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Letter to Partners #18

Q4 2022 *(10/01/2022 - 12/31/2022)*

January 15th, 2023

Dear Partner,

In the fourth quarter of 2022, **our fund returned +9.67%**. Thereby, the return for the year 2022 amounts to -38.26%. At the end of the quarter, the fund volume stood at EUR 18.5 million. Since the beginning of the year, the fund has received EUR 0.5 million in net inflows.

EUR 100.00 invested at the start of the fund in mid-2018 was worth EUR 109.51 at the end of the quarter. The **overall gain since inception is +9.51%** and the **compounded annual gain is +2.04%** (compared to +9.63% or +2.06% 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	-38.26%	-38.72%	-38.48%	-22.83%
Since inception	**+9.51%**	**+6.07%**	**+8.99%**	**+9.63%***
Annualized return	**+2.04%**	**+1.37%**	**+2.18%**	**+2.06%***

* 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**

Competitive advantage

In the last letter, we spoke about the "liquidity crisis" that European and especially the small- and micro-cap segments are facing these days. Since then, we have continued our conversations with bankers, brokers and investors. A conversation with an Italian broker earlier this year stood out. He mentioned that on multiple occasions he received calls from Italian and French fund managers being angry about having to sell shares in quality companies at discounted prices as their principal investors redeemed funds. Further, he mentioned that a lot of US funds had withdrawn from their European small-cap allocations, creating additional price pressure.

Usually, when we speak about competitive advantages, we present you with a case study of a new investment we entered. This time though, we would like to focus on the competitive advantage of the fund. From the start, we strongly believed that we could deliver a superior return to us and our co-investors, if we focus on a segment of the market that is less efficient. Therefore, we chose European small- and micro-caps as our hunting ground.

To maximize the probability for success in this space, we knew that having the right investor base on board would be an advantage. As of today, based on our own estimates, we still know >80% of the co-investors behind the committed capital in person and we enjoy these relationships a lot. In 2022, we did our best to cultivate existing relationships and build new ones. The main reason why we believe this is so important is that every other year, we will experience a bear market characterized by high volatility and uncertainty. We can proudly say that we achieved net inflows in the last year.

And exactly that is our key competitive advantage. A patient, well-informed and engaged investor base that keeps its hand still when others do not or are forced to sell. This allows us to hold our portfolio positions when they become more attractive due to lower share prices and to pick good businesses with durable competitive advantages at discounted prices. Good, well-led businesses usually are not up for sale, but that is exactly what we are targeting, and we are glad to provide you with further examples of new positions later.

While we strongly outperformed our reference index post-COVID, as of year-end 2022, we are very dissatisfied about not having been able to defend this strong prior performance. Reflecting on the returns delivered in 2022, we would like to highlight a few general points, beside the liquidity theme and underperformance of small caps. First, entering the year, we had very little exposure, if none, that could have gained from the Russia/Ukraine situation or from surges in energy or raw material prices such as defence, energy or metals and mining stocks. Second, we had relatively little exposure to defensive sectors such as healthcare. Thirdly, as you know, we do not hedge the portfolio of businesses we own.

On the flip side, we did our best to adjust the portfolio as good as possible throughout the year and therefore enter 2023 with an elevated level of excitement. While several of our companies are affected by a weaker environment, we believe that they are well positioned for the coming years and that the current prices overcompensate us as shareholders for the potentially weaker short-term outlook.

Briefly, we wanted to catch up on the general section of the last letter: "*It is always darkest before dawn*". At the end of the last quarter, our fund closed at a blip below EUR 100 per share. Since then, it has recovered by more than 16% while the economy, except for slightly lower than expected inflation data and (much) lower gas prices, has not improved too much. If this was merely a bear-market-rally or if we have seen the bottom of the stock market in Europe already, remains to be seen.

We think that these data points tie in nicely with the discussion around timing the markets, which we had outlined in the previous letter. If this were the bottom, then the statistic shown in the table in the last letter would once again be right, which showed that the market bottoms before the economy bottoms. Overall, we still believe that European small- and micro-caps are in a distorted market phase and will only get back to normal over the next quarters, maybe 1-2 years. Looking at the current portfolio, we are confident that we can achieve our goal of a double-digit net-return p.a. through the cycle.

Portfolio

At the end of October, **Basic-Fit** provided an update on its current trading. From our point of view, the most important data point is the membership figures (adjusted for the effects of new openings). Basic-Fit was able to increase the number of members by 42% to 3.15m compared to the beginning of the year. The number of members per "mature" gym – the most relevant KPI for us – has already returned to the pre-Corona level. This is particularly remarkable since the gyms have not had a "normal" January/February period – the most important time for customer acquisition – since the outbreak of the Corona pandemic.

In addition to the positive news on members, Basic-Fit has announced that the expansion is proceeding somewhat more cautious than originally planned. In the current environment, this is very understandable for us. It is also not decisive, especially at the current valuation, whether Basic-Fit will open 200 or 250 new gyms next year. However, the capital market has focused on this message. We have used the decline in the share price to materially increase our position size.

On December 30th, Basic-Fit confirmed that it had reached its target number of members for this year (3.35m). This means that there has been no weakness in demand in recent months either. We expect that the number of members per gym will continue to grow in the coming months and that Basic-Fit will ultimately find itself in an even stronger and more comfortable position than before Corona.

If Basic-Fit can continue to deliver good results and membership figures in the coming months, this would be another datapoint supporting the thesis that the business model is much more stable than many investors assume, even in the current situation. Even if a weakness in demand should occur, the current share prices of Basic-Fit and GYM Group are far too low in our view.

Cancom is one of the leading IT service providers in Germany and a new position which we established in October. At the time of our purchases, at a share price of ~EUR 25, the market capitalization was ~EUR 875m. Thanks in part to the sale of the UK business, Cancom is currently sitting on a high cash balance. We estimate that there will be almost EUR 500m in cash at year-end. After adjusting the guidance, which was to be expected, Cancom expects an EBITDA of ~EUR 120m and an EBIT of ~EUR 75m in 2022. The valuation at our purchase price is thus 3x EBITDA or 5x EBIT. In our view, this is clearly too low for an overall well-positioned IT services company. In particular, the strongly growing and more profitable Cloud Solutions segment has driven the earnings development in recent years. We assume that the growth of this business will lead to further increasing profits and cash flows in the coming years.

Cancom aims to use much of the excess cash to buy other companies and improve its product portfolio. Due to the exceptionally low valuation of Cancom's own stock, we would prefer to see returns of capital to shareholders (via share buybacks or dividends). However, acquisitions can also be very value-accretive, especially in what may be a more difficult environment for many companies.

Due to its strategic importance as one of the major IT services companies in Germany, especially in combination with its currently very low valuation, Cancom could also be considered as an acquisition target by (international) players.

In November, **Solar** announced excellent third quarter results, exceeding their own expectations, and prompting another increase in guidance for the full year. The EBITDA is expected to reach DKK 1.17bn against an original target of DKK 0.85bn. Including the new guidance and a slight increase in the share price throughout the quarter, Solar still trades at less than 4x EBITDA.

Solar has yet to give guidance for 2023, but exceptional demand from "climate" products and remaining pricing benefits should help somewhat offset weakness they might face from a potentially slowing building industry.

In early December, **Catana** released their full year earnings results which included an impressive 16% operating margin against a 14% margin a year ago. The profitability shows the company's ability to pass on raw material and energy prices as well as leverage their fixed costs as they continue to grow. Hiring and salary inflation continue to be an issue the company tackles as they steadily grow well beyond double digits per year to meet demand and execute on their order book.

In the release, Catana once again updated their order book which is a nice reminder to the market after full year sales fell short of expectations (although sales grew nearly 50%, some sales were just pushed to the next financial year due to supply chain issues). The company now has an order book of over EUR 500m in sales over the next two financial years. Assuming a conservative 15% EBIT-margin on these future sales implies a trading multiple of less than 2x the operating profit of the current order book alone. In addition, the demand on recent industry fairs has still been strong.

Italian Wine Brands announced an impressive acquisition at the end of November. They have not only acquired a company that fits a missing piece of the desired business composition (covering an important Italian wine region) but have also paid a very reasonable price using attractive financing. Overall, it is further evidence of management's capability to make value accretive acquisitions and consistently meet their strategic goals.

Traumhaus is a developer of standardized row houses for young families. In an environment of very quickly rising interest rates – and thus higher financing costs – and increasing building costs at the same time, the business of many developers partially came to a standstill. Traumhaus cannot escape this market backdrop either, also since the often financially weaker customers have to fulfill increased equity (down payment) and annuity requirements of banks. At the end of November, the company subsequently announced that 2022 will be significantly worse than originally planned.

Following these challenges, the share price has developed very negatively in 2022 and lost almost 2/3 of its value. At this point, the market capitalization stands at only EUR 30m. Of course, the real estate sector in particular, is characterized by great uncertainties, especially in the new construction of real estate. However, the structural supply problem remains – there is not enough living space. Due to the low number of new builds in 2022 and probably also in 2023, as well as the strongest population growth Germany has seen in a long time (mainly due to immigration), the balance between supply and demand will worsen further. In our view, affordable housing will be even more relevant and more in focus in the coming years. The long-term trend remains fully intact.

For this reason, we continue to assume that Traumhaus will be able to generate a net profit of EUR 10m+ per year in the medium term with continued attractive growth rates. In this case, the share should trade at a multiple of today's price.

At present, the extraordinarily unfavorable macroeconomic environment is placing a particular burden on the company. It is therefore all the more essential for us that, with the CEO and founder Otfried Sinner, a true entrepreneur is leading the way, someone who is fully committed to expanding the company's core competence – the creation of affordable housing. His financial and personal investment underlines his and our conviction that we are on a successful path despite the short-term headwinds.

The past few months have been quite eventful for **Kamux**. First, the founder, majority owner, and CEO since inception, Juha Kalliokoski, has stepped down and will move to the Board of Directors. Tapio Paiuhariu the current CEO of Finnish-listed Harvia Oyj, who is also already a member of Kamux's board, will take the CEO role and push the company's international efforts. International expansion is something he has already managed very successfully at Harvia.

Tapio has a particularly difficult task in the short term as the used car market has been heavily affected by the current macroeconomic environment which includes a looming recession, high inflation, high borrowing costs, and high energy costs, all factors that impact consumer confidence and auto purchasing decisions. In this context, although outperforming the market, Kamux has adjusted their guidance three times throughout the year, with the latest downgrade happening on the final trading day of the year.

While visibility for the 2023 used car market remains low, we still hold an optimistic view about Kamux's performance and position once the market improves, as the company continues to be profitable and take market share. In December, we met the Head of Germany at Kamux in person in the greater Hamburg area in one of the shops, and left with a positive impression on the expansion and capital allocation strategy for the German market, which is a key market in their international plans.

In the last quarterly report, we reported on a new opportunistic position in the special situation of **3U Holding**. Already in November, after only two months, we sold the shares again. In this short time, we were able to achieve a return of >7%. This profit was very attractive, especially considering the short holding period and the very low risk from our point of view.

Origin Enterprises plc – Harvesting cash flows

In Q4, we started a position in Origin Enterprises, a Dublin-headquartered agricultural distribution and services company. Origin has several market-leading positions, including fertilizer sales in Ireland and the UK, animal feed in Ireland, crop protection in the UK, and agricultural amenity products in the UK. They are also a top 3 player in their Continental European markets (Poland, Romania, and Ukraine) and a top 5 player in Brazil.

Supporting Origin's market leadership is their unrivalled position in research and development in the UK. They have more trial facilities / farmland and number of trials performed than any competitor. This has been confirmed in our analysis, including through Tegus calls. As one expert put it, *"(Origin) is very much an R&D agronomy firm"*. Independent research is particularly important as there is no reliance on a single brand or product, which allows Origin to perform more comprehensive research and better support their clients.

A key advantage to this business model is that it is quite sticky as farmers rely heavily on advice from agronomists. As the main contact point and sales channel, Origin's agronomists help with farmer's strategic planning and decisions, with the end goal being optimized crop yields and returns. Additionally, many (especially smaller) farmers don't have the qualification that is required to buy certain chemicals and apply them, which the agronomist would have.

Due to the farmer's reliance on agronomists, the agronomist typically visits a farm once every few weeks and the relationship lasts 15-20+ years. One expert described the relationship with the following words: *"The serviced agronomist […] is a truly embedded part of that farmer's business. The farmer would really trust that agronomist. He would be his adviser for not just chemical but for everything that goes on in the farm. And it's like having a farm manager basically, having a service agronomist."*

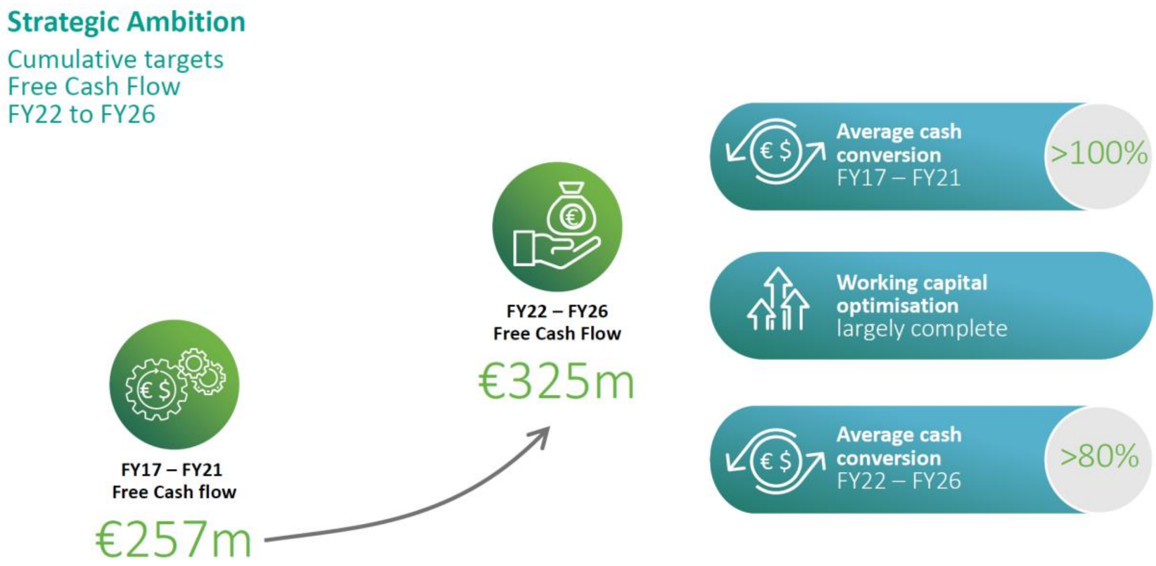
Farmer sophistication varies by market, in which the British and Irish farmers tend to be more yield and return driven, whereas Continental European farmers still put more emphasis on upfront prices. This creates a divergence in operating performance between the geographies, but also an opportunity to improve as the latter become more educated about yield-maximizing strategies.

Overall, the agriculture market is driven by world population growth, and therefore meeting food consumption demand and sustainability. As a value-add, input-agnostic distributor, Origin is set to play a role in recent initiatives such as Farm to Fork and UN Sustainability goals.

Major themes that are playing a role in the current environment include sustainable farming (such as the application of bio-solutions) as well as general sustainable land use (an example: solutions that make urban areas more ecologically friendly), both areas that Origin can benefit from through their current products and services offering.

Although the end markets themselves are quite stable, there are many factors that can create variability in the results, with weather and raw material prices being the most notable. To combat this, Origin is expanding (organically and via acquisitions) the fastest in the amenity and ecological / environmental services space which is more profitable and far less impacted by these factors that create operational volatility.

As results can vary from year to year due to the effects of the unpredictable weather, Origin provides cumulative profit and FCF forecasts over a five-year period. Origin has a market cap of just below ~ EUR 500m and it had a net cash balance at the end of the year. Against that, Origin aims to generate an FCF (pre-expansion investments) of EUR 325m in the next 5 years, i.e., it would earn back around 2/3 of the market cap in only a few years. In our view, this goal is even conservative considering Origin's history, potential improvements to the business and profitability, and also the currently very favourable environment.



Source: Origin Enterprises plc; as of May 10th, 2022.

In the past, the company has already proven to be very cash generative. Despite that, very little value was created. In the years between 2008 and 2019, Origin has spent around EUR 475m on acquisition activities. During the same period, the EBITA has nearly not moved, and today's market cap equates to less than the amount spent on acquisitions since 2008 (some dividends have been paid in the meantime). This certainly makes for a terrible track record.

On the fundamental side, the core business (especially in the UK & Ireland) is very healthy also today. It generates good returns on capital of 20%+ and earnings translate very well into cash flows. Our checks on the market positioning in the UK & Ireland and on the business characteristics in general were quite positive.

A better allocation of the funds should lead to very different returns going forward. In this respect, management has changed in recent years. The acting CEO joined Origin in September 2018 as CFO and was appointed CEO in July 2020. The CFO has joined in January 2021.

The new management is taking the right steps in our view. On the capital allocation side, the most tangible step so far was initiating a buyback program in the beginning of 2022. We view this very positively given that the company has a strong balance sheet and is facing a positive market backdrop whereas the valuation of the shares is very low at the same time. Origin bought back 8% of the outstanding shares at very low prices within four months. After finishing this program, a new EUR 20m buyback program was started right away (for another ~5% of the outstanding shares).

Besides returning a significant amount of the cash to shareholders also in the next years, management is looking for value-accretive M&A. Even though that plan doesn't look obvious considering the company's capital allocation history, we are more constructive that M&A will be accretive going forward. In our view, the new management is looking for the right things – profitable businesses, transferable expertise in new, but very synergistic areas, and attractive prices.

We estimate that Origin generates an EBIT of ~EUR 80m in a normalized environment (current earnings are significantly higher thanks to the tailwind of high commodity prices). Even after the recent rise in the share price, the shares trade at a normalized EV/EBIT multiple of around 7x or at a double-digit FCF yield. In our view, this valuation is too low for a very solid and stable business with a leading position in an attractive end market. We believe that Origin will be able to grow its profits and cash flows at reasonable rates going forward. A divestiture of the South American or of (parts of) the Continental European business could provide further upside, as could the successful execution on the M&A plans.

We would like to thank you for your continued trust. As always, please feel free to contact us at any time with questions or comments.

We wish you a healthy, happy and successful 2023!

Sincerely yours,

Daniel Gehlen *Marc-Lennart Bräutigam*

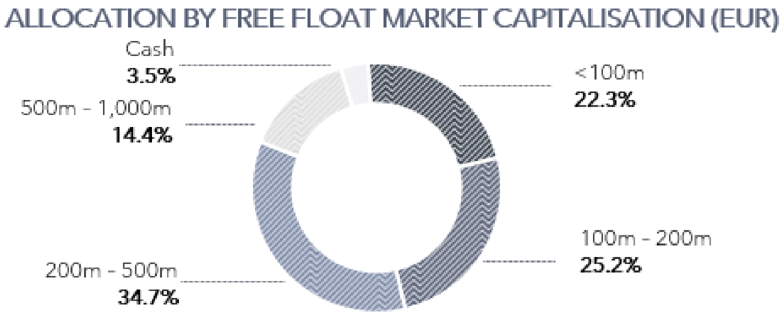
<u>Portfolio overview – as of December 31st, 2022</u>

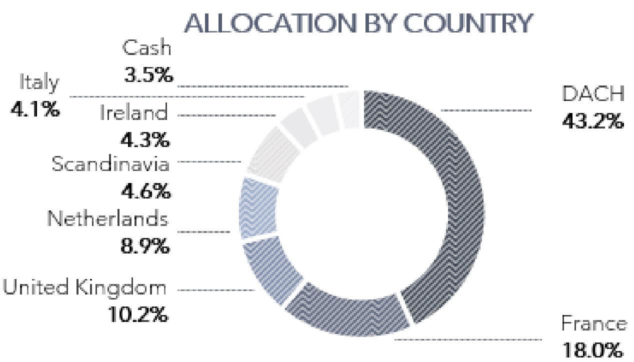
Top 10 positions with respective weightings:

1	Sto	9.8%	6	Catana	4.8%
2	Akwel	8.3%	7	Kamux	4.6%
3	The Gym Group	7.8%	8	SAF Holland	4.6%
4	Basic-Fit	5.1%	9	Origin Enterprises	4.3%
5	Guillemot	4.9%	10	Villeroy & Boch	4.3%

Source: Gehlen Bräutigam Capital; HANSAINVEST.

Allocation:





Source: Gehlen Bräutigam Capital; HANSAINVEST.

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