TRIUM BLACKWALL EUROPE L/S FUND

European Long/Short Equity

QTD: -0.55%* YTD: -0.55%*

AUM: EUR 190.5M*

Q1 2017

Dear Investor,

In Q1 2017 the Fund posted a decline of -0.55%, which brings the performance since inception to +9.2%.*

During times of increasing market complacency as outlined below, we believe it is very important to stay disciplined and to continue following a cautious investment approach. In Q1 2017, our average net exposure and our average beta-adjusted net exposure were +4.3% and +0.5%, respectively. This is below the historic average net exposure and average beta-adjusted net exposure from inception up to end of 2016, where we had figures of +15.3% and +3.5%, respectively.*

Assets under management in Q1 increased from EUR 182.9m to EUR 190.5m.

*Source: Trium. The figures refer to the past. Performance is quoted net of fees based on unaudited figures. Performance from launch (19 December 2014) to 31 December 2014 was -0.10%. Inception date: 19 December 2014. All at 31 March 2017. Beta-adjusted net exposure is calculated using the STOXX Europe 600 (Net Return) Index. Exposure figures are calculated using the average of month end data points.

UNCORRELATED, UNLEVERED, UNCROWDED

Equity markets have been rising recently, achieving new all-time-highs in the US and close-to-all-time highs in Europe. However, there is a growing group of discerning investors taking notice of elevated levels of optimism.

In the US;

- the cyclically adjusted Shiller PE stands at 30x – only exceeded in 1929 (32x) and 2000 (44x)
- the institutional bull-bear survey, dating back to 1988, is at a record level of optimism
- in December, stocks showed the 3rd highest momentum in over 100 years of data
- in February, the winning streak of markets rising hit 12 consecutive days, a record high over 30 years; only beaten once in 1987
- and while investors are buying, director dealings show the other extreme with corporate managers selling 11:1 (another 30-year-plus record)

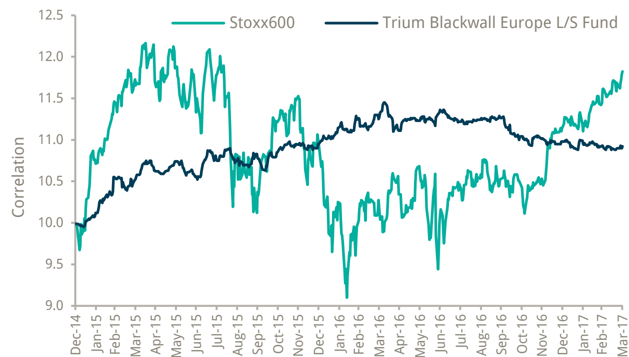
In Europe, the general perception is that valuation levels are much lower than in the US, thus allowing us further upside. However, once we adjust for sectorial biases and compare like-for-like, the “undervaluation” quickly disappears. Moreover, in many ways small discounts for European stocks are justified given the poor economic (though slightly improving recently) and unstable political environment. At the same time complacency in the European markets shows similar patterns to that in the US as represented by the V-DAX (anticipated volatility of the DAX) posting 20-year lows.

In addition, there seems to be a growing list of low-probability-events with a very fat tail risk. For example: 1) economic risks like a US border-adjustment-tax impact on global trade or increased protectionism by altering trade agreements; 2) political risks like another European secessionist party victory in France or Italy or a left swing in Germany; 3) geopolitical conflicts with Turkey or North Korea. In a world of stretched valuations across all major asset classes, record high levels of debt and rising inflation, markets do not have a lot of cushion against bad news or a shock event.

Being uncorrelated, unlevered and avoiding crowded areas of the markets are key elements of our investment philosophy to seek to preserve capital in the months and years ahead.

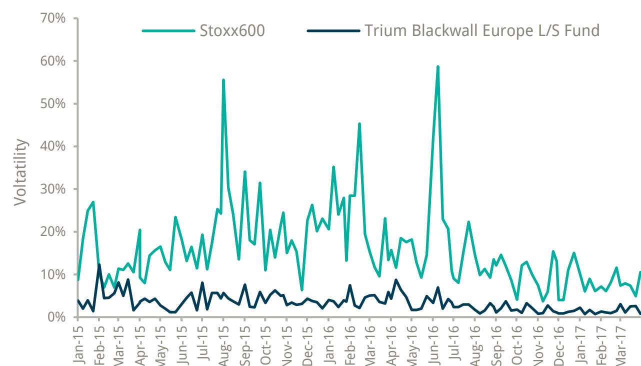
Uncorrelated

Our investment philosophy is strictly bottom-up fundamental research of Western European companies. In general, the rising prices paid for equity reduces the pool of companies at attractive valuations and low risks, while increasing the opportunities on the short side. As a result, the Fund has run a net exposure of between -5% and +20% for about 90% of the time since launch. With a hit ratio of 60% on average (79% longs, 45% shorts) we achieved a performance of +9.2% with an annual volatility of just about 4.2%.*



Source: Bloomberg, Blackwall Capital Investment

Hence, while lagging in recent months, we achieved a similar performance to the Stoxx 600 Index but with a much lower level of volatility.



Source: Bloomberg, Blackwall Capital Investment

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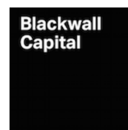


Unlevered

Our gross exposure is capped at 100%, while the net exposure is very flexible. There are several benefits from this approach:

- it allows for allocating capital towards the strongest investment opportunities with the highest reward-to-risk ratios
- it gives the opportunity to preserve capital in significant bear markets and to benefit from the upside that tends to follow a strong market correction

Uncrowded

Before we launched the Fund we spent a considerable amount of time analysing the best set-up of the investment process. One of the key decisions was to locate our office in Switzerland, but more importantly, it was a decision to be outside of London. We strongly believe being distant from the consensus-driven London investment community allows us to avoid crowded trades and makes our portfolio look less similar to market mainstream. In our view, the "herd instinct" was one of the key reasons why long-short equity funds performed poorly in 2008.

As our investors keep telling us, our portfolio looks different – and that is unlikely to change. Aside from the benefits of our location, our investment process was designed to generate ideas independent of others as illustrated by the investment case on RIB Software, an under-researched company in Germany. Bernd Laux and I have combined primary research experience of more than 50 years which allows us confidence and conviction in selecting ideas based on original thought processes. In an environment preparing for MIFID II, this should be a growing competitive advantage allowing us to tap into future under-researched companies by the sell-side.

A brief recap of Software AG

Following up briefly on our investment case highlighted last time, Software AG, we are pleased to see that management announced at its Capital Market Day to pursue higher organic growth as well as a EUR 100m share buy-back – essentially meeting our expectations. Though the stock reacted positively (+ 7.5% YTD) on these announcements, ultimately their delivery on higher growth should lead to a further re-rating closing the valuation gap.

Introducing RIB Software

RIB Software is a high-conviction long investment. It is a building and construction software vendor with a market cap of EUR 580m (EUR 150m net cash), operating in the area of 5D BIM (Building Information Modelling) software. The sector benefits from structural growth due to; 1) the construction industry's "catch up" on IT investments as it historically massively underspent and 2) regulatory changes that require 5D BIM software for public buildings (EU directive as of 2020).

In recent years, the company's share price has been held back by persistent investor concerns regarding management's mixed track record due to several earnings misses, non-conservative accounting practices related to R&D capitalization and mediocre cash flow generation. However, while we believe these investor concerns correctly reflect the past, such a view currently fails to capture the very real opportunities for RIB Software going forward. In fact, from our perspective, none of the upside from recent strategic moves has yet been priced in by the market. Moreover, the company's guidance policy has reversed and can now be characterised as "cautious".

Thanks to three major strategic steps last year, the management team has completely repositioned the company. Investors have not given them any credit for this yet but industry participants have already adjusted their view and consider RIB Software as a pioneer in industrializing modern construction. RIB's products lead the industry in terms of innovation and the company is on the verge of disrupting the chronically low-productivity construction sector (as confirmed by McKinsey Global Research and World Economic Forum).

Having partnered with the leading global CAD software vendor Autodesk, RIB Software's 5D BIM solution integrates Autodesk's CAD Kernel into its software offer (availability from Q3-2017), thereby providing customers with substantial added value at minimal incremental cost. The global distribution alliance with Indian IT service provider Wipro should help RIB Software deal with the significant increase in customer demand, while at the same time boosting its distribution power (from mid-2017).

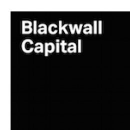
Most importantly, the formation of RIB Software's 50/50 joint venture, YTWO, with US-based manufacturing services giant Flex has the potential to disrupt global residential (and later commercial) construction by way of modularization, standardization, and hence industrialization. The joint venture is Flex's entry into a new vertical, construction, with the target to realize revenues north of USD 1bn within a short-period of time. Note: Flex operates 12 divisions with each division generating more than USD 1bn in sales, typically targeting 5%+ global market share and generating a total of USD 25bn in sales.

We are convinced, driven by Flex's use of RIB Software's best-in-class 5D BIM software, the joint venture is moving fast to create a sustainable competitive edge with no competition on the horizon. Already on March 23, the JV announced its first client in Germany; CG Gruppe AG, a real estate developer in residential construction, targeting EUR 4.7bn of investments within the next 5 years. Within the coming 6 to 9 months, we expect the YTWO-targeted 4 to 6 initial key residential construction customers from China, Germany and the US to be signed up.

The related potential purchasing volume to be executed via YTWO's software platform and Flex's supply chain expertise could well exceed USD1bn within 18 to 24 months and may reach several USD billions by 2020, with the promised cost savings (30+%) for customers poised to create a pull-effect for YTWO throughout the entire residential industry.

Even though the impact on RIB Software earnings may be small in the initial years (and even slightly dilutive for 2017E due to several EUR millions in start-up expenses), the longer-term potential from; 1) equity income from YTWO (50%) and 2) transaction fees for RIB Software in conjunction with the executed YTWO transaction volume should not be underestimated. According to our DCF valuation, the "fair value" of YTWO may well surpass the current EV of total RIB Software within no more than a couple of years and significantly more in the medium/long-term.

At current multiples of 12.5x EV/EBITDA and 3.9x EV/Sales (both for 2017E), we are convinced RIB Software's current valuation is based on past assumptions and perspectives that are no longer valid. Although 2017 represents a year of transition, during which all three strategic moves are about to be finalized, we believe none of the benefits of the Autodesk, Flex and Wipro partnerships have been priced yet. Thus, as soon as new customer contracts confirm RIB Software's forward growth strategy, we expect the shares to start re-rating.



A consolidated portfolio view

For better transparency, we consolidate our portfolio holdings on the long side – as well as on the short side – into a notional combined entity allowing us to better illustrate to investors the economics of an average company in the portfolio. Our 'average company' looks like the following:

Long Investments: Typical Company Economics

Financials* (EUR m)	2015	2016	2017E[1]	2018E[1]
Sales	7361	7427	7603	7810
Gross Profit	1895	1921	1982	1998
EBIT	667	762	831	865
Net Income	465	541	585	610
FCF	335	390	460	538
Net Financial Debt	1011	718	362	-68

Valuation Ratios* (EUR m)	2015	2016	2017E[1]	2018E[1]
P/E	23.1	19.6	16.3	14.5
P/BV	2.6	2.7	2.5	2.3
EV/EBIT	17.5	16.2	13.1	11.4
Net Debt/EBITDA	1.0	0.6	0.3	-0.1
Dividend Yield	2.6%	2.4%	2.6%	3.0%
ROE	14.5%	18.1%	19.2%	20.5%
ROCE	15.0%	16.5%	19.8%	23.6%

Short Investments: Typical Company Economics

Financials* (EUR m)	2015	2016	2017E[1]	2018E[1]
Sales	18290	20258	21111	21893
Gross Profit	10061	11111	11608	12095
EBIT	4293	4893	5117	5478
Net Income	3409	2747	2891	3152
FCF	2957	2507	2586	2497
Net Financial Debt	10725	10258	9353	8598

Valuation Ratios* (EUR m)	2015	2016	2017E[1]	2018E[1]
P/E	22.0	25.7	23.3	22.9
P/BV	5.0	4.6	4.6	4.4
EV/EBIT	16.0	19.3	17.9	18.0
Net Debt/EBITDA	1.7	1.4	1.2	1.0
Dividend Yield	2.5%	2.6%	2.6%	2.8%
ROE	19.5%	18.8%	20.1%	18.9%
ROCE	17.1%	18.4%	20.2%	20.9%

*Source: Bloomberg, Blackwall Capital Investment AG.

[1] Note that there can be no assurance that these estimates will be achieved.

Our investment philosophy is to go long great companies at attractive valuations, with midcaps being our sweet spot, and to short weak and overvalued companies, preferably in the large cap area. The different sizes of companies, on either side, is well underpinned by the average revenues and other fundamental data provided in the tables above. However, there are significant differences when it comes down to FCF growth, leverage and valuation:

FCF growth: We expect the average long company to grow FCF in the magnitude of 15-20% p.a. in 2017E and 2018E. Furthermore, some of our key holdings show profiles of growth accelerating in the years ahead, benefiting from multi-year restructuring programs and/or structural growth drivers. On the other hand, the average short company illustrates on the same metric growth rates of just about 0-5% p.a. in 2017E and 2018E, with a clear deceleration in place.

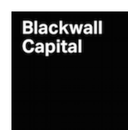
Leverage: The majority of our long companies are operating with a net cash position or close to net cash, thus posting an average net debt/EBITDA of 0.3x. At times of potentially rising interest rates, this might provide strategic optionality while others are constrained. In comparison, the average company on the short side is posting a net debt/EBITDA of 1.2x, although this is still well below the market average of 3.4x.

Valuation: In terms of valuation, we use various metrics, with our preferred ratio being EV/EBIT. On average our long portfolio trades at 13.1x for 2017E, with the short portfolio trading at 17.9x. Given stronger growth expectations going forward, the spread increases further with longs trading at 11.4x for 2018E and shorts at 18.0x for 2018E. This is amongst the highest valuation spread we have observed since launch.

In summary, we argue that the companies invested on the long side are substantially more attractively valued with a much higher growth profile and lower leverage than the ones on the short side.

Best regards,

Thomas Karlovits



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