Q1
March 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

Just as the Chinese leader Zhou Enlai remarked in 1972 that it was "*too early*" to judge the impact of the French revolution – we feel similarly at the end of the first quarter of 2021. Bond markets have been more interesting than they should be as inflation expectations have started to rise; equities are in the midst of a rotation to Value from Growth; and two hedge funds managed to blow up near all-time market highs. Time will tell what all this means.

Within this context the FHC fund returned +9.3% versus a +7.7% return for the MSCWI ACWI ex-US (€).

Performance review

Aker – the Norwegian holding company – was the largest contributor to performance. The shares returned +17% over the quarter, with impressive NAV growth of +19% slightly diluted by a widening of the discount from 19% to 21%. The bulk of NAV growth came in roughly equal parts from Aker BP, whose shares returned +14%, and Aker Horizons, which enjoyed a transformational quarter.

During the quarter Aker Horizons – the new holding company created in 2020 to pursue investments in renewable energy and green technology - conducted a private placement and listed on the Euronext Growth exchange. In conjunction with this Aker Horizons announced the acquisition of a 75% stake in Mainstream Renewable Power, a renewable energy company within the wind and solar markets, and also launched and listed its newest venture in Aker Clean Hydrogen. This high level of activity has created a new leg for Aker's growth, and is indicative of how families think about securing growth and wealth on a generational time horizon. The progress at Aker Horizons added an estimated +8% to Aker's NAV over the quarter, and exemplifies the attractions of aligning capital with active owners.

D'Ieteren – the Belgian holding company – was the second-largest contributor to returns during the quarter. The shares returned +23% during a period in which the company reported annual results. Our estimated NAV grew by +25%, with the discount broadly unchanged at 40%. The key driver was Belron, the world leader in vehicle glass repair, replacement, and recalibration, which accounts for the largest part of D'Ieteren's NAV. Belron is undergoing a structural transformation, as windscreens are increasingly fitted with Advanced Driving Assistance Systems (ADAS) cameras, which require recalibration when replaced. Combined with general trends toward increased windshield complexity, as well as efficiency measures, this has been transformational, with operating margins reaching 15% in 2020 – a far cry from the mid-single-digit level when we visited its European distribution centre back in 2018. Operating profit grew +40% in 2020 and management forecast for +20% in 2021. Over time our base case is that Belron will list in the US, which should shine a further light on the attractions of the business, and in turn lead to a narrowing of D'Ieteren's discount.

Turning to the other end of the portfolio, VNV Global was the only material detractor. The shares declined -7%; however, this should be seen in the context of having returned +63% in the prior quarter. Press reports continue to suggest that largest holding, Babylon, will seek a listing in the near-term, and we expect this to occur at a material uplift to the carrying value in VNV's reported NAV. During the period we reduced our exposure to VNV to better reflect the risks and rewards, with the position having grown on account of good performance.

Q1 portfolio activity

During the period we started to build a new position in FEMSA, a Mexican family-controlled holding company whose origins date back to the establishment of Mexico's first brewery in 1890. Today FEMSA's NAV is comprised of **1)** FEMSA Comercio (76% of NAV), which operates Oxxo-branded convenience stores and other small format retail stores (pharmacies, fuel) across Mexico and other parts of Latin America; **2)** a listed stake in Heineken (18%); **3)** a listed stake in Coca-Cola FEMSA (12%), the world's largest Coke bottling business; and **4)** a collection of smaller unlisted distribution and logistics businesses (6%).

It is FEMSA Comercio generally, and Oxxo specifically, that are of particular interest to us. A typical Oxxo store is a little over 100m² and sells ~3,500 high-frequency-low-cost items such as snacks, cigarettes and beer to customers who are principally motivated by convenience. It costs about $130k to fit out a new store, which at maturity earns c.30% returns on capital, with a payback period of around three years. Oxxo are master operators of this format and currently have just under 20k stores in Mexico, opening a new one every 6 hours (pre-Covid), with a long growth runway, both in Mexico and, increasingly, Brazil.

1 in 10 Mexicans visit an Oxxo store every day where they can make payments for a whole range of services, such as cell phone plans and e-commerce purchases. Management has ambitions to grow this into a fully-fledged digital wallet, serving the needs of Mexico's large unbanked population. Of course, success here is far from assured. However, at current prices, this doesn't matter: FEMSA is cheap as it is, with the unlisted stub trading sub-10x EBITDA vs. a long-term average of closer to 15x. We therefore have a free option on its digital initiatives.

During the period we added to Berkshire Hathaway and Associated British Foods. We also added to Kinnevik, as we sold our direct position in Zalando. The purchases were funded through reductions of Softbank following a material narrowing of the discount, and VNV, as discussed above. We also sold the entirety of our position in Jardine Strategic, following Jardine Matheson's take-private offer.

Outlook

"the smartest thing we can do is act big" – Janet Yellen, US Treasury Secretary, January 2021

The period following the 2007/8 financial crisis was characterised by expansionary "un-conventional" monetary policy but restrictive fiscal policy. This time is different: not only has the once unconventional become all-too conventional, but fiscal policies are also moving in tandem. This is especially true for the world's largest economy – the US – where Janet Yellen's advice has been heeded. In further contrast to 2009, households are flush with savings and raring to spend.

This raises the prospect of a period of high growth. This is clearly a good thing: many of our companies, from Louis Vuitton to CNH Industrial, will benefit from strong earnings growth. However, investors are worrying about the possibility of runaway inflation, and what this might mean for bond yields and in turn equity valuations.

Early signs of how markets will navigate this uncertainty came during the quarter as US 10-year bonds saw yields climb from 0.93% at the start of the year to over 1.7% come March. This in turn led to a sell off in the more speculative areas of the equity market, whilst those companies best placed to benefit from economies re-opening continued to outperform.

In our experience, the key to generating strong equity returns over the long term is to focus on the fundamentals; to buy high quality businesses that are well manged and conservatively financed. The companies within this fund have stood the test of time, with many into their fourth, fifth, and even seventh generation. They have thrived through periods of inflation and deflation, wars and famine; we are confident they will do so again.

Investment Manager – Joe Bauernfreund

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

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