Q4
December 2020

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

In our first quarter update we quipped that markets are characterised by "*long periods of boredom punctuated by moments of sheer terror*". Clearly, in the doldrums we had forgotten that markets are also prone to periods of enthusiasm. The fourth quarter was one such period, as global equity markets rose strongly following breakthrough announcements in the search for a COVID-19 vaccine. Indeed, the month of November saw a number of regional stock markets achieve record monthly returns.

Within this context the FHC fund returned +23.5% in Q4 2020, compared to +12.1% for the MSCI ACWI ex-US (€). For the full calendar year, the fund returned +15.4% versus +1.5% for the same index.

As such in the first thirteen months of operation the fund has comfortably outperformed the benchmark, with a return of +16.1% vs. +4.0% since the start of December 2019. Clearly this is a short period and we expect to be judged over much longer periods, but it's a healthy start and we believe testifies to the attraction of investing alongside prudent families, who own quality assets trading at discounts to NAV.

Performance review

VNV Global (7.6% NAV) – the Swedish holding company that makes early-stage investments in technology-enabled businesses – was the standout performer. The shares returned +63% over the quarter and contributed +344bps to returns.

The story here was principally about Babylon Healthcare, the digital healthcare company that accounts for 66% of VNV's estimated NAV. The FHC fund historically had exposure to Babylon via Kinnevik – also investors in Babylon – and invested in VNV earlier in the year to boost our exposure.

During the quarter Babylon presented at VNV's capital markets week, providing investors with greater insight into the company's strategic priorities and growth plans, and in particular the opportunity in the US value-based care market. Sales were budgeted to grow 4x in 2020, accelerating to >5x in 2021, as the US expansion continues. In our view it seems likely the company will seek to list soon, crystallising value and giving it currency to pursue M&A in a sector undergoing a period of consolidation following the merger of Teladoc and Livongo.

We have long thought VNV's NAV valuation for Babylon to be too low compared to listed peers. Recently the market seems have come to a similar conclusion, bidding VNV up to trade at a substantial (45%) premium to reported NAV. Whilst recognising that the range of outcomes is wide for relatively early-stage high growth companies we still see further upside in Babylon, even at the premium implied value. Indeed VNV trades at a 26% discount to our estimated NAV.

Prisa (4.0% of NAV) was the second largest contributor to returns – rallying +123% (!) – as it was announced that they had agreed to sell the Spanish arm of education business Santillana and refinance their debt. The sale of Santillana Spain – something we'd long advocated – achieved a premium multiple of 9.6x EBITDA and enterprise value of €465m. This has helped pay down ~30% of Prisa's debt as part of a refinancing deal that sees maturities extended until 2025. With the wolf kept from the door, management are now free to pursue their next act: splitting the media assets and the crown jewel Santillana Latin America business in two. There has already been reported interest of buyers of the media assets, and we view either a listing of Santillana or merger with Brazilian peers Arco or Vasta as probable outcomes. At a 46% discount to our estimated NAV, we expect further returns as the share price continues to climb back out of the red.

Elsewhere several of our more cyclically exposed companies enjoyed strong returns, with shares in EXOR and Aker increasing +42% and +39% respectively over the quarter. Pershing Square Holdings was also a strong contributor, with NAV growth of +15% boosted by a narrowing of the discount from 30% to 23% following its inclusion in the FTSE 100.

At the other end of the portfolio, Mandarin Oriental (2.1% of NAV) was the only real detractor of note, declining -6%, and taking -21bps off performance. As we commented in the last letter, at discount of close to 60% we can afford to be patient as we wait either for the family to actively unlock value, or the market to assign a fairer value. In this sense, nothing has changed.

Q4 portfolio activity

We continued to take profits from our position in Kinnevik – by far and away the year's largest contributor – approximately halving the position during the quarter. In conjunction we initiated a direct position in Zalando, the e-commerce company that accounts for 46% of Kinnevik NAV, in effect retaining our exposure but having removed the discount risk.

As well as this we initiated a new position in Associated British Food ("ABF"), the conglomerate controlled by the Weston family, and owner of Primark. The company trades on a 34% discount to our estimated NAV, and we view it as well positioned to benefit from the re-opening of the physical economy.

We further topped up positions in Christian Dior, EXOR and Prosus, funded by trimming Pershing Square Holding and Softbank Group, where discounts had narrowed.

Outlook

The turning of the year is accompanied by a stampede of Wall Street strategists proclaiming the path ahead. As ever, we remain sceptical of such futurology – after all as J.P. Morgan (the man) is alleged to have told a young fellow asking for his thoughts on the course of the stock market: "*it will fluctuate*".

Within that framework of knowing how little we know, we remain cautiously optimistic. The autumn announcements on the successful development of a COVID-19 vaccine means there is now light at the end of the tunnel, and the prospect of strong GDP growth feeding into company earnings as economies re-open. There are of course still risks – everything from variant strains, to the state of labour markets and national debt levels – but broadly the picture ahead seems much brighter.

Over the last year much has been done to improve the quality of the portfolio, and the underlying assets to which we are exposed. In the long-run this NAV growth will be the key ingredient to attractive returns. As such we remain optimistic.

Please do get in touch if you have any questions.

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