Made in Italy Fund

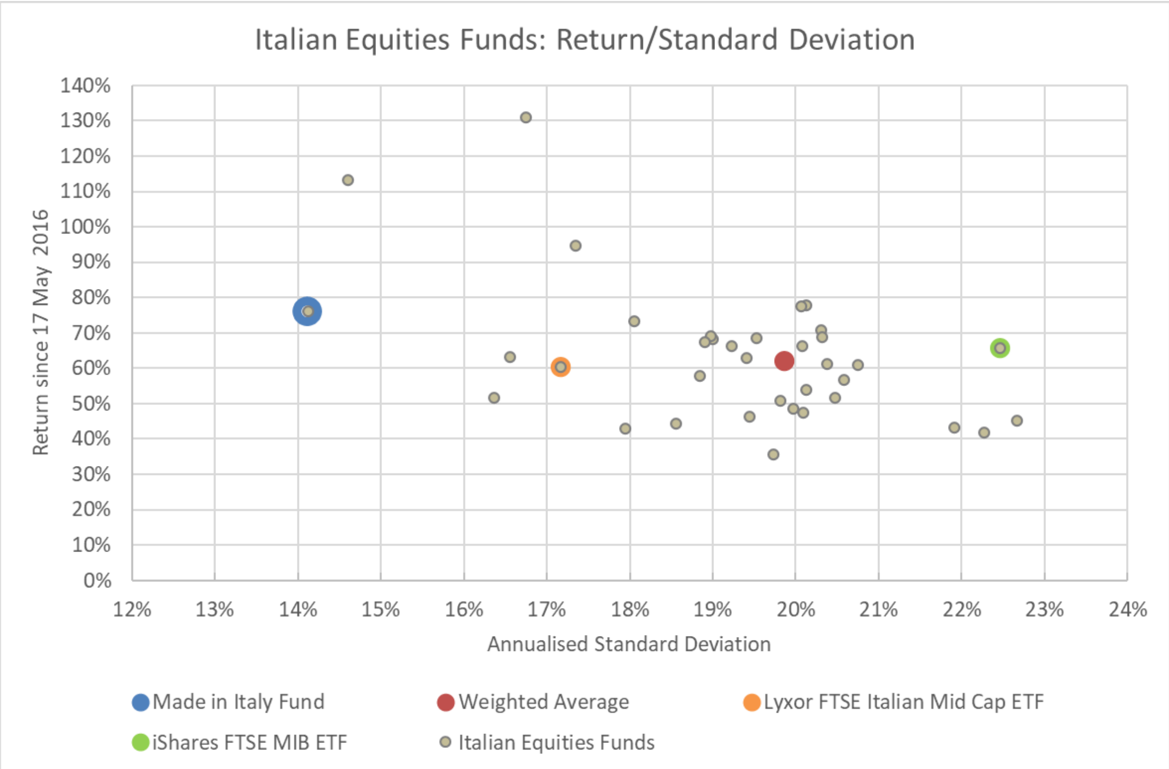
Bayes Investments

# Investor letter – Second Quarter 2021

Dear Fellow Investors,

The Made in Italy Fund (MIF) had a return of 16.5% in the second quarter of 2021. The return since inception (17 May 2016) is 76.1%. Returns are net of fees and all administration costs.

In the quarter the MIF was again ahead of the Italian Equities fund universe, whose weighted average return since MIF's inception is 62.1%:




Source: Factset

The MIF return is higher than the 60.4% return of the most comparable ETF – the Lyxor Mid Cap Fund – as well as the 65.6% return of the main Italian Equities ETF – the iShares FTSE MIB.

The MIF return continues to be accompanied by lower volatility. The annualised standard deviation of its daily returns is 14.1%, compared to 19.9% for the weighted average fund, 17.2% for the Lyxor ETF and 22.5% for the iShares ETF.

**Second Quarter 2021**

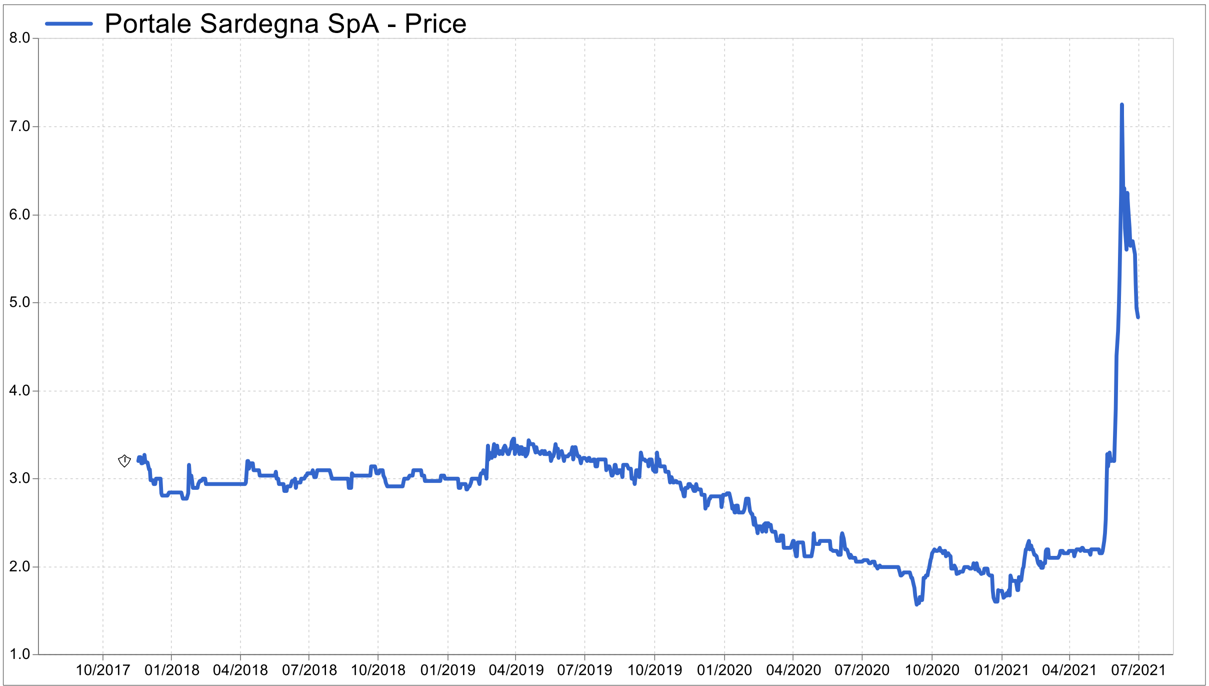
Our 16.5% return for the quarter compares with a weighted average return of 6.6% for the Italian Equities universe, 12.0% for the Lyxor ETF and 3.1% for the iShares ETF.

In the first half of the year the MIF is up 36.1%, versus 18.6% for the weighted average fund, 26.0% for the Lyxor ETF and 14.6% for the iShares ETF.

Our upward move continued in the second quarter at the same pace of the first, but more decidedly ahead of the Italian Funds average and the main market index in each of the three months. Our NAV is now firmly ahead of its High Watermark in all four Fund classes.

Again, most of our stocks had strong advances in the quarter. And again, we highlight the first three.

The top performer was **Portale Sardegna**, up 122%.




We bought the stock in Q3 2020 at less than 2 euro per share and accumulated the position in the fourth quarter at around the same price. We said at the time the company was the smallest in our portfolio – just a 4 million market cap – but we thought it was on the way to a great future. Nine months later, it is still the smallest, but its market cap has doubled to 8 million and we believe its future is ever brighter.

The second top performer was **EdiliziAcrobatica**, up 120%.

We introduced the company in our Q1 2019 letter, shortly after buying it at its IPO in November 2018 at 3.33 euro per share (plus free warrants). The stock started its climb immediately – in stark defiance of the prevailing bearishness in Q4 2018 – and by the third quarter of 2019 rose above 8 euro. It then inverted its course, ultimately precipitating to below 3 euro in the throes of the Q1 2020 Covid panic. We took this opportunity to accumulate our position over time, at an average purchase price which currently stands at 5.5 euro, 58% below the 13 euro price level reached at the end of the quarter. Thanks to our steady buying and the strong appreciation since the beginning of the year, the stock is now our largest position, which we recently had to trim in order to stay within the mandated UCITS constraint limiting each position to be below 10% of NAV.


The third top performer was **Labomar**, up 61%.

We also bought the stock in Q3 2020, along with Portale Sardegna, at an IPO price of 6 euro, and likewise proceeded to accumulate the position at a current average price of 7.3 euro – half of the level reached at the end of the quarter.

Last quarter's top performer **Doxee** continued its rise, up a further 54% in the quarter and 164% since the beginning of the year. The other top performer **Sebino** was also strong, up 38% in the quarter and 116% year-to-date, while **Intred** had a pause, up only 5% in the quarter but 61% in the first half of the year. Last quarter's IPO **Vantea Smart** surged 49% in the second quarter, and so did the other Q3 2020 IPO **Reti**, up 46%. **Longino & Cardenal** was also strong, up 42%.

During the quarter we exited two positions, bought a new position and participated in a new IPO.

The new company in the portfolio is **Eurotech**. It is a producer of 1) Computer boards and modules for embedded applications 2) Rugged hardware platforms for edge infrastructures 3) Intelligent applications for data storage and communication 4) High Performance Embedded Computing 5) Hardware and software IoT solutions. The company serves a variety of industries and sectors, including transportation, energy, healthcare, defence and aerospace.

We had been following this interesting company since Fund inception but stayed away from it – despite watching its price shoot up from 1.3 euro in early 2018 to 9.7 in late 2019 – as we thought its management lacked clarity and purpose. The price subsequently reverted, touching a low of 3.3 euro in late 2020, shortly before Antongiulio Marti – who has been a Eurotech investor since early 2019 and subsequently became a Board member – joined Bayes Investments as co-manager of the Made in Italy Fund. Antongiulio has been at the forefront of a strategic refocus at Eurotech, which culminated with the appointment of a new CEO in April this year. The company has a market value of 160 million euro and closed 2020 with revenues of 69 million, down from 110 million a year earlier. But 2019 had been an exceptional year for Eurotech, which had been showing a flat to declining top line since coming to the market in late 2005, with poor or negative profitability in most years. We now believe the stage is set for the company to fulfil its great potential, focusing of the sustainability of the revenue mix and a remodelled marketing strategy.

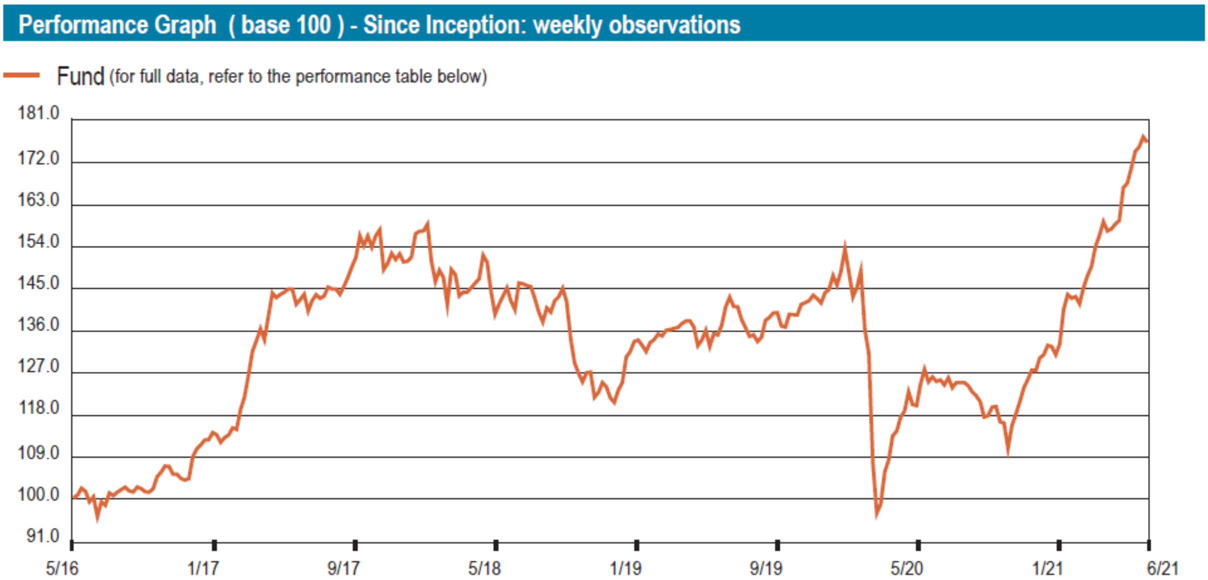
The new IPO is **The Italian Sea Group**. The company designs, builds and services yachts and large ships. Its Shipbuilding division builds and sells made to measure 20- to 100-metre-long luxury superyachts and ships with the Admiral and Tecnomar brands. The NCA Refit division provides refitting services for its own yachts as well as motor and sailing boats built by third parties. The company has a market value of 280 million euro and has been growing rapidly in the last several years, reaching revenues of 116 million euro in 2020 with a 13% EBITDA margin, expected to increase to 160 million in 2021 with a 16% margin and to 250 million by 2024 with a 17% margin. The company runs efficient production lines, based on order intakes rather than inventory, with clients paying upfront instalments along a sequential production cycle, thus guaranteeing revenue visibility and minimising risk. We paid an IPO price of 4.9 euro per share at the beginning of June, which rose to 5.7 by the end of the month.

The current sector composition of the Fund is the following:

| | Number of companies | % Weight |
|---|---|---|
| Producer Manufacturing | 5 | 14.1% |
| Electronic Technology | 2 | 4.6% |
| Process Industries | 3 | 8.5% |
| Consumer Non-Durables | 1 | 1.9% |
| Consumer Durables | 1 | 2.5% |
| Industrial Services | 2 | 9.3% |
| Commercial Services | 4 | 10.4% |
| Consumer Services | 2 | 7.5% |
| Technology Services | 9 | 26.8% |
| Health Technology | 1 | 2.9% |
| Communications | 1 | 3.4% |
| Utilities | 2 | 3.8% |
| | | |
| Total | 33 | 95.6% |
| | | |
| Cash | | 4.4% |

**Five troublesome years**

Our 76.1% return over a bit more than five years corresponds to an annualised return of 11.7% per year. It is a pleasing result, especially when we look back at the assorted troubles we went through over the period (the graph below is from our Factsheet, which is updated monthly here):

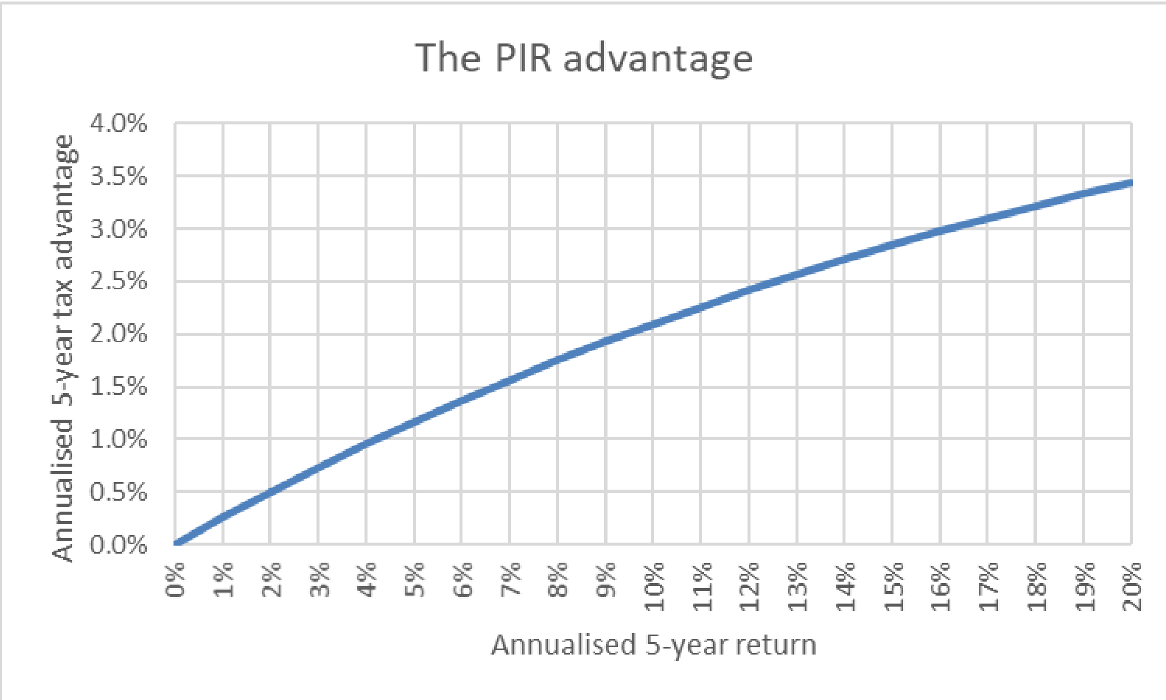



The Fund was launched in May 2016 and made steady progress until January 2018. Then a negative phase started, aggravated for us by large redemptions at the beginning of 2018, Italian political turmoil in the middle of the year and collapsing global stock markets in the final quarter. We made a good recovery in 2019, until Covid panic struck and – for a mercifully brief but extremely uncomfortable time – brought us back to square one. There followed a sharp rebound in the second quarter of 2020, then a retracement until the beginning of November, which turned out to be the premise – *reculer pour mieux sauter*, as the French say – for the steep climb we have been experiencing in the last eight months.

A Rip Van Winkle sleeping throughout the period would have woken up 76% richer. But for us, the awaken, it has been an adventurous ride, duly journaled in our Quarterly investor letters. We are grateful to those investors who have been with us for all or most of the period, through good times and bad times, always interested in our perspective and ready to increase their investment at opportune turns. Investing for the long term is a principle that most investors nod at approvingly in theory, but fewer have the determination to adhere to in practice.

How will the next five years look like? We don't know. But we find it reasonable to expect that they will not be as tough as the last five. Hence our returns may well exceed what we have achieved so far. As we keep saying, the Italian equity market is replete with good investment opportunities, and many more interesting companies will join the stage in the coming years. Even the Italian macro picture, which has hardly ever been a positive factor in the past, seems poised to add to the attractiveness of our market. Of course, we will see more ups and downs, and we will continue to guide our investors through the maze as well as we can, knowing that our best investors are those who understand what we do and stick with us through volatile times.

Also, as we have been hammering on recently, Italian resident investors will enjoy a huge tax advantage in the next five years if they invest in our fund through a PIR account. An untaxed 12% annualised return corresponds to a 9.4% taxed return at a 26% capital gain tax, equal to a 2.4% advantage per year – or more, if the annualised return turns out to be higher:

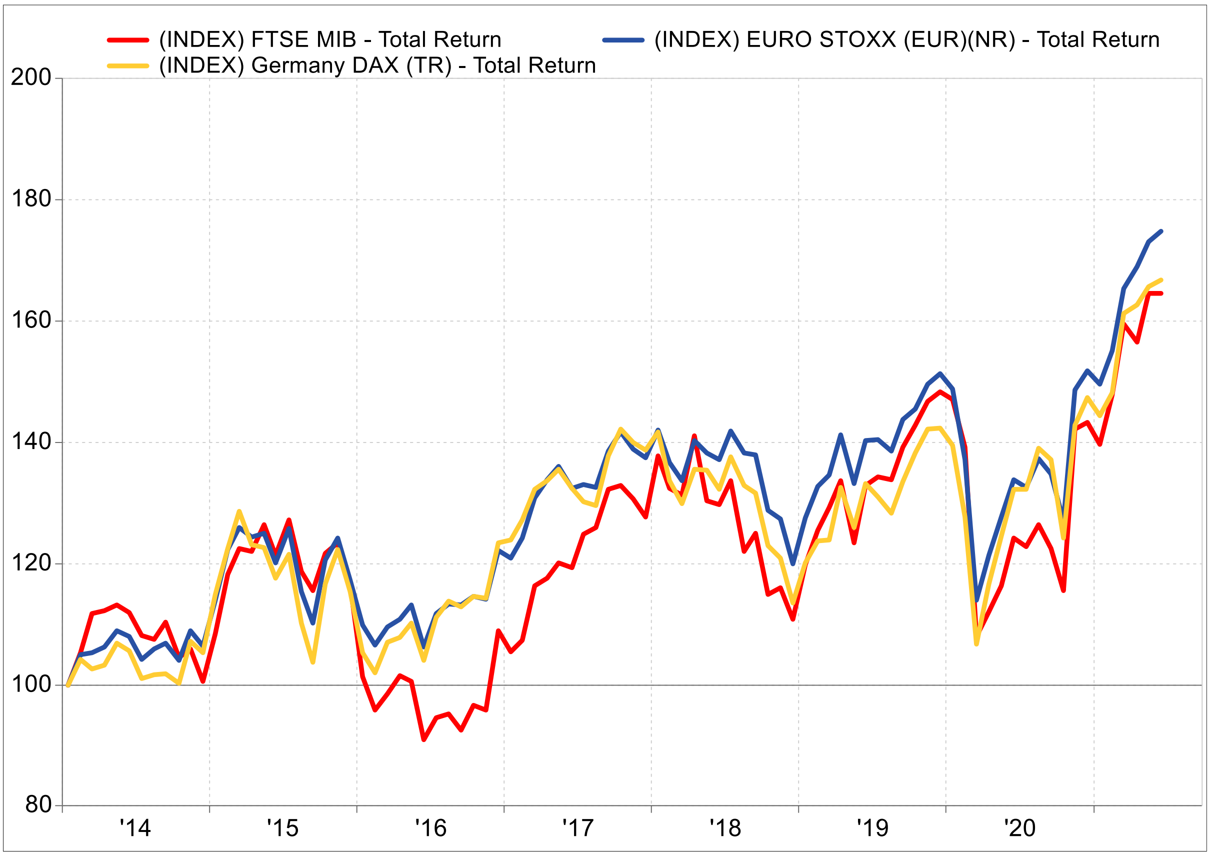



A good expected return, a big tax advantage and the pleasure of contributing to the growth of the best small companies in the country: a great combination of financial gain and wholesome patriotism that our British friends assure us would be extremely attractive if it were available in the United Kingdom.

**The illusion of geographical diversification**

As for non-Italian investors, we reiterate the point made in our [Q2 2020 letter](). There used to be a time, in the '80s and '90s of last century, when it made sense to distinguish among European stock markets and think about country allocation. But as European integration progressed in the new century, national indices became more closely correlated and country allocation was steadily replaced by a pan-European approach.

Here is the graph we showed on page 6 of the letter, updated to the present. We have also added the Euro Stoxx index:




What's the point of distinguishing between Italian and German stocks when their index returns are 90% correlated? The advantage of pan-European investing is not in the ability to allocate among countries but in the breadth of stock picking opportunities. Why limit the choice to a few hundred Italian stocks when one can select among thousands across Europe?

This is a fair question. But we have an answer: intension versus extension. It is obviously true that a larger universe of choice contains a larger number of attractive investments. In fact, most 'value investors' like us favour a global, unconstrained approach, allowing them to pick any great company, wherever it happens to be quoted. This sounds good, and there is nothing wrong with it – as long as one is able to recognise that there is a practical trade-off between width and depth.

It is true that the universe of choice of global and pan-European investors includes Intred. But how many of them know the company, own it, let alone bought it at the 2018 IPO, at one seventh of today's price? How many know Portale Sardegna, EdiliziAcrobatica and Labomar? And if they do, how deep is their knowledge? A few of them may have looked at some numbers, read some report, even sat in a group meeting with the company management at some conference. But is that enough to take a meaningful position in the stock?

That is why, while spoilt for choice in theory, most global value funds only own a few Italian companies in practice – Fiat and Ferrari have been recent favourites – and only a handful have the dedication and the resources to venture a little deeper. One can know a little about a lot of companies, or a lot about fewer companies. We have chosen the latter path, focusing on a place – the Italian stock market – which is and will continue to be full on interesting investment opportunities.

Our international investors who understood this point – they buy companies, not countries – have reaped the benefit of their foresight in the last five years. We hope more will follow in the next five.

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