**Q1**
March 2024

**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**

Global equity markets have been in fine spirits with the S&P 500 posting back-to-back quarters of +10% returns for only the eighth time since 1950. US equities continue to outperform other global markets, and breadth remains narrow.

Within this context FHC returned +6.9% in the first quarter, which was slightly behind of the benchmark, the MSCI ACWI ex-US (€), which returned +7.1%.

**Performance review**

**D'Ieteren** was the top contributor to performance (+167bps), with the shares rising +16% over the quarter. This was split roughly equal parts between NAV growth (+8%) and a narrowing of the discount from 38% to 33%.

During the quarter D'Ieteren reported a solid set of full year results. Belron, the global no.1 operator in the Vehicle Glass Repair and Replacement ("VGRR") industry which accounts for 61% of our estimated NAV, continues to benefit from structural trends toward increased windshield complexity and the proliferation of Advanced Driver Assistance Systems ("ADAS"). For FY23 Belron grew sales +9% organically with a further boost of +2% for M&A. Positive mix effect and price increases saw operating margins increase +226bps to 20.5%, which led operating profits to increase +22% year on year.

We believe the structural growth and margin trends can continue for many years ahead, with Belron's dominant and scale-advantaged position entrenched by strong insurance-partner relationships (which account for ~70% of jobs) and the increased technical and capital requirements of recalibration (which Mom & Pop operators cannot fulfil).

In 2021 a consortium of private equity investors (led by Hellman & Friedman) became minority shareholders in Belron at a €21bn enterprise value. We estimate the EV is closer to €24.5bn today (17x our 2024e EBIT), and D'Ieteren's 50% equity interest accounts for 61% of D'Ieteren's NAV. In due course we expect a liquidity event for these investors to help highlight Belron's significant value, and like situations such as this where we are aligned with highly incentivised PE co-owners and management teams. As such we see scope for a further narrowing of D'Ieteren's 33% discount, as well as NAV growth underpinned by strong earnings growth prospects.

Other strong performers included **Schibsted** (+89bps)% as the company announced plans to return ~35% of its market cap to shareholders), as well as **Berkshire Hathaway** (+89bps) and **Eurazeo** (+80bps), both of which saw their discounts narrow. In the case of Berkshire this led us to exit the position shortly after quarter end.

**Aker** was the most meaningful detractor, shaving -89bps off returns. The shares declined -6%, which was principally a function of the NAV declining (-5%) and to a smaller extent a widening of the discount from 23% to 24%. The negative contribution was amplified by a -4.9% decline of the NOK versus the Euro.

The sluggish NAV performance in 2024 is the result of Aker BP (60% of NAV) which has significantly underperformed, with the shares declining -6% whilst oil prices have risen +13%. Production guidance for 2024 was slightly softer than the market had anticipated, with increased uncertainty regarding the eventual plateau of the Johan Sverdrup oilfield and whether this would occur in late 2024 or during 2025. With Johan Sverdrup having consistently outperformed expectations since production started in 2019 this has been digested poorly by the market, with Aker BP shares now trading on 9.4% dividend yield – a level rarely observed in the company's history. This appears good value to us in the context of unchanged long-term production guidance and management's track record of value creation. Indeed, we believe the future for well-run low-cost-low-emissions operators such as Aker BP is likely to be bountiful as oil continues to play a long and elongated role in the energy mix. Accessing this on a 24% discount with a strong alignment of interest with a controlling shareholder with a track record of significant value creation is highly attractive.

**Q1 portfolio activity**

During the quarter we took some profit out of strong performing holdings where discounts had narrowed such as Schibsted, FEMSA and Christian Dior. We also fully exited a small position in Digital Garage, where the prospects of successful engagement had declined.

This capital has been used to boost positions in D'Ieteren – now once again the largest holding – and News Corp.

Over the last six months, we have also built a position in Frasers Group, the £3.5bn market cap retail empire controlled by Mike Ashley, which trades at a 44% discount to our estimated NAV. In the appendix we introduce the company.

**Outlook**

Equity markets have been marching to new highs. The beat of the drum however has changed slightly. The first quarter of 2024 has seen equity markets rise *despite* higher bond yields. It is widely accepted that the economy has proved much more resilient than anticipated. How long this can continue remains to be seen, and whether the tightrope of strong-economy-not-too-stubborn-inflation can be navigated.

Far from the madding crowd of increasingly concentrated equity markets, it remains an exciting and fruitful time for our approach to investing. As indicated by the 30% portfolio weighted average discount, valuations and discounts are generally wide and beneath the surface of equity markets there are lots of interesting opportunities.

We have assembled a concentrated-yet-diverse collection of companies that should compound NAV at attractive rates; discounts are generally wide and across the portfolio there are numerous potential corporate catalysts to unlock value. We believe this to be an attractive medley.

**Appendix – new position in Frasers Group (3.7% weight):**

Over the last six months, we have built a position in Frasers Group, the £3.5bn market cap retail empire controlled by Mike Ashley, which trades at a 44% discount to our estimated NAV.

The vast bulk of NAV is accounted for by UK Sports Retail, International Sports Retail and Premium Lifestyle retail, however over time Property (5% NAV) and Financial Services (4%) will likely grow in stature, and the portfolio of listed equity stakes (6%) provides both strategic and financial optionality.

Despite its status as a FTSE100 company, we believe there is a vast gap between popular perception and reality. The assets are of higher quality than is commonly perceived, and this is masked in the consolidated accounts; the strategy (or rather perceived lack thereof) is seen as haphazard and poorly understood with limited historic communications with The City; and the controlling shareholder is thought of as oafish, despite being arguably the greatest retailer of his generation, as well as a tenacious and sagacious deal maker.

From one sports shop in Maidenhead in 1982, the company grew to 465 stores and £1.2bn of sales in the year prior to its listing as Sports Direct International in 2007. Since then, the company has grown and diversified further, with >1,630 stores and revenues of £5.7bn, whilst reducing its share count by close to 40%.

Despite the group's diversification (and indeed name change), the bulk of the value still lies in UK Sports Retail, which accounts for over 70% of underlying retail profits. Principally through Sports Direct, the company is the #1 sports retailer in Britain. Over the last twenty years the industry has consolidated (Sports Direct & JD Sports account for ~70% market share) and segmented between sports equipment (Sports Direct) and trainers/apparel (JD Sports). This results in significantly lower competitive intensity than is perceived (~10-15% SKU overlap) and makes Sports Direct an increasingly crucial channel for brands to reach customers outside of major cities.

The concentrated nature of the supplier base (Nike & Adidas) erects high barriers to entry, with the approval of these two gatekeepers a pre-requisite for doing business. However, it clearly also presents a key risk, having been the genesis for Sports Direct's "Elevation Strategy" over the last half decade. This has seen the company evolve from its stack-em-high-sell-em-cheap model which readers might remember, and that one journalist memorably referred to as "quasi-claustrophobic."

We expect the UK Sports Retail business to continue chugging along as a cash cow (with cumulative group operating cash flows of >£3bn since 2015) and for these cash flows to be invested in creating new growth avenues, as well as increased shareholder returns, with an £80m buyback having recently been announced. Looking ahead one key area of focus will be in International Sports Retail where, with brand relationships at an all-time high, there is an opportunity for consolidation in the highly fragmented European market.

As well as this, swimming against the tide, Frasers has bought and built a ~15% share in the £11bn UK premium / luxury clothing market, such that we estimate that they capture close to £1 in every £3 pounds spent outside of own-brand stores. Whilst 85% of department stores have closed in the UK since 2018, through House of Fraser and Flannels, the group is filling the void as the way for luxury brands to reach customers outside of London. The exodus of other players means the group, in conjunction with Sports Direct, can achieve highly favourable lease terms, often with low turnover-based rents and landlords making considerable capex commitments.

We are also optimistic about the budding Financial Services business that Fraser's has started to build – both in of itself (profits) and for the second order effects it endows (incremental sales). The acquisition of Studio Retail brought with it a hard-to-come-by consumer credit license, and the focus is now on the roll-out of Fraser's Plus, the group's in-house Buy Now Pay Later offering. Financial Services achieves trailing operating profits just shy of £60m. We note Next's financial services business is nearly three times larger and see no reason why Fraser's can't achieve similar success.

Finally, capital will likely also continue to be allocated to real estate and stakes in listed businesses, both areas where the company has shown itself to be a shrewd operator.

The attractions and value potential seem far from reflected in the current share price, which languishes at 9x this year's underlying earnings. Looking out to next year, the shares trade at 8x, a discount of c.40% to peers (adjusting for depreciation differences), and well below the 14x they have averaged since the listing in 2007. Under the leadership of Michael Murray – who is incentivised to the tune of £100m to lift the share price from the current £8 to £15 by October 2025 – we believe the company is not only taking steps to drive value creation but also to rectify the undervaluation. Recent measures to improve financial disclosure, renewed investor relations activity, significant board additions, and continued share buybacks are moves in the right direction, although there remains lots more to do.

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IMPORTANT INFORMATION

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