AVI Global

AGT trades on an attractively wide discount, despite its long-term outperformance and potential capacity to rebound...

Update
07 April 2022

Overview

AVI Global (AGT) takes a clearly differentiated approach to investing in global equities. Joe Bauernfreund leads the management team, and he is supported by Tom Treanor as Head of Research and a team of nine investment analysts. They seek to identify high-quality businesses, but critically, they look to identify those that are trading at intrinsic discounts to their estimated NAVs. AGT's portfolio can be broken down into three distinct categories: closed-ended investment funds, family-backed holding companies and asset-backed Japanese special situations. The team seek to enhance shareholder returns by actively engaging with their investments when possible to address governance issues, which can in turn lead to further discount narrowing. In the **Portfolio section** we discuss some examples of how this approach has borne fruit, including the team's successful engagement activities with their hedge fund holdings and their exposure to the forthcoming IPO of what will be the world's only pure-play hydroelectric company.

The team's idiosyncratic approach to investment has led them to outperform both their peers and benchmark (the MSCI ACWI ex US Index) over the short and longer term. This **Performance** has been achieved despite their strategy, and discounted investment vehicles in general, having historically seen greater underperformance during the more painful market downturns due to discount widening.

AGT's outperformance has not been reflected in its **Discount**, however, as its current 8.2% discount is wider than that of its peers, although in line with its own long-term average. As a result of AGT's process, it also trades on a 'double discount' of c. 36%, reflecting a combination of both the trust and its underlying assets' discounts.

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Analyst's View

AGT offers investors a unique investment approach to global equities, as well as being one of an increasingly small cohort of value-orientated trusts that are available to investors, making it potentially attractive for those looking to diversify away from growth or core equity allocations. In our opinion it is also likely that many investors will have few investments that share the same holdings as AGT given the team's unique approach, which may mean that AGT may also be a strong source of stock-level diversification for investors.

Given the current market dynamics, we think AGT offers a possible 'buy the dip' opportunity. If companies which trade at deep discounts to their NAV do indeed have the propensity to overshoot during sharp market drawdowns (as we are seeing currently), then the current environment may offer an exciting entry point. It could be that a Ukraine peace deal or easing of supply-chain issues becomes the catalyst for a strong rebound. Similarly, AGT's historically wide share price discount may also be attractive, as this could narrow too.

BULL
Combines high-quality business models with deep-discount opportunities
Offers a compelling source of both stylistic and stock-level diversification
Has outperformed its peers and benchmark over the near term, despite market downturn

BEAR
Discounted portfolio can increase exposure to market downturns
Gearing can enhance losses on the downside
High KID RIY

Portfolio

AVI Global (AGT) follows an investment process that is highly differentiated from those of its global equity peers and is run by the team at Asset Value Investors (AVI), led by CEO Joe Bauernfreund, who is supported by Head of Research Tom Treanor and a team of nine investment analysts. The team have created a portfolio of idiosyncratic opportunities, focussing on three categories of investments: family-backed holding companies, closed-ended funds and asset-backed special situations (currently predominantly focused on cash-rich Japanese operating companies). While the nature of their holdings can differ substantially from one other, they all share the characteristic of trading on an intrinsic discount, meaning that their share price is below that of their estimated NAV. Yet each investment the team purchase is an amalgamation of high-quality assets that can all demonstrate strong long-term return potential despite trading at a discount. The team believe that the high-quality business models offer the primary source of returns, with the potential for the discount to narrow being a secondary attraction. As we outline later, this can be the result of the market's increased recognition of the opportunity – as has happened in the European equity market – or through unique events like the IPO of an unlisted holding.

The AGT team also seek to add alpha via actively engaging with management teams when possible, so as to offer an additional avenue for resolving the issues causing these discounts. A recent example of their success was their engagement with Third Point Investors (TPOU), a listed hedge fund. The team proposed that a new independent director be added to TPOU's board to improve its governance, and in February 2021 it was announced that this director had been invited to join. The AGT team have since withdrawn their campaign, with TPOU's discount narrowing from 18% to 11% post-announcement.

Given the team's focus on discount opportunities, at least on the surface AGT has many of the hallmarks of a value strategy, such as much lower valuation ratios than the wider global equity universe. However, one of the key advantages of AGT is its ability to offer investors access to an array of high-quality companies at valuations that cannot be found outside of the trust's preferred structures. Closed-ended funds often trade on discounts to NAV, even when the underlying assets are growth equities. Holding companies do too, due to the perceived complexity or concerns around management teams having to oversee what are at times widely different types of companies, a concept termed 'conglomerate discount'. By exploiting these opportunities, AGT can offer access to quality assets on wide discounts through idiosyncratic opportunities like the European mono holding company Christian Dior, one of AGT's top ten holdings. Christian Dior is the vehicle through which the Arnault family control LVMH, the luxury goods conglomerate. The below table shows AGT's largest underlying exposures alongside the respective companies that are held directly and reported by AGT, allowing us to directly observe some of the unique exposures that the trust's holdings offer. While not an exact representation of AGT's current top ten, it also demonstrates the concentration within AGT's portfolio, given that these ten holdings make up c. 50% of the trust.

Top Ten Underlying Holdings And Related Stock Positions

TOP TEN UNDERLYING HOLDINGS		RESPECTIVE COMPANY HELD BY AGT	
Name	**AGT exposure (%)**	**Name**	**AGT holding (%)**
LVMH	4.4	Christian Dior	4.4
KKR Fund Management Business	4.4	KKR	5.5
Universal Music Group (UMG)	3.5	Pershing Square Holdings and Directly Held	8.5
Hidroelectrica	3.4	Fondul Proprietatea	5.1
Aker BP	3.2	Aker	5.6
Video Games Business	3.0	Nintendo	3.7
Wacom Operating Business	2.9	Wacom	3.5
Apollo Fund Management Business	2.8	Apollo Global Management	3.5
FEMSA Comercio	2.3	FEMSA	3.2
Ferrari	2.0	EXOR	6.6
Total	**31.9**	**Total**	**49.6**

Source: AVI, as of 28/02/2022

When we recently caught up with the AGT team, they highlighted a number of recent changes they had made to the portfolio, as well as explaining how they are adapting their allocation to the evolving nature of their comparatively unique asset classes. One of the unfortunate characteristics of holding companies is that their discounts tend to widen during periods of heightened risk, yet the team also observe that historically market downturns can be great opportunities for them to enter new positions. The team has taken advantage of recent market weakness to cautiously added to their existing high-conviction positions, and are maintaining a watch-list of new and existing positions to add to should they hit their target prices. Recent top-ups include FEMSA, the Mexican family-backed holding company that owns the region's largest convenience store chain, and IAC, a US-based holding company that primarily invests in the internet and media.

Both of these are asset-backed holding companies. There is also Wacom, a Japanese consumer technology company which sits in the asset-backed special situations category. One recent sale of an entire position was that of Associated British Foods (ABF) on concerns of the impact of heightened inflation on its holding in Primark (which constitutes the largest part of ABF's largest NAV and is a low gross margin business) and question marks over whether the enduring nature of the pandemic had fundamentally altered the investment case behind Primark.

There have also been some more subtle changes made to AGT's portfolio. The team remark that European holding companies have seen their discounts progressively narrow over time. As a result the team have begun to concentrate their positions in this sector, focussing on a smaller number of companies with the widest discounts. For example, they have increased their allocation to EXOR up to 6.6% of AGT's portfolio for this reason. The team also note that their Japanese holdings have shown remarkable defensiveness over the last year. While they do aim to invest in Japanese companies which are undergoing corporate governance improvements so as to increase shareholder returns (e.g. via returning cash to shareholders through dividends or buybacks), they highlight that their cash-heavy holdings act as a cushion in times of volatility. Companies with large cash positions are better poised to weather market downturns as they did with COVID-19, so with today's inflationary pressures, their cash effectively acts as a war chest to offset any loss in profitability. Over time, the team have gravitated AGT to the larger end of the Japanese equity market, especially in comparison to AGT's sister trust AVI Japan Opportunity (AJOT). This is a result of AGT's growth, and therefore its need for more liquid companies. It also reflects the broader thematic opportunities the team see, whereby they hold both Nintendo and Sony to capitalise on increasing demand for digital entertainment.

One of the other benefits of AGT's preferred asset classes is their exposure to unique investment opportunities. While AGT has an already high active share of 99% with little exposure to the mega-cap names that dominate global equity indices, the often unlisted nature of the trust's underlying holdings only manages to further increase AGT's diversification potential. For example, there are the aforementioned companies like FEMSA, which owns Mexico's largest convenience store chain and is well positioned to capitalise on the digitisation of Mexico's economy. Or IAC, which owns DotDash, an unlisted online magazine publisher that is primed to benefit from the growing demand for contextual advertising . Yet there is one particular holding that perfectly demonstrates the idiosyncratic return profile that AGT's holdings are capable of, Fondul Proprietatea (FP). FP is a $2.5bn Romanian fund and another top-ten holding of AGT, is described by the team as the "biggest closed-ended fund no one has heard of". Having been established as a vehicle by which Romanian citizens could be compensated for land seizures under the former Communist-led regime, it has realised holdings, returned proceeds to shareholders, and is now down to only a handful of stakes. However, one of these stakes is a 20% holding in Hidroelectrica, a Romanian hydroelectric power producer. Hidroelectrica is now pursuing a public listing in Romania (with FP's manager, Franklin-Templeton, pushing for a dual listing in London), with FP likely to sell a minimum of 75% of its stake. The team highlight that Hidroelectrica will be the world's only pure-play hydroelectric opportunity, which will fill an important niche in a world where sustainability is becoming all the more relevant, meaning the company may thus be able to command a strong premium. However, due to the complex nature of FP, it has long traded at a large discount to its NAV perhaps due to investors not fully understanding the value of its investments. The team therefore believe the discount has the potential to substantially narrow upon the successful IPO of Hidroelectrica.

Gearing

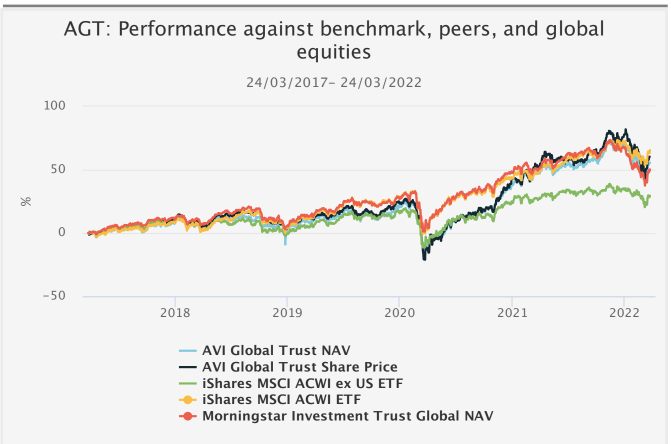
AGT employs net gearing of 0% (as at 28/02/2022), which is lower than both the simple average 5% of its peers and its own five-year average gearing of 7.2%. The team currently have long-term outstanding sterling and euro debt, held through three long-term loan notes with 2036 (£30m at 4.184% p.a. and €30m at 3.249% p.a.) and 2037 (€20m at 2.93% p.a.) maturities. A total of c. £30m and €50m in loan notes has been issued respectively, representing c.7% of NAV based on current exchange rates.

Gearing is primarily used to purchase opportunities that the team could not otherwise buy if the trust were fully invested and ungeared. While the team have reduced their net gearing to 0% in light of perceived increases in recent market risk, they are now open to the prospect of increasing it to capitalise on the currently depressed market valuations.

Performance

Over the last five years AGT has generated an NAV total return of 55.7% and share price return of 60.4%, outperforming the 29.5% return of its benchmark, the MSCI ACWI ex US Index (proxied by an ETF here), as well as the 50.3% simple average NAV total return of its peers. However, AGT has underperformed the MSCI ACWI over the period, which returned 65.5% (figures as at 24/03/2022). This underperformance is primarily the result of AGT's substantial underweight to US mega-cap tech, which has led global equity markets over the last five years. AGT's underweight is a natural reflection of the team's investment process, as their target companies lead them to avoid mega caps.

Fig.1: Five-Year Performance

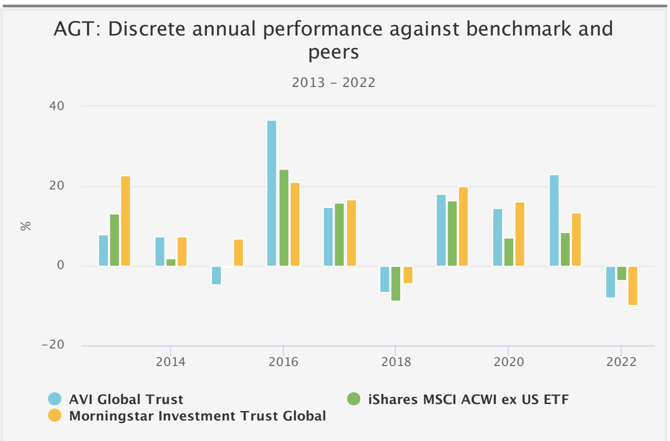


Source: Morningstar

Past performance is not a reliable indicator of future results.

As we mentioned in the **Portfolio section**, AGT has the propensity to undershoot during major down markets due to the additional impact of discount widening. Yet AGT also has the propensity to rebound, and even sustain its uptick in performance, during prolonged bull markets. This is neatly demonstrated by AGT's discrete annual performance. As can be seen below, AGT has been able to outperform its benchmark in the majority of 'up market' years. Yet AGT has largely underperformed its benchmark in 'down market' years – 2015, and 2022. This leads us to believe that AGT could currently offers investors an opportunity to 'buy the dip', so long as they agree with the AGT team's notion that discounted companies have the ability to demonstrate a strong rebound post-crash.

Fig.2: Discrete Annual Performance



Source: Morningstar

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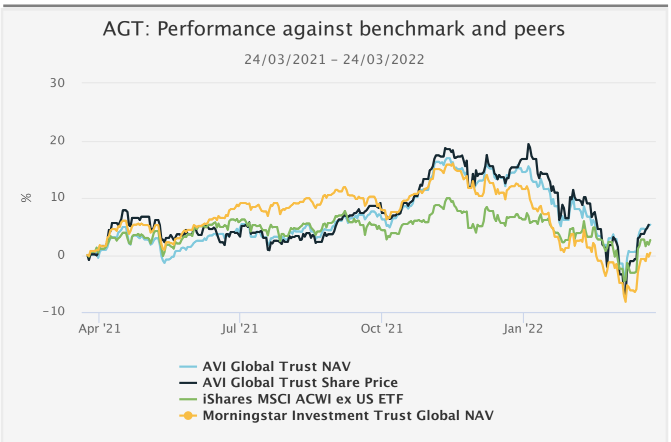
While AGT has historically felt the pain of market sell-offs, the last 12 months have demonstrated the advantages of having a preference for conservatively valued companies. Despite the selling pressure that many of AGT's holdings have faced, AGT has still been able to generate an NAV total return of 5.3% and share price return of 5.3%, beating the 2.6% of its benchmark and 0.4% simple average NAV total return of its peers (figures as at 24/03/2022). We believe that this is the direct result of AGT having been able to avoid the painful sell-offs that growth equities have seen over the period, with many of its global equity peers having a dedicated exposure to such companies. AGT's outperformance has been achieved despite the substantial detraction from Sony, which was de-rated by the market on the back of Microsoft's purchase of Activision, which substantially increased the competition Sony will face in the video game market.

Fig.3: 12-Month Performance



Source: Morningstar

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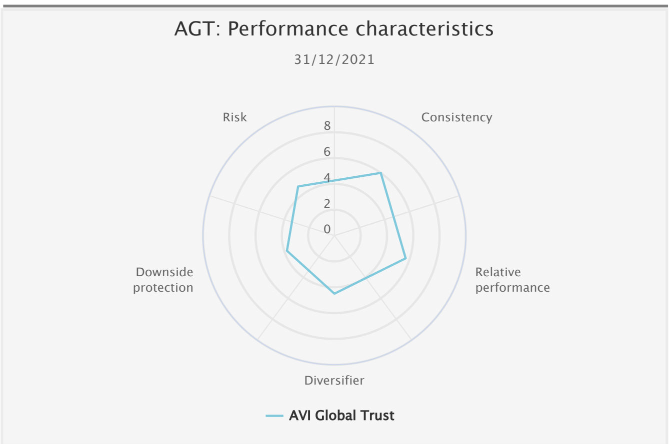
Below is our proprietary KTI Spider Chart. This shows how AGT has performed versus an expanded peer group of all global, global small-cap and global equity income trusts over the past five years in some key categories. Each category is scored out of ten based on rolling 12-month returns over the last five years, and scores are normalised to the peer group. Please note that the benchmark utilised in this chart is the MSCI ACWI, so as to reflect the broader global equity market. As can be seen, AGT has been able to generate an above-average relative performance as well as consistency in investment approach, a reflection of the team's commitment to their investment niche and the opportunity presented by deeply discounted companies and funds. Given how much of global equity performance has been driven by US equities, to which AGT is substantially underweight, these figures are impressive given the trust's inherent inability to capitalise on US mega-cap growth. We also note that AGT has an above-average diversification against bonds in the underlying data, a reflection of the wide discounts its holdings trade on, which in turn reduce their interest rate sensitivity.

Fig.4: Performance Characteristics



Source: Morningstar

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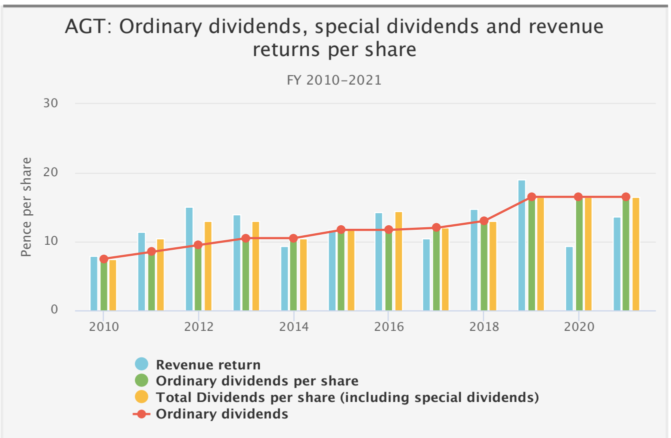
Dividend

AGT has the sole aim of generating long-term capital growth, and so the investment approach is not designed for income generation. During the previous financial year (which ended on 30/09/2021), AGT's board declared a final dividend of 16.5p per share, unchanged from that of the 2019 and 2020 financial years. Based on the current share price, AGT currently has a dividend yield of 1.6%, below the AIC Global peer group's average 1.9% dividend yield (as of 05/04/2022). During the previous financial year, AGT's revenue return per share increased 40% to 13.68p per share as many of the underlying holdings began to repay increased dividend levels on the back of the COVID-19 pandemic. We estimate that AGT has a revenue reserve coverage ratio of 1.64x, based on the FY 2021 dividend.

Since 2017, AGT's board has been permitted to distribute capital profits generated within the portfolio as dividends, with the trust's investment philosophy leading to its underlying holdings paying increased or special dividends that can cause a somewhat volatile revenue stream across years.

Fig.5: Dividend And Revenue Per Share



Source: AVI Global

Management

Joe Bauernfreund has been sole named manager of AGT since October 2015. Joe is CEO and CIO of Asset Value Investors (AVI), and has been with the group since 2002, starting as an analyst working on European holding companies. He became co-manager of AVI Global (then British Empire Trust) in 2013 before becoming sole named manager in October 2015. We note that AGT has operated with a very low manager turnover, having only had three portfolio managers in over 35 years.

Joe is supported by Tom Treanor, head of research and an AVI director since 2017. Tom leads on closed-ended fund research and activism engagement, and has significant experience in various roles covering closed-ended fund analysis. They are further supported by a team of dedicated analysts, and have been adding significant analytical resources in recent years.

Thanks to the success of AVI, there have been a number of new additions to the team, including two new junior analysts, two dedicated Japanese analysts and one dedicated ESG analyst. This means the AVI investment team now have 12 dedicated investment specialists.

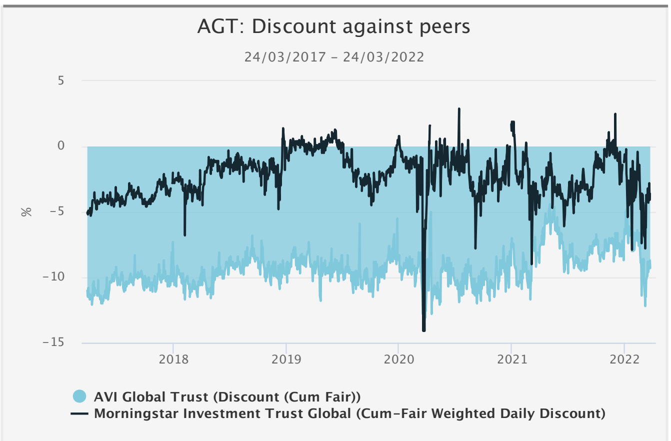
Discount

AGT has consistently traded on a wide discount to NAV over the last five years, and currently it trades on an 8.2% discount which is wider than its peer group's simple average discount of 6.5%, but in line with its own five-year average discount of c. 9.3% (as of 05/06/2022).

On a historical basis, AGT's discount has been wider but less volatile than the peer group's, thanks in part to the board's discount control mechanism. The board will repurchase and reissue shares to control the volatility of the discount as and when it is deemed to be in shareholders' best interests to do so. During the previous financial year (which ended on 30/09/2021), AGT's board repurchased 3.3% of the original number of shares in issue at an 8.2% weighted average discount. Investors should also be aware that on 9 November 2021, AGT implemented a five-for-one share split, substantially increasing the number of shares in circulation from circa one million to circa five million.

As we noted in both the **Performance** and **Portfolio sections**, AGT's holdings have the capacity to be oversold during market downturns, a characteristic which may have also spread to AGT itself. This means that the recent widening of AGT's discount may in fact be an attractive entry point, so long as investors' views are aligned with those of the AGT team. Yet given the propensity for its underlying holdings to rebound, AGT's own discount may also narrow.

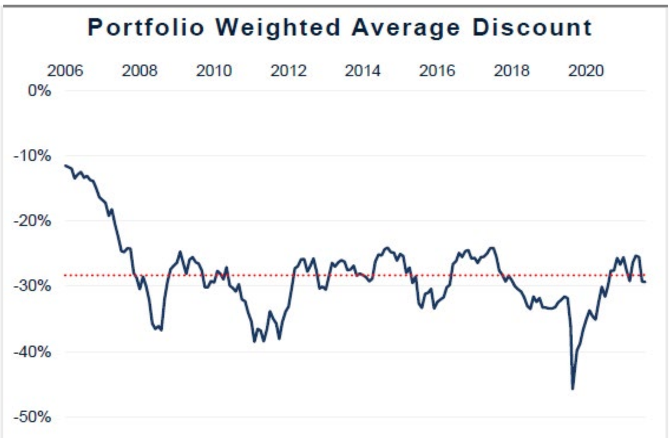
Fig.6: Five-Year Discount



Source: Morningstar

AGT also has the rather uncommon characteristic of a 'double discount', whereby investors are presented with the combination of both AGT's own discount and that of its underlying holdings. AGT currently has a 'double discount' of 36.2% (as at 28/02/2022). As can be seen below, the underlying holdings have averaged a discount close to the 30% mark since AVI took over management of the trust. While this is in part due to the impact of major market downturns, it also reflects the team's natural rotation out of companies whose discounts are narrowing and into their more undervalued peers, so as to capitalise on the more attractive discount-narrowing opportunities.

Fig.7: Weighted Average Discount Since



Source: AVI Global

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Charges

Currently, AGT has an ongoing charges figure (OCF) of 0.83%, which is above the AIC Global peer group's simple average of 0.62%. A tiered management fee means 0.7% per annum is charged on the first £1bn of assets and 0.6% thereafter, calculated on a quarterly basis. Based on AGT's current NAV of c. £1.03bn, we calculate the weighted management fee to be c. 0.7%. AGT has no performance fees.

AGT's current KID RIY is 2.46%, which is higher than the peer group's 1.33% simple average KID RIY. However, we caution that calculation methodologies can vary from trust to trust, and AVI notes that the KID RIY additionally includes the costs of the gearing of the underlying investments. In addition, AVI highlights that performance fees on the underlying holdings (many of which are investment trusts) will inflate the KID RIY, and are indicative of strong returns where they are incurred. AGT charges 70% of its management fee and finance costs to capital based on the board's anticipated long-term split of total returns in the form of capital and revenue returns of 70% and 30% respectively.

ESG

The team account for material ESG risk factors throughout their investment process, having recently improved the depth and independence of their analysis. Over the last 12 months they have developed their own proprietary ESG database, allowing them to avoid a passive over-reliance on third-party data providers and instead implement an active system that aligns with the team's unique approach and knowledge of its companies. While AGT is not an 'ESG fund' and will not compromise returns for superior ESG metrics, we believe it still represents a potentially attractive opportunity for ESG-conscious investors. The team's usage of active engagement to improve shareholder returns represents the most onerous element of the 'G' in ESG. While avoiding the worst-governed offenders can be an attractive proposition, one can take the view that it is ultimately through proactive attempts to improve ESG factors that the most good can be done. The team are in fact so committed to ESG that they have recently added a dedicated ESG analyst to the AVI team, Esme Morter. This additional resource enables AVI to engage with more portfolio companies to encourage progress on a wider variety of ESG issues. We note that Morningstar has assigned AGT a sustainability rating of 'below average' when compared to its wider global equity peers, although this likely reflects the poor ESG disclosures and complex structures of family-backed holding companies and pooled investment vehicles.

When it comes to more general ESG analysis, the team break down their assessment into distinct subcategories, which are applied across all of AVI's strategies. Environmental categories are: environmental impact, tackling climate change and sustainable management. Social categories are: dignity and equality, well-being and development, and community engagement. Whereas governance categories are: quality of the governing body, corporate strategy and ethical behaviour. The team are particularly focussed on avoiding ESG controversies, given the significant effect they can have on a company's valuation. Investors can find a more detailed breakdown of AVI's **ESG policy here**.

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