in "fixed" G&A costs and the significant build-up of inventories also disappointed us. We expected that Naked would, even at its current size, turn into a profitable and cash-generating business once growth slows down. But that hasn't happened, mainly because of those factors. We had sold some Naked Wines shares earlier this year – fortunately before the strong drop following the recent results – and had reinvested the money into our newly initiated position in HelloFresh. We still hold the remainder of our position in Naked Wines (currently ~2% of the portfolio) and monitor the developments of the company closely.

On home24, we took the painful decision to sell our position at a large loss. The share price has only further deteriorated since then. Even though sales and order intake, respectively, have decreased 15 to 20% vs. last year's Q1, we don't view the operating performance of the company in the current circumstances as particularly bad. The environment for selling furniture has just become very challenging. In addition, home24 decided to buy Butlers in December last year. We were skeptical of the value of this acquisition and the timing. At least in hindsight, this acquisition was a mistake and now puts a significant burden on home24's liquidity position. Even though we can see how home24 could be worth multiples of its current price if the situation improves, we view the visibility for the development in the coming years as too low. We also see a risk that the company will face liquidity issues.

What we have written about the current situation in our Q1 letter still holds true. Unfortunately, the environment and the outlook for the next months has only worsened further since then. Inflation, a weakening economy, exploding energy prices and a potential stop of the gas supply from Russia to Europe paint a very challenging economic picture. Challenges don't even stop there, e.g., supply chain issues are ongoing, especially caused by China's zero-Covid policy, and many countries are again facing a rising number of Covid cases.

Against such an outlook and facing the risk of a serious recession, it is tempting to cut losses and avoid further pain. However, when looking at history for a guide, selling when things looked the worst, has more often than not been a bad strategy.

Unfortunately, we don't know if we have seen the bottom in the financial markets yet or how much further share prices might decline from here. This will – especially in the short-term – depend on the development of the crises mentioned above, inflation (expectations) and interest rates but also the mood of investors. Those are all variables we (and no one else) can accurately predict. Unfortunately, waiting for more clarity and a better outlook usually means missing the real bargains as the lack of certainty is usually precisely why these bargains exist.

With a medium-term time horizon, we see significant opportunities today. Share prices of many companies have already dropped strongly. Several companies are likely trading at valuations that will be seen as bargains when looking back at today's prices in a few years – assuming the world continues to exist and isn't completely different than it is now, which still seems like a very reasonable assumption to us.

Sto – update

The following update on the current valuation of Sto, our largest position as of today, provides a good example of a current opportunity and what is being priced into selected share prices already.

Sto's stock price has declined about 40% since the beginning of the year. As a reminder, Sto is one of the leading manufacturers and distributors of wall insulation systems.

The potential challenges in the construction sector are obvious, especially in the new-build area. Large and quick increases in the prices of building raw materials, as well as problems with the general availability of materials, have increased the uncertainty around the planning and construction of new buildings. Higher interest rates pose an additional challenge on the financing side for building contractors. Against this backdrop, several projects have been delayed already.

Larger renovation projects are also costly and more people might think twice about such an investment in a weaker economic environment (although there are few signs of that yet). On the other hand, higher energy prices increase the attractiveness of lowering the energy consumption of the home, e.g., by installing a (better) insulation system. Sto's CFO has phrased it this way: "In the medium-term, higher energy prices have always been a net positive for our company."

In addition to the already increased economic attractiveness, most of the countries Sto operates in are very eager to reduce the energy dependency on other countries, in particular Russia. German homes account for a large share of the consumption of gas imported from Russia. It wouldn't be surprising to us if further incentives to install and upgrade insulation systems will be announced by the government.

At a share price of EUR 140, Sto has a market cap of ~EUR 900 million and an EV of around EUR 750 million. For the entire year, Sto expects revenues of EUR 1.74 billion (up 9.4% vs. 2021) and an EBIT of EUR 114 to 134 million (vs. EUR 134 million in 2021). This puts the shares on an EV/EBIT multiple of <6.5x or a (normalized) FCF yield of more than 10%. In our view, this is highly attractive.

We believe that the guidance for the current year does not fully reflect Sto's earnings potential as the company is burdened by higher production costs in the short term and faces a delay in passing on higher prices to its clients. In Q1 of this year, sales grew by 21.2%. Due to the increases in procurement prices, the earnings increased less than in the first months of the last year.

Sto has a very healthy balance sheet with a net cash balance of EUR 270 million (c. EUR 170 million after deducting the pension deficit). In an environment such as the current one, this provides some obvious advantages. First, it gives comfort that Sto will not face a difficult liquidity position. Second, it allows the company to potentially seize opportunities arising from a more difficult environment, e.g., by buying struggling competitors which don't have such a strong balance sheet at attractive valuations.

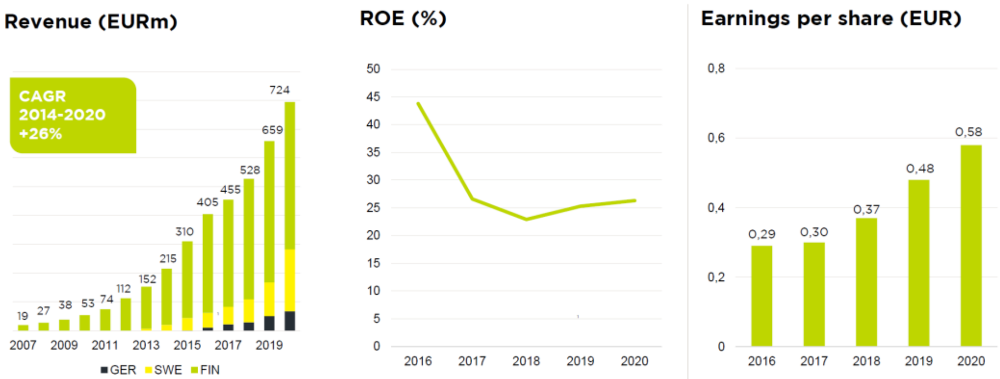
What is priced in? To get to the current price, we would have to assume a drop in revenues of more than 30% in the next two years *with no subsequent recovery* and a long-term EBIT margin of 6%. The margin would be around the worst margin level in Sto's (recent) history and would compare very unfavourably against the ~9% margin achieved in the last two years and the mid-term margin goal of >10%.

Even without any additional political support, we view such a scenario as highly unlikely. A 30% drop in revenues would be highly contradictory with Europe's announced goal of doubling the (energetic) renovation rate in the next years. On the other hand, we don't have to be very creative to imagine a scenario in which Sto's valuation should be twice as high as the one implied by its current share price.

We see a similar situation for many of our portfolio companies as we do with Sto. While the near-term environment poses significant obstacles, the valuations more than reflect said challenges, and once the economy inevitably improves our companies will look much too cheap at the current prices.

Kamux – new position

Considering the potential market opportunity in which many quality companies have seen their valuations fall significantly, we have decided to add a new position to the fund, Kamux. The Finnish used car dealer has an impressive track record of profitability (high returns on capital) and growth, while still offering a long runway thanks to both geographical expansion and taking market share from traditional players.



Source: Kamux Capital Markets Day – March 2021.

Kamux does not necessarily have a business model that benefits from the current situation but rather one that is resilient due to its mostly variable cost base, profitability, and steady market share gains. It is also trading at an increasingly cheaper valuation than when we first started following the company well over a year ago, down nearly 60% from recent highs.

Kamux has succeeded with its omnichannel approach to become Finland’s number one used car dealer and has been in the process of expanding this business model to Sweden and Germany. Car dealerships with a digital approach continue to take market share from physical dealers as consumers seek online buying and selling options – preferring not to feel the pressure of interacting with traditional used car salespeople. This trend helps Kamux grow quickly and outperform the market (including difficult markets).

Founded in 2003 by current CEO and largest shareholder Juha Kalliokoski, Kamux went public in 2017 with the vision of becoming the #1 used car retailer in Europe. Since inception, Kamux has grown to 79 showrooms while increasing sales volumes from 2,645 cars in 2008 to 68,429 cars in 2021. Beyond the strong growth, Kamux’s profitable approach allows the company to be well protected in the current environment while some industry peers with a digital approach such as Auto1, Cazoo, and Carvana must shift gears as their high cash burn behaviour is increasingly risky in this environment.

It is without a doubt that today’s consumer purchasing habits are under pressure, and large investments, such as cars, might be delayed. We take comfort that used car sales are historically resilient and long-time players such as Carmax have proven profitability can be maintained during crises periods. We also take comfort that the market is pricing in not only very negative operational impacts from a long, severe recession but also failure to succeed in international markets. We believe there is adequate evidence that both situations are (highly) unlikely. Even so, we think Kamux’s Finnish business alone is worth more than the market value of the entire business.

The current situation is without question difficult to navigate. There is almost no place to hide from the turmoil – even cash isn’t a “save” option in times of high inflation.

In times of falling share prices, investors often seek safety and liquidity. This can hurt the shares of smaller companies disproportionately. Small caps have come down significantly more than larger caps this year. E.g., the DAX has declined 20% in the first half of 2022 whereas the SDAX is down 28%. Similarly, the MSCI Europe is down 14% during this timeframe whereas the MSCI Europe Small & Micro Caps index is down 23%.

Whereas this is – for obvious reasons – undesirable on the way down, it often also provides the chance for a stronger rebound once share prices go up again and investor confidence comes back. We are willing to accept this potentially higher volatility as in our view small caps can offer higher returns and better long-term investment opportunities thanks to more frequent mispricing.

In our last letter, we have written the following:

The valuations of many companies […] are close to historic lows. Even though it is still difficult to assess how the current situation and the economy will develop over the next few years, with a medium- to long-term view, we see an extraordinary amount of potential for our portfolio today.

Although the economic situation hasn't developed favourably since our last update, we think that this is even more true today than a few months ago. This applies to existing holdings as well as to new ideas. We are currently working very intensively on new ideas and aim to emerge stronger, as we did during the Covid crisis. It is now particularly important to show patience and to take advantage of the opportunities that arise.

We would like to thank you for your continued trust in such challenging times. As always, but particularly these days, please feel free to contact us at any time with questions or comments.

Sincerely yours,

Daniel Gehlen *Marc-Lennart Bräutigam*

GEHLEN BRÄUTIGAM CAPITAL GMBH. KURFÜRSTENDAMM 11. 10719 BERLIN.
+49 30 42141851. info@gbcvalue.com. gbcvalue.com

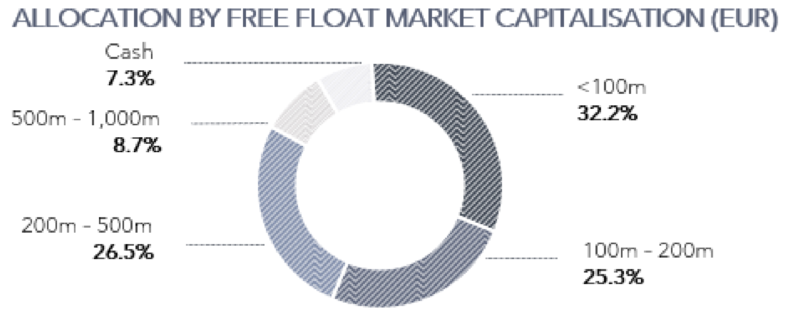
Portfolio overview – as of June 30th, 2022

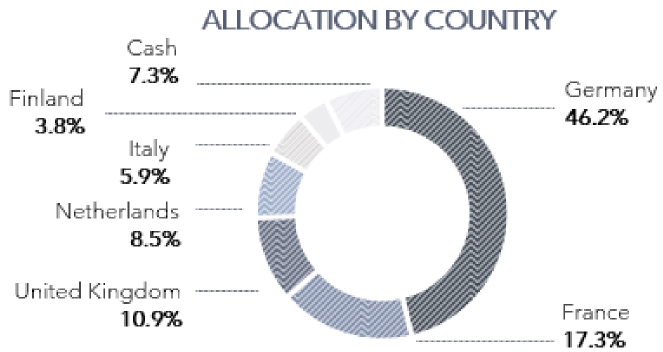
Top 10 positions with respective weightings:

1	The Gym Group	9.2%	6	Basic-Fit	4.7%
2	Sto	9.0%	7	SAF Holland	4.5%
3	Muehlhan	7.7%	8	Traumhaus	4.2%
4	Guillemot	7.3%	9	Villeroy & Boch	4.2%
5	Akwel	6.2%	10	HelloFresh	4.1%

Source: Gehlen Bräutigam Capital; HANSAINVEST.

Allocation:





Source: Gehlen Bräutigam Capital; HANSAINVEST.

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