

**GEHLEN
BRÄUTIGAM**
C A P I T A L

Gehlen Bräutigam Capital GmbH
Herderstrasse 28
12163 Berlin

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

Letter to Partners #20

Q2 2023 (04/01/2023 - 06/30/2023)

July 14th, 2023

Dear Partner,

In the second quarter of 2023, **our fund returned -0.55%**. At the end of the quarter, the fund volume stood at EUR 20.5 million. The fund has received EUR 1 million in net inflows in the first half of 2023.

EUR 100.00 invested at the start of the fund in mid-2018 was worth EUR 115.55 at the end of the quarter. The **overall gain since inception is +15.55%** and the **compounded annual gain is +2.93%** (compared to +14.98% or +2.83% 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%
2023 YTD	+5.52 %	+5.15%	+5.36%	+4.88%
Since inception	+15.55%	+11.53%	+14.83%	+14.98%*
Annualized return	+2.93%	+2.29%	+3.12%	+2.83%*

* 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

GEHLEN BRÄUTIGAM CAPITAL GMBH. HERDERSTRASSE 28. 12163 BERLIN.

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Marketing information.

Five-year review

With this letter we have reached the five-year mark for the Gehlen Bräutigam Value HI fund, which has been launched on 2 July 2018. Even though we were mentally prepared for a fair amount of volatility, looking back, this has been a wild ride so far. Just after the start, recession fears drove down equity markets in the back of 2018, which affected us only to a very minor extent.

Even though 2019 was a year of strong returns in the market, our performance was muted (+10%). As we have often highlighted, the performance of our fund can differ strongly from the performance of the indexes due to the concentrated nature of the portfolio. But it certainly also didn't help that "value" shares underperformed by a wide margin during this year.

In February and March 2020, the world went into a pandemic and equity markets around the world crashed by 30-40%+ within a few weeks as financial markets became concerned about a system collapse. The rebound came swift and strong. Only a few months later our fund reached all-time high levels as did the indexes. We were able to enjoy a time of strong returns for one and a half years after having seen the Covid lows. At the high point, the fund price was up more than 80%.

Driven by inflation fears and accompanied rising interest rates as well as the uncertainties caused by the war and geopolitical tensions, equity markets tanked again in 2022. Unfortunately, our fund underperformed last year. Today, we are again looking at indexes trading near all-time highs. The big difference to the Covid period for us is that - until now - the fund hasn't seen such a strong rebound (yet). As we are about to discuss in section two, we believe that this is temporary and provides an opportunity.

Generally, we think that investment returns for equity funds can only be judged with some degree of reliability over very (!) long periods. However, five years is certainly more meaningful than a few months or a year. In the following paragraphs, we will look back on our performance and analyze our mistakes to see what we can improve in our process.

We do so while being very careful about learning too much from outcomes of the recent past. We believe that this is a fatal error which many investors make, and which often leads to worse long-term outcomes. E.g., in 2021 one could have looked at the last few years and decided that investing in the right trends and companies which are positioned to benefit from that might be much more important than the valuation of shares and the quality characteristics of the business in question.

Given that five years is a relatively short period in investing, the point in time to do such an analysis still matters an awful lot as well. Had we done the same performance review 1.5 years ago, the outputs would have looked quite different, and we might have drawn very different conclusions if we focused too much on the individual outcomes (over such a short period of time).

The last 18 months was the worst performance period in absolute and relative terms in our young history. We are convinced that, when looking back at this analysis in a few years, it will have been done at a low point of our longer-term performance history. Despite having slightly outperformed our reference index on a net basis since day one, we are far from our goal of a double-digit net return, which we are fully convinced we will achieve again.

With that caveat, let's look at our worst performance contributors since inception (out of 73 investments we made in total) with an explanation of the mistakes for a few selected stocks where we are convinced that we made mistakes in our investing process.

Company	Performance contribution	Avg. weighting
Sogefi S.p.A.	-1.65%	1.52%
Playmates Toys Group	-2.03%	0.22%
Naked Wines PLC	-2.43%	2.92%
Gym Group PLC	-2.74%	6.12%
Promotora de Informaciones S.A	-3.08%	0.41%
Koenig & Bauer AG	-3.69%	3.66%
French Connection Group PLC	-3.97%	0.40%
Traumhaus AG	-3.98%	3.44%
MPC Münchmeyer Peters. Cap. AG	-4.68%	0.55%
home24 SE	-5.10%	2.04%

Source: HANSAINVEST; as of 30 June 2023.

home24 (prior position) is a Berlin-based online furniture retailer. The business model exhibits a limited differentiation, and the company is active in a highly dynamic and competitive industry. After we entered the position, the management also made a significant capital allocation decision (acquiring Butlers) which we didn't like. Given the uncertainty around the quality and longer-term profitability of the business model, we should have allowed this idea only a small allocation in the portfolio (if any). We made the biggest mistake in the weighting, especially when adding to the position into growing headwinds and uncertainty.

MPC (prior position) is a Hamburg based real asset manager. In hindsight, we should have investigated the company's balance sheet in even greater detail and should have depended less on management's (optimistic) guidance. We should have also given the company's capital allocation framework greater consideration. See [LtP #6](#) for a comprehensive post investment analysis.

Naked Wines (current position) is a UK based online wine retailer. Like home24, a company in a highly competitive industry with a relatively new business model where the track record was limited and the range of possible outcomes for the business was (and is) very wide. The biggest mistake was again the weighting, especially not reducing or selling the position when strong headwinds combined with doubts about the company's execution emerged.

Endor/Guillemot (current positions) are sim racing / flight sim esports equipment manufacturers. As a note, our investments overall didn't contribute a major loss (we had higher weightings when shares went up and lower ones when they went down). We believe we could have managed the investment better by at least reducing our positions when tailwinds vanished and valuations were still elevated, considering that there are uncertainties about the level of profitability in the longer-term.

The most common mistake that ended in significant losses was investing in situations where it was very hard to judge the outcome because we couldn't have enough conviction on the quality of the business and then weighting them too highly in the portfolio. At the same time, the business models had in some cases not been sufficiently (proven) in the past. On rare occasions, we probably went too far away from our core circle of competence (e.g. Promotora de Informaciones or Playmates Toys).

We will focus even more on making sure that we are very confident in our estimate of the value of a company and that we are paying a low price compared to most outcomes. We will also pay especially close attention to the weighting in the portfolio considering our confidence in a good outcome as well as our alignment with shareholders. After all, we want to have large positions in those stocks where we see only a low probability of losing a substantial amount.

What is less obvious but equally important is that we certainly could have had more winners. As of today, only a limited number of shares have contributed very meaningfully (e.g., more than four percentage points) to the performance since inception. A part of this is of course driven by the point in time at which we are making this analysis as described above and in the second section. The shares of many of our holdings have retreated (unfairly and frustratingly much we believe) in the last 18 months. Nevertheless, we would still aim to have more significant winners in the future.

Company	Performance contribution	Avg. weighting
Gamesys Group PLC	7.34%	1.53%
SAF HOLLAND SE	6.97%	3.46%
Basic-Fit N.V.	5.87%	4.11%
Daejan Holdings PLC	5.33%	0.25%
STO SE & Co. KGAA	5.14%	7.37%
Volex PLC	4.16%	0.66%
Catana Group S.A.	3.32%	3.36%
Italian Wine Brands S.p.A.	3.18%	3.17%
Akwel S.A.	3.10%	6.40%
7C Solarparken AG	3.01%	0.85%

Source: HANSAINVEST; as of 30 June 2023.

Besides the analysis over the entire period, we also looked individually at the worst (relative) years since inception. In 2019, the fund increased about 10% whereas our benchmark index gained more than 30%. In 2022, we lost more than 38% whereas our benchmark index lost about 23%.

Especially 2022 is interesting. As mentioned, we had a very disappointing performance in 2022 in absolute and relative terms. However, we only had a few particularly bad contributors. GYM Group (current position) cost around 5ppts, Naked Wines and home24 3.5-4ppts each. But maybe the more stunning observation is that we had literally no (more than marginal) winners.

On a portfolio level, we held mainly industrial (incl. construction-related) and consumer-focused businesses in late 2021/early 2022. Our general bias goes towards these types of businesses as we believe that we can better understand and value them. Unfortunately, these sectors were amongst the hardest hit in the last year. Nevertheless, we have already diversified the portfolio more and are actively working on improving this further. We have been actively looking to find more companies from other sectors.

Conclusion

In summary, in the future we aim to have a higher hit-ratio. On the one hand, we will try even harder to not make avoidable big mistakes, but we will especially be even more selective about situations in which we can't be confident enough about the value of a company and our alignment with the key decision makers. We recently read [What I Learned about Investing from Darwin](#). In this book, Pulak Prasad, a very successful investor in the Indian stock market, describes a few techniques to increase the ratios of winners to losers in one's portfolio. One of the key messages from the book starts on page 20 – "A Great Investor Is a Great Rejector": *There are very few good investments in the market.* To be fair, it is not new to us, but we aim to become better on the margin and make less compromises.

As mentioned before, we strive to find more winners. We don't mean that we will now only look for 5x or 10x shares but we aim to find more significantly positive contributors. In general, we are looking for situations in which we can expect an IRR of 20% or more (i.e. about a 2x over four years) with limited risks to the downside and we like optionality to the upside beyond that.

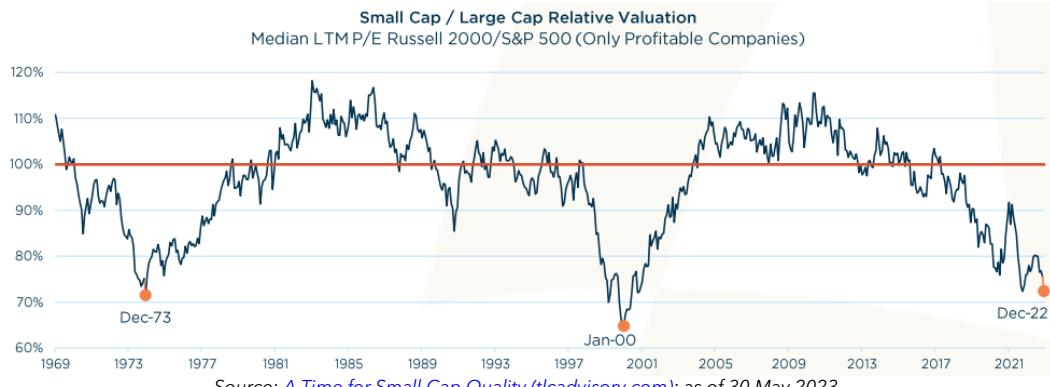
We are convinced that we have a lot of investments in our portfolio today which possess exactly these characteristics. The market has not been kind to these stocks in the recent past. But this also means that the investment profiles have for the large part improved in our view.

The key takeaway for us is that most mistakes were done "outside of the portfolio" – in those good investments that we haven't looked at and/or didn't invest in. We believe that the largest contributor to achieve the above goals is looking at (many) more companies and situations. This will naturally allow us to be even more selective and avoid more difficult and uncertain situations. This way, we can find investments with higher return expectations or with similar return expectations but for higher-quality businesses and more certain outcomes.

We have highlighted it before but one crucial way to manage this is to say "No" quickly to a lot of situations. Beyond that, setting goals on looking at a higher number of new situations each week or month helps us already today to implement it in our day-to-day work and prioritization schedules.

Looking ahead

We recently held a [web conference](#) (in German) in which we presented our latest thoughts on the European small cap space. Small caps are once again historically cheap! The below chart compares the relative valuation between small and large caps, i.e., listed stocks with a low vs. a high market capitalization. Since the 1970s there were only two phases in which the valuations deviated as much as they currently do. Once in 1973 at the time of the collapse of the Bretton Woods system and during the Tech Bubble in 2000.



Source: [A Time for Small Cap Quality \(tlcadvisory.com\)](#); as of 30 May 2023.

The above implies that small caps offer attractive yield premiums compared to large caps. In the table below we show selected indices with their price-to-earnings-ratios (P/E ratio; last-twelve-months). The higher the ratio, the higher the valuation. The range lies between a staggering >30x for US Tech (iShares NASDAQ 100) and <10x for European Small Caps (MSCI Europe Small Caps). Said differently, the currently implied (no-growth) equity yield ranges between 3.1% for US Tech and 10.2% for European small caps.

Indices	P/E ratio	Implied equity yield
NASDAQ 100	31.8x	3.1%
S&P 500	21.8x	4.6%
MSCI World	18.5x	5.4%
MSCI World Small Cap	12.1x	8.2%
MSCI Europe	14.2x	7.1%
MSCI Europe Small Caps	9.8x	10.2%

Source: Gehlen Bräutigam Capital; iShares; as of 23 June 2023.

Secondly, we would like to highlight the valuation spreads between value and growth stocks in more detail. At least on some measures, global valuation spreads are back to tech-bubble highs, i.e., value is historically cheap compared to growth.¹ One example that particularly stands out for us is NVIDIA, which has delivered a great share price performance so far this year on the back of the AI boom. The company does not fall into our scope but out of interest we investigated the current valuation in a bit more detail. We have tried to determine what is currently baked into the share price of NVIDIA, i.e., “what do you need to believe for the future to regard the current share price as fair?”.

Starting from 60% top-line growth for 2023, according to our own analysis, the company would have to grow by 22.5% each year of the following 10 years, which implies sales to 10x over the period to nearly \$300bn in 2032. The EBIT margin would have to remain at levels at or above 50%. If this were to happen, an investor could expect a high-single-digit (~8%) return. We like to be conservative with regards to such lofty assumptions and would probably not find a sufficient margin-of-safety here, i.e., there is not much room for error and if things turn out different the probability for a permanent loss of capital would be high.

¹ Source: Value Spreads Are Back to Tech Bubble Highs: Is Everyone Out There Cray-Cray? (aqr.com).

Contrary to the lofty assumptions already baked into the Nvidia stock price, we find that several companies in our universe trade at historically cheap valuations on many metrics. The below examples and several other of our holdings trade on double-digit FCF yields on our assumption of the companies' free cash flow in a **normal** environment (i.e., not based on potentially inflated figures in the current environment).

Koenig & Bauer trades at a near-term EV/EBIT multiple of <7x on depressed margins. The management believes that the margins will meaningfully increase in the next years, and we find that very credible considering the actions that have been taken and the headwinds (supply chain issues hit the company particularly hard) which are vanishing. The success of new products could lead to additional growth and margin increases.

GYM Group trades at a double-digit no-growth FCF yield. We believe that the company will most likely further build up the membership base (or/and increase prices) in the next years which could quickly double the cash flows due to the operating leverage inherent in the business model.

Kamux trades at <7x of our near-term EBIT estimate and we believe that they can double this in the next years thanks to a return to top-line growth and a further recovery of currently depressed margins in a more normal market environment.

Despite the recent increase in the share price by >40% since our investment at the beginning of the year, **KSB** still trades at an EV/EBIT multiple of only ~7x and a single-digit PE multiple. With the opportunity to further increase its margins and grow faster in the next years, this company is still significantly undervalued, which also shows how much upside some of these stocks potentially have.

With large cap growth at historical all-time highs and small cap value at historical lows, the obvious question is - when will the cycle turn and valuations normalize? Unfortunately, we will have to disappoint you. We do not have a crystal ball, but you could expect three things: 1. When the tide turns, it often happens quickly and forcefully. 2. Recessions, war and inflation fears will ease sooner or later. 3. It does not make any sense for us to change our approach in the meantime.

On the contrary, several analyses show that small cap value stocks have delivered the highest return over the long-term as demonstrated by the stats in green below. While we certainly disagree with most of the valuations quoted for our portfolio companies, we constantly look out for new opportunities to upgrade the portfolio constantly and have added new positions to the portfolio. We will not comment on them in this letter yet as we are still in the process of building the positions.

United States: 1963 - 2022			Developed International: 1990 - 2022		
	Value	Neutral	Value	Neutral	Growth
Large	12.1%	10.3%	10.2%	5.9%	6.1%
Small	15.2%	13.6%	8.4%	8.5%	4.0%

Source: Verdad Capital - The Size Factor; Ken French data library; as of 30 May 2023.

To summarize, 1. the market experiences a historically high valuation disparity between large and small cap stocks, across developed equity markets. 2. Attractive implied yields and historically high yield premiums for small caps indicate an attractive opportunity for a medium-term investment. 3. Value stocks have significant upside risk compared to growth stocks and should be a particularly attractive bucket in the small cap universe.

Overall, the data indicates that European small cap value stocks offer the highest yield opportunity from a mid-to long-term perspective. We are supportive on the European small cap space from a stock picking perspective and believe it should be a rich hunting ground for alpha.

Please note that we have changed our address recently to the following:

Gehlen Bräutigam Capital GmbH
Herderstrasse 28
12163 Berlin

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.

Sincerely yours,



Daniel Gehlen



Marc-Lennart Bräutigam



GEHLEN BRÄUTIGAM CAPITAL GMBH. HERDERSTRASSE 28. 12163 BERLIN.
+49 30 42141851. info@gbcvalue.com. gbcvalue.com

Marketing information.

Portfolio overview - as of June 30th, 2023

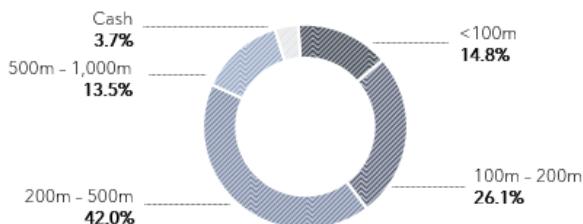
Top 10 positions with respective weightings:

1	KSB	9.2%	6	Basic-Fit	4.9%
2	Sto	6.8%	7	SAF Holland	4.9%
3	Kamux	6.7%	8	Akwel	4.7%
4	The Gym Group	6.3%	9	Villeroy & Boch	4.5%
5	Koenig & Bauer	5.5%	10	Solar A/S	4.4%

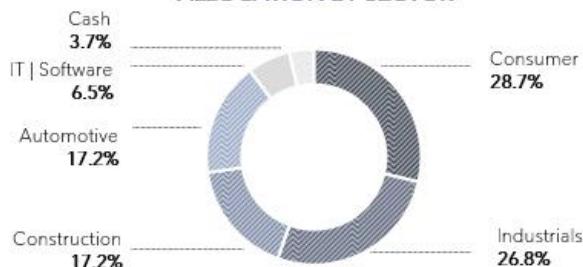
Source: Gehlen Bräutigam Capital; HANSAINVEST.

Allocation:

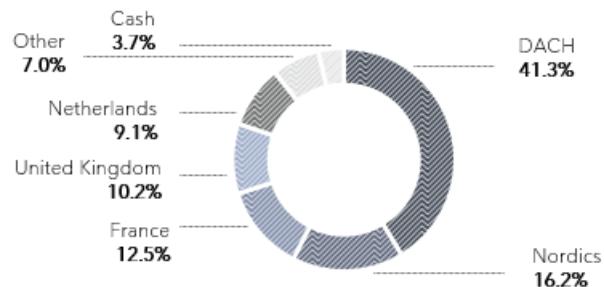
ALLOCATION BY FREE FLOAT MARKET CAPITALISATION (EUR)



ALLOCATION BY SECTOR



ALLOCATION BY COUNTRY



Source: Gehlen Bräutigam Capital; HANSAINVEST.

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