Farrer Wealth Managed Solution Quarterly Update

Q3 FY2024 Returns Summary

(Quarter ending March 2024)

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%	4.13%		1.50%	15.66%	15.89%

	Cumulative	Annualized
Model Portfolio Return Since Inception***:	-39.21%	-16.56%
Benchmark (SGD) Return Since Inception:	14.55%	5.06%

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
Sea	High water mark:	Yes
Sendas Distribuidora (ADR)	Liquidity:	30 days notice
Total Weighting of Top 5: 64.78%	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…

While I'm pleased the portfolio made money this quarter, the benchmark had a much stronger performance. AI fuelled rallies have been hard to compete with over the past year or so, and not owning stocks like Nvidia (+87% this quarter), TSMC (+30%) and Microsoft (+14%) has been tough. However, we are not completely left out of the AI race with our holdings in Alphabet (+9%) and Digital Bridge (+8%) giving us some exposure to the rally. The shortfall in our returns this quarter versus the benchmark was mostly driven by one of our largest positions, eDreams ODIGEO's stock falling 12% calendar year-to-date. This is despite eDreams posting stellar financial returns during the quarter and initiating a much-awaited buy-back program that has only started in the past few weeks. Thus, while the stock's return was negative this quarter, I do not worry about the medium and long-term performance of the company.

Looking at overall returns, while we have posted positive returns in FY23 (4.4%) and FY24 (1.5% so far), the growth is still dwarfed by our drawdown in FY22 (-42.6%). The recovery, while steady (we are up ~17% cumulatively over the past 5 quarters), has been *excruciatingly* slow. I do not have a great answer as to why our portfolio holdings have not had a more rapid recovery, but timing stock performance is a tricky thing. There is a reason private equity funds lock your capital up for ten years! Further, there is very little overlap between our holdings and the benchmark's holdings. In fact, we share only a ~2.52% overlap with the benchmark (weighted-average position size) and almost all that overlap is due to our position in Alphabet. So, the fact that the benchmark has had a solid recovery does not mean much for our portfolio.

Portfolio Updates…

Blackstone:

We sold our position in Blackstone this past quarter. Besides Blackstone being a world-class alternatives brand and led by excellent management, we had two ‘tactical’ reasons for investing in Blackstone. 1) A belief that the market was unnecessarily punishing the stock for BREIT redemptions 2) a valuation that only considered the present value of the fee-earnings (i.e. the market was giving you the ‘carry’ position of earnings for free). These two elements of the thesis largely played out like we expected. BREIT, Blackstone’s private real-estate investment trust, was hit by a series of redemptions in 2022 and the company had to ‘gate’ the fund, implying that investors could not get their money out exactly when they wanted to. This led the market to think that the REIT was facing serious problems with its assets and could not honour the redemption. However, the gate was implemented by design considering most of the assets in the portfolio are illiquid. Blackstone foresaw a situation like this and knew they would need to conduct an ‘orderly’ exit. Since 2022, BREIT has been slowly but surely honouring all redemptions, and in March this year, they met 100% of the redemption requests they received. Considering BREIT posted positive returns in 2022, lost only 0.5% in 2023, and is up YTD 2024, it’s highly likely redeeming investors took no major losses (and likely only made money). On the valuation gap, Blackstone was included into the S&P 500 index in September 2023. This proved to be a large catalyst for the stock which was up ~75% in 2023. This increase caused a re-rating in the valuation of the stock from around 18x forward PE from when we invested to about 25X when we exited. Given that the short and medium thesis played out and that the valuation was quite full, we decided to exit for a ~33% IRR (or 38% total return) on our investment. While we are done with the Blackstone investment for now, we reserve the right to add it back to the portfolio should valuation prove conducive in the future.

Apollo Global Management:

We rolled most of the Blackstone position into a new investment in Apollo Global Management. Apollo is a competitor to Blackstone but has a distinct strategy and focus.

	Blackstone	Apollo
Strategy	Pure-Play Asset Management	Asset Management + Insurance
Focus	Real Estate/Private Equity	Credit
Liabilities	Light	Heavy

As you can see the approaches that the two companies take are quite different. Now it's not to say that Blackstone does not do credit (it's their third-largest investment focus) and that they do not have insurance partners, they just go about sourcing their assets in a different way. Blackstone sources its assets like most traditional asset managers, by going to institutions/wealth managers/HNIs and raising money for their funds. While Apollo does this too, most of its capital comes through its retirement services. Retirement Services, while under the 'insurance' umbrella, consist of annuity providers in the Apollo context. For those unfamiliar, an annuity is a retirement product where the policy holder exchanges a lump-sum payment for a stream of future payments. The largest and most well-known annuity provider under the Apollo banner is Athene (which Apollo merged with in 2022).

Now certainly the question to ask is given its annuity liabilities, isn't Apollo a 'riskier' investment than Blackstone? This is also what I first assumed when we invested in Blackstone, choosing to eschew "asset-heavy" players such as Apollo and KKR. However, upon further investigation two points jumped out at me. First, having an annuity arm is a great way to ensure a steady stream of AUMs. While Blackstone is reliant on the fundraising cycle to boost AUMs, Apollo sees more steady growth. For example, during the 2022-2023 cycle which was particularly tough for fundraising, Blackstone grew its fee-earning AUMs by 17% whereas Apollo grew its by 33%. Now granted, Blackstone is larger (total AUMs of over $1 trillion versus Apollo's $650bn), but the inflows of annuity premiums smooths out the volatility that a standard fund-raising cycle can have. The second point is that an asset-liability mismatch is unlikely. However, to further explore that potential risk, we must first take a step-back to understand how Apollo operates.

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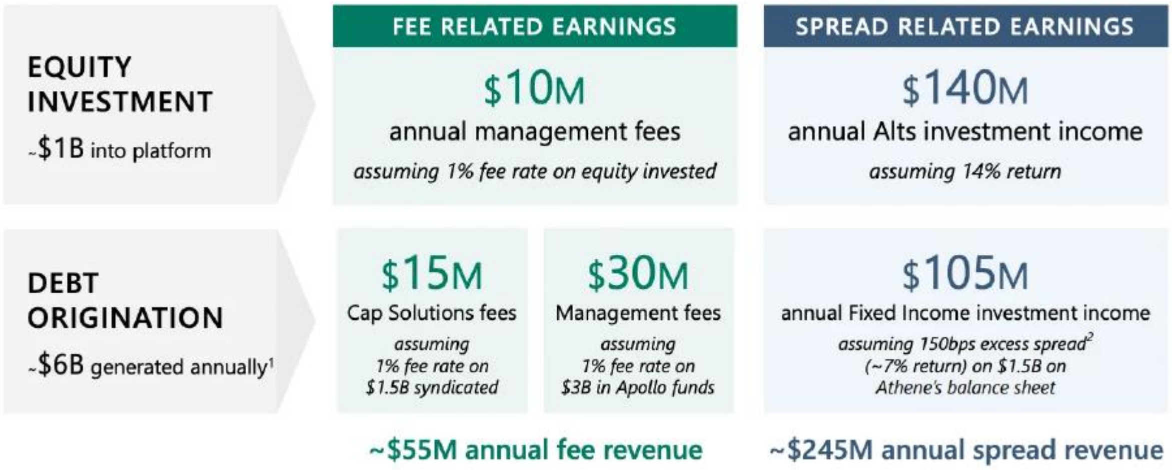


The above diagram is a bit dated but shows how Apollo makes money. Essentially there are two key parts of Apollo's 'earnings' one is fee-related earnings (FRE) and the other is spread-related earnings (SRE). FRE is quite standard, it is basically the management fees that Apollo earns on assets it manages (i.e capital from Institutions/HNIs/Athene) less operating expenses. This is just like any other asset manager. SRE is what the retirement services business earns based on the difference between what they earn on their assets and what they pay on their liabilities.

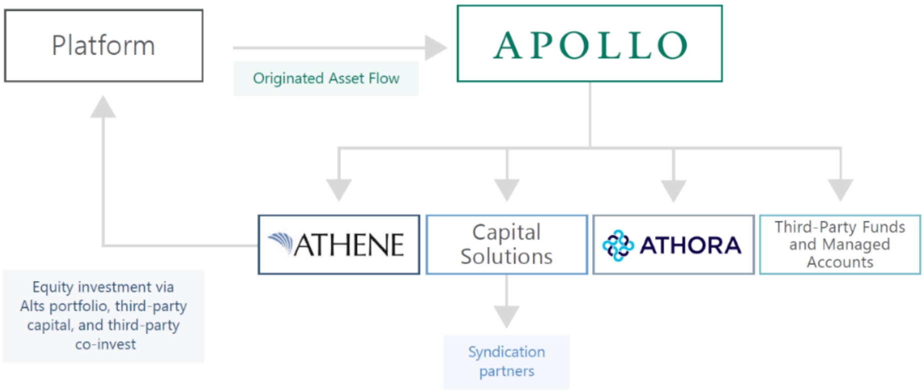
To simplify, let's go through an example (and this will help highlight the potential risk). Let's say Athene sells one annuity which has a principal value of $10. Let's further say they owe the policy holder $1/year. Apollo then takes the original $10 (Apollo is the asset manager for Athene) and invests it in credit and earns $2.50/year. The 'difference' or 'spread' between the $2.50 Athene earns and the $1 it owes on an annual basis is the spread-related revenue, which in this case is $1.50. Take out operating expenses, fees it pays Apollo, and other adjustments and you get SRE.

There are three potential risks here – your assets default or fall in value, your liabilities are more than expected, or there is a mismatch between the duration of your assets and liabilities (which recently brought down Silicon Valley Bank). However, we believe that Apollo has thought all these issues through. 95% of the annuity's business assets are invested in investment-grade credit. Further, the duration of the assets and liabilities are matched as most annuities are long-dated and have heavy surrender charges (so makes early 'withdrawal' unlikely). Finally, the annuity business, in my opinion, is a less risky element of insurance than say property and casualty where unexpected events can force the insurer to make major payouts.

Apollo's differentiation

One of the key differentiating points of Apollo versus other alternative asset managers is its focus on private credit. The impetus behind the growth of private credit is that since the global financial crisis in 2008, banks have faced tighter regulatory capital requirements making it harder for them to lend. Rules are getting even tighter with the likes of JPM having to put up more and more capital against risk-weighted assets. As Marc Rowan, CEO of Apollo says, "As investors…you will see over the next decade a series of financial products that you've never seen before because they have historically been resident only on the balance sheets of large banks, and they are on their way to you as an investment product."

Further, Marc Rowan believes that capital looking for yield is plenty, but finding high quality assets is the hard part. Thus, Apollo has built out its own origination business that essentially 'feeds' the retirement services balance sheet. The rest of this gets syndicated, taken up by Apollo funds, managed accounts, or is sold to third-party funds.



The "Platform" mentioned in the diagram is made up of 16 businesses which manage around $130billion of AUMs across credit verticals – from home loans to airplane financing, etc. These businesses are not consolidated into Apollo, but Apollo does own significant minority stakes.

These businesses originate loans, and then with the help of Apollo the asset finds a home in three places. The first is Athene (or other retirement services) balance sheet (~25% of volume), the second is Apollo funds and SMAs (~50%) and third is to the market in general aided by Apollo's Capital Solutions Business (~25%).

The capital solutions group is also a source of revenue for the Group with fees being generated from the sale of these assets from the originator to the end holder (i.e. the market in general). In fact, this part of the business has done so well that their 2026 estimate for revenue ($500MM) has already been surpassed in 2023E.

The question becomes how large a part Apollo can become of the entire credit ecosystem. As of now the company thinks the entire "Fixed Income Replacement Market" or the market of high-grade credit that can be subbed out for private credit is around $40 trillion. Currently, Apollo originates around $100billion/year. About $45bn of this comes from the platform (the rest is from Apollo's broader ecosystem – i.e. the Capital Solutions Group's broader business). So, there is significant market share to grow from here.

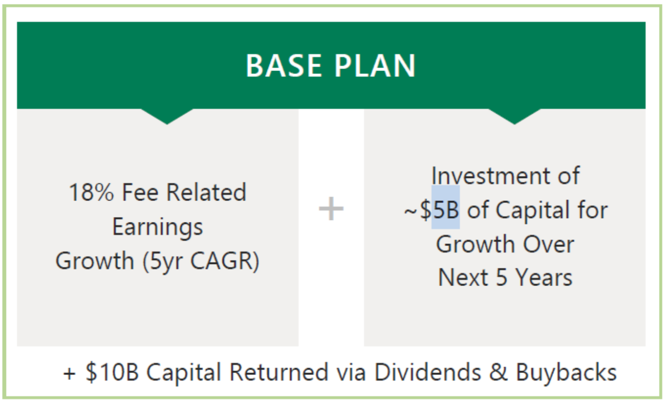
Financial Model/Valuation:

We think that FRE will continue to grow in the 15-20% range going forward driven by increasing AUMS and a better cost base as more compensation moves to equity. We have not added back equity comp because we believe continued buybacks (see below) will neutralize the additional issuance.

We think SRE will grow at high-single digits but then drop to low single-digit growth because of the pace of growth so far. SRE growth has been so fast that the company achieved its 2026 goals in 2023.

Statement (USD MM)	2023A	2024E	2025E	2026E
Trailing Adj. FRE/ Share	2.92	3.59	4.26	4.95
Trailing Adj. SRE/ Share	5.13	5.78	5.98	6.22
Trailing Adj. Principal Investing Income				
Principal Investing / Share	0.13	0.53	0.94	1.08
Gross	8.18	9.90	11.18	12.26
Tax	1.44	1.78	2.01	2.21
Net	6.74	8.12	9.17	10.05
Apollo Stock (Current Price)	114.00	114.00	114.00	114.00
Multiple	17	14	12	11

This leads to a 2026 post-tax earnings per share of around $10.05 (14% CAGR), which would put the current price ($114/share) at 11x 2026E. We believe that Apollo should trade at closer to 15x due to the mix of SRE and FRE. Thus, at a $10.05 earnings per share and an 15x multiple the 2026 price should be around $150 or a 11% IRR from the current price. Now, I've stated in the past we look for 15-20% IRR investments, but this writeup comes a bit late, and when we started investing Apollo at around $100/share, the IRR was indeed in that range. The stock has just run up quite a bit. Further this valuation does not account for the M&A discussed above, dividends, or buybacks beyond what is used to neutralize the issuance of shares. Lastly, Apollo will hold another investor day toward the end of 2024, and we suspect they will give greater clarity into what their SRE target is, and should provide further upside.



*SEQ Figure * ARABIC 1) Apollo's capital allocation plan as presented during the 2021 investment day.*

Overall Thesis

The overall thesis of the Apollo investment relies on a few points.

- A growing credit-based asset management basis not reliant on fundraising but a robust annuities business.
- 95% of the annuity's business assets are invested in IG credit. Further, the assets and liabilities are matched as most annuities are long-dated and have heavy surrender charges.
- We believe that FRE + SRE per share will continue to grow at around a 12% CAGR. This is driven by better cost management (switch to equity comp), share buybacks, and a robust organization platform for credit which leads to outperformance over reference rates, and reduced competition from banks.
- There is a potential for Apollo to be added to the S&P 500 which could be a value unlocking catalyst, as we saw with Blackstone.

About Asset Managers...

You may have seen that we have added more asset managers to the portfolio over the past ~1.5 years. Blackstone, Apollo, Digital Bridge, while having different foci, have one thing in common. Each of their businesses have an extremely predictable stream of cashflows. The management fee can be counted on year-in-year-out since once assets are gathered, they are locked in for a decade or more. This predictability is a common theme in our portfolio. eDreams has a subscription model that now makes free-cash flow much easier to predict. Evolution has steady margins so you know for any given level of revenue how much profit/cash flow the company will generate. Howden Joinery has a compensation model for each of its depot managers which almost ensures the 60% gross margin they deliver annually. So as time goes on, I would imagine us being drawn to these types of models, and you will likely see more of these types of business in our portfolio.

Basic-Fit:

Speaking of predictable models, we own two retail businesses, Assaí (food retailer) and Basic-Fit (low-cost gyms). One of the reasons investors like retail businesses is that they are easy to think through. If the business has X amount of locations, each location generates Y in revenue at a Z% margin you can predict, with some confidence, how much profit will be generated within a year (X x Y x Z%). However, the downside of such models is that companies in the sector tend to flirt with a good amount of debt. This, at times, can sour investor sentiment, which is what has happened with Basic-Fit so it's worth giving a quick update here.

The stock has struggled and is down 20% in 2024. There are two reasons for this 1) The company's leverage has not come down and will likely increase again this calendar year. 2) The company has had some hiccups in the maturation of some of its club locations. On the first point – we are a bit surprised that the market is surprised. In our original model when we underwrote the company, we didn't think that the company would start reducing debt till 2025 as it continued its ambitious expansion plan. Admittedly the company got a bit 'over its skis' and has reeled back some of its expansion plans. However, even then, it seems like the company is still generating lots of cash. In fact, we think that in

2024 before growth capex, the company will generate some €200MM in free-cash flow (ie post rent, maintenance capex, and interest payments) versus total net debt of around €877MM, making the overall financial risk of the business limited in my opinion.

On the second point about club maturity, the company has struggled a bit. Members/Club has come off a bit over the past year from around ~2.8K members/club to about 2.7K. While it seems like a small difference, a decline of 100 members/club is a loss of around $42MM in revenue and has a ~16% impact on EBITDA. A big part of this issue is that 50% of clubs are in France, which as a country has struggled. In 2023, protests across the countries blocked roads and limited members' ability to go to clubs/new members' ability to join. Further, the market is sceptical of the company's plans of expansion in Germany, which is a much more competitive environment for low-cost gyms. While there is merit to these issues, the company seems confident that the membership numbers will increase in the back half of 2024. We are keeping a close eye here and could change our mind about the company should the member/club ratio deteriorate significantly.

That said, we think overall, the company is progressing like we expected. However, we are yet to add much capital to the position. For us, this has always been a 2025 onward story, and that this year could see more volatility with the stock price.

A reasonable question would be that would the same issues happen with Assaí, and there I say the risk is far less. For one, Assaí is already on a deleveraging cycle, in a declining interest rate environment, and while consumers might cancel their gym memberships, they will never not want groceries at a low cost.

Looking Forward…

Our goal is to over a 3-to-5-year period give you a solid return compared to the benchmark, and as we approach that three-year mark, it is fair to ask when that return will materialize. While I cannot give you an exact timeline, I will say a few things:

- So far this year our companies have posted excellent financials. While there were one or two companies that I felt could have done better on certain benchmarks, overall, I was very pleased by earnings seasons.
- I still see over a 90%+ upside in our portfolio, which is against an CY25 target (indicating that realizing these returns is in the offing).
- Our portfolio continues to trade cheaper than the benchmark and is growing revenues faster on a forward basis, meaning eventually the relative underperformance should correct itself.

Name	Street Estimates FY24 PE (x)	2024 Rev Growth	FY25 PE (x)	2025 Rev Growth	FW Projected Upside
Evolution	21	17%	19	16%	46%
eDreams	61	12%	15	18%	159%
Assai	22	15%	13	12%	118%
IAC*	10	-9%	5	6%	107%
Sea Limited	32	14%	19	13%	92%
Alphabet	22	11%	19	11%	56%
Howden Joinery	19	2%	16	7%	53%
Basic-Fit	27	18%	15	19%	230%
Adyen	57	23%	45	24%	10%
Digital Bridge	20	4%	28	10%	62%
Tactical Position #1	11	13%	9	8%	15%
Apollo	14	13%	12	14%	60%
Tactical Position #2	6	-7%	5	2%	30%
Weighted Average	**28**	**11%**	**16**	**13%**	**90%**
Benchmark			**17**	**5%**	

*2) Managed Solution Portfolio (*IAC uses FCF/Share instead of P/E)*

Coming back to the question of timing, I repeat that an exact answer is hard to give. That said, I suspect the adage about how change happens "slowly at first, and then all at once" is apt here. I feel that if our companies continue to put up strong numbers this calendar year then we should see the realisation of the embedded value in our portfolio follow suit.

In Conclusion…

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).

Pratyush Rastogi
CEO – Farrer Wealth Advisors