AVI
Asset Value Investors

# Family Holding Companies Whitepaper: Keeping it in the Family

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# Keeping it in the Family

## THE HUNT FOR HIDDEN GEMS

For an investor, finding an undiscovered investment opportunity that the rest of the market has overlooked is the holy grail of stock picking. It's the equivalent of a football agent unearthing the next Lionel Messi, a wine connoisseur finding a rare vintage, or a Gen Z-er creating the next TikTok trend. We all want to be there when the next big thing drops, to say we knew it was coming all along, to say we were in on it, right from the start.

And investing is no different.

Investors are constantly looking for hidden gems, companies whose compelling valuations have seemingly gone unnoticed by the rest of the market. The hunt is always on for strong, high-quality companies with good underlying businesses, assets trading at a discount to what investors believe are their true valuations, or a company that possesses a catalyst that will shine light on its value.

But discovering a hidden gem isn't easy. It's not like finding a £20 note on the ground as you walk to the shops. That's pure luck. Finding the right investment requires a great deal of skill, patience, and dedication. The best active managers spend hour upon hour researching and investigating companies, trying to find those with assets that have the strongest fundamentals, ultimately leading to investment decisions.

And as with anything, the more work you put in, the more likely you are to reap the rewards. All that time researching a company, gives an investor the best possible chance of picking the right company to invest in over the long-term.

## HOW DO WE FIND THOSE HIDDEN GEMS?

At Asset Value Investors (AVI), our aim is to deliver long-term capital appreciation by identifying and investing in companies with significant growth potential, and whose shares are trading at a discount to their Net Asset Value (NAV).

AVI has followed this distinct investment strategy for over 35 years and has built up considerable knowledge of the types of companies that fit our framework. Generally, this is a part of the market that is poorly understood, with relatively little research coverage and understanding.

This provides an opportunity for our eleven-strong investment team – who work tirelessly, undertaking detailed fundamental, bottom-up research, using both quantitative and qualitative techniques in a bid to find the next hidden gems.

## WHAT ASSETS DO WE LOOK FOR?

At AVI, we believe we offer a differentiated approach to long-term investing, by focusing on areas that are often overlooked, under-researched and misunderstood by the market. We look to invest in assets that are in unconventional structures leading to pricing inefficiencies. Due to these structures, the asset is usually trading at a discount to NAV.

Returns from these investments can come in three forms. Firstly, the discount at which the company trades at narrows, this occurs when the share price of the company increases whilst the NAV stays the same. Secondly, the company's NAV can grow whilst the discount stays the same. This occurs when the

share price rises by the same amount, in percentage terms, as the NAV growth. The final and most desirable outcome is when there is both NAV growth and discount narrowing, resulting in a compound effect which is accretive to returns. At AVI, we look to own companies that can experience these compounding returns.

Because of this, the investment universe across AVI – and indeed within the AVI Global Trust (AGT) more specifically – focuses on three specific investment structures, namely:

1. Family-controlled holding companies
2. Closed-ended funds
3. Cash-rich Japanese companies

In this white paper, we will take a deeper dive into one of these asset types in particular, family-controlled holding companies. We're going to discuss what they are, how they work and why they are appealing to us, before going through case studies of some of the family-controlled holding companies we've invested in within AGT, and what it is about their specific collection of businesses which made them attractive to us, and how they've performed since.

And while you may not have heard of the family-controlled holding companies that we've invested in before, we're sure you will have heard of some of the companies that they own.

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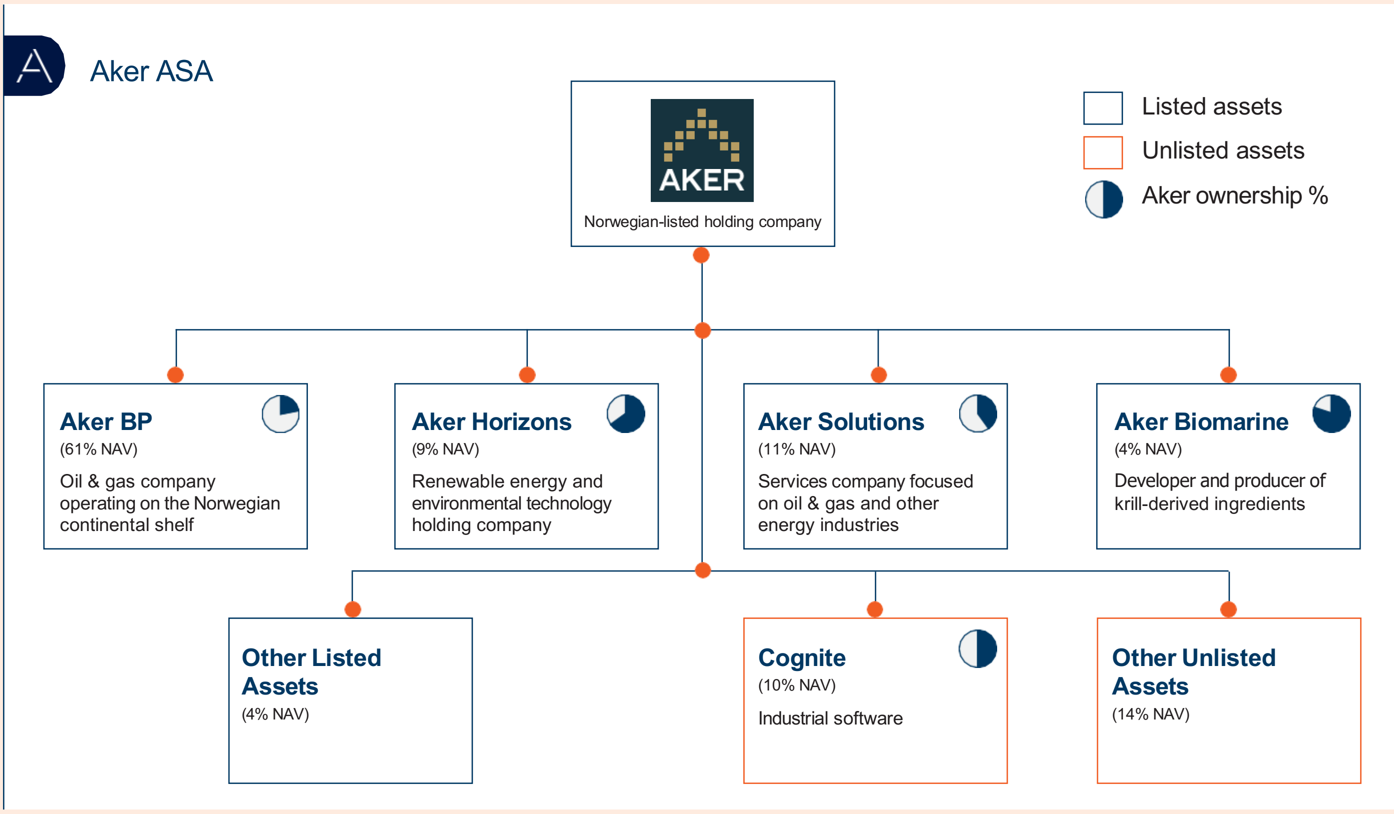
## WHAT ARE FAMILY-CONTROLLED HOLDING COMPANIES?

A holding company is a type of company whose principal business is holding an economic interest, usually through common stock, in other companies. A holding company doesn't produce or sell goods and services, their role is to manage the underlying assets, driving long-term value creation. A family-controlled holding company is one in which the controlling shareholder of the holding company is a family or family entity. These family-controlled holding companies have usually been in the family for many generations, with descendants of the founder in control today.




## WHY DO FAMILIES SET UP HOLDING COMPANIES?

There are a variety of reasons as to why a family might set up a holding company structure and each family will have their own reasons for setting one up. Typically, however, family-controlled holding companies are set up as a means to control their assets, whilst preserving a family's wealth. A lot of the family-controlled holding companies within the AVI universe have a rich history, dating back many decades and even centuries, with the founder amassing significant wealth during their lifetime. By setting up a holding company, founders are able to preserve their wealth and keep control of their assets, which they will then pass on to the next generation of the family, who in turn, nurture and grow it for future generations.

## WHY DOES AVI INVEST IN FAMILY-CONTROLLED HOLDING COMPANIES?

We've been investing in these unique types of companies since 1985. During that time, we've learnt a lot about them, how they work and the families that create and run them. Our experience and knowledge gained over these many years, gives us confidence that these, often overlooked companies can make some of the best investments for long-term capital appreciation. Some of the reasons, being the following:

- Family-controlled holding companies allow us to align ourselves with high-net-worth families, focused on creating long-term value
- Unconventional structures, made up of both listed and unlisted businesses, create complexity which scares off investors
- They are often under-researched and overlooked by other investors, creating pricing inefficiencies

Linked to the lack of research, there are several common misapprehensions about family-controlled holding companies. Even the concept of family control is controversial. Many investors see this as a source of interference. We, however, see families as both long-term stewards and active owners, working to create value. The long term out-performance of such companies attests to this.

While family-controlled holding companies are predominantly found in Europe or Asia, the reality is that many of these companies are in fact global in nature, owning attractive, quality assets across the world. The following table summarises how we see family-controlled holding companies:

## Why Family-Controlled Holding Companies?

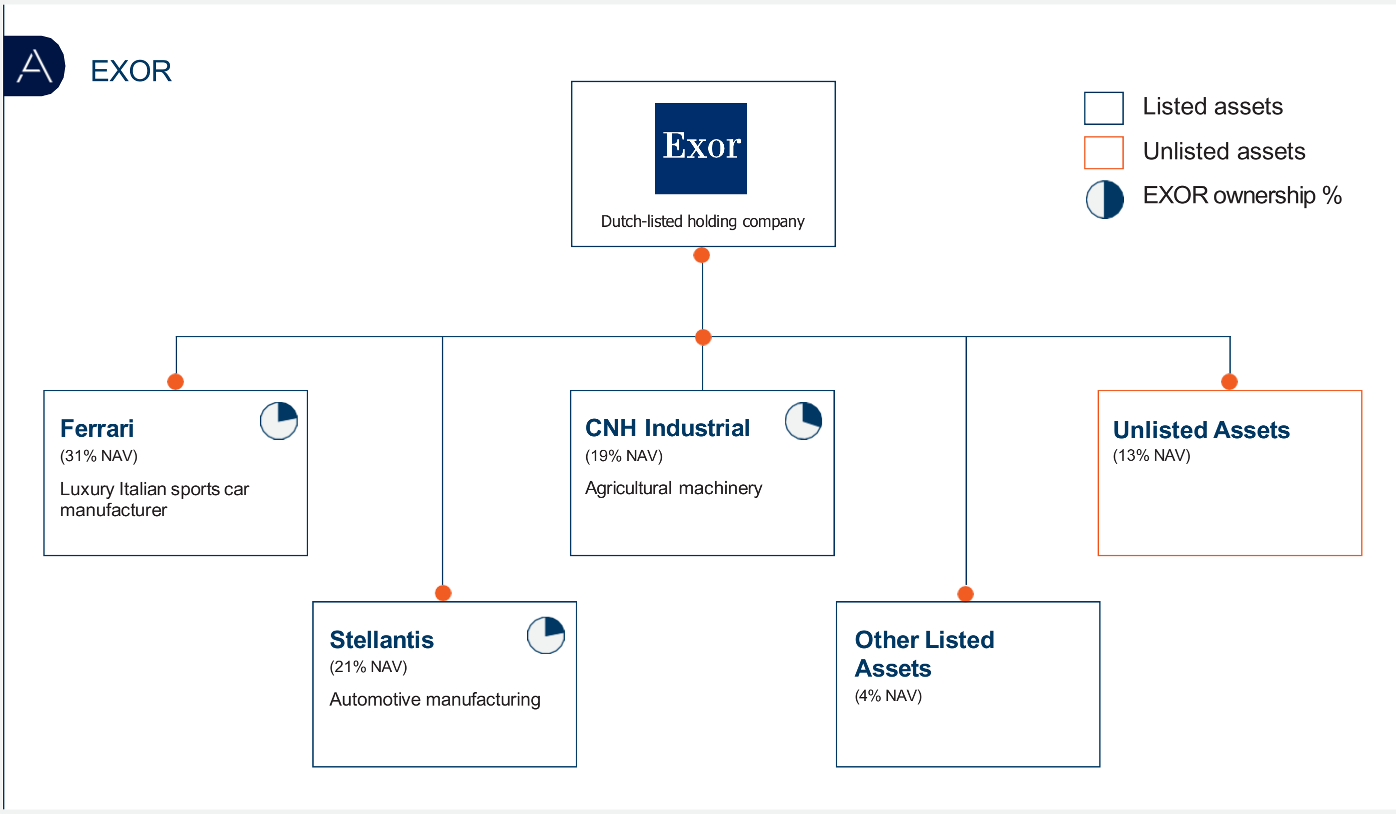
| | WHAT OTHERS SEE | WHAT WE SEE |
|---|---|---|
| FAMILY OWNERSHIP | Interference | Stewardship, active ownership & a truly long-term horizon |
| UNLISTED ASSETS | Uncertainty | A source of hidden value |
| DISPARATE ASSETS | Unclear Strategy | Reduced risk & high quality |
| COMPLEX STRUCTURES | Confusion & Inefficiency | A source of mispricing and low running costs |

The diverse nature of a holding company's assets means that a concentrated portfolio of the most attractive names still results in a well-diversified look through exposure. A combination of this diversification, the quality nature of their underlying assets, and their long-term orientation make family-controlled holding companies well placed to navigate volatile markets. We believe, investors would be wise not to overlook this.

Case Studies:

# How do Family-Controlled Holding Companies Work in Practice?

# EXOR




EXOR is a holding company run by the Italian Agnelli family, whose wealth emanated from the founding of Fiat in the late 19th century.

John Elkann, the great-great-grandson of Fiat's founder Giovanni Agnelli, has developed a strong track record of compounding wealth, well in excess of global equity markets. Elkann actively manages EXOR's portfolio with an eye on value creation, such as spinning Ferrari out from Fiat. Since then, Ferrari's share price has more than doubled.

In recent years EXOR, ever the active owner, has focused on unlocking further value from Fiat Chrysler Automobiles (FCA; now Stellantis) and CNH Industrial.

## The Fiat Chrysler Automobiles merger with Peugeot

AGT's first investment in EXOR was in 2016, with a thesis predominantly revolving around the upside potential of Fiat Chrysler Automobiles (FCA) – then trading at a highly depressed valuation – with significant levers to unlock value through self-help initiatives and industry consolidation.

The $52bn merger between FCA and the PSA Group, the parent company of Peugeot, in 2021 marked a step change. The new group, to be called Stellantis, would become the 5th largest automobile manufacturer in the world, by number of automobiles sold, and allow for increased competition with larger rivals such as Ford, GM & Volkswagen Group.

Under the leadership of CEO Carlos Tavares, the merger has been nothing but a success, with Stellantis achieving €7.1bn in net cash synergies, exceeding the €5bn target more than two years ahead of plan. In addition, Stellantis is planning for a fully electric fleet by 2026, with over €30bn earmarked for investment between 2021 and 2025 to help achieve this goal. Plans for double-digit operating margins by 2026 have already been achieved, with group operating margins of 13.0% in FY22, placing Stellantis as one of the most efficient car manufacturers in the world.

Despite superior fundamentals, Stellantis trades at a significant discount to close automotive rivals Ford and General Motors. We believe this to be unjustified, with attractive upside in the stock through multiple re-rating.

## CNH Industrial

CNH Industrial operates within the agricultural machinery and construction equipment industry, designing, producing, and selling through key brands such as Case, Steyr and New Holland Agriculture.

As part of a strategy outlined in September 2019, CNH Industrial spun out its on-road assets into a separate listed entity called the Iveco Group, in early 2022. This transaction is further evidence of attempting to unlock hidden value within the EXOR group. With CNH Industrial historically trading at a notable discount to industry leader John Deere, this spin-out should help management to focus on the core agricultural assets, with potential for re-rating in the stock if management can execute successfully. In February 2023, CNH went a step further in trying to close this valuation gap, by proposing to de-list its share from the Milan Stock Exchange, resulting in a sole listing on the New York Stock Exchange.

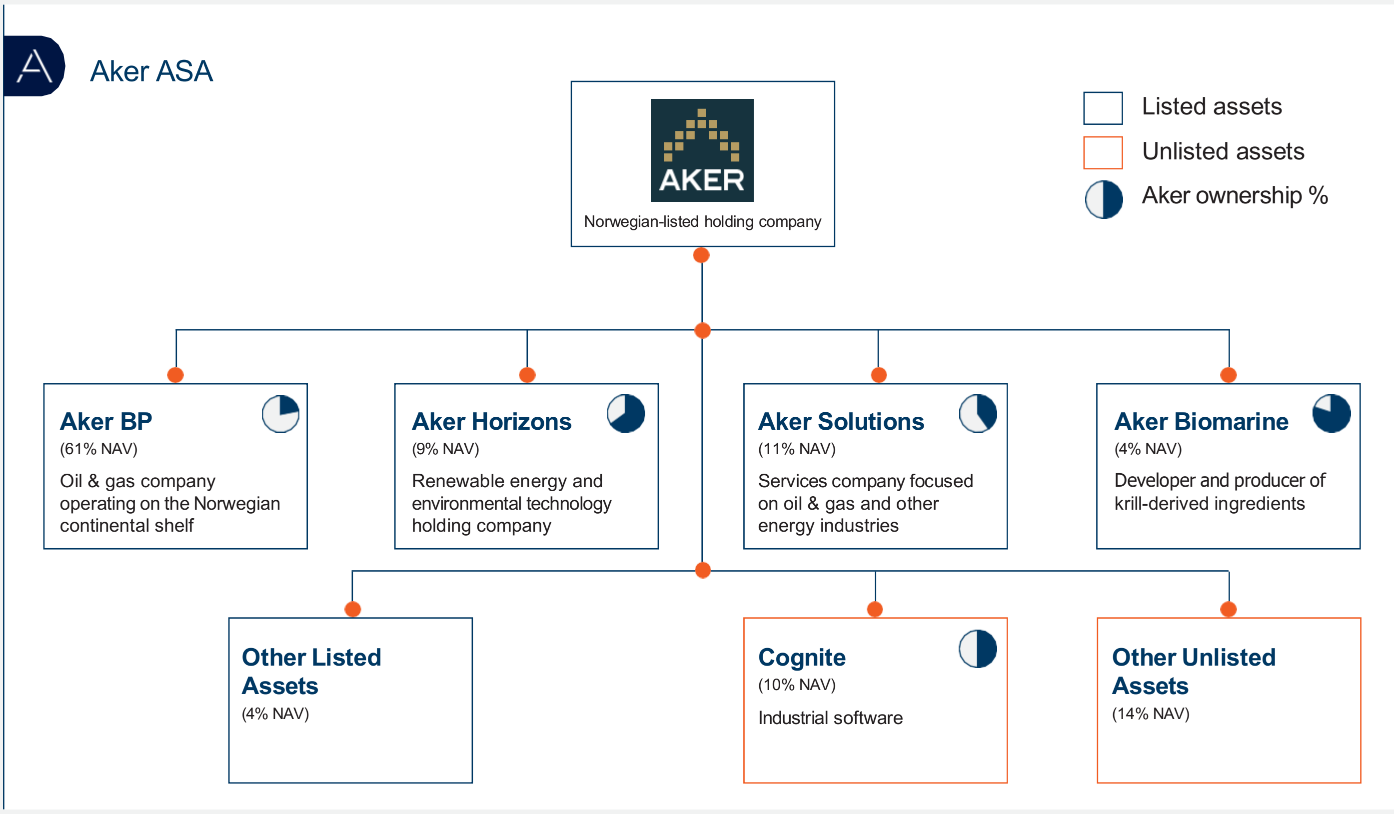
A recent acquisition of Raven Industries strengthens CNH's Precision agriculture portfolio, with the technologies helping to reduce farming costs, whilst promoting more environmentally friendly activities. CNH management believe the integration of Raven autonomous technology into the CNH product line will be a key driver of revenue towards the middle of the decade.

## EXOR: IN CONCLUSION

EXOR has compounded shareholder wealth well in excess of global equity markets since listing in 2009. EXOR embodies many of the traits we look for:

1) a wide discount to NAV, 2) good quality undervalued assets, and 3) active long-term ownership by the family.

## AKER ASA




Aker ASA is a Norwegian holding company with investments principally in oil & gas, renewables & green technologies, and industrial software. Aker's history dates to the 1800s, as one of Oslo's leading industrial businesses. By the turn of the century, Aker would establish itself as the largest shipyard company in Norway. Throughout the 20th century, Aker would diversify their operations, with expansion into oil & gas, fishery & marine activities and more recently into renewable energy. Kjell Inge Røkke has been the driving force in the development of Aker since he took a controlling stake in 1996.

Today, the majority of Aker's NAV is comprised of their ownership stakes in listed, majority industrial, companies. Aker takes an active approach in the development of their industrial holdings, cooperating with each company's management and board to drive value creation.

Aker has been a consistent and successful name in the AGT portfolio. Since our initial investment in 2008, Aker has generated an IRR (Internal Rate of Return)* of 18% in GBP.

### Aker BP

Aker's largest holding is its 21% stake in Aker BP, an oil and gas exploration and production (E&P) company, operating on the Norwegian continental shelf. Due to the push for a more sustainable future, capital expenditure budgets for Aker's oil & gas competitors have fallen materially in recent years, with the prevailing budgets insufficient to meet supply. With many non-Opec operators coming under shareholder pressure to reduce debt levels, maintain dividends, and facilitate decarbonisation, it would appear investment is likely to remain insufficient to meet demand. With Aker BP somewhat immune to these pressures, due to the ownership structure they sit in, the company is able to grow production and benefit from this imbalance.

A recent merger between Aker BP and Lundin Energy will create what management believes to be the E&P company of the future. The combined company will boast industry-leading low production costs, whilst being one of the lowest carbon emitting E&P companies in the industry. These traits, along with a supportive shareholder base, we believe bode well for the

* IRR is the adjusted annualised rate of return earned by an investment.

longer-term picture of Aker BP. In addition, Aker BP provides valuable upstream capital to Aker in the form of dividends, which is used, in part to facilitate their own energy transition, through Aker Horizons.

## Aker Horizons

Cognisant of the need for a more sustainable future, in 2020 Aker announced the creation of Aker Horizons – a “holding company dedicated to developing and operating companies within renewable energy and low-carbon segments”. Initially, Aker Horizons’ portfolio consisted of stakes in two assets spun-off from Aker Solutions: Aker Off-shore Wind and Aker Carbon Capture, complimented by the acquisition of a 75% stake in Mainstream Renewable Power (MRP), a company active in wind and solar energy internationally. The launch and listing of Aker Clean Hydrogen, further expanded the company’s renewable efforts, with exposure to the clean hydrogen market.

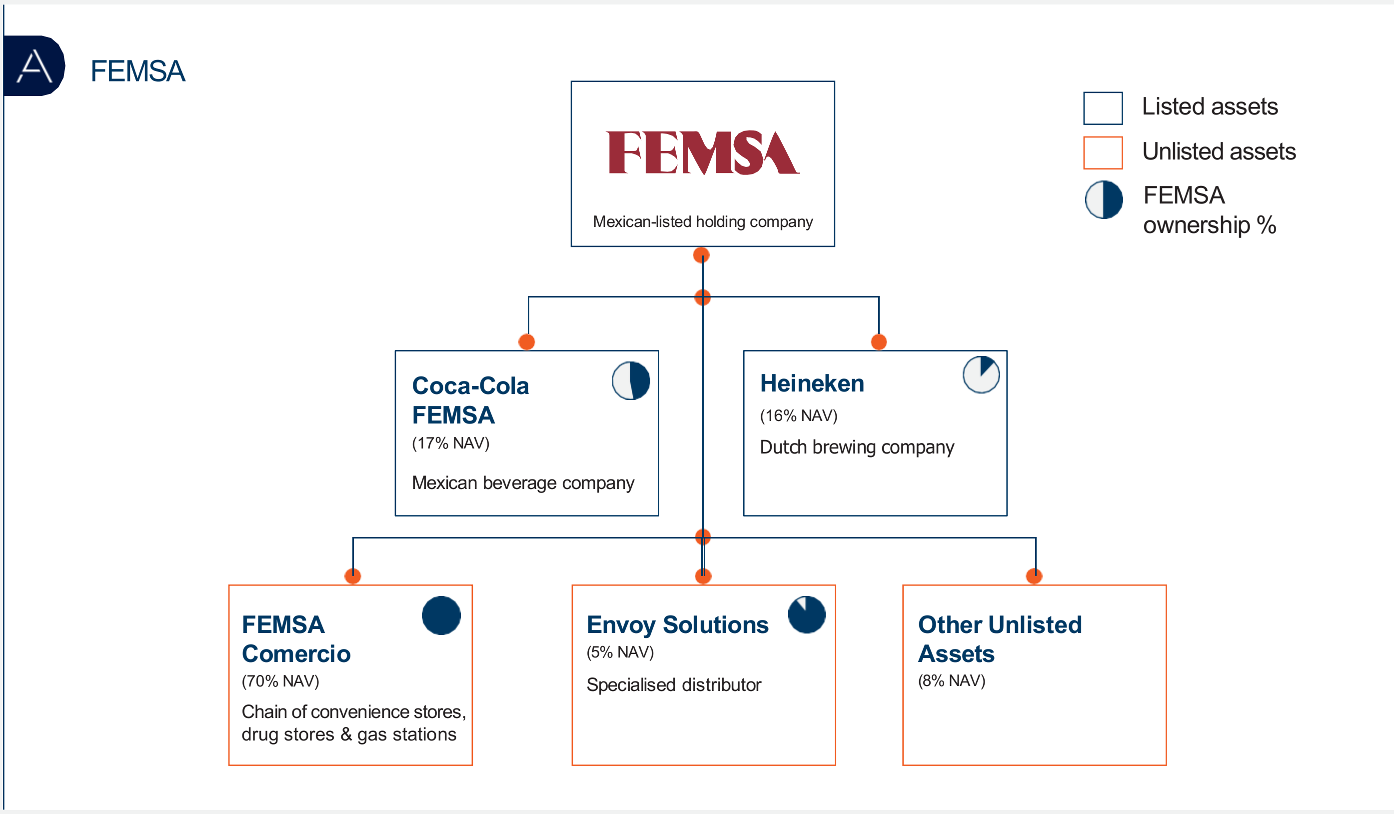
Taken together, Aker has created a diversified collection of renewable energy and technology companies. Collectively, these companies are active across the whole value chain – from energy production to transmission, and even the capture and storage of emissions. As is indicative of how family run businesses manage risk, the diversified nature of Aker Horizons’ operations means that success is not wedded to one future energy market outcome.

### AKER: IN CONCLUSION

Aker Horizons is just the latest example of Aker thinking of the longer-term picture, with a view of what will be the next driver of growth. They see this as a strategic development, not as a step-change as some have depicted it, but rather as an extension of a trend that forms an integral part of Aker’s history. This evolution should be seen within the context of Aker having continually adapted and moved with the times, from a manual workshop to shipbuilding; from offshore construction to oilfield services; and now from oil and gas to renewables. At each stage in Aker’s history, the knowledge, skills and capital of the prior step inform the next.

Aker is another example of how a well-run family-controlled holding company, adopting a sensible approach to capital allocation with a long-term view of value creation, can compound wealth well in-excess of the market. Evidence of this is best demonstrated through Aker generating an annualised return of 20% vs 7% for the MSCI All Countries World Index since its listing in September 2004.

## FOMENTO ECONÓMICO MEXICANO (FEMSA)




FEMSA is a Mexican family-controlled holding company with its history tracing back to Mexico's first brewery in 1890. With the exception of vertical expansion, the company stuck to its core operations of brewing for much of the 20th century. In 1978, they opened their first Oxxo branded convenience store, as a means through which to sell their beer, which today forms the bulk of the company's NAV. In addition to the Oxxo stores, FEMSA has stakes in listed equities:

1. Coca-Cola FEMSA – The world's largest Coca-Cola bottling business

2. Heineken – Second largest beer producer in the world

### FEMSA Comercio

FEMSA Comercio is a 100% owned subsidiary that operates the Oxxo branded convenience stores, predominately in Mexico but also throughout LATAM. Oxxo is an expertly managed scale-advantaged operator with strong unit economics, improving margins and a long reinvestment runway.

Oxxo's foray 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. In addition, 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.

## FEMSA: IN CONCLUSION

We believe FEMSA is materially undervalued, with its non-listed assets, which we refer to as the stub, trading at a record low implied valuation. If this stub were to re-rate to its longer-term average, there would be significant upside in the stock. With the digital initiatives in their early innings, we view their success as a free option.

The board are aware of the historically wide discount to NAV the shares currently trade at, having asked the new CEO to complete a “comprehensive strategic review” of FEMSA, with a focus on unlocking the sum-of-the-parts discount at which it trades. Boston Consultancy Group were recently hired to support FEMSA management in conducting this strategic review. We view this as the first step in the possible unlocking of value through a simplification of the holding company structure.

# Family Holding Company Summary

Throughout our 35+ years of investing in this, often overlooked, sector of equity markets, we have gained considerable insight into how these companies operate. By aligning capital with experienced and pro-active families, who actively create value for all shareholders, minority investors can take part in significant value creation. Despite records of out-performance of broad equity markets, investors remain sceptical and fundamentally misunderstand the attractions of family-controlled holding companies. This works to our advantage, allowing us to invest in high quality assets at discounted prices.

Investing is all about identifying hidden gems that the market misses. With 44% of the AGT portfolio made up of family-controlled holding companies, as of 31 December 2022, we're very much a fan of this particular part of the equity market, and know the benefits these assets can bring to our portfolios, and to our clients.

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