Q3
September 2022

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.

It feels timely to remember the then-Chancellor Norman Lamont's description of Black Wednesday – which occurred 30 years ago last month – as "*an extremely difficult and turbulent day*".

Well, markets have been difficult and turbulent over the last few months. The bear market rally of July has proved just that, as investors have re-awoken to the risks of a so-called "hard landing". In the UK the new Chancellor's budget has proved anything but "mini", with extreme volatility in currency and gilt markets.

Within this context FHC returned -1.8% in the third quarter, which compares to a -3.9% return for the benchmark, the MSCI ACWI ex-US (€).

Year to date we have returned -22.3% vs.-14.7% for the benchmark. The portfolio has performed in-line with our expectations, suffering from a double whammy of declining NAVs and discount widening.

Performance review

We wrote in the second quarter letter that whilst discounts had generally widened, few so far had reached "*screamingly cheap*" levels. We highlighted that EXOR was approaching such a level, and as such it is pleasing that the shares have started to rebound, with EXOR being the greatest contributor over the period, adding +89bps to returns.

The shares returned +10% in Q3 as the NAV increased by +4% and the discount narrowed from 46% to 43% (a +6% return). During the period Stellantis, Ferrari and CNH reported quarterly results, with operating profit figures +22%, +7% and +11% better than consensus analyst expectations respectively. We continue to see good prospects for NAV growth, especially from Stellantis, where the fundamentals and share price have become increasingly disconnected (over the last year the shares are down -20% whilst persistently better than expected results have driven consensus forecasts for this year and next year's operating profit up +42% and +17%). Combined with the potential for further returns from a narrowing of the discount from its still very wide level, prospective returns from EXOR appear attractive.

Other notable contributors were Pershing Square Holding, T Hasegawa and Christian Dior, which added +80bps, +52bps and +47bps, respectively.

Turning to the other end of the portfolio, IAC was the by far and away the largest detractor, as the shares declined -27%. We wrote about IAC, and Angi (15% of NAV) extensively in our Q1 letter. Rather than rehash this here, it is worth noting what has gotten incrementally worse – namely Dotdash Meredith (23% of NAV).

Dotdash Meredith – the wholly owned digital media company - has suffered from dual issues of a slow-down in digital advertising as recessionary fears have loomed, and slower than anticipated integration of the Meredith assets. Accordingly their $450m digital EBITDA target for 2023 has been pushed back by 6-12 months. In our view, these issues are by definition temporary in nature and the strategic logic and long term financial profile remain intact. Indeed, intent driven advertising is becoming increasingly valuable in a world where Apple have upended the cookie-based iOS ad market.

IAC trades on a 41% discount versus 23% at the start of the year. Given IAC's long and successful history of spinning assets to shareholders, we believe the fair discount is zero. Combined with the prospects for NAV growth from Angi, MGM and Dotdash, and further optionality around how IAC deploy their $1.2bn (14% of NAV) cash pile, there is much to be excited about. It has been a painful last twelve months, but the ingredients for attractive long-term returns appear to be in place.

The other major detractors were Aker (-84bps) and Eurazeo (-41bps).

Trading activity

During the period we raised a small portion of cash by shaving some of the largest positions: Pershing Square Holdings, Aker, D'Ieteren EXOR and Christian Dior. This is one of the beauties of a concentrated portfolio – we can raise capital when needed and maintain the shape and concentration of the portfolio, with those five holdings still accounting for 47% of the fund at the end of September.

Over the last few months we have built a new position in Schibsted, a £3bn market cap Norwegian listed holding company offering exposure to high quality online classified ads businesses at a discounted valuation, with multiple potential corporate events to unlock value.

The origins of the company date back to Christian Schibsted establishing a publishing company in 1839, however the more modern history is defined by his great-grandson, Tinius Nagell-Erichsen, who built the business into a media conglomerate in the latter half of the 20th century, taking the business public in 1992.

From the turn of the millennium, Schibsted have built and bought a collection of online classified ads businesses, which today account for 93% of portfolio value. This is spread across Schibsted's unlisted Nordic assets (54% of portfolio), and a stake in Adevinta (39% of portfolio) which they listed in 2019 as a vehicle to house their international classified ads businesses and pursue sector consolidation (which it has done via the acquisition of eBay's classified ads business for $9.2bn in 2020).

Such businesses exhibit winner takes most dynamics, with strong network effects whereby listing inventory and user traffic mutually reinforce one another. The dominant #1 player in a category becomes the reference point for individuals or businesses looking to buy and sell in that vertical. This integral position translates into high levels of pricing power and excellent financial profiles, with healthy organic growth rates, EBITDA margins of 40-60% and high free cash flow conversion.

Attune to these attractions we had monitored Schibsted from afar for a number of years. However, it took a more than 60% decline in the shares from the summer of 2021 to June 2022 to pique our interest. Both Schibsted and Adevinta have been caught in a perfect storm of earnings downgrades and multiple compression. On top of this, at the Schibsted level, investors have increasingly questioned capital allocation and the group structure.

Schibsted B shares – which we own – trade at a 45% discount to our estimated NAV. Ex-Adevinta the Stub trades at 5x forward EBITDA, with EBITDA expected to grow +14% p.a. 2022-24. This equates to an EV-EBITDA-Growth multiple of 0.4x, versus global classified peers at 1.4x and legacy media peers at 1.0x. Some discount is warranted given the group's conglomerate structure, but the current level appears unduly wide.

Management are acutely aware of Schibsted's undervaluation, and have bought shares in the open market, as has the controlling Tinius Trust. We believe a resolution of their stake in Adevinta is key to unlocking value and that the status quo will not persist in the medium term. An in-specie distribution of Adevinta to shareholders, or the sale of Schibsted's stake, most likely to a private equity buyer as part of a take-private transaction, are in our view potential outcomes that would unlock value. As well as this, there is potential further upside from a collapse of the A-B share class structure, and near-term non-core asset sales (such as Lendo).

Schibsted exhibits many of the traits we look for: high quality assets, discounted valuations, and potential events to unlock value. Prospective returns appear attractive.

Outlook

Jerome Powell's acknowledgment at Jackson Hole that bringing down inflation would "*bring some pain*" was aimed at households and businesses - but it might just as well have applied to equity investors.

The past year has been bruising as it has become apparent that the era of ever declining interest rates has come to an end. Risk has been re-priced and higher bond yields have been felt along the risk curve. On the "E" side of the equation, how well corporate profits can withstand margin pressures and squeezed consumer incomes is yet to be seen. On top of this, recent fears in the UK regarding pension funds' Liability Driven Investing strategies highlight how pain points across the financial system only reveal themselves in times of stress.

As a long-only equity fund we will always be correlated with broader markets in the short-run. With that said, our experience shows that discount widening and panic are our friends in the long-run. Valuations – both within the portfolio and our wider universe - are increasingly attractive.

We remain humble in our inability to predict the future, but seek comfort from the alignment of interest with long-term orientated families who've weathered significant storms before; the valuations we observe, as indicated by the portfolio's 35% weighted average discount; and the attractive nature of our underlying assets.

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