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Letter to Partners #22

Q4 2023 *(10/01/2023 - 12/31/2023)*

January 28th, 2024

Dear Partner,

In the fourth quarter of 2023, **our fund returned -1.93%**. At the end of the year, the fund volume stood at EUR 18.5 million. In 2023, the fund has received net inflows of EUR -0,1 million.

EUR 100.00 invested at the start of the fund in mid-2018 was worth EUR 110.39 at the end of the quarter. The **overall gain since inception is +10.39%** and the **compounded annual gain is +1.81%** (compared to +22.01% or +3.68% 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	+0.80%	+0.09%	+0.50%	+11.30%
Since inception	**+10.39%**	**+6.17%**	**+9.54%**	**+22.01%***
Annualized return	**+1.81%**	**+1.13%**	**+1.84%**	**+3.68%***

* 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**

General stock market and results

In last quarter's letter to partners, we said the following:

"We believe that this is a time during which exceptional future returns can be locked in across European small and micro caps."

Our view of the general market levels for European and UK stocks is that they are neither particularly over- nor undervalued. This view relates to large and mid cap stocks. This view, if accurate, implies that investors can expect roughly average returns for the next years. In contrast, we continue to view many European and UK small and micro caps to be priced below intrinsic value. We think of them as historically inexpensive compared to large and mid caps. Assuming we are right, this could lead investors to above average returns over the medium- to longer-term.

Generally, last year has been a satisfactory year for investors in European public equities. European large and mid cap stocks, measured by the MSCI Europe index, have advanced by more than 15%. For investors in smaller European companies, the picture has been slightly more mixed. European small caps, measured by the MSCI Europe Small Cap index, have expanded by above 12%, whereas the MSCI Europe Micro Cap index (the most illiquid bucket) has lost 0.3%. Our fund, which is invested in around 20 selected European and UK small and micro caps, has returned a slightly positive return of 0.8% in 2023.

Key negative contributors to the fund's performance in 2023 have been Traumhaus (exited), Guillemot (hold) and Naked Wines (exited). Traumhaus' liquidity profile worsened further substantially over the course of the year, as their client base (often younger families) continued to be unable to afford the purchase of a new home due to the sudden increase in financing costs, the expiry of subsidy programs as well as higher building costs. This unfortunately could not be resolved which has forced the company to ultimately file for self-administration proceedings. Guillemot continues to work through the high stock levels at their customers and agents, which should be finally resolved over the first half of 2024. Naked Wines continues to suffer from multiple headwinds leading to a continuously weakening operating performance over the course of the year. This includes a significantly lower retention of existing customers which puts even more pressure on the struggling business.

Key positive contributors to the fund's performance in 2023 have been KSB, SAF-Holland, and Mortgage Advice Bureau. KSB's preference shares have recently been included in the SDAX. This is a testament to the continuous operational and governance improvements that the management has been working on. SAF has come from a very depressed valuation as the market was afraid of a potentially strong cyclical set-back. In-line with our view this hasn't materialized and 2024 looks rather like a cooldown than a strong downturn (thanks to the high age of the customers' fleets which leads to a significant replacement demand). Against this background, the acquisition and integration of its latest major acquisition (Haldex) also looks like a success so far. Our recent investment in Mortgage Advice Bureau has proven to be well timed. Until today, the stock has advanced well due to a more favourable interest rate environment in the UK. Post quarter end, the company has reported encouraging numbers and a more optimistic outlook.

The recent fall in (longer-term) interest rates seems to have led to a first strong rebound in (selected) European small caps. Our fund has only partially been able to benefit from this yet. We have observed that some of our stocks' larger peers outperformed our holdings, sometimes by a wide margin. We had experienced similar times before, such as during Covid, when our performance reignited with a certain delay. We believe that there is a good chance that we will see a similar catch-up. The projected additional reduction of (core) inflation as well as anticipated interest rate cuts by central banks could lead to greater investor confidence which could also support inflows into less liquid but potentially higher yielding European small and micro caps.

Our philosophy is that buying cash-flow yielding businesses, in which management allocates capital reasonably well, leads to attractive returns over time. As we believe that we own many companies at double-digit (normalized) free cash flow yields while expecting those cash flows to grow at attractive rates in the mid-term, we are very optimistic that these holdings will deliver satisfactory returns. Therefore, we are confident to have significantly more positive contributors to the overall portfolio going forward as compared to the last two years.

We have also started to observe an uptick in M&A activity amongst public and private investors. In recent months, there has been an increasing number of takeovers (some at large premiums) in companies we follow. We wouldn't be surprised if some of our holdings are also of interest to those market participants. As a reminder, in

April 2023, Sureserve plc has been the most recent take out from our portfolio. Overall, such activity could serve as an additional trigger for re-ratings amongst our portfolio positions.

Our portfolio

Over the last four years, our portfolio has been positioned mainly towards consumer (cyclicals), industrials and automotive as well as the construction sector. While this has worked out very well in 2020 and 2021, it has certainly been a performance drag over the two most recent years. At least with hindsight, we should have been allocated to a higher degree towards defensive sectors as well as special situations at the beginning of that challenging period. As of today, we are convinced that the portfolio is well positioned for a cyclical recovery, which we think could happen with a good likelihood as of the second half of 2024. Once the market starts anticipating such a scenario, our portfolio should see meaningful gains. In the meantime, it offers attractive upside as well as resilience.

Besides that, we are convinced, that the current portfolio scores the highest since inception in terms of the attractiveness of our internal weighting considerations. We believe that we have continually improved our portfolio from a robustness, quality, growth, and governance as well as valuation perspective. We have also put an even stronger emphasis on the risk side and do believe that the portfolio is comfortably positioned from a liquidity, balance sheet and individual risks perspective of the underwritings we have made.

As stated initially, we find very attractive ways to allocate our co-investors' principal during this period. In the last letter alone, we have highlighted four sizeable new investments over the third quarter. Over the most recent quarter, we have continued to operate at a similar pace. We present another new investment in this letter. We would also expect this unusually high turnover of portfolio companies to decrease again once there are fewer distortions in our core universe.

Overall, we feel very committed to achieving satisfactory results for our co-investors in a timely manner and fully understand the frustrations some of you may have with the more recent results. As we navigate the opportunities and challenges that lie ahead, we are very upbeat to see a prosperous year ahead.

Bijou Brigitte modische Accessoires AG (BIJ) is a Germany-based omni-channel retailer that operates in the fashion jewelry and accessories space. BIJ manufactures, imports, and distributes fashion jewelry, fashion accessories and complementary products. These are sold directly to consumers mainly via its own store network (c. 900) across Europe at affordable price points as well as to a smaller degree online and via concessions. BIJ serves mostly female customers by providing a trusted and low-cost solution for short-term needs for fashion jewelry and accessories.

Source: Gehlen Bräutigam Capital GmbH, as of November 2023.

BIJ is a small cap company, listed on the Frankfurt Stock Exchange with a market capitalization of c. EUR 300m at the time of our initial investment. The free float market cap is significantly lower at EUR 150m as the founding family holds slightly north of 50% of the shares (liquidity is quite low). Only one research institution covers the stock and management is usually only available for investors via the AGM. Despite that, and thanks to a long-standing and trusted broking relationship, we finally managed to meet the CFO in person in Hamburg in November last year, where we interviewed him around outstanding parts of our initial investment thesis.

The company's balance sheet is an absolute fortress with zero bank/bond liabilities and c. EUR 170m in net cash by FYE2023e. Although, we estimate that roughly EUR 80-100m of it is *trapped* and therefore not available for distribution to shareholders. We understand that management views it as a buffer against challenging circumstances. Due to the conservative nature of this policy, BIJ comfortably survived Covid without the need for any outside capital from investors or banks. This leaves BIJ with a distributable cash balance of FYE2023e EUR 67m (EUR 8.70 per share), roughly equal to 22% of the market capitalization. We certainly view this policy as too conservative and would advocate for even higher potential distributions to shareholders. On the other hand, we would rather have it this way than the other way around, especially in such a competitive industry.

BIJ has quite an impressive and long-term track record of distributing cash to shareholders via dividends as well as buybacks and we are convinced this will continue for the foreseeable future. The pay-out ratio, which has been at an average of 92% since 2007 (according to our numbers and excluding Covid-years) is expected to remain generous. We believe that the founding family views this business as a cash cow within their broader portfolio of assets and will continue to milk it. Buybacks are an option for management and have been executed in the past, but we would be surprised if anything was announced in the short term. The dividend policy provides a base dividend of EUR 3.00 per share (7.7% yield) with an estimated upside potential from additional distributions closer to or above 10%.

Past economic crises indicate that the business is very resilient during downturns. We believe a key advantage, compared to more cyclical mid- or higher end jewelry, is the relatively low and affordable price point that BIJ offers across its product portfolio. Further, BIJ has proven that it can pass along price increases to customers and is therefore holding up well against inflation. We expect BIJ to deliver a flat margin year-over-year despite several headwinds such as higher raw material, transport, and electricity prices as well as wage increases. Further, we understand that price increases have not impacted customers' demand for the products and therefore feel confident that BIJ can and will further increase prices in the future. This gives us confidence in the management's ambition to keep margins at least stable over the next couple of years.

Over several cycles, BIJ has successfully maintained its competitive positioning and we believe it will at least stay well positioned. Don't get us wrong, this sector is highly competitive, barriers to entry are low and there have been several periods over the company's history with elevated levels of competition. Usually, we would stay away from a set-up like this. So why invest despite all this?

We have noticed that during the period prior to Covid, and accelerated by the pandemic, some competitors have retracted and closed. Thanks to that BIJ might now enter a period of milder competition. In the past, BIJ went through several phases of higher and lower competition. Unsurprisingly, lower levels of competition meant higher margins and better returns on capital.

Given the high-margin, high return on capital and highly cash-generative nature of the business, any additional growth would be very accretive. Generally, management is very cautious with regards to investments in new store openings, which we like, as there is a low risk of unfortunate capital allocations. BIJ has successfully consolidated its own store network over recent years and its expansion team sees attractive opportunities to grow in selected markets across Eastern, Southern and Western Europe over the medium term. Further, we expect growth via franchising and concessions. Inorganic growth is less likely in our view but not impossible.

With our expectation for a solid FY2023, a very strong balance sheet and EPS growth going forward as well as generous dividend distributions, we are roughly paying a 2023e P/E of 7.5x (adjusted for the distributable cash excl. management's safety buffer) today. This translates into an earnings yield of c. 13%. We consider this simply too cheap for a decent quality company with a proven track record of delivery and the potential for at least stable margins supported by a more benign competitive environment. Further, we would like to highlight the, in our view, very favorable risk/reward profile of this case. We believe there is limited downside not only due to the proven resilience of the business model but also because BIJ holds a large share of their market capitalization (nearly 60%) in net cash and is generating cash continuously.

We have (partially) financed the new investments by exiting Traumhaus and Naked Wines as well as CTAC and Catana.

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

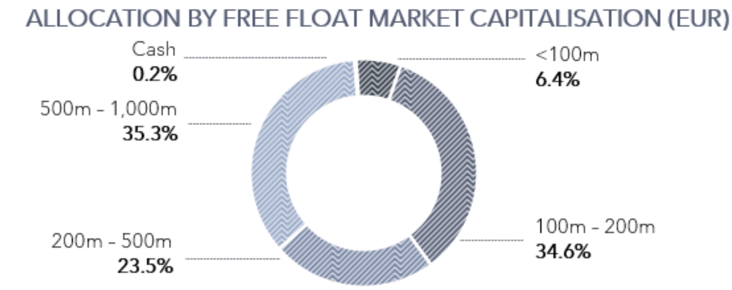
Portfolio overview – as of December 31st, 2023

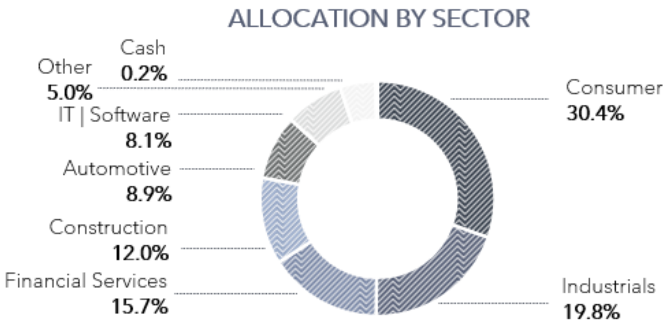
Top 10 positions with respective weightings:

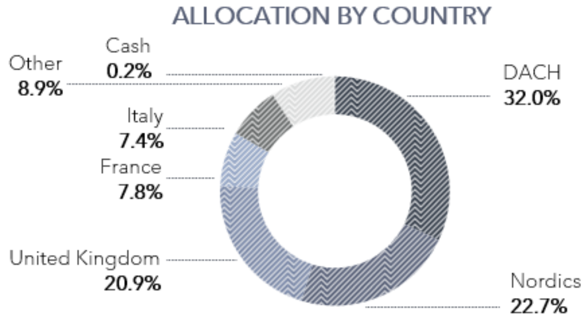
1	KSB	9.7%	6	Petershill Partners	5.1%
2	The Gym Group	8.0%	7	Enad Global	5.0%
3	Kamux	8.0%	8	SAF-Holland	4.9%
4	Sto	7.1%	9	Anima	4.7%
5	Mortgage Advice Bureau	5.9%	10	Basic-Fit	4.6%

Source: Gehlen Bräutigam Capital; HANSAINVEST.

Allocation:







Source: Gehlen Bräutigam Capital; HANSAINVEST.

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https://www.hansainvest.com/deutsch/fondswelt/fondsdetails.html?fondsid=720

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