Q4
December 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.

Following another unwanted foreign policy intervention, in 1946 Clement Atlee denounced his party Chairman Harold Laski, writing that *"a period of silence on your part would be welcome"*.

After a bruising year for equities, Clement Atlee's plea might just as well apply to investors and central bankers (or indeed, clients and their fund managers!)

Global equity markets rallied during the fourth quarter of 2022, rising strongly in October and November, before falling in December. This pared back some of the losses in what has been a miserable year for equities. Certainly, it has been a challenging year for investors of all hues, with the classic 60:40 portfolio enduring its worst performance since 1937.

Within this context FHC returned +7.3% in the fourth quarter, which compares to a +4.9% return for the benchmark, the MSCI ACWI ex-US (€).

For the full year, the fund returned -16.7% vs. -10.5% for the benchmark. Although painful and disappointing to report such returns, the portfolio has largely behaved in-line with our expectations during times of volatility and market stress, suffering from a double whammy of declining NAVs and discount widening.

Since inception – three years and one month ago – the fund has returned +22.1% vs. +8.5% for the index.

Performance review

There were a number of strong performers during the quarter, however D'Ieteren was the standout contributor. D'Ieteren shares rose +23%, adding +224bps to returns. This was driven exclusively by a narrowing of the discount from 36% to 21%. Having added to the position below €120 per share in March when the market overreacted to a disappointing set of results, we partially reduced the holding at €177 in November, with the position having grown outsized. At quarter-end D'Ieteren was the fund's third largest position at a 9.1% weight.

FEMSA was also a meaningful contributor to returns, with the shares rising +26% as a +8% increase in the NAV was boosted by a narrowing of the discount from 39% to 30%. During the period the company reported Q3 results which showed continued robust operational performance, with Oxxo sales growing +20% organically and strong operational leverage as margins increased to 9.4%. Despite the recent share price outperformance, the company remains cheaply priced, with an implied stub multiple of 6.6x forward EBITDA – a 50% discount to peer Walmex. The board are currently in the process of conducting a strategic review into unlocking this value anomaly and the sum-of-the-parts discount at which the company trades. Investor interest in this event has risen in recent months, however the market doesn't seem to be placing a high probability on a satisfactory outcome.

Other notable contributors include Christian Dior (+15% during a period in which LVMH reported very strong sales figures), Digital Garage (+32% following activist pressure to reform its corporate structure) and Schibsted (+31% having taken initial steps to unlock value from its stake in Adevinta).

At the other end of the portfolio – and capping off what has been a painful and humbling year - IAC was the most significant detractor from returns in Q4, shaving -138bps from performance. The shares declined -20%, as a -14% decline in NAV was compounded by a widening of the discount from 41% to 45%.

In our Q3 letter we detailed how the outlook for Dotdash Meredith (now just 13% of NAV) had deteriorated following slower than expected integration of the Meredith assets, and a softening ad market. These issues continued and indeed worsened into Q4. Management have had to further cut financial targets (with 2022 EBITDA now expected to be slightly below $250m vs. $300m previously) and the company not expected to return to growth until mid-2023.

Investors are rightly sceptical following continued disappointing execution and performance. This is reflected in the low valuation at which the company trades – with the stub value equating to 4x Dotdash Meredith's 2022e EBITDA and everything else for free. Of course, the stub can still get cheaper (or indeed turn negative as it has in the past) and there are no immediate catalysts to drive a re-rating. However comfort is sought from the absolute cheapness of the shares, Barry Diller and Joey Levin's long-term track record of value creation, and the holding company's $1.3bn (32% of market cap) net cash position.

Q4 portfolio activity

During the period we continued to build a position in Schibsted – now a 6.3% weight. This was funded by the reduction in D'Ieteren and the exiting of Jardine Matheson. As way of reminder we built a toehold in Jardine Matheson when the shares fell on its ejection from an MSCI Index in August. We sold for a flat return vs. a -7% return for the MSCI ACWI ex-US (€) over the same period.

Outlook

Inflation and the monetary policy response have dominated investor thinking in 2022. The good news is that inflation appears to have peaked. The bad news is that we are not out of the woods just yet.

Indeed, peak inflation is a necessary but not sufficient cause for equity market optimism. How embedded and sticky will inflation prove to be? At what level will bond yields and discount rates settle? What kind of slowdown or recession will ensue? What will happen in labour markets? What about corporate earnings and margins, consensus estimates for which still appear relatively rosy? These are the important questions for markets.

We however are not in the game of forecasting markets. Rather we are focused on bottom-up fundamental analysis, seeking out high quality assets that are misunderstood and mispriced, trading at discounts to NAV. As 2022 attests to, as a long-only equity fund we expect to be bashed by broader market moves in the short-run. However over the longer-term, as our track record shows, we expect to outperform through a concentrated yet diverse portfolio of lowly valued companies, with often idiosyncratic catalysts for NAV growth and discount narrowing. We remain excited about the prospects for the portfolio we have assembled and opportunities in the broader universe.

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IMPORTANT INFORMATION

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