BANOR
SICAV

MISTRAL L/S EQUITY

INVESTOR LETTER – Q3 2022

Value Long Short Equities – Europe. A fund managed "bottom-up" with focus on fundamentals, a long-term view and a relatively diversified portfolio to grasp the best opportunities and generate alpha.

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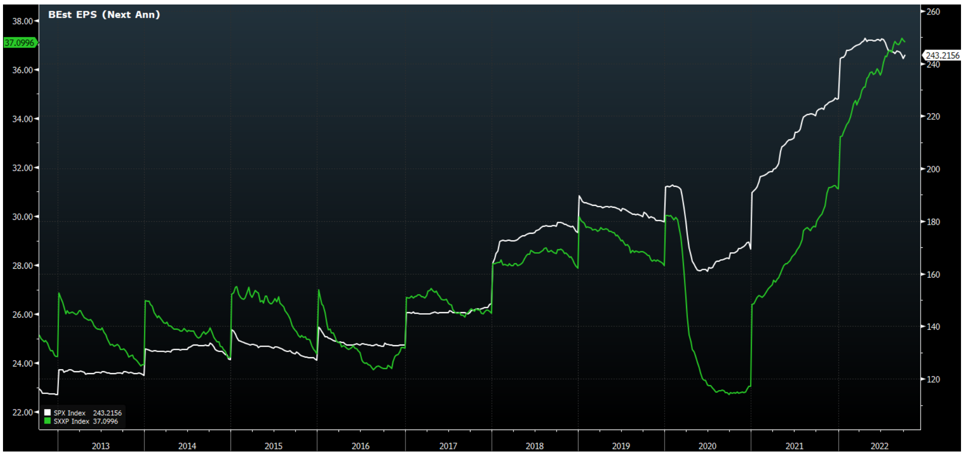
Banor SICAV Mistral L/S closed the month of September 2022 with a **+7.76%** YTD performance, with a negative third quarter loss of **-4.01%**; Eurostoxx50 lost in the same period **-22.8%** (**-3.96%** in the quarter) with cash returning basically zero. The narrative in the market did not change: economies are still growing above trend, causing a steep increase in inflation rates across the globe which triggered hawkish messages from Central Banks, with the addition of the spike in energy prices due to the war between Russia and Ukraine. A mild recession and the return to a moderate inflation in 2023 are now the base case discounted by the more liquid bond markets, while looking at stocks there is still a significant lag in 2023 EPS estimates, expected by consensus still to grow between 4% and 8% year on year reaching all-time highs, something not consistent with a recession.



Source: Bloomberg

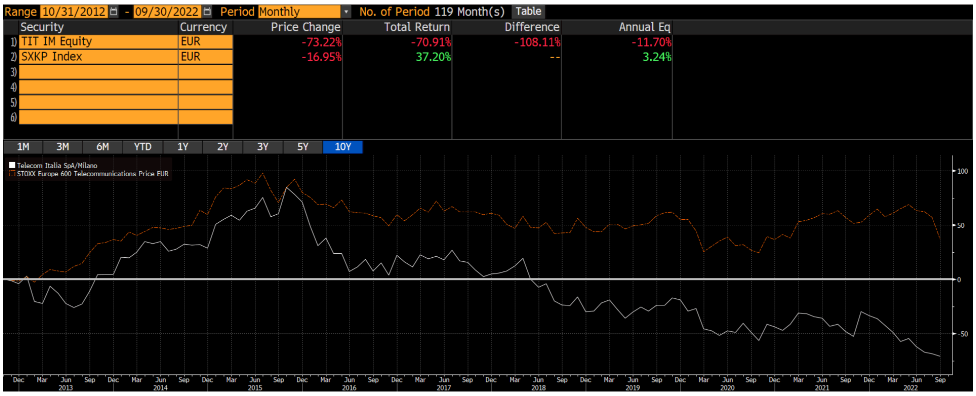
These unreliable expectations make us cautious in any analysis based on multiples: we are likely to enter a period of negative earnings revisions with volatility and dispersion in stock movements, creating chances for alpha generation. For these reasons, we are sticking to our framework in selecting stocks: avoiding over-leveraged companies, focusing on cash generation, competitive positioning, management and ability to weather the storm.

Our portfolio has been continuously changing shape during the last months due to several market dislocations: in late 2021/early 2022 it was clear to us that being long on Reopening players and Energy was the right move, while inflation and interest rates increase would have weighted to Non-Profitable Tech and Secure Growth stocks for a reset in valuation. Now the strategy on the equity side is focused on three pillars: finding companies the least dependent on macro situation given uncertainties (i.e.: special situations); investing in great companies with a good margin of safety (i.e.: GARP stocks); buying stocks with a sustainable cash flow/dividend yield much higher than bond yields (i.e.: dividend stocks). On the short side, we are able to hedge several positions with companies belonging to the same sectors trading at much higher valuation or with a less clear competitive edge versus our longs.

In accordance with article 8 of EU regulation 2019/2088, the fund promotes environmental, social and governance characteristics in accordance with European regulation. Notably, the fund's investment process excludes companies having low practice or standards in these sectors, or those with a high long term sustainability risk.

1. Special Situations (12% of the portfolio)

We define Special Situations as investments where the outcome is not depending (if not marginally) by macro conditions. Some of them are stocks under tender offer where we believe that there could be a bump in price or where the market is afraid of some regulatory hurdle to pass. Others are holding companies, where we expect a catalyst to reduce holding discounts like spinoffs, buybacks, etc. Finally, there are companies where some corporate actions can unlock value, i.e. one of our main positions is Telecom Italia Savings (TI). Since the inception of the Fund we never invested in TI, believing that issues like debt, governance and lack of a clear strategy would have destroyed value over time. This actually happened: in a sector which in the last 10 years returned +37% (mainly the dividend), TI lost 71% bringing its market cap to only 4 billion Euros versus 21 billion debt. While the debt pile is huge and should leave us far from the stock, there are plans for spinoff, minority sale or full sale in the four divisions (grid, Brazil, Enterprise solutions, Consumer) which under the tenure of the new CEO are likely to happen, triggering dividend payment (minimum 25% of current saving price) and solving the issue of debt. The market is sceptical given the numerous parties involved (Italian government, KKR, Maquarie, CDP, Vivendi, trade unions…), but after the Italian elections of September 25th the pieces of the puzzle are starting to fall into the right places making us confident on a positive outcome which is only marginally dependent on the macro situation.



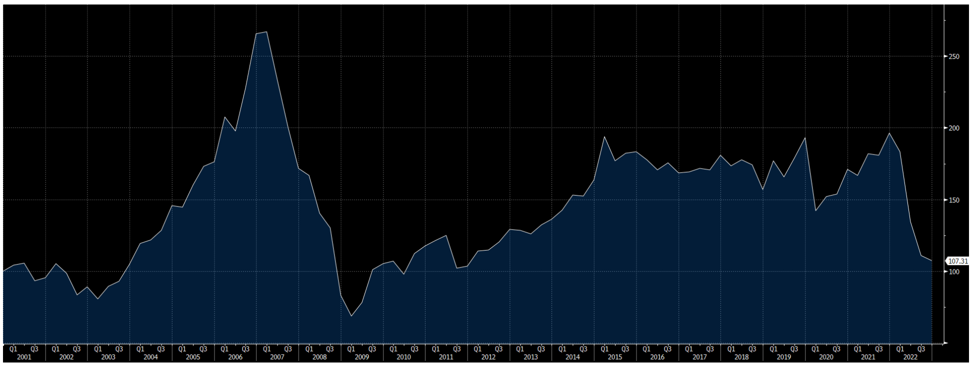
Source: Bloomberg

2. GARP stocks (16% of the portfolio)

As we anticipated in the past letter, even if they are not anymore a bargain as they were in 2008 or 2011, we started to add 5 percentage points of NAV in companies which we believe will be good long term investments at current prices, ready to increase significantly these positions in case of another correction. The correction came and we increased significantly these positions, both in terms of total weight and number. They belong to sectors which have been penalized by the uncertain outlook on 2023: in particular consumer discretionary due to the consumer spending outlook (Inditex, Zalando, Adidas, Amplifon, Fielmann…) and industrials given energy price increase and global PMI deceleration (Interpump, De Longhi, Racing Force, Zignago Vetro…). What these companies have in common is a very strong competitive positioning (number one or two in their reference markets), the ability to weather the storm (no significant debt) and a valuation which is appealing. On this topic, we recognize that 2023 numbers will be cut, but even applying a 10-20% haircut on EPS, depending on cyclicality and operating leverage, the average P/E ratio of this part of the portfolio is 18x, while just one year ago it was 33x, with an expected long term EPS growth higher than 15%.

3. Dividend stocks (15% of the portfolio)

The steep increase in interest rates caused also a repricing of high cash flow/low growth stocks: companies like ENEL or Poste Italiane, despite their theoretical defensiveness, lost more than 20%. On average, this part of the portfolio has a weighted dividend yield of 6.15%, with low risks of dividend cut and in some cases an upside on total distribution yield given by buybacks. We would like to underline the negative performance of the Real Estate sector, one of the worst in the Eurozone: in this case companies with a defensive profile stand out as potential great investments for the future. In particular, Vonovia given their residential exposure, the German regulatory system (which at the end creates an almost zero vacancy rate and missed payments), the limited leverage and the long duration of the debt became an interesting dividend play, with an 8.5% sustainable dividend yield; considering that rents are in part indexed to inflation it can also be seen as an inflation hedge. The drop in Stoxx600 Real Estate Index has been massive, but after this steep decline, we have usually a quite long period of recovery for companies which are able to survive, with a double digit annual total return.



Source: Bloomberg

4. Corporate Bonds

On top of those equity positions, we increased the high yield corporate bonds exposure to 21% of NAV; the Yield to Maturity/Call stands between 7 and 12% for companies which we know very well. We believe that this was due to a general sell off in the High Yield space driven by lack of liquidity and fear of recession, but our deep knowledge of the companies we invest in let us confident in their solvency. For example, IMA which was delisted in 2021 and re-levered at around 3x Debt/Ebitda works in a defensive segment (machines for food, diaries, pharma, tobacco), has a low energy intensity (energy weights 3% of sales) and has a very solid debt structure (the only debt are 2028 bonds). We believe that a yield of 8% and a spread versus government bond at 500 bps are a great reward for a company with a limited solvency risk.

We continue to believe that there are dislocations in valuations inside the stock market: some companies are discounting a deep recession (Auto, Retail) while others are not even discounting a slowdown (Luxury…); also geographically we see huge divergence in valuations (in some cases US companies trading at premiums above 100%). Given uncertainties on the macro situation and the risk of an energy shortage, during the next quarters we want to maintain a net long under control (30%): we entered the third quarter with a net long in the 20% area but being very quick and flexible to adapt to the various possible macro outcomes.

LUCA RIBOLDI

Advisor Banor SICAV Mistral Long Short Equity