Farrer Wealth Managed Solution Quarterly Update

Q2 FY2023 Returns Summary

(Quarter ending December 2022)

All values in SGD terms unless otherwise stated, data 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%	-5.71%			-9.09%	-1.66%	1.96%

	Cumulative	Annualized
Model Portfolio Return Since Inception***:	-47.85%	-35.21%
Benchmark (SGD) Return Since Inception:	-13.85%	-9.46%

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 (ADR)	Liquidity:	30 days notice
Total Weighting of Top 5: 56.61%	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. 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. 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 to hedge or conserve capital on a position.

Returns discussion…

This quarter, the Managed Solution returned -5.71% versus the benchmark's returns of 3.16%. So far, for the 2023 financial year, the Managed Solution returned -9.09% versus the benchmark's returns of -1.66%. Since inception (six quarters), the Managed Solution has returned -47.85% versus -13.85% for the benchmark (all figures are in SGD terms).

The loss this past quarter was entirely driven by unfavourable FX (The SGD strengthened against the

USD), as our USD portfolios had a return of positive 1%. While the continuing negative returns are hard to look at, we took the worst of losses in the first half of the 2022 calendar year. Since then (and into 2022) most positions have begun to recover as the market recognized that their prices were not a reflection of their business performance.

However, the underperformance versus the benchmark remains frustrating. Key indices like the S&P 500 and the MSCI All-World (our benchmark) remain relatively strong despite the carnage underneath. Just to give you a sense of what I mean; In the 2022 calendar year, the MSCI All-World index was down only about 20% while stocks like Apple, Amazon, Facebook, Google, Microsoft, and Tesla were down 29%, 50%, 64%, 39%, 28%, 69% respectively. Thus, it has not been an easy year for individual stocks and the benchmark has benefited from the strength of Oil & Gas stocks and China (which staged a strong recovery toward the end of the calendar year).

As I reflect on our portfolio's performance this year, it was very much a mixed bag. Our holdings in emerging markets (Assai and HDFC Bank) had strong positive returns. Our position in Evolution, while down, performed well on a relative basis. The obvious stocks that did not work were tech stocks such as Sea and Spotify for which, as we have discussed in past letters, the theses have undergone a change. These positions make up a small portion of our portfolio now. What did surprise me is how poorly stocks of businesses that are in a transition phase performed. Stocks like IAC, eDreams, and Vizio were punished in a market that is focused overly on the short-term. These stocks, which pre-covid were all profitable, are for one reason or another going through a transition in the way they operate. IAC is working through its acquisition of Meredith which will generate about $250MM in EBITDA next year. eDreams has launched a promising subscription program that has attracted more than 4MM users, and last quarter showed strong cash EBITDA numbers. Vizio is transitioning away from a pure hardware producer to a data licensing and advertising model and is delivering stable gross profit despite declining revenues. To give you a sense of what this looks like in numbers, I present the chart below, which highlights the business performance of these companies as compared to their stock performances.

Company Name	Q3_22 YoY Revenue Growth	Q3_22 YoY EBITDA Growth	Stock Performance (CY 2022)	EV/EBITDA (1Y Fwd)	Potential Upside (internal targets)
eDreams Odigeo	43.44%	26.54%	-60%	12.40	400%
IAC	41.00%	81.00%	-67%	7.15*	131%
Vizio	-26.02%	Turned Positive	-62%	16.32	94%
Multiple adjusted for MGM Stake					

As you can see, our positions have seen their market prices dislocated from their underlying business performances. Thus, I strongly believe that our portfolio contains significant embedded value, which given the right amount of time, will unlock with some force.

Portfolio Changes…

We did not sell any positions this past quarter but did add positions in Blackstone and in State Bank of India (GDR).

Blackstone (BX):

Blackstone ("BX") is an alternate asset manager with US$951bn in AUM as of Q32022. It focuses on investing in Real Estate (34% of AUM), Private Equity (29%), Credit and Insurance (28%), and Hedge Fund Solutions (9%). In the alternate asset management segment, Blackstone is nearly $200bn in AUM larger than its nearest competitor, Brookfield. Out of the $951bn of AUM, BX has $706bn of fee-earning assets and $360BN in permanent capital (assets that cannot be forced redeem nor have a scheduled date of return to investors). Most AUM come from institutions (75% of AUM) whereas the rest comes from private wealth and insurance. Blackstone differs from its key competitors such as KKR, Apollo, and Brookfield by choosing an asset light model. BX takes small stakes in insurance companies to gather AUM rather than buying them outright.

Blackstone is an interesting investment for us, as most who know us well know our scepticism of Private Equity returns in general. IRR is not CAGR and PE funds have a unique 'ability' to show little volatility in highly volatile markets. However, the fact that PE funds have significant leeway in how they value their investment, to me, seems like a feature and a bug. This ability to 'hide' volatility is something investors want whether they like to admit it or not. Institutional Investors who cannot stand volatility (which tends to be extremely common) flock to alternate asset managers for products which provide steady gains and limited drawdowns. BX, for its part, fulfils this promise and has a steady track record for returning 2x your money over the lifetime of a given fund. This consistency, as well as shrewd dealmaking/structuring has given Blackstone a solid reputation in the industry. A strong reputation for returns and consistency is imperative to reach Blackstone's scale.

Blackstone seems to have dominated the alternative asset management industry. For example, in 2021 Blackstone increased AUM by $262bn backed by $270bn in gross inflows. To put this in perspective, the Carlyle Group ended 2021 with $301bn in AUM. This implies that in 2021 Blackstone grew an entire Carlyle sized business just via fresh AUM. The firm has secured its market leading position via three key elements. Superior/steady Performance, a strong distribution platform, and a culture of promoting within and focusing on "not losing money." Our discussions with experts in the industry have illustrated that Blackstone has a deadly combination of marketing and distribution prowess combined with imaginative products (such as private REITs) that gives them a leg up over competition. This edge has made them the largest alternative asset manager in the world with fee-earnings AUM have grown 19% per year on average from 2007-2021 (inclusive).

We have been buying Blackstone during a difficult time for the stock. Peak-to-trough, the stock has sold of 50%, and this is driven by a few reasons:

- Rising interest rates which has killed the "TINA" (there is no alternative) paradigm that has existed for the last decade. This trend benefited alternative asset managers which historically could provide strong returns in comparison to treasuries and investment grade bonds.
- General fear of valuations of portfolio assets declining as the cost of capital has increased.

- “Outflows” from BREIT, Blackstone’s private REIT vehicle.

The last point, the focus on BREIT seems to have captivated most market commentators, and news about it is dominating price action. As some background, BREIT is a private REIT launched by Blackstone in 2017. It gives investors access to real estate products with solid returns (13%+ annualized since inception) and without the MTM volatility that came with public REITS. Even in 2022, when public REITs have seen double digit negative returns, BREIT is up 8.4%. BREIT has a diversified portfolio, however over 50% of assets are in the rental housing space, 20% in logistics, and 10% in hotels making the product a good hedge on inflation. BREIT has been extremely popular with the HNI base and is distributed through investment advisors. Its positive total return has an embedded 4.5% post-tax yield. BREIT has over $70bn in AUM and continues to grow. Even in 2022 with an increasing interest rate environment the vehicle continues to have strong positive net inflows. For example, in Q3 2022, inflows totalled $4.2bn, with another $900MM coming in partway through October.

This all sounds great – but the market is worried about two aspects of BREIT. The first are the returns and second are redemptions the fund is facing. On the returns, I understand the scepticism. How is it that a private REIT is up 9% when most public REITs are down 20-30%. The convenient answer is that Blackstone is not marking its asset values correctly. Steve Schwarzman, the co-founder/Chair of BX, has publicly discussed his dislike for mark-to-market accounting (“MTM”). In his autobiography, “What It Takes” he attributes a large chunk of the 2008 crisis to MTM accounting issues. Private asset managers also have significant leeway on how they can value their assets. However, I don’t think the purported truth, that the valuations are wrong, is so simple. For one, 70% of BREIT (as mentioned above) assets are in housing and logistics, which are all seeing higher rentals, some cases as high as 30-40% greater. Second, Blackstone was quick to recognize a rising rate environment, and made nearly $5bn in profits in BREIT hedging interest rates in 2022 (vs AUM of $70bn). Thus, while it’s possible the marks are not entirely accurate, it is also quite possible the BREIT has made solid investments and risk management calls that are helping them significantly outperform in this environment. On the redemptions, BREIT has always been clear and upfront about the fact that they only allow about 5% of assets to be redeemed per quarter. BREIT was hit by a wave of redemptions in November, hitting that 5% cap, which caused BREIT to gate the fund. This was, according to management, driven by Asian investors who were getting margin calls on their other investments. To counter this, Blackstone struck a deal with the University of California which infuses $4bn in fresh investment capital, for which Blackstone has put up $1bn of its own stake in BREIT as collateral against a minimum IRR of 11.25%. This deal which we believe is a win-win for all sides, gives BREIT fresh AUM to make up for those redeemed. While there was some confusion given that the initial press release was not very clear, the 11.25% is not guaranteed, and thus Blackstone is not ‘on the hook’ for it.

Beyond the ramifications for BREIT, this deal really helped support our thesis. Blackstone is an incredible dealmaker and has an above-market ability to attract capital. Even in 2008/09 when net asset values were falling Blackstone's fee-earning AUM did not fall, because they attracted even more capital than was 'lost' to MTM changes. In fact, in its public history Blackstone has never seen fee-related AUM drop each year. If this continues to be true, fee-revenue can be treated as a perpetuity, which after taking out operating expenses and taxes, has a present value equivalent to the current market of Blackstone. This implies that you are getting any carry fees and fresh AUM growth for free.

Current Share Price	79.22
Marketcap ($000s)	95,579,229
Fee-Bearing AUM (Q3 2022) ($000s)	705,865,351
Average Fee	0.850%
Revenue ($000s)	5,999,855
Op Ex ($000s)	3,748,211
Profit (after 18% Tax) ($000s)	1,846,348
AUM Growth Rate (S&P 500 LT Return)	6%
Discount Rate	8%
PV ($000s)	***91,014,438***

Further, a history of strong deal making gives me great confidence in the $180bn in dry powder the Blackstone is yet to deploy, especially given we are during tough market and macro conditions where value is dislocated. During the 2008 crisis, Blackstone did some of its best work including its deal in Hilton Hotels and its purchase and sale of Sam Zell's Equity Office properties.

Given Blackstone's history, deal making ability, distribution network (that has brought in $141bn in fresh AUM in the first nine months of 2022 alone), and the 7%+ future dividend given the stock drawdown, we believe this is an excellent time to be accumulating shares in a solid brand.

State Bank of India (GDR):

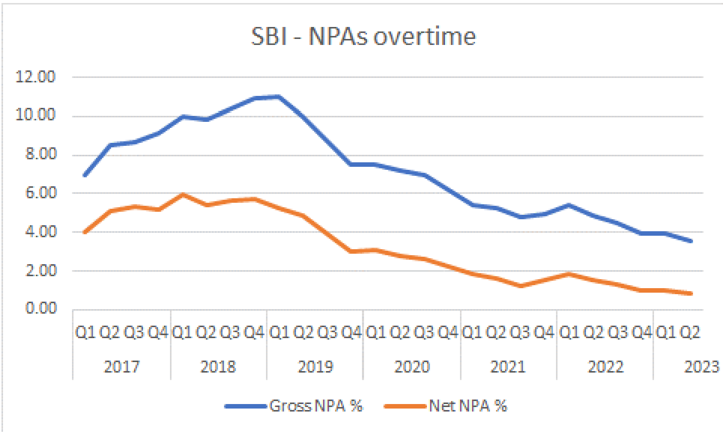
Our position in State Bank of India (SBI) is more of a tactical play rather than a long-term investment (about 10% of our portfolio is more tactical). We started to investigate SBI after our investment in HDFC Bank started to reach what we think is fair value. To take a step back, we recommended clients invest in HDFC Bank during the pandemic induced market crisis in 2020. The investment overtime has worked out very well, but there are two major headwinds facing the company. One is an overhang over the merger with HDFC (parent) and the second is that the stock trades at a premium valuation compared to most other private and all PSU (public sector) banks. Their first issue, the merger, is more of an 'obvious' problem as it throws up many questions. How will management deal with the scale and complexity of the merger? How much will the cost of funds increase? Will cross-selling actually happen or is this just marketing? However, the second problem, the premium valuation has long been a 'given' for HDFC Bank. It has grown faster, done so with better underwriting, and generally stayed out of the mess that has mired the Indian banking industry in 2018. Thus, the premium was warranted. That said, over the past few years, other banks have been cleaning up their acts and starting to put up numbers that are equivalent, if not better than HDFC Bank. Further, HDFC Bank has had some missteps, in particular, with their technology stack which led to the RBI banning them from issuing cards for a while. We find getting this piece vital in the Indian market as large chunks of incremental loans are coming from the digital channel. Now none of this is to say HDFC Bank won't do well in the long run, but considering its more of tactical position, we believe there are other places to put our money in the interim.

SBI is India's largest bank and has a history of being slow and bureaucratic. However, over the last few years it has really cleaned up its act and has started to put up strong numbers. As you can see in this table, SBI is posting figures very similar to HDFC despite trading much cheaper (see valuations below). The 'grey-area' here is if the underwriting of credit is as strong with SBI as it is with HDFC Bank. While we won't know till the next crisis, there are some really encouraging trends in the Indian banking industry as well as SBI specifically.

Q2_FY23	SBI	HDFCB
Loan Growth	19.93%	23.40%
NIM	3.55%	4.30%
Op Profit Growth	16.82%	17.00%
Net Income Growth	73.93%	20.10%
CASA Ratio	46.24%	45.00%
GNPA	3.52%	1.23%
NNPA	0.80%	0.33%
RoA (H12023)	0.76%	0.76%
RoE (H12023)	16.10%	16.08%

For one, the Indian courts have taken a strong stance against those defaulting on loans and the bank officers who sanctioned those loans. Vijay Mallya and Nirav Modi (both significant defaulters) have lost their extradition case. Chanda Kochhar and Rana Kapoor (ICICI Bank and Yes Bank CEOs) were thrown in prison and face tough court cases going forward. None of this stops bad or corrupt credit underwriting, but it does send a signal from the courts that no matter how rich, powerful, or connected you are – they will come after you if you default on loans or if you act fraudulently when in charge of a bank. A second trend is that India has gone through a few credit cycles in short-order. First was a corporate loan crisis in 2018 and the second was a tough retail credit environment during covid (although covid-19 related measures helped). Thus, a lot of the 'bad books' have been flushed out as non-performing loans have peaked and come off, helped in part by government initiatives such as the NARCL (i.e. the "bad bank"). As you can see in this chart, SBI has seen a rapid decline in NPAs.

Comparative Valuations	SBI	HDFC BANK
A) Current Price/Share	596	1570
B) Value of Subidiaries/Share	156	105
C) Standalone Price/Share (A-B)	440	1465
D) Shares Oustanding (Cr)	892	557
E) Fair Value (Rs. Cr) (C*D)	392,489	815,931
F) Standalone Book Value (Rs. Cr)	304,020	254,111
G) P/Book Multiple (E/F)	1.29	3.21



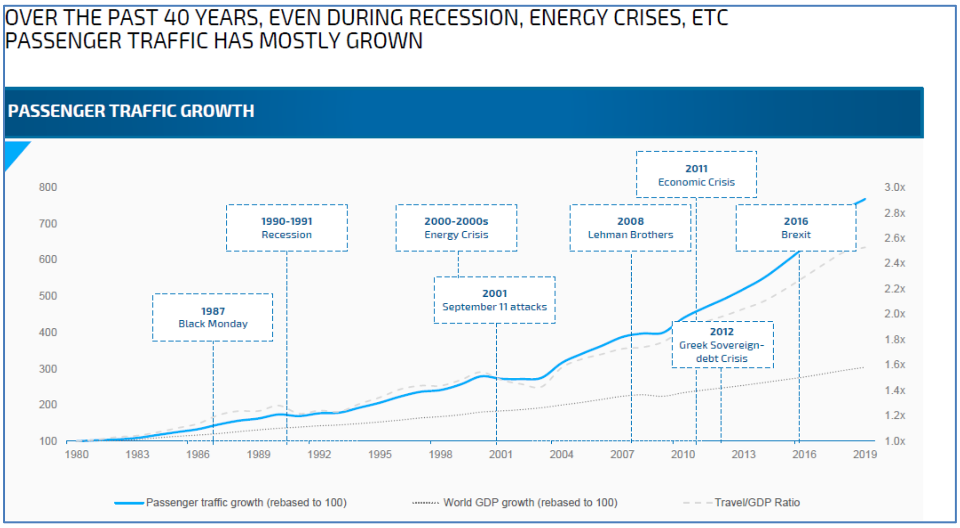
While Indian banks are continuing to expand branches, especially in rural areas, one of the key 'battle grounds' is in the digital space. Banking 'apps' are their new sales force, with each bank pushing apps onto their customers to both gather better data but more importantly to ramp up their loan books and cross sell other products. SBI has been particularly good at this, and their 'YONO' app has been hailed as quite a success. This success is showing up in the numbers with 45% of incremental retail assets and 62% of savings accounts being acquired through the app in Q2FY23. According to Goldman Sachs the YONO app is "already accounting for 30-40% of personal loan incremental growth over the past few quarters." Thus, we think over the short and perhaps medium-term SBI should perform better than HDFC Bank given the strong performance of the former and the headwinds for the latter. We are in the process of making this switch (as pricing and liquidity allows) and thus for the time being investors will see both HDFC and SBI in their accounts.

CY 2023….

2022 was a tough year for the global economy and for markets. There are strong expectations that 2023 will be much the same. It seems that while inflation is coming off, a recession in several countries is likely as restrictive central bank action stalls growth. It's also highly likely that while interest rates will not rise much higher, they will stay at elevated levels through 2023. Thus, the question becomes in a scenario where there is a recession and elevated interest rates, would our portfolio hold up?

The interest rate question is a bit easier to answer. Interest rates have two large impacts. One is on valuations and second is on debt funding. On the valuation part we have already started to hike the discount rate we use when valuing our companies and we continue to feel all our investments provide a highly attractive return from this point (on a weighted average basis we calculate that the portfolio has around a 2.5x return potential from here). The very few businesses which are reaching fair value, such as HDFC Bank, are being switched out. With regards to debt, while we do have companies that have non-minimal debt amounts, almost none of it is due till 2025. By then, all those companies should have ample cashflow to be able to pay off that debt or refinance at much better rates. There are also some portfolio companies that benefit from higher rates such as Banks (HDFCB and SBI), asset managers who mostly own floating rate note credit (Blackstone), and companies sitting on significant portions of cash (Vizio, Google, IAC, etc). Although we would much prefer, they return this cash to shareholders in one form or another.

The recession part is harder to answer because a lot depends on the length and breadth of the recession. Certainly, a prolonged and deep recession will cripple most industries, but this does not seem to be on the cards. That said, looking through the portfolio we have large pockets of strength. For example, consumer non-discretionary goods (Assai) are highly resilient to recessions. Further, while travel does get impacted during a recession, leisure travel (eDreams) tends to be far less affected. As you can see from the below chart, over the past 40 years, despite several crises, passenger traffic has not been so impacted.



But I believe the broader thing to remember is that the market leads recession by about six months. This means that it tends to start its decline much before the recession hits, and bottoms before the recession is complete. By many measures the recession has already begun. Thus, if a recession does solidify in 2023, we would have already started feeling the effects of it both in our portfolios and our personal lives. If this is true, some 'effects' of a recession should already be priced into the stocks of the businesses we own. Overall, I am not too worried about the potential pitfalls of 2023. Do note though, a lack of worry does not mean complacency, and we will continue to revaluate all our portfolio companies as earnings are released.

Looking forward…

The past six quarters have certainly not gone the way I would have liked. However, we are clearly in a bear market with a tough economic backdrop. That said, I always ask clients to invest for the long-term, and over a five-year period I am confident we will provide solid returns. We are only 1.5 years into our journey. I do understand it's been difficult to see the value of your hard-earned money decline, but I will remind you that a business is not its stock price, and overall, I remain pleased with how the businesses in our portfolio are performing. Given time, I do think their stock prices will reflect their underlying business fundamentals. I thank you again for your patience and am always a phone call away should you have any questions.

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' definition).

Pratyush Rastogi
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