Farrer Wealth Managed Solution Quarterly Update

Q2 FY2024 Returns Summary

(Quarter ending December 2023)

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%	13.54%	1.16%	4.40%	13.05%	16.33%
FY 2024	-11.29%	9.88%			-2.53%	4.50%	7.10%

	Cumulative	Annualized
Model Portfolio Return Since Inception***:	-41.62%	-19.37%
Benchmark (SGD) Return Since Inception:	3.51%	1.54%

Top 5 Holdings (Alphabetical Order)	Key Terms:	
eDreams Odigeo	Management Fees:	1% p.a, monthly
Evolution	Performance Fees:	15% p.a/bmark
Google (Alphabet)	Minimum Size:	S$250,000
IAC	High water mark:	Yes
Sendas Distribuidora (ADR)	Liquidity:	30 days notice
Total Weighting of Top 5: 65.16%	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 9.88% versus the benchmark's returns of 7.48%. Since inception (1st July 2021), the Managed Solution has returned –41.62% versus 3.51% for the benchmark (all figures are in SGD terms).

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While this was a decent quarter, we both made money and outperformed our benchmark, it was not nearly enough to offset the previous poor performance. That said, we are seeing real momentum in the portfolio and after a weak October (-9.66%), November (+11.57%) and December (+9.01%) posted strong returns. While we hope the momentum continues, it's always difficult to predict such events. Instead, it is more relevant to look at the embedded valuation in the portfolio which we believe continues to trade at ~50% of fair value (on a weighted-average basis). Thus, we think there is significant (~98%) upside remaining in the current portfolio.

	Street Estimates				
Name	**FY24 PE (x)**	**2024 Rev Growth**	**FY25 PE (x)**	**2025 Rev Growth**	**FW Projected Upside**
eDreams	70	17%	17	16%	147%
Evolution	20	18%	17	17%	88%
Assai	15	17%	10	11%	130%
IAC	8	1%	7	7%	110%
Alphabet	21	11%	18	11%	66%
Sea Limited	29	11%	15	12%	80%
Basic-Fit	26	20%	15	19%	206%
Howden Joinery	17	3%	15	6%	57%
Blackstone	24	34%	19	17%	19%
Tactical Position #1	9	13%	8	10%	30%
Adyen	47	21%	36	24%	12%
Digital Bridge	NA	4%	NA	12%	78%
Tactical Position #2a	7	0%	6	4%	30%
Tactical Position #2b	15	0%	15	0%	30%
Weighted Average	**28**	**14%**	**14**	**13%**	**98%**
Benchmark			**15**	**5%**	

We further believe that the portfolio remains both cheaper than the benchmark and growing weighted average revenues at ~2.6x the pace.

Coming back to what worked this quarter, several of the catalysts we spoke about in the previous quarter's letter were realized.

- eDreams continued to post a strong financial performance, and guided to free cash flow generation that would put the current stock price at a 10% March 2025 yield. The stock was up ~22% during the quarter and the anticipated stock buybacks haven't even started yet.
- Adyen's Investor Day reminded the market about the strength of their business. The company provided more realistic goals going forward, which was highly appreciated by the market. In this past quarter Adyen's stock was up ~65%.
- Basic-Fit's Investor Day was well received by the market, but the stock price didn't move much. However, about a week ago the company announced it was buying over a major competitor's business in Spain, proving to the market how much stronger their operations were than that of their competitors.

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We also previously spoke about the catalysts for Sea, Assai, IAC, and Digital Bridge. While we started to see inklings of those catalysts, we think another 1-2 quarters are required to show their true potential.

Portfolio Updates…

We did not add any new positions this quarter, but we did sell the last tranche of our position in Vizio.

We had been trimming our position in Vizio for several quarters, and after the position rebounded 64% from its October 2023 lows, we sold the remaining shares. We have been thinking about the types of mistakes we have made in the portfolio as we reflect on what we have done well and where we need to improve. We categorize our 'mistakes' in three buckets.

1. Mistakes in Risk Management - Not selling stocks when they reached absurd valuations or sizing positions too large.
2. Mistakes in Business Quality – When we expect a greater growth rate or margin expansion than what does occur.
3. Mistakes in Management – When management does not make the right capital allocation decisions or makes unethical decisions.

Most failed investments tend to fall into one of the three of the above, and are often a combination of a few. In the case of Vizio, the error was due to points 2) and 3) above. As a reminder, Vizio is one of the leading TV Brands in the US (either #2 or #3 depending on what survey/segment you look at). What caught our interest was the fact that Vizio had its own operating system (OS) installed on its TVs unlike its competitors that typically used an Android or Roku OS. When we first invested in 2021, Vizio had started to monetize this OS through ads ("Platform Business"). We are big believers on the shift from offline to online advertising and felt that connected TV was one of the key frontiers for the shift. We also felt that while Vizio's overall revenues would stay flat as they deprioritized revenue in the hardware business to push the Platform Business, that overall gross profit would increase considering the Platform Business has 65%+ margins. This, to its credit, came true, and Platform gross profit increased 3x during our investment period (to around $230MM expected in 2023). However, it was not enough to offset the decrease in hardware gross profitability which declined from ~$115M for the full year 2021 to zero in 2023. This occurred because to sell more TVs Vizio dropped its hardware margins to break-even levels.

The strategy itself was sound, drop your hardware margins, make TVs cheaper, get more TVs in the hands of consumers. Then make the money back through the far more profitable business once consumers start to use those TVs. However, it was the magnitude of the drop in hardware margins that we didn't see coming. While we expected *some* drop from the initial 10% margin, we didn't expect them to go to zero (or in some quarters to negative territory). What this told us was that the industry was far more competitive than we expected, and that Vizio's position in the industry was far more tenuous. We also saw that Vizio was tepid in its marketing efforts to grow the brand, and instead decided to compete on price and shelf share, which seemed short-term in nature.

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Still, we gave the company a wide berth as we knew that they were shifting their business model, and such transformations take time. Further, we trusted that the CEO, William Wang who has been in the TV business for nearly twenty years, knew how best to toggle margins of the business up and down to reach their long-term goal of leveraging the platform to serve ads, online purchases, collect data, and even license the OS. However, the one area that we disagreed with management was in their capital allocation. Through this entire business transformation, Vizio was cash-flow neutral, had no debt, and yet sat on nearly $400MM in cash. At one point 40% of the market value of the company was in cash. It made no sense to us why they didn't return that cash to shareholders in the form of a buyback.

We spoke to IR, wrote letters to the board, and pleaded our case to the CFO on two occasions. We even walked William through our thinking over zoom. Yet, it seemed the company was too conservative or knew something we didn't. William told us he was saving the cash for a rainy day, but to us, as investors, it had been storming for quite some time. Thus, given this disagreement, we made the decision to sell our stock. We wish the company the best, and especially wanted to thank their Head of Investor Relations, Michael Marks, who got us all the access to management we asked for. He is a credit to his profession.

Tactical Portfolio…

We added a new tactical position in a European chemicals business that was spinning off its speciality chem segment. Post-spin, the stub business was trading at just 5x free-cash flow and the new spin-co is trading at a ~50% discount to competitors. We invested prior to the spin, and thus have recognized some of the embedded value already, but still feel there is a further 30-40% upside across both businesses that should be realized as earnings are released.

Our only other tactical position remaining is in an Indian Bank, which we have discussed in previous letters. While the financial performance of the business continues to be solid, it is taking more time than expected to realize fair value on the investment. The position in the portfolio is profitable and remains a source of cash should we need it.

Looking Forward…

On a macro front, most central banks have signalled an end to the rate hiking cycle and will likely start cutting rates in CY2024. Such action should benefit our portfolio as several of our larger positions (i.e Assai and eDreams) have debt on their books. Secondly, our portfolio skews more toward the mid- and small-cap space, a space which has underperformed its large cap cousin of late. For reference, in the 2023 calendar year, the Russell 2000 (the US small-cap index) underperformed the S&P 500 by around 10%. Typically, as interest rates are cut, small- and mid-caps tend to do better as they have more floating-rate debt and are more debt-dependent in general as compared to large-cap stocks. Secondly, as risk-appetite increases, "riskier" stocks tend to do better, and just given their size, small- and mid-caps are deemed as riskier than large-cap stocks. While the correlation between interest rate cuts and small- and mid-cap outperformance is not 100%, I do think the odds are good.

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In Conclusion…

In summary, we are in a position where the macro environment should benefit our portfolio, have several catalysts still to go, and continue to see significant embedded value in the portfolio. Thus, if you were looking to add capital to your portfolio, we do believe this to be an opportune moment.

We've said this before, and will repeat it often, but it is an immense privilege to manage our clients' hard-earned money. It is a privilege we do not take lightly and work daily at earning and keeping our clients' 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' definition).

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