Blackwall Capital

European Equity Long-Only

Quarterly Newsletter
Q2 2019

Blackwall Europe Equity Fund

Quarter to Date Return: 1.08%*
Year to Date Return: 3.31%*
Assets Under Management: EUR 16.7m*

Dear Investor,

The Blackwall Europe Equity Fund ended in June +0.19% to finish Q2 at +1.08%. After launching in December last year we are now well advanced in the ramp-up period of our portfolio. Currently we are +71.62% invested and continue to prudently increase our exposure further over the upcoming weeks.

The market development throughout Q2-2019 can be split in three tiers. April and early May were driven by the release of corporate results for Q1-2019, which came in better than expected, but only after expectations had been slashed shortly before the release of the earnings results. In aggregate, earnings growth was negative YOY at a rate of -5% which is the first quarter of negative earnings growth since Q4-2016. With the hope of sequential improvement going forward, the market showed strong resilience.

The second development was the reinforced US-China tensions (additional tariffs on both sides) and the termination of critical US technology supply to Chinese companies listed on the US National Security Entities List) - in combination with further deteriorating fundamentals (both, leading indicators as well as actual economic data) that led to increasing concern about the rate of global economic growth.

The third driver of Q2-2019 performance has been re-igniting of hope that a more dovish central bank policy, resulting in rate cuts soon to come, together with the resumption of US-China trade talks which would reverse the economic slowdown. That hope was reflected in market recovery, with indexes finishing the quarter at the high point. However, forward earnings estimates keep on being cut, with the originally anticipated H2-2019 recovery increasingly seen as a failed hope.

Voltabox

This quarter, we wish to present one of our conviction small-cap growth investments: German rechargeable Li-Ion battery systems supplier Voltabox. The company develops, manufactures and distributes customized high-performance battery systems with integrated proprietary battery management for a wide range of industrial applications, in particular intralogistics, mining, trolley buses, agricultural/commercial vehicles, motorbikes, and going forward some selected automotive applications. The company is about to expand its portfolio to supply its customers not only battery systems but complete electrical drivetrain solutions including chargers, etc.

Our investment thesis for Voltabox is: due to investor misperception and one-time issues Voltabox shares are very underpriced, neither reflecting the company's mid- to long-term growth nor its return potential. In light of Voltabox's EUR 1.1bn 5-year order backlog (equaling 9x 2019 revenues), a continuous flow of incremental new customer acquisitions, the steadily rising number of applications for Li-Ion battery systems, and Voltabox being a pioneer in its field, we are convinced that

*Source: Northern Trust as per latest month end. The figures refer to the past. Past performance is not a guide to future performance. Performance is quoted net of fees based on unaudited figures for the current year. Performance is calculated using NAV figures (Class I EUR) rounded to two decimal places. Launch date: 13 December 2018.

the company will be able to sustain its high double digit % YOY growth rate for much longer than it is being credited for. Given very stable pricing, due to mostly multi-year sole supplier contracts and the supply of non-commoditised high-performance battery systems, we are convinced Voltabox will be able to further expand profitability over the coming years, with operating returns getting a boost from economies-of-scale and hence moving up from the high single digits well into the teens.

The company's massive 2018 cash burn, which scared investors, has been a one-off, related to a temporary contractual change with its formerly dominant customer Triathlon whom Voltabox provided with some cash support. After the terms of trading with Triathlon have been reversed to "normal" as of 2019, the cash burn of the previous year should be widely reversed over 2019-20. Hence, Voltabox has forecasted a zero-to-slightly positive free cash flow for this year, in spite of 70+% YOY revenue growth. With management's strong focus on cash preservation/generation, market concerns about tight liquidity appear misplaced, not least in light of EUR15.6m in net cash at end-Q1-19.

Finally, worries related to Voltabox's accounting, reflected in an objection of the German Accounting Standards Board released last April, had been justified. However, the accounting errors were exclusively related to the 2017 accounts and had already been corrected and communicated by Voltabox with the 2018 Annual Report. Furthermore, they were fully non-cash effective. Consequently, we even took advantage of the related short-term market uncertainty and added to our position at depressed prices.

Trading currently at EV/EBITDA multiples of 9x and 6x as well as EV/EBIT multiples of 12x and 8x for 2020 and 2021, respectively, does not adequately reflect Voltabox's prospects for generating earnings growth well in the mid double digits for years to come. We regard Voltabox as an underestimated pioneer in the rapidly rising battery sector that is set to capitalize on the electrification wave in industrial applications thanks to its differentiated skills and first mover advantage.

A consolidated portfolio view

For better transparency, we consolidate our portfolio holdings 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:

Table 1: Blackwall 'average company' portfolio example

Long Investments:
Typical Company Economics

Financials* (EUR m)	2017	2018	2019E[1]	2020E[1]
Sales	3,162	3,281	3,386	3,520
Gross Profit	1,025	1,165	1,229	1,284
EBIT	375	422	466	498
Net Income	259	273	308	343
FCF	217	205	242	283
Net Financial Debt	255	278	122	174

Valuation Ratios*	2017	2018	2019E[1]	2020E[1]
P/E	16.4	18.9	16.0	15.0
P/BV	2.4	2.8	2.5	2.2
EV/EBIT	12.0	15.5	13.0	12.1
Net Debt/EBITDA	0.4	0.3	0.2	0.2
Dividend Yield	1.9%	2.0%	2.2%	2.4%
ROE	16.8%	19.4%	20.3%	21.4%
ROCE	11.7%	12.2%	13.2%	14.4%

* Source: Bloomberg, Blackwall Capital Investment AG
[1] Note there can be no assurance that these estimates will be achieved

Our investment philosophy is to invest in great companies with a sustainable and superior economic return at attractive valuations, with midcaps being our sweet spot.

Margins: The average company is showing a gross margin of 36.3%, an EBIT margin of 13.8% and an FCF margin of 7.2% (all 2019E), demonstrating strong business models.

EBIT growth: We expect the average company to grow EBIT in the magnitude of around 7-10% p.a. in 2019E and 2020E based on conservative estimates. 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. This allows for additional resilience against any economic downturn.

Leverage: Most of our companies are operating with low net debt positions (some are net cash), thus posting an average net debt/EBITDA of just 0.2x. At times of rising corporate interest rates, this might provide strategic optionality while others are constraint.

Valuation: In terms of valuation, we use various metrics, with our preferred ratio being EV/EBIT. Our average portfolio trades at 13.0x for 2019E and 12.1x for 2020E.

In summary, we argue that the companies invested are attractively valued with a solid growth profile and low leverage.

Best regards,

Thomas Karlovits

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