Q4
December 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

Despite bouts of worry over the Chinese property sector and the new Omicron variant, global equity indices continued to move higher in the fourth quarter of 2021. Beneath the surface there has been significant volatility in US mid-cap tech / SaaS / high growth areas of the market, however this has remained localised.

Within this context, the FHC fund returned +10.5% versus +3.8% for the MSCI ACWI Ex-US (EUR). For the full calendar year FHC was up +26.3% versus +16.0% for the index.

Performance review

D'Ieteren was the greatest contributor to returns in Q4 as the shares returned +35%, adding 296bps to fund performance. This capped off a strong year, with the shares up +156% in 2021.

Returns in Q4 were driven almost exclusively by a narrowing of the discount from 43% to 23%. As we noted in our last letter, D'Ieteren's discount had widened as the market took time to digest the announcement of a new minority investment in Belron (71% of NAV) at a €21bn enterprise value. Share prices and NAVs don't always trade in lockstep (if not we'd be out of a job!), so Q4 was a case of the shares catching up with the tremendous NAV growth from earlier in the year.

With the discount in the low twenties versus a three-year average of 40%, and the position having grown to 10.6%, we partially reduced the weight to 7.7%. We believe the prospects of NAV in the years ahead are strong, and D'Ieteren should trade at a materially tighter discount than what was clearly a large mispricing at close to 40% in recent years.

Other notable contributors were Pershing Square Holding (+166bps), Investor AB (+159bps) and Aker (+144bps).

FEMSA detracted 47bps from returns during the quarter. The shares declined -10%, as marginally positive NAV growth was offset by a widening of the discount from 19% to 28%. We took advantage of this and added to the position.

As readers may remember from our Q1 letter, the investment case is predicated on FEMSA Comercio (73% of NAV), an unlisted business which operates Oxxo-branded convenience stores, and other small-format retail stores, across Mexico and Latin America.

Oxxo is an expertly managed, scale-advantaged operator with strong unit economics, improving margins and a long reinvestment runway. Q3 results were encouraging, with sales up +5% versus their 2019 level and operating profit margins back to pre-pandemic levels (9.1%). We expect the pace of store openings to re-accelerate into 2022 and see a long runway for growth and improved profitability, particularly outside of Mexico.

As well as this, Oxxo's forays into digital services and fintech seem promising with their dense store network an integral and irreplicable link between Mexico's underbanked cash-reliant population and increasingly digital services. This, as well as Oxxo's strong brand equity and people's familiarity with using Oxxo for payment services, means they are well positioned to move centre stage as a fintech player, with positive implications for margins, multiples, and value creation. We await the full roll-out of their digital wallet- Spin by Oxxo- in 2022.

The FEMSA stub trades at an implied 8.3x forward EBITDA, compared to a long-term average of ~14x. We believe this to be fantastic value for a high-quality growing business. FEMSA is cheap "as is", with a free option on digital success and possible further returns if and when the family seek to simplify the group conglomerate structure

Q4 portfolio activity:

During the period we initiated new positions in Eurazeo and T Hasegawa and continued to add to IAC.

Eurazeo is a French-listed holding company controlled by the Decaux family. AVI have invested in Eurazeo at various points over the last 20 years and in recent years have studied from afar Eurazeo's evolution from traditional holding company to alternative asset manager. We believe Eurazeo are at an inflection point in this transition, with the prospect of strong growth in third party AUM and even faster growth in earnings as margins expand due to the inherent operating leverage in such businesses. We acquired our shares at wider than average c.25% discount to reported NAV. In turn we believe this NAV to be conservative, most notably with regard to Eurazeo's asset management activities (20% of NAV), which are valued at a steep discount to peers, who command high near-term multiples reflecting the long growth runway for alternatives assets, and the high-quality nature of fee income.

T Hasegawa (TH) is a Japanese global top-ten flavour and fragrance (F&F) company founded by the namesake family in 1903. Flavours are a critical component of consumers' purchasing decisions, while accounting for a small portion of overall costs. This creates sticky customer contracts, strong barriers to entry, and pricing power. TH trades at a 50% discount to our estimated NAV, and at 10.6x EV/EBITA versus global peers at 28.4x.

As well as this we trimmed our position in Pasona (now a 2.7% position) and tidied up some small tail holdings.

Outlook:

"I think it's probably a good time to retire that word (transitory)" – Jerome Powell, Chair of the Federal Reserve

Global equities enjoyed a bumper 2021, continuing the strong returns that began in March 2020.

As is always the case, there is plenty to worry about. Monetary policy appears set to become less accommodative as central banks seek to thread the eye of the needle, taming inflation on the one hand, whilst not extinguishing growth on other. There are risks on both sides.

That said, the global vaccine roll-out continues with aplomb, and there are indications that the Omicron variant is less severe, undoubtedly a good thing for humanity and the economy. This bodes well for growth, corporate profits, and equities.

Rather than worry too much about the above – which is all well-known and discounted in equity prices – we remain focussed on the portfolio. We have assembled a concentrated yet diverse portfolio of high-quality, well-managed and conservatively financed companies, which are controlled by families with records of value creation over generational periods. Whilst there have been cases of extreme discount narrowing (and premia) in parts of our universe we continue to find mispriced opportunities and remain excited about prospective returns.

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