Farrer Wealth Advisors

Farrer Wealth Managed Solution Quarterly Update

Q1 FY2022 Returns Summary

(Quarter ending September 2021)

All values in SGD terms unless otherwise stated, data is as of most recent quarter end

					Year-to-Date Returns		
Model Portfolio Returns*	**Q1**	**Q2**	**Q3**	**Q4**	**Portfolio**	**Benchmark SGD****	**Benchmark USD**
FY 2022	-0.20%				-0.20%	-0.02%	-1.26%

	Cumulative	Annualized
Model Portfolio Return Since Inception***:	-0.20%	
Benchmark (SGD) Return Since Inception:	-0.02%	

Top 5 Holdings (Alphabetical Order)	Key Terms:	
Evolution	Management Fees:	1% p.a, monthly
Facebook	Performance Fees:	15% p.a/bmark
IAC	Minimum Size:	S$250,000
Sea Limited	High water mark:	Yes
Sendas Distribuidora	Liquidity:	30 days notice
Total Weighting of Top 5: 46.47%	Structure:	SMA

* In order to display the most accurate representation of the returns, we use a model portfolio which has been subject to full fees since the inception of the Managed Solution. While this model account is a real client account, clients should check their own statements via their Interactive Brokers accounts to ascertain their returns as fluctuations between accounts are to be expected. Model Portfolio returns are in SGD.

** We use the iShares MSCI ACWI ETF as our Benchmark. Since this Benchmark is in USD, we convert to SGD based at the prevailing FX rates for an easier comparison. All return figures are indicative only, clients should check their own statements via their Interactive Brokers accounts for accurate figures.

*** Inception was 1st July 2021; The Managed Solutions financial year goes from July-June

Background

We launched the Farrer Wealth Managed Solution ("Managed Solution") on 1st July 2021. The goal is to provide our clients with positive returns over the medium and long-term using bottoms up research and asset selection. While the mandate of the Managed Solution is quite broad, we tend to stick to equities as it's the asset class we know best. Typically, the Managed Solution will have between 12-20 positions in assets which we believe will outperform the relevant benchmark over time. Our investment decisions are based on deep fundamental research, much of which we publish on our website. Investments are sector and geography agnostic, and instead focus on businesses that are growing market share in markets that are growing. The Managed Solution's goal is to give our clients outperforming returns so that they do not have to make the individual asset selection themselves. The solution does not short nor use leverage but may buy options from time to time to hedge or express a particular view.

A word on returns

In SGD terms, the Managed Solution returned -0.20% this quarter, underperforming the benchmark, which in SGD terms returned -0.02%. This was a frustrating quarter with the market performing the cha-cha (one step forward, one step back), and many of our holdings remained stubbornly rangebound. That said, with very little exception, each of our portfolio holdings delivered solid results

during the quarter, and overall remain woefully undervalued. Thus, we remain excited for the quarters ahead. We also are still holding ~13% of net asset value in cash and gold and will use any continued market sell off to add to our positions. As we have stated, we don't measure our performance on any given quarter, and rather look to a three-to-five-year period to deliver outperforming returns.

A quick word on benchmark

We often get asked why we selected our benchmark (the iShares MSCI ACWI ETF) and if we use it as a guide. To answer the first question, it's because we believe if our client wanted to receive a (very) broadly similar exposure to the Managed Solution, they could simply buy the ETF. This is because we mostly invest in equities and do so globally. That said, with regards to the second question, we do not use the benchmark as a guide whatsoever. Gun to our heads, we could guess at what the top five holdings of the ETF are, but we wouldn't be able to tell you their weightings or any other details of significance.

A not-so-quick word on our portfolio

Going forward we will comment on each asset we own if it is a new addition, if we've removed it from the portfolio or if there has been a significant development during the quarter. However, since this is our inaugural letter, we will discuss some of our lesser-known names in our portfolio. Should you want to dig into our ideas further, we tend to publish most of our research publicly on our site, so head over there to read the full-writeups. Do note that almost all our positions as of 1st July were ones we had already recommended to clients previously. Besides two small starter positions (which we may comment on should they become full positions), there were no "new" additions to the portfolio this quarter.

Evolution AB:

Evolution (EVO) develops and operates live casino gaming solutions. They are best known for their live studio games which are licensed to online gambling companies. The live studios are operated by EVO, who set up the space, train the staff, create the interface, and manage the games for any cheating/abuse. For those not familiar with live casino, it gives you the feel of a casino but while playing at home. The dealers are real, the interaction is intimate, but the cards and chips are all virtual. (see image below)

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EVO is the market leader in this space with over a 60% market share. This has been accomplished by providing a higher-quality solution than competitors and being far more innovative. This innovation, led by the company's CPO Todd Haushalter, has birthed games such as Crazy Time, Lightning Roulette, and Infinite Blackjack. To understand how and why the company innovates, watch this video about the making of Crazy Time. From our channel checks and expert interviews, we have learned that EVO is a 'must have' brand for online casinos. Players expect to see EVO games when they enter virtual lobbies and at times, even seek out their favourite dealers (who interact with the players).

EVO makes money by taking a 'cut' of the gross gaming revenue (around 10% take rate) as well as earning a fixed fee to set up 'dedicated' tables for operators who want it to appear that the studio/dealer is their own. The company has grown its revenues by 49% on an annualized basis over the last five years and boasts EBITDA margins of 68%. Despite its dominant market share, rapid growth, and fat margins, the company trades at only 30x 1Y fwd EBITDA multiple. This, in our opinion, low multiple, is due to certain perceived risks by the market, ones which we will discuss those below. Some we believe are real risks to consistently evaluate, while others make little sense to us.

- *China, China, China:* Several shareholders were bemused this quarter when on days when Chinese gaming stocks sold off, EVO would too. It seemed like the market seemed to confuse "gaming" with "gambling" and anything related to the words would selloff. To be clear, online gambling in China is completely illegal, and EVO does not operate in markets which are considered "black". That does not mean that EVO does not eventually serve a Chinese clientele, which is obvious with its versions of Sic Bo, Fan Tan, and Baccarat. For one, the Chinese diaspora globally is large, and secondly, Chinese players can access EVO games by playing on sites based out of the Philippines (for example) via VPN/CDN. However, as stated, online gambling in China has always been illegal, and China cracking down on other industries (gaming, education, etc) is not 'new' news to the gambling industry. That said, one of the biggest risks to the EVO story is that most of its revenues do come from unregulated markets. Unregulated does not mean illegal, it means where the rules are 'grey' or undefined. We have seen significant parts of the world recently turn

from 'grey' to 'black', such as in India where three large states (combined population of 150MM) have declared online gambling illegal. Further, countries like Germany and the UK are tightening their rules. That said, we see this as a short-term disruption but long-term gain. EVO and all gambling websites would benefit from clearer regulation globally and having rules in black or white will give a lot of clarity and certainty to the investor base. Tighter rules benefit players like EVO who have the margins to spend more in countries where competitors would find it cost-prohibitive to operate in. Lastly, the world's largest consumer market, the US, has started to warm up to online casinos. With state budgets across the US on the brink (Forbes put budget shortfalls at $450bn over the next 3 years), over 30 states have either launched or legalized sports betting. This is generally a precursor to allowing online gambling, with a handful of states having already legalized and launched online gambling, notably New Jersey, Pennsylvania, and Michigan. In the latest quarter, EVO's revenues from North America grew nearly 3x despite only operating in two US states at the time.

- *Bringing it in-house:* We've seen some consolidation in the casino market with several M&As occurring recently (potential purchase of Entain by Draftkings, 888 acquiring William Hill, Draftkings purchasing Golden Nugget Online). This has led to talk of two potential risks for EVO. For one, consolidation means that operators could have larger operations and thus, more bargaining power. However, considering there are over 1,000+ online sites offering gambling, and over 100 significant players, there needs to be a lot more consolidation before this becomes an issue, and so far, the company has guided to maintain its current margins. There is also talk about how some operators, especially land-based casinos, bring their live gaming operations in-house. However, every expert we talk to has told us that this is incredibly difficult to do, and many have tried and failed. The key here is understanding that EVOs studios are not just a building full of tables, but instead a television studio combined with a casino, all backed by systems developed to maintain quality and detect fraud.

- *Sell all growth!* With the 10 yr and 30 yr yields rising, growth stocks took a hit toward the end of the quarter. However, we feel that "growth" has become a catch-all word and all types of companies get painted with the same brush. The market seemed to make no discrimination between a company trading at 23x sales with no profits, versus a company trading 23x sales but with nearly 70% EBITDA margins.

With EVO, we expect to see several positives in the next two quarters. The launch of the Michigan studio, the release of a slew of new games, the incorporation of the Big Time gaming acquisition as well as a potential return to growth for its NetEnt acquisition. It's also an exciting time to be accumulating the stock as it is trading cheaper (valuation wise) than it did at the start of the year despite 60% organic revenue growth (100% if you include acquisitions), all of which is after a market-beating YTD performance!

Sendas Distribuidora

Sendas Distribuidora operates Assaí Atacadista (Assaí), the largest standalone cash and carry (C&C) business in Brazil, and the second largest food retailer in the country. The company (as of August 2021) operates 189 stores and will cross over 210 by the end of the year. Sendas was spun off its parent, GPA, earlier this year, to unlock value in the C&C business, which has been a fast-growing segment of Brazilian food retail. This boost has been particularly strong during covid lockdowns as cost-conscious shoppers turned to the lower prices of the warehouse model, choosing C&C process to complete their "compra do mês" (monthly shopping). In 2020. C&C as a business model increased its market share of retail grocery shopping to 26.7% versus just 13% for Super/Hypermarkets, and has a 65% household penetration rate in 2021, overtaking supermarkets. C&C is now the most popular food sales format in Brazil and as such, Assaí not only serves the lower/middle-income groups but is also patronised by more affluent individuals. Assaí stores are strategically located in peripheral areas while still remaining close to city centres and are easily accessible by car. Locations offer large parking spaces to allow ease of loading bulk purchases made at the store.

Assaí's main competitor, Atacadão (operated by Carrefour Brazil), operates 236 cash & carry stores but that is one part of a larger business that also includes supermarkets, hypermarts, and drugstores, etc. Assaí has been able to compete extremely well against this larger competitor due to a few reasons. For one, Assaí has a far more flexible business model, offering different sizes of stores depending on the location/demand, focusing on organic growth rather than inorganic expansion (Atacadão has made several acquisitions over the past year), and having far more efficient store designs and layouts. This has led to Assaí having an average sales/sqm figure 29% larger than its competitor.

We were a bit unsure about the above having never been to either chain (and we couldn't visit due to the pandemic) so as part of our investment process we hired freelancers to walk into the stores and take photos and record qualitative data for us, and indeed, it became clear that Assaí was a far more efficient operation. Over the past five years, the Assaí brand has grown its topline by 30% a year, and while the future will not be as swift, we do expect 15-20% growth for the next several years. The company is led by Belmiro Gomes, who while we haven't spoken to yet (we have spoken to other members of the c-suite), strikes us as a unique leader. For one, unlike his counterpart at Atacadão, he appears highly engaged with the business at the ground level. He's at each store opening, is active on social media when greeting new employees or saying goodbye to veterans leaving, and we've heard he also spends significant time at his stores where he's been known to stand behind cashiers to gauge efficiency. This behaviour reminded us of the founders of Home Depot who also took a heavy hands-on approach, which led to enormous success.

When we initially recommended Assaí to our clients, the company's stock was trading at ~9x EBITDA, despite the price increasing nearly 50% since then, the EBITDA multiple has stayed the same. We're excited for the growth ahead and the price that it's being offered to the market for, given the quality of the business and the management. Now with any investment in South America, currency is a factor,

but if we're right about Assaí's potential, even with the currency depreciating at the same rates as the past, we should still make a solid return on our investment.

eDreams Odigeo:

The newest entry into our portfolio, eDreams is a timely investment considering where we are in the pandemic recovery cycle. eDreams Odigeo is the leader in Europe for OTA Flights, and third in the world behind Expedia and Ctrip. The company is an amalgamation of several brands including eDreams, GoVoyages, Opodo, Travelink, Liligo. Initially primarily focused on flights, the management team, led by Dana Dunne (previously of EasyJet and AOL) has transformed the company to focus on non-flight bookings (seats, insurance, car rentals, hotels) in the past several years, and has launched an ambitious (but successful) Prime program which gives travellers large discounts on flights and hotels for a EUR 50-70/annum fee.

As of Aug 2021, Prime has over 1.5 million subscribers and eDreams is acquiring them at an accelerating rate (500,000 added in just 3 months, whereas the previous 500,000 took 15 months to achieve). Prime makes customers 2.2x more profitable over 12 months and over 4x more profitable over 36 months. Prime members now make up ~40% of bookings, which reduces reliance on metasearch/Google as members become captive audiences. 52% of flight bookings are now made on their app, reducing CAC by 37% from FY15-21.

As of now eDreams trades at 11x 2019 EBITDA, and at a discount to industry peers. We feel that the market is not realizing the benefit of Prime, and is caught up on two main issues.

- *Loss-making product:* There is an impression that the market has that Prime is a loss-making product. On the surface we can see why this impression exists. For one, Prime's cost to the subscriber is just Euro 50-70/year whereas discounts are given on every purchase. One can imagine that it won't take much of a discount or too many purchases to 'eat up' that Euro 50-70. However, there are a number of levers being pulled behind the scenes. For one, the discount is offset by the revenue received by eDreams from the Airline/hotel. Second, eDreams operates a complex algorithm which dynamically prices the discount for the customer based on how many additional products they may purchase. This is a key part of eDreams 'secret sauce,' as they have made significant progress in diversifying their revenues away from purely the flight. In fact, out of 100 flight products sold, 88 ancillary products are also sold (seats, insurance, rental etc). These additions are highly profitable for the company and help make up for the discount. Lastly, once a customer becomes a Prime subscriber, the customer becomes captive, and will return to eDreams to book again at no additional spend on acquisition. Our conversation with management (and former management) has reinforced that it would be a rare case indeed for a Prime customer to not be LTV/CAC positive. This is starting to show in the results, with Q1FY22 numbers showing that the success of Prime has allowed the company to return to cash EBITDA positive, just 5 quarters after the pandemic began.

- Copycats: The other pushback we get is that if the program is successful, each of the other OTAs will copy it. For one the evidence for this is weak, as almost every OTA has some sort of loyalty package or service. So it's clear that each OTA is taking a different approach to customer retention, but only eDreams has gone with the subscription model (well, so has TripAdvisor, but see our writeup as why we don't think they will be too successful). The beauty of the model is that it gives the customer instant gratification whereas more loyalty programs require you to be "loyal" for a while before you start to reap the benefits of the discount. Second, it doesn't seem like every OTA can just copy Prime. Our conversation with an ex-csuite member left us with this *"You can really kill yourself with a program like Prime if you don't have it optimized and if you don't have the right algorithms. Let's say that you are not able to screen well the prices you are offering in Prime and you start offering huge discounts to people that would come direct in any case. You're draining yourself. If you are not able to attach seats better than anyone or bags better than anyone, or if you do not have products like insurance for any reason and know how to retail it, then you will not have the additional dollars for every booking that would make the booking profitable. If you don't have that, it can become a serious drainer to your business. There is a huge amount of capabilities having been invested in Prime so it's not that easy to copy."* It's clear from this quote that eDreams has built a unique ability to pinpoint who to offer discounts to, cross-sell products better than others, and manage a tricky program incredibly well. Given they've been experimenting with Prime for over 4 years, eDreams has a huge advantage over their competitors.

As stated above the market seems to be refusing to give eDreams much credit for the Prime program. However, with delta cases falling around the world, and travel coming back, we believe the end of 2021 and most of 2022 are going to be strong years for the company and feel lucky we got to build our position as cheaply as we did.

A word on portfolio construction

We've realized that when it comes to portfolio construction there is no one correct strategy because if there was, we would have all copied it and all become billionaires. What we are convinced on, though, is that how a fund or a portfolio should be constructed should reflect the manager's personality. For example, we don't think we could run a portfolio like Charlie Munger, who had just two to three holdings at times when he ran his partnership, or like Peter Lynch who had hundreds of stocks in his portfolio. Further, we don't think we could have a portfolio full of growth stocks nor a portfolio full of value. We have in our portfolio stocks trading at 100x EBITDA as well as those trading at 10x EBITDA. We own businesses from across the globe, from companies heavily investing cashflows to gain market dominance in the ecommerce space to conglomerates who have 30% of their value in cash. This 'balance' is not by design, it's a reflection of our personality. Anyone who knows us well knows we like to live our life in balance (or at least strive to do so) with no one part of our life completely overtaking the other. Thus, when we look for businesses to invest in, we don't necessarily focus on one area or one type (although there are industries/countries we avoid but that's another

story). We let our curiosity take us to wherever we think a great business exists and try to buy them for at least what we think they are worth (if not cheaper). Put it another way, we feel our portfolio is diverse without actually seeking diversification. The only thread in our investing tends to be investing in businesses that are gaining market share in markets that are growing.

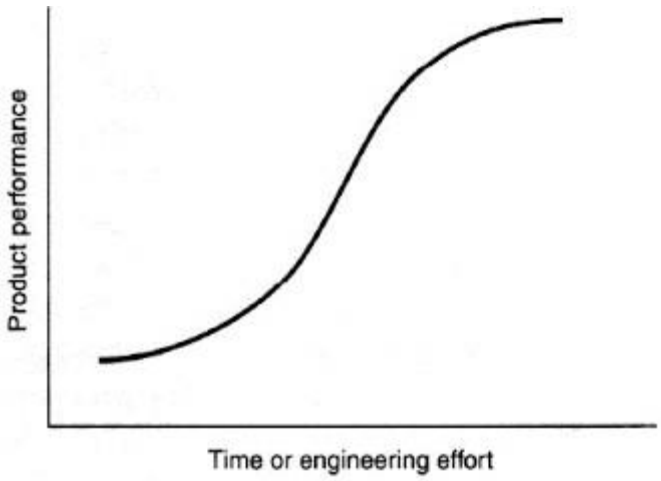
Lastly, many of our clients have a significant portion of their liquid net worth in our Managed Solution, so having that balance helps them stick with the strategy during tough times. Further, that balance helps them and us sleep well at night, which we've discovered is really the key question to answer when it comes to portfolio construction.

A word on position sizing

Position sizing and portfolio construction go together so you cannot comment on one without commenting on the other. Again, we don't think there's a "right" way to position size although in this case, there could be some wrong ways to position size (basically look at any fund that's blown up and don't do what they did). The way we think about position sizing is quite simple but works with our overall portfolio approach.

We generally have 3 tiers of portfolio sizing – small, medium, and large. We won't comment on what those percentages are, but for the purposes of this discussion a general description will work.

We then assess the business on where it is on its innovation curve (most of you will be familiar with the curve, on the right). Now this is typically used for 'tech' businesses, but we find it can apply to any business if you just think of the curve of where they are in their product development and expansion.



We tend to avoid businesses at the extremes such as on the far left of the curve which are yet to generate significant revenues (certain SPAC targets come to mind) and we also avoid the far right where a business growth might be slowing significantly or where innovation might be completely stagnant. We then overlay valuation onto the curve to determine if that business will take a small, medium, or large position in our portfolio. For example, a company like Evolution will earn a 'large' position for a few reasons. It has a best-in-class business, is growing rapidly, and still has significant room for growth (including optionality) and is trading at what we think are very reasonable valuations for the quality of the business. However, a business like Adyen, which we think shares almost the same characteristics as Evolution, will only earn a 'medium' size position because we think valuations are stretched. Frequent followers of our blog will know we had significant success with our Afterpay recommendation early last year, however that business only occupies a 'small' position in

our portfolio now as we think BNPL is still in its very early stages of evolution, Afterpay and Square have a lot to prove post-merger, and valuations have become quite demanding. That said, we are obviously still bullish. We are just not as bullish as we were when we first initiated the position due to the dynamics discussed.

Do note the above is how we determine *initial* positions. What happens to the position after that is determined by a few factors. We are strong believers in letting our winners run (although we'd be lying if we didn't trim from time to time – remember, 'balance') and will add to positions if either valuation relative to business quality falls or if the business continues to execute/impress. Similarly, we will cut or sell businesses if the opposite turns out to be true.

A concluding word

As this is the Managed Solutions inaugural quarter, this letter has run a bit longer than what we expect to be the average length going forward. We wanted to flesh out the thinking behind our Managed Solution so that our clients can better understand our thought process, and we hope you've enjoyed reading those thoughts.

We sincerely want to thank our clients for joining us on this journey. It is an immense privilege to manage your hard-earned money, and we don't take the responsibility lightly. We remain honoured by your trust, and while we can never guarantee returns, we do guarantee that we will work everyday to justify that trust. Should you have any questions – please feel free to reach out.

Lastly, for non-clients reading this letter, if you are interested in learning more about Farrer Wealth please reach out at pratyush@farrerwealth.com. All interested parties must be based in Singapore and must be Accredited Investors (as per MAS's definition).

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