Q2
June 2021

Investment Objective: To achieve long-term capital appreciation and to exceed the returns of the MSCI All Country World (ex U.S.) Index through the active management of a focussed portfolio of listed equity investments in family-backed holding companies.

Introduction

Global markets have continued to grind higher during the second quarter of 2021. The so-called reflation trade has – temporarily at least – started to reverse, with bond yields declining from their March peak. Particularly over the last month, Growth has outperformed Value, and the US has outperformed the rest of the World.

Within this context, the FHC fund returned +4.0% versus +4.5% for the MSCI ACWI Ex-US (EUR). For the calendar year to date, FHC is up +13.6% versus +12.6% for the index.

Performance review

Christian Dior ("CDI") was by far and away the largest contributor, with a share price total return of +32% over the quarter. Returns were driven by both NAV growth (+17%) and a narrowing of the discount from 21% to 11%.

During the period LVMH released a very strong first quarter sales update, well ahead of consensus expectations. Sales grew +30% year on year, or, for a more useful frame of reference, +8% versus their 2019 level. This was led by the all-important Fashion and Leather division, where Louis Vuitton continues to raise the bar. We expect mega brands to continue to outperform and capture share, with their scale advantages and top of mind status driving sales growth as physical economies continue to re-open and travel restarts.

Turning to the discount side of the equation, FHC benefited from a material tightening of CDI's discount, as the Arnault family continued to tinker with the structures through which they control CDI and LVMH. Our base case remains that the family will collapse the structure at some point in the future when it suits them, and that as such CDI should trade at close to a zero discount.

Other strong contributors for the quarter were Investor – now the fund's largest position – and D'Ieteren, who raised their full year guidance as Belron continues to perform well.

At the other end of the portfolio, Prosus, Prisa and EXOR were the three largest detractors.

During the quarter, Prosus and Naspers (the holding company which sits above Prosus) announced a long-awaited restructuring in order to try and tackle the large discounts at which they both trade. The plan – which post quarter end was approved by Prosus shareholders – involves Prosus offering to acquire 45% of Naspers in return for newly created shares.

Whilst we commend companies taking active steps to unlock value, we are afraid in this case that management are too focused on only some of the issues (Naspers weighting in the JSE and Prosus' low free float) and have come up with sub-optimal "solution". The creation of a cross shareholding structure adds complexity, which is rarely a good ingredient for dealing with discounts. As such, we voted against the proposal.

So where does this leave us? Clearly there is a lot of value trapped in the current (and proposed) structure. In the past, we have learnt the hard way that waiting for such events can be painful. However, what makes Prosus attractive is the underlying exposure to Tencent and the prospects for NAV growth, which in the long-run will be the most important factor in our returns. As such we can afford to be patient and continue to hold Prosus.

Q2 portfolio activity

During the period we fully exited Kinnevik, as it traded on a large premium following the distribution of its stake in Zalando, which we also sold. We had held Kinnevik since the fund's inception and generated an ROI and IRR of +84% / +110%, versus +10% and +11% for the MSCI ACWI Ex-US (both in Euros).

Kinnevik is indicative of what we look for: high quality undervalued assets, managed by skilled and long-term orientated operators, trading at what was at times a very wide discount to NAV. We were aggressive in doubling down on our position during the COVID-19 sell-off at a ~30% discount to NAV, with these incremental purchases generating a more than two-fold return. At the right valuation we would love to own Kinnevik again.

There were no new positions during the quarter, but we did materially add to EXOR, at what we believe to be a highly attractive valuation, trading on an unjustifiably wide 41% discount.

Outlook

"Transitory, or not transitory, that is the question" – (not) Hamlet

Equity markets have continued to climb higher as economies re-open and vaccine roll-outs progress. However, all three – markets, economies, and vaccines – are unevenly distributed, with the US seemingly enjoying the most success, whilst Europe and Asia trail. New variants and mutations are an ongoing risk.

Worries about inflation continue to dominate investors' minds. The comments of Fed officials are analysed in painstaking detail for clues on the path ahead. We remain, however, aware of the impossibility of predicting the future.

Rather, our time is focused on the bottom-up, which is key to generating long-term outperformance of equity markets. In this vein, with the weighted average discount on the portfolio at 29%, and a collection of high quality, well managed, and conservatively financed businesses, prospects appear attractive.

Investment Manager – Joe Bauernfreund

AVI Ltd. +44 20 7659 4800 info@assetvalueinvestors.com

Information may be found on the following websites:
www.assetvalueinvestors.com