# GEHLEN BRÄUTIGAM

CAPITAL

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**Letter to Partners #23**

**Q1 2024** *(01/01/2024 - 03/31/2024)*

April 7th, 2024

Dear Partner,

In the first quarter of 2024, **our fund returned -1.44%**. At the end of the quarter, the fund volume stood at EUR 16.7 million.

EUR 100.00 invested at the start of the fund in mid-2018 was worth EUR 108.80 at the end of the quarter. The **overall gain since inception is +8.80%** and the **compounded annual gain is +1.48%** (compared to +25.73% or +4.07% 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% |
| 2024 Q1 | -1.44% | -1.64% | -1.52% | +3.05% |
| **Since inception** | **+8.80%** | **+4.43%** | **+7.87%** | **+25.73%*** |
| **Annualized return** | **+1.48%** | **+0.78%** | **+1.46%** | **+4.07%*** |

* 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**

## Our portfolio

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

*"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 in recent letters, we find very attractive ways to allocate our co-investors' principal during this period. In one of our last letters, we have highlighted **Mortgage Advice Bureau plc** (MAB) as a new investment. We believe this case demonstrates the unique opportunities we can take advantage of in the UK these days. Over the most recent quarters, we have taken advantage of the uncertainties there and present another new UK investment in this letter.

Similarly to the property market in Germany, the UK housing market is facing substantial disruptions since 2022 and experienced significant turmoil in 2023. For us, such severe disruptions can mean opportunity. What can happen during times of pressing uncertainties, is that negative projections about the near-term get projected too far into the future by investors. Fundflows take care of the remainder. Therefore, we had screened the real estate & property small- & micro-cap universe to identify high-quality companies facing short-term headwinds and therefore potentially trading at temporarily depressed valuations.

During that time, we turned many rocks, screened a lot of initial ideas, and had a significant number of conversations with management teams. In the end, besides MAB, which stood out to us as a brilliant founder-led company with an exceptional track-record of value creation, we found two very small companies, that excited us tremendously. Both showed very similar characteristics to MAB but a different exposure to the sector. After careful due diligence, we decided to invest in one of those two micro-caps. Surprisingly, shortly after our investment, both ended up within the portfolio!

Unlike MAB, which basically offers a royalty on UK mortgages, **The Property Franchise Group plc** (TPFG) is one of UK's largest multi-brand lettings and estate agency franchising groups. What this basically means is that TPFG enables its hundreds of franchisees in offering the best possible service to UK landlords and home buyers. Therefore, it takes a cut on every deal that happens within the system, i.e. every time a house is sold, or a new lease contract is signed. In essence, it offers a royalty on UK property sales and lettings contracts.

Franchisees on the one hand manage around 76,000 properties for landlords by renting out the houses and apartments, collect the rent and make sure the services are compliant with UK regulation. Besides that, the franchisees broker thousands of transactions between buyers and sellers of UK residential real estate every year via its multi-brand high-street, hybrid as well as online estate agency offerings.

Due to its franchising nature, TPFG is a very high-quality business model with a high share of recurring / annuity like revenue streams while parts of the business currently profit from rent inflation in the UK. Given that TPFG's business requires almost no property, plant, and equipment (PP&E) and that net working capital is often even negative, organic ROICs are extremely high. EBITDA margins are above 40%. Management is very focused on profitability and appears very cost conscious. The balance sheet is strong with only a tiny amount of financial debt and a net cash position at our initial investment.

As of YE 2022, 58% of revenues come from Management service fees (MSF), which include royalty payments made by franchisees on sales and lettings activities. TPFG receives a c. 10% cut on revenues from their franchisees every month, which allows for favourable WC dynamics (often negative in years). Especially the lettings and property services pieces are highly recurring, annuity like and have basically no churn.

EweMove is the only TPFG brand that has a slightly different estate agency model where franchisees pay a GBP 1.0-1.4k franchise fee a month for access to all operating systems, marketing support and 24/7 call centre. The brand is strongly growing its territories and could double territories from here, which offers a good margin and top-line opportunity. In this segment, MSF grew 15% y-o-y in H1 2023 despite the current headwinds.

The second largest revenue stream is Owned offices (19%) where TPFG makes money from lettings, sales, and other services. The third largest revenue stream is Other (16%), which includes sales and IT support as well as

software fees from franchisees. Financial services (6%) are a slowly but steadily growing contributor to the top line and offer another growth opportunity, which we believe should strongly accelerate in coming years.

The underlying business model is highly cash generative, and earnings translate very well into free cash flow (basically 100%). At the time of investment, the share price (c. GBP 2.60) offered a 9.5-10.5% FCF yield. Shares traded at a single digit P/E multiple on a 1-year forward looking basis, which we believe is way too low for such a business. In our DCF analysis, the base case suggested a target price of GBP 4-5 or an upside of >70% and therefore a deep undervaluation and a significant margin of safety.

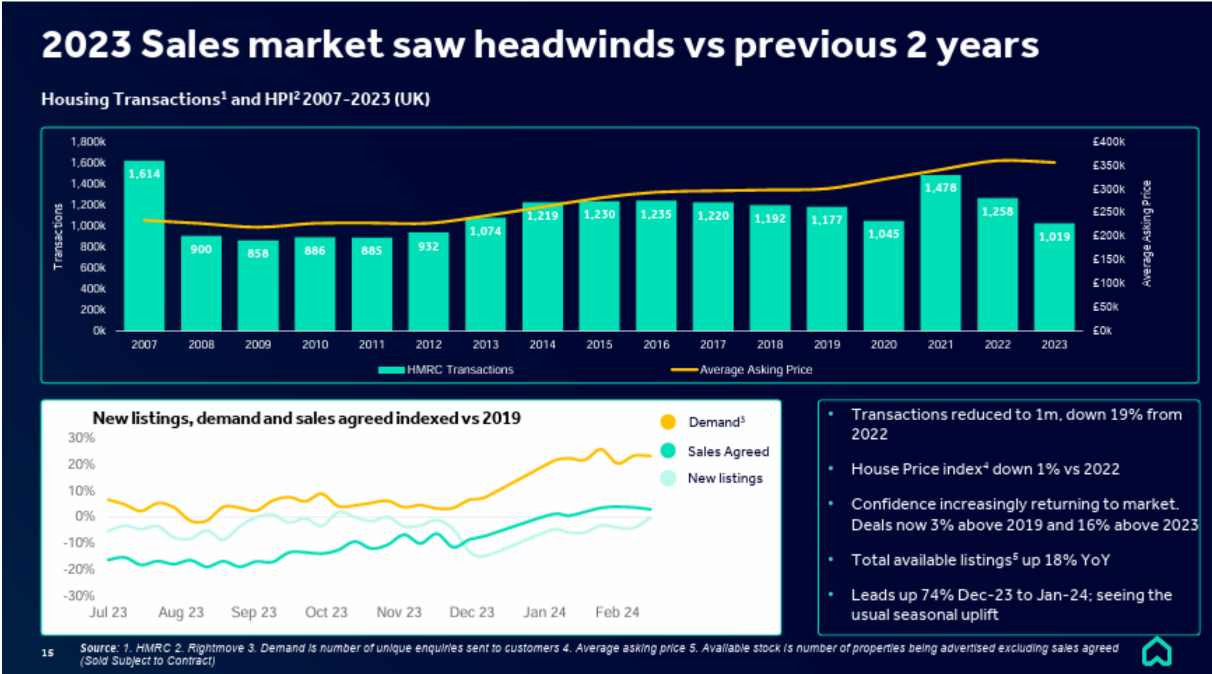
Shortly after we had bought our first shares in TPFG, the company announced the intention to merge with its closest listed peer **Belvoir Group plc** (BLV). BLV is essentially the same company at roughly the same size and traded at roughly the same valuation. We had analysed the company closely and spoken to management before. At the time we very much liked it but preferred TPFG due to, in our view, a slightly stronger focus on cost control and return on capital employed.

When we read in the release that the intention to merge was based on common ground and that TPFG's management would take over the helm of the combined group, we got very excited. There was a previous attempt to merge the two companies a couple years ago which had failed, but this time the path was way clearer, and the parties seemed to have learned from it.

We used this opportunity to also acquire BLV shares below the merger price (ratio) at which we would receive new TPFG shares if the merger was signed-off and completed. This has happened by now and we are very happy shareholders in the combined entity (TPFG). We are absolutely convinced that the merger makes sense, and that management will be able to drive cost and revenue synergies out of it.

With regards to our investment in MAB, we are also looking forward to growth in its network of mortgage advisors via the merger between TPFG and BLV. The latter runs MAB's largest advisor network and has significant expertise in doing so. The Financial Services Director who has extensive experience in running the business within BLV has now joined the TPFG management board and we are confident that a further roll-out of the network will be accomplished across TPFG's and BLV's networks.

Given that it was an all-share merger, TPFG did not use cash to finance the deal. As BLV also had a very healthy balance sheet, the combined entity will end up with a very comfortable (net cash) balance sheet situation and will therefore be able to continue to invest into the network, return excess cash to shareholders and grow via acquisitions as well as support its franchisees in financing value-accretive acquisitions.




*Source: Rightmove, as of February 2024.*

A normalization of the property sales market should accelerate growth and margin expansion in the coming years. Since the rapid rate increases and the mini-budget crisis, the UK property sales market has been in decline over the past two years and has only seen signs of a recovery in early 2024 as indicated by the above chart. According to Rightmove, the lack of housing supply continues with landlords facing ongoing legislative and financing challenges. We believe though that TPFG's lettings business is currently facing tailwinds from this development due to rent level increases of +9% YoY across the UK.

Given the recurring, high-quality and strong cash generation of the businesses we are convinced that the shares have a very good chance to trade at a (significantly) higher multiple once the market realizes the full potential of the group. This assumption is further underlined when we look at other listed franchising stocks as well as past private market transactions such as the Permira/Engel & Völkers deal.

Finally, we expect the shares to become increasingly accessible to institutional investors. When we first entered the TPFG shares were quite illiquid and BLV shares' liquidity was even tighter. Now the new group has a combined market capitalization of more than GBP 200m, and we expect it to increase (significantly) over time. We will see where the daily traded volumes will end up in the short- to medium-term, but we are encouraged from the initial signs. Besides that, we are confident that management will market the story very well to new and existing investors.

With the merger being effective as of March 2024, TPFG's FY2024 figures will only include 10 months of BLV. The first full year of combined reporting will therefore be 2025. By then, we also expect the first synergy potentials will have been utilised. For 2025, we estimate the shares (at GBp 330 per share) to currently trade at an EV/EBITDA of below 8x and a P/E of c. 10x as well as a FCF yield of above 9%. As of today, we are convinced that investors will sooner or later agree that this is way too cheap for a business of this calibre and are excited about the contributions we expect this investment to deliver for the fund.

In terms of other new investments, we have built a position in **IWG plc** (c. 4.5% of assets under management), which is probably best known for its flexible office brand Regus. IWG reports massive growth in its new asset-light partnership business model in the US, which could add significantly to EBITDA over the next years. Given that the market has only begun to price this opportunity into the shares, we see a strong upside potential.

Smaller additions to the fund during the quarter include **Balco AB** (c. 0.5% of assets under management for now), a micro-cap from Sweden, that is focused on selling (glazed) balconies in the Nordics as well as **Nagarro SE** (c. 1% of assets under management for now), an IT engineering company. Nagarro was spun-off from Allgeier SE in December 2020 with strong operating momentum that has retrenched and is only expected to reaccelerate later in the year. Medium- to longer-term, we sense that this company still has a long runway of profitable growth ahead of itself and is currently trading at a depressed valuation relative to its prospects.

As always, the first quarter is one of the busiest quarters of the year with companies reporting their full-year results and share their outlook for the upcoming year. On top, we attended Capital Markets Days where a few of our holdings updated investors on their new strategies.

Overall, we think that the earnings season was mixed with most companies showing good signs of (top-line and margin) recovery after the recent inflationary headwinds, while some of our holdings need a little bit more time. In most cases, where we have seen initial indications of a solid recovery, we noted that the shares have not yet meaningfully gained. In some cases, we have observed, in our view, irrational market reactions with shares declining after solid results and after (in our view) encouraging outlooks were given. In selected cases we have taken advantage of these movements, added to our positions and consolidated the portfolio further. Below, we have commented on the, in our view, most notable results:

**Sto** published a new mid-term plan in which it (unsurprisingly) pushed back its previous mid-term targets by two years (from 2025 to 2027). This might sound negative at first but can't come as a surprise to anyone following the company. In fact, the newly published revenue target for 2025 was EUR 200m higher than our Base Case assumption. The bottom end of the margin range lies above our Base Case as well. Overall, the mid-point EBIT guidance is >30% higher than our (admittedly cautious) Base Case assumption for 2025. While there are still a lot of challenges in the building and construction space, the new guidance also implies a pretty okay 2024 (as we don't expect Sto to assume a very high revenue growth rate for 2025). We had noted a few weeks before that Rockwool, a major peer, also had published a very solid outlook for the current year.

After an initial decline, shares recovered swiftly on the day and even surged above the previous close post the release. We think that the further delivery of the results would be a big relief for investors, which are still hesitant towards the sector. Sto's shares trade at around 6x EBIT based on our new Base Case estimate (we are still conservative in our assumptions) or below 5.5x based on the mid-point of the new EBIT guidance. That does not make much sense to us. A fair price is much higher in our view, especially also given the very good FCF/EPS growth potential after 2025. We expect high structural growth due to significant renovation needs of the existing housing stock which will likely and hopefully also be supported by subsidies given the existing regulatory pressure.

**Kamux** has presented its new strategic ambitions and long-term targets at its latest Capital Markets Day in March. In a traditionally very stable market, the European used car omni-channel retailer is aiming to take advantage of the ongoing consolidation. The company aims to defend its #1 position and solid profitability in its home market Finland and to improve its ranking and profitability in Sweden and Germany via organic and potentially inorganic growth as well as the implementation of standardised processes. Beyond that, Kamux is looking at potentially entering further European markets.

We believe that Kamux has a good chance to emerge as a long-term winner from the recent headwinds the used car market has faced in Europe. We think there is a good chance that the company will deliver its EUR 1.5bn longer-term sales target (currently at around EUR 1bn sales) as well as the 4% adj. EBIT margin. This would imply an EBIT of EUR 60m vs. a current EV of c. EUR 240m, i.e. only 4.0x for a company that could grow profitably at double digit rates for a significant amount of time given the huge addressable market and high fragmentation.

**The GYM Group** has delivered a decent performance overall in 2023 and the shares reacted positively to the results and outlook. With its results, the company has given a convincing strategy update and medium-term outlook. The suggested focus points are not a complete shift but a continuation and intensification of existing measures which make sense in our view.

We think that the pace of the new roll-out program for gyms is ambitious with around 20 gyms each in 2025 and 2026. Especially considering this fast roll-out pace we like that management seems to be very much focused on its 30%+ ROIC target for the new openings. From our analysis and conversations, we, as of today, believe that these metrics are realistically achievable.

On our figures, the shares are trading at a double-digit adj. FCF yield (excluding expansion capex) on 2024e figures and at an even higher adj. FCF yield when some unfavourable energy price hedges run off. As investors can, after challenging years which began with the Covid closures, now again look forward to further increasing results from existing gyms – as members continue to recover slightly and (above-inflation) price increases fall through to the bottom-line – as well as significant profitable growth through new gym openings. Therefore, we believe that this is a very interesting time to revisit the share for many investors.

**Mortgage Advice Bureau** has delivered results in-line with markets' expectations for 2023 and has given an optimistic outlook for 2024, as January and February 2024 trading was significantly above the previous year's levels. We expect 2024 to be a solid year for MAB that will build the foundation for a return to double digit growth rates in the coming years. Since we initiated our position, the shares have rerated quite meaningfully already. As of today, we neither think the shares are significantly over- or under-valued but we see further short-term upside if management delivers on investors' expectations as well as long-term compounding potential at very high incremental returns on capital.

**SAF Holland** goes from strength to strength under CEO Alexander Geis. The recent acquisition of Swedish group Haldex seems be a success and adds significantly to the highly profitable aftermarket segment. The underlying profitability was strong in 2023 and the company is deleveraging progressively. The outlook is tougher for 2024 as unsurprisingly, truck and trailer markets are expected to be down in most markets. Shares are currently trading above EUR 18 per share, which including dividends we have received is close to 6x our initial purchase price of around EUR 3.50 per share during the peak of the Covid fear in March 2020. As of today, we believe that the shares are still not trading at a very high valuation. We have started to reduce our position, mainly to allocate the funds into more favourable set-ups (some of which remind us of SAF four years ago).

**KSB** has delivered results within expectations for FY2023 and managed to increase its market capitalization above the EUR 1bn mark over the course of the year. For 2023, the dividend proposal is EUR 26.26 per preference share, which translates into a roughly 7% dividend yield on our average entry price. Late in 2023, the preference shares got included into the German SDAX index and management decided to uplist the company

to the highest listing standard of the Frankfurt stock exchange, the Prime Standard. For us, this underlines the ongoing operational and governance improvements that management keeps delivering.

In our view, the shares are still significantly undervalued and trade with a heavy discount to peers. We believe the main reason is the still relatively low liquidity of the shares compared to peers. To solve this issue, we are convinced that the two share classes need to be merged into one. This would not only improve the liquidity but also reflect positively on the corporate governance and give the ability to raise additional funds at valuations that are more in-line with the underlying value, when required. Finally, it would increase the stock's weighting in the indices.

As of today, we understand that the corporate governance is trending in the right direction, but there is still a way to go. We will certainly do our best to keep in close touch with the relevant people at the company and have prepared some tangible discussion materials (German only – we recommend Google translate for documents) in preparation of our latest meeting with the company in that regard. While we do not expect a merger of the share classes in 2024, we believe it could be more realistic for 2025. If this were to happen and management would keep delivering towards their ambitions, we think the share price still has a lot of room to run.

On the other hand, we think that most of the low hanging fruits have been picked up and additional operational improvements will not be as easily predictable as before. In addition, management aims for a sizable acquisition in the US, which makes strategic sense, but bears execution and valuation as well as dilution risks for minority shareholders like us. Besides that, the fund must respect certain rules with regards to the weighting of positions. Finally, having compared the top positions against each other by taking into account our internal weighting criteria, we currently see other top positions offering slightly superior profiles. Therefore, after careful consideration, we have decided to trim our position from around 9.5% to slightly below 5%.

**Origin Enterprises'** H1 results (not very meaningful as the company generates nearly all its profits in H2) came in slightly weaker than expected but the company has also given an outlook for the full-year which was slightly below (sell-side) consensus expectations. Yearly results are affected by weather conditions (which weren't particularly favourable this year) as well as by the currently very strongly downward-moving price environment (e.g. for fertilizers). Both are fair reasons in our view, and we therefore are not too worried about the slightly lower outlook for the current year.

In fact, the current share price puts the shares on a P/E FY2024e of 6.5-7x (based on the guided earnings per share of 44c to 49c). The company has net debt, but this is a highly attractive valuation for a very stable business which is undergoing some very interesting developments and is led by very capable and disciplined capital allocators. We have described them in more detail in the write-up in our LtP #18. We find the valuation especially attractive as this result would be achieved in a weak year (i.e. the shares would trade even lower based on a normalized year).

The management sees it the same way and is using a significant amount of the cash flows for dividends and buybacks. In addition to paying out significant dividends (close to 14% of the current market cap in the last three years) and engaging in meaningful M&A activities, the company has bought back nearly 20% of its shares over the past three years. The management has also put their own money where their mouth and bought shares after the recent results were released.

**Italian Wine Brands**, the by now largest private Italian wine producer, has delivered strong cash generation and fought back against inflation successfully, by delivering a meaningful margin recovery back to a double-digit EBITDA margin. The company was able to continue its deleveraging after its latest acquisitions and to surprise investors to the upside. We are pleased with the strong delivery after the company had suffered from multiple inflationary headwinds and shortages (labour price increases, availability of materials and material price increases such as for glass bottles as well as logistics costs) while wine has at the same time been a category which hasn't seen large price increases. In our view, the shares are trading at a very significant discount to fair value. We therefore added to the position.

We have financed the new investments and outflows from the fund by exiting Akwel, Koenig & Bauer, Guillemot and HelloFresh. Due to the ongoing consolidation in the OEM space, Akwel has experienced increased levels of customer concentration. We understand that this is one of the main reasons why the company is struggling to restore its margin and therefore longer-term profitability. Besides that, we have experienced a deterioration in the corporate governance as management has become even more reluctant to speak to outside investors. While we were initially hopeful that Koenig & Bauer could turn around its operations quicker, we were

disappointed by the recent results. We have therefore moved on and allocated funds to more promising opportunities. In contrast to our initial thesis, Guillemot is facing competition from several new entrants. As a mid-market player, we are not sure how this is going to play out for them in the longer-term. Lastly, we exited our remaining position in HelloFresh before the recent results were announced, due to continuously deteriorating operating performance, which means we have increasingly less conviction in its ability to generate material future profits. As stated previously, we would expect this unusually high turnover of portfolio companies to decrease again once there are fewer distortions in our core universe.

Following on from the beginning of this Letter, our overall opinion has not changed. We remain confident that this is a great time to hold and/or buy shares in our fund despite the current time of underperformance. From our perspective, small and micro caps have the opportunity for a strong catch-up in the current market environment. There are very good reasons for why the segment performs better in recovery phases: 1. higher growth potential; 2. stronger margin recovery opportunity; and 3. significant multiple expansion potential. Although, we agree that the timing remains challenging and are happy to discuss this relevant aspect with you.

With a long-term perspective, we remain convinced of our differentiated approach, reinforced by our continuous learning process, recent process improvements and our pursuit of keeping an open mind. As John Elkann recently stated:

*"We are committed to delivering attractive long-term returns to our [ ] partners, protecting their capital from permanent losses while accepting concentration, illiquidity and volatility."*[1]

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*

[1] Who We Are - Lingotto

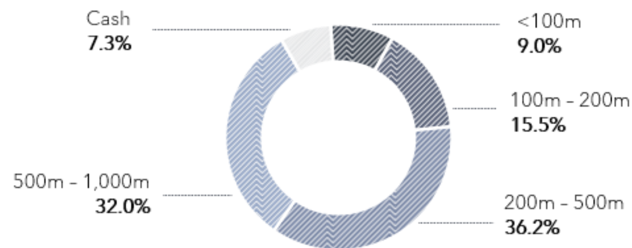
## Portfolio overview – as of March 31st, 2024

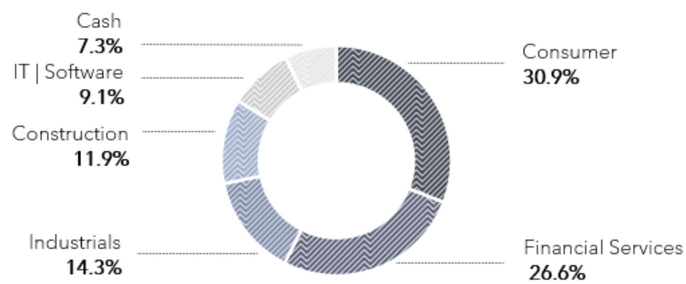
**Top 10 positions with respective weightings:**

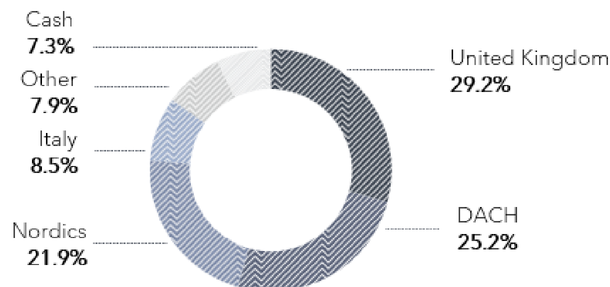
| | | | | | |
|---|---|---|---|---|---|
| 1 | Sto | 7.8% | 6 | SAF-Holland | 4.9% |
| 2 | Kamux | 7.5% | 7 | KSB | 4.8% |
| 3 | The Gym Group | 7.5% | 8 | Anima | 4.8% |
| 4 | Mortgage Advice Bureau | 7.2% | 9 | Petershill Partners | 4.7% |
| 5 | Property Franchise Group | 5.4% | 10 | IWG | 4.5% |

*Source: Gehlen Bräutigam Capital; HANSAINVEST.*

**Allocation:**




*Source: Gehlen Bräutigam Capital; HANSAINVEST.*

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In the event of any legal disputes, you will find an overview of all instruments of collective legal enforcement at national and EU level under the following hyperlink:
https://www.hansainvest.de/unternehmen/compliance/zusammenfassung-der-anlegerrechte.
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