Farrer Wealth Managed Solution Quarterly Update

Q1 FY2023 Returns Summary

(Quarter ending September 2022)

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%	-7.40%	-20.47%	-21.96%	-42.64%	-12.39%	-15.15%
FY 2023	-3.59%				-3.59%	-4.67%	-7.22%

	Cumulative	Annualized
Model Portfolio Return Since Inception***:	-44.70%	-37.74%
Benchmark (SGD) Return Since Inception:	-16.52%	-13.45%

Top 5 Holdings (Alphabetical Order)	**Key Terms:**	
eDreams Odigeo	Management Fees:	1% p.a, monthly
Evolution	Performance Fees:	15% p.a/bmark
HDFC Bank (ADR)	Minimum Size:	S$250,000
IAC	High water mark:	Yes
Sendas Distribuidora	Liquidity:	30 days notice
Total Weighting of Top 5: 55.04%	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
** 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
*** 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. Through the solution we aim to provide our clients with positive returns over the long-term using bottom-up research and asset selection. While the mandate of the Managed Solution is 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 businesses that we believe will outperform the relevant benchmark over time. Our investment decisions are based on deep research, much of which we publish on our website. Investments are sector- and geography- agnostic. We focus on businesses that are growing market share in markets that are growing. The solution does not short nor use leverage but may buy options from time to time to hedge or conserve capital on a position.

A rocky start to our second year…

This quarter the Managed Solution returned -3.59% versus the benchmark's returns of -4.67%. For the 2022 calendar year so far, the Managed Solution returned -40.16% versus the benchmark's returns of –21.39%. Since inception (5 quarters) the Managed Solution has returned -44.70% versus -16.52% for the benchmark (all figures are in SGD terms).

This quarter marked the start of the second year of our Managed Solution. While we outperformed the benchmark this quarter, outperforming while still losing money feels about as good as winning first place when there are only two competitors in a race and neither of them finished. This quarter

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was even more schizophrenic than the ones previous where the market went from predicting softening inflation and a fed pivot to nuclear war fears, fed-induced destruction of the global economy, and potential bank failures in a span of few weeks. Our portfolio reflected this via a volatile performance throughout the quarter. The earnings of our portfolio companies were overall very decent, with a majority beating earnings estimates and most others just marginally missing. However, this quarter it seemed that fundamentals really didn't matter, and once inflation numbers came in hot and the fed continued its hawkish stance, correlations essentially went to 1 and all assets seemed to sell off. Investments in typically 'safe' assets did not help either with gold down 10%, major bond indices down 15%, and long-dated US treasuries down nearly 30% this year. There have been pockets of success especially in the energy sector (although also sold off from its highs), it's not an industry we make investments in as it is outside our circle of competence.

None of this is to defend the performance of our portfolio which we will discuss below. However, it is to paint a picture that it's been a tough year for investing in general, and no matter what asset you choose you were likely to lose money. Unfortunately, this is part of investing, and years with negative returns are all but certain. The good news is that these drawdowns have created fantastic opportunities that we are excitedly assessing and if appropriate, adding to our portfolio.

A word on performance…

The above notwithstanding the performance of our portfolio continues to be poor on a relative basis. While we can make several excuses about the market not valuing our companies appropriately, or about the macroeconomy the reality is simple. 1) *We are down* because we run a concentrated portfolio that contains positive beta stocks, so when the market posts negative returns so will this strategy and 2) *we have underperformed* because our portfolio companies have fallen more on average than those making up the benchmark.

As stated in our previous quarter's letter I don't think we could have avoided losing money this year. This is unless we had gone to almost all cash or shorted stocks – neither of which is allowed in this strategy. However, our continued underperformance is our fault.

Yet, before we get too far into a struggle session let's look at the positives.

- Our portfolio has had some winners. Our positions in Sendas Distribuidora (Assai) and HDFC Bank both outperformed YTD and were significant positions in the portfolio.
- Most of the underperformance of our portfolio was driven by results in Q42021 and Q12022. Since Q12022 (or March this year) our portfolio has performed largely inline with the benchmark especially after considering FX (about 50% of our portfolio is denominated in non-USD currencies, including ADRs[1]). Also, as stated above our portfolio did outperform, albeit marginally, this past quarter.

[1] The SGD is correlated to the USD

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- During periods of positive momentum our portfolio has outperformed. During positive swings in March and July/August this year the portfolio outperformed by about 5%+ and 2%+ respectively.

Given these points, it does seem that are silver linings in the portfolio, and we could be bottoming with respect to our underperformance. However, I do believe that to turn positive we would require the macro environment to improve.

Portfolio positioning…

Given the macro background we have been reallocated capital to businesses that we think are either continually executing or are just 1-2 years away from their inflection points. Thus, our top 4 portfolio companies Assai, eDreams, Evolution, HDFC Bank all continue to post excellent results, and I believe are ripe for appreciation as market sentiment improves. Our fifth largest position, IAC, had had a tough year given the merger between DotDash and Meredith and the excruciatingly slow turnaround of Angi. Based on our conversations with the company most of the work needed to integrate Meredith is done and now the company can start playing offense with regards to bringing in advertising dollars. The business should do around ~$300MM in EBITDA within the next year, most of which should translate to free-cash flow. Considering the values of IAC's stakes in MGM and ANGI, this generation of free cash would value the remaining business at 10x.

Considering this focus on near term profitability, the next question to ask is what we've done with our positions that are likely to take several years to inflect i.e. Spotify and Sea Limited[2]. We've essentially trimmed those to about ~8% of the portfolio (in total). While we are still bullish on both Spotify and Sea's long-term prospects, they need several years to prove out their models. Now neither is without risk and need to be watched. Sea has real liquidity problems, that, if they don't solve by significantly lowering their cash burn rate over the next two quarters, will get worse. Spotify, while in my opinion has been executing wonderfully with regards to product and user growth, still needs its gross margins to inflect. This will take several years so committing too much portfolio capital here in my opinion is a mistake. A valid counterpoint here might be – why not sell these and buy them back later when their economics improve. There are two reasons for this, 1) the move in these stocks will be rapid when economics become clearer meaning we may miss out on significant upside before we buy them back and 2) While it was a mistake to have too many high-beta names going into this year, I think that error would be compounded by having none right now. We have already seen the Bank of England blink, if the Fed blinks (which is far from a non-zero possibility) high-beta tech stocks will fly.

[2] see our Q1 and Q2 letters where we discuss these positions in more detail

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Portfolio Changes…

We made one addition to the portfolio this quarter and made one almost exit. We have also added a starter position in one other business which we will discuss if we build it into a full position.

TaskUs (TASK)

Yes, another BPO (business process outsourcing) company. We started a position in TASK last quarter but only built it into a full position this quarter. This investment might raise some eyebrows due to the industry it is in, but I strongly believe that BPOs get an unfairly bad rap. Yes, there are low barriers to entry and yes services/offerings capabilities tend to be uniform among competitors, but scaling is quite difficult in the industry. That's why if you observe some of the leaders in the industry such as Accenture, Teleperformance, Genpact etc they have had consistent growth over the last 10 years (except for in 2020) with steady margins. Thus, even after the drawdowns this year the stocks of these businesses have compounded at around 12-15% annually over the past five years.

TaskUs was started in the late 2000s by friends Bryce Maddock and Jaspar Weir right after college, TaskUs started as a business to provide buys professionals with virtual assistants based out of the Philippines. They quickly pivoted to more traditional outsourced work (data entry and transcription) for venture-backed tech companies. TASK was amongst the first to have a tech-focused strategy by taking on business that was deemed 'too small' by the industry incumbents. After proving themselves, they were given more complex work such as advanced technical support and critical content review. TaskUs was bootstrapped for the first seven years and kept costs low by adopting technology and streamlining the hiring process (days vs months).

To give a sense of how hard it is to scale and how well TaskUs has done, in a bit over 10 years the company's revenue is about to crack US$1bn. TDCX, a key competitor, has been in the business since the late 90's does only around $650MM. Now, the cat is out of the bag. Every BPO company worth its salt is focusing on "digital-born" clients. So competitive advantage is derived from the following.

- **Sales and Marketing:** It cannot be understated how important a solid sales and marketing function is for a company in this space to grow. If you don't have it in place, sales will stagnate. TASK excels here in our opinion as evidenced by how it has continually lowered its concentration of revenues from its top two clients. Concentration is normal in this space as most firms get their start from one or two large clients. Getting away from this concentration is difficult though, and only the best do it well. Our checks have shown that Jasper Weir (co-founder and current President) is not so involved day-to-day but spends most of his day drumming up business for the company and is connected to most of Silicon Valley allowing the top-of-the-sales funnel to open.
- **Focus:** This industry was built on sales agents handing phone calls of irate telecom customers. While this seems dated, most of the industry revenue still comes from "voice" customer service work, which tends to be low-margin and difficult to execute well. TaskUs is focused instead on digital customer experiences, content security, and artificial intelligence

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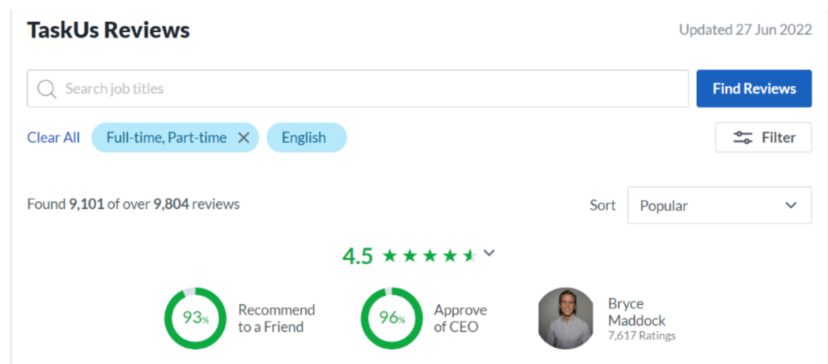
operations. These are higher value-add and higher-margin businesses (TASK's EBITDA margins are around 22% versus 15% for the industry).

- **People management:** The BPO industry is not an easy one to work in. The work is taxing, stressful, and pay can be low. Companies have also been accused of not giving adequate support to employees doing content moderation work. TASK's founders understood this about their industry and decided to go an opposite route. They offered great benefits to employees – like what would be found in Silicon Valley. This included 120 days of paid maternity leave, paying above market wages, tropical vacations for best performing employees, kids' education funds, and getting to work on exciting projects. They aligned their culture with that of their tech clients, so much so when the Facebook team visited TASK office in the Philippines, they commented on how similar the feel was to that of their office in Mountain View. While attrition is generally high in the industry (and attrition numbers are gamed frequently) TASK does have the best Glassdoor ratings among its peers. A strong culture and work environment does result in lower attrition and greater client satisfaction.



TASK has had a tough year and considering it is interlinked with tech companies its stock sold off with the high-growth tech. At one point the stock was down 75% YTD and that proved to be a good entry point with the company trading at less than 7x EBITDA. The company also posted decent Q2 results but had to scale back guidance due to a drop off from crypto-related clients. While this might make tough Q1 and Q2 comps in 2023, we should see growth reaccelerate in the back half of the year. With management guiding to improving margins as the onshore/offshore mix stabilizes and the $100MM in share buy backs (vs current market cap of $1.6bn) announced, we believe there is a high likelihood this stock doubles in a few years.

Meta

While we are still completing our sale of Meta, we have decided to exit the position. It was a tough loss for the portfolio given the drawdown from our holding price (roughly down 50%) but despite the cheap valuation the various layers of our thesis kept breaking. We initially invested in the company for 4 reasons. Below we'll discuss how those panned out.

- *A dominant social media conglomerate with a growing/steady user* base – while overall daily active users have grown since we invested, we are starting to see weakness in Europe and UCAN numbers. While the drop off is slow we are seeing data that time spent on the family

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of apps is behind the likes of TikTok. Bulls here point at the success that the company is having from downloads in emerging markets; however, the issue is that ARPU for a US and European user are about 10x and 3x higher respectively than that of an Asian user. Thus, for every loss of a western user, Meta needs to add 3-10 net users in the rest of the world. Also, as forays into Asia for companies like Netflix, Spotify, and Disney have shown, Asian users do not monetize easily and when they do so in small amounts.

- *Ability to shake off elimination of IDFA*: This has not been the case. The company has admitted that not having access to third-party data has affected both targeting and measurement. This seems to have impacted the company at a tune of $10bn a year, which doesn't sound like a lot considering their revenue base but has a margin impact and forces the company to spend a lot on R&D to close the gap. We have though seen from expert calls and transcripts that it seems that budgets are coming back despite poorer targeting and measurement (it's getting better but not quite where it was) as there is no clear alternative yet. But this impact has certainly been felt with almost 0 growth expected this year in the top line. The problem with a company like Meta is that they have so many clients it's hard to string together a trend from a few data points so only earnings will tell if growth is back and if so that it is sustainable (and not just of a low base).
- *Significant monetization potential (shopping, VR, payments)* – While WhatsApp seems to be making progress with payment and JioMart checkout, this is in emerging markets. VR at this point seems to be far too early and somewhat of a must-do-to-survive project which is burning billions of dollars a year. Lastly, it was disappointing to see Instagram step back from shopping as further monetization of that userbase in the US would have been quite lucrative. Overall, we haven't seen any monetization attempt excite us. Further the ads business will also take a hit while the company figures out how to monetize Reels.
- *Valuation:* This is the one part of the thesis that has strengthened in a way. The stock has gotten even cheaper. We entered the position at a 15x future EBITDA, and that has dropped to less than 7x. Unfortunately, this is due to both a declining numerator and denominator making this not enough of a leg to stand on by itself.

Overall, I would say most of the theses are broken or are partially broken forcing us to sell out and reassess. While we have been trimming the position for a while, the last tranche is likely being done at the lows. However, we do need to stay disciplined to the fact that our thesis is broken and exiting the position will allow us to reassess with a fresh set of eyes.

Macro…

I never thought I'd have to comment on the macro environment this much, but that was a privilege for calmer days. The overall environment is certainly troubling, and this has let to a negative sentiment that seems to be driving most assets. While I don't have an opinion on the near future, I am of the belief that eventually inflation will come under control and eventually rates will be cut. This is because the world has faced both high inflation and high interest rates before and come out the other end.

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That's not to say that it was not without significant pain, but we are feeling that pain right now both in markets and in our personal lives. The point is there is a playbook to deal with such an environment.

The issue here is that I know I have a natural bias to be bullish. I am of the belief that most macro issues the world faces eventually get resolved and we move on to better days. I am biased this way because it is all I have experience in my 35 years. Eventually – things work out and get better. I am aware of this bias however and have controlled against it by using hedges frequently, raising cash at certain times, and exiting positions that are no longer working. We will continue to do this for the foreseeable future.

That said, the war in Ukraine is troubling. I'm not sure what Russia's endgame looks like and this conflict could drag on for a while. The potential for the use of nuclear weapons is terrifying, however I think if that does happen, portfolio returns will be the least of our worries. As of now this conflict and its externalities (i.e., the energy crisis in Europe) have not affected the financial performance of our European holdings. But we are watching this closely. Basic-Fit for example could be hit hard by high energy costs, and while they have fixed those costs till the end of the year, if prices don't subside going into 2023, we might have to adjust the positing. That said our conversations with the company do lead us to believe they are being proactive here and their recent changes in membership structures have moved members to higher-paying tiers thus offsetting increases in operating expenses.

In summary…

It's been a tough four quarters or so (our first quarter was quite flat), and I have made mistakes which we discussed extensively in our last quarter's letter. The good news is I don't believe we have repeated any of those mistakes. Further, while I could throw in several Buffett quotes here about thinking long-term or about how the market is a voting/weighing machine I think it would insult your intelligence. The fact is we are down and underperforming and we must do better. We must make back lost money and at the very least, outperform. That said, I remain confident that this will occur, all we humbly ask for is patience, we are in the early innings.

We've said this before, and will repeat it often, but it is an immense privilege to manage our client's hard-earned money. It is a privilege we do not take lightly and work daily at earning and keeping our client's trust. If you are a current client and ever have any questions or just want to chat, please do not hesitate 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 Asia and must be Accredited Investors (as per MAS's definition).

Pratyush Rastogi
CEO – Farrer Wealth Advisors

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