



Holland Views – Exor S.p.A (Price: €42.91; MCap: €10,540m)

Cloning Berkshire Hathaway (in Turin)

Two years ago whilst looking at Fiat we were led to **Exor S.p.A.** the holding company that controls Fiat and a number of other groups such as CNH (the former Fiat Industrial), Cushman and Wakefield and Juventus football club. That the holding company then traded on a c.30% discount to the sum of its parts we noted as interesting and likely offering excellent value, particularly against assets that might themselves have been undervalued. (Today it trades on a 20% discount to a much higher NAV). What we found more interesting still was that Exor, via John Elkann the 39-year old Chairman and CEO (in effect Exor's controlling shareholder), was working very hard to transform itself into something very different from its Italian holding-company roots.

As a result of this research, Exor remained very much on our radar both as a possible source of value versus its constituent parts, but also because of the quality of the leadership we think it has in Mr Elkann and how this seems underappreciated by our dear friend Mr Market. Against this backdrop last week we saw a headline that made us sit up and take notice:

“Exor offer to Buy Partner Re in Friendly \$6bn offer”

Breaking the Italian mould

To be frank, what interests us the most about John Elkann is his close following and admiration for Berkshire Hathaway which is regularly referred-to in his annual letters. He has been seen at the Berkshire annual meeting many times and has apparently become friends with a few of the US value investors who are close Buffett-followers.

“We have a lot of affinity and things to learn from family groups like ours in the Midwest with roots in manufacturing and finance,” he says, naming the Pritzkers, Ridleys and Waltons. “I’m very interested in seeing how a family can develop over time and work in a different way” – John Elkann (quoted in the Financial Times)

Elkann is of course, still a very long way from having Buffett's credibility when it comes to investing but he has been trying very hard to simplify and modernise Exor and the companies it control in a way not seen inside Italian conglomerates for many years. As a result, the holding company structure is simple, i.e. there is now only one type of Exor share that both he and outside investors own. Equally, the individual parts of the empire that the Exor group controls have been improved immeasurably with a focus on profitability – Fiat being the prime example. Elkann was the one who brought Sergio Marchionne in to turn around Fiat (where Elkann is today Chairman) in 2004. The pair seemed to have formed a formidable partnership since. Upon his joining the Exor board in 2003, Elkann displayed his fortitude by candidly conceding the magnitude of the task he faced:

“If the situation had been different, I might have had more time to ease into the job but I was forced into the middle of a bad moment. The company was being mismanaged, the family was ageing and sick, the financial community didn't support us any more. At that point you have the choice to let it go or you try to fix it” – John Elkann

Today all the group's biggest divisions are run under what seems to be high-class managers and have laid out ambitious plans for profits that they plan to make 3-5 years from now.

We will see how each division fares in comparison to these targets in the coming years, but what is being pursued is a clear focus on profitability maximisation and accountability. Simplification of the group with fewer larger investments is the future Elkann has recently outlined. Partner Re, we suggest, is another building block for that process.

[John Elkann – the man behind Fiat’s rejuvenation](#)

Exor is an Italian holding company long controlled by the Agnelli family who played a central role in Italian society and commercial life over the past century. In the 1990s, more than a hundred years after its founding, few would have argued that Fiat and the Agnelli’s seemed to be coming unstuck. Enter John Elkann, the Agnelli-anointed heir who was chosen to take over running the empire in 1997 (when he was just 21!) by his maternal grandfather, the legendary industrialist ‘Gianni’ Agnelli. Despite his prince-like upbringing in the Agnelli clan, Elkann showed early-on that he was not afraid to get his hands dirty. Notably he worked incognito in production plants in Birmingham and Poland and in a car dealership in France as part of his varied education before ultimately joining Exor in 2003. He is a qualified engineer but also, we suggest, a man with an eye on the best businesses and investment practices across the globe.

Exor today is a company that perhaps very few investors take seriously. Likely it is still perceived as just an Agnelli’s holding company and not shareholder-friendly. But we assess Mr Elkann very differently. He is diligent and reportedly somewhat misunderstood by the well-heeled in Italy (some say because he is incredibly hard working!). We also believe that for some years now he has been studying the best conglomerate model in the world – Berkshire Hathaway.

[Enter the Trojan Horse – Partner Re](#)

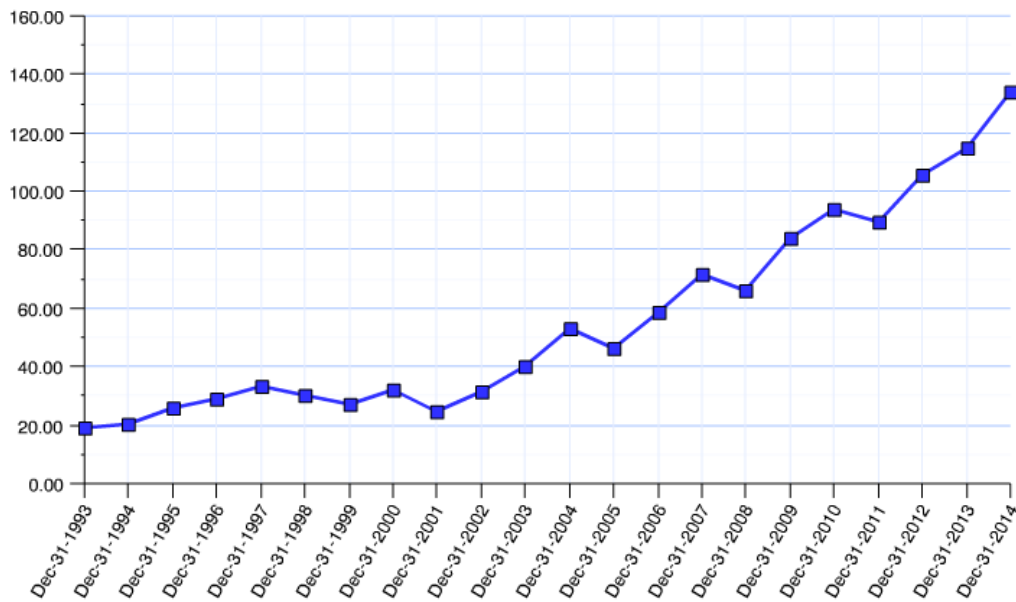
Exor’s proposed purchase of Partner Re suggests to us that he is much further down the line in Exor’s evolution than maybe many might realise. A number, (albeit not a high number), of investors *really* understand how Buffett uses insurance float to significantly boost the returns that Berkshire is able to make. If you are just investing a pool of capital that has grown to say \$1bn on which no leverage is deployed, it soon gets pretty hard to maintain high annual returns (c.20-30%). Yet Berkshire famously still managed to do just that, compounding at that rate right up until the mid-1990s. How did Buffett do it? In a word: Float.

In other words, Buffett controlled businesses that looked after other people’s money (mostly insurance). He was able to retain the returns he made on that capital during the time he controlled it. This model has subsequently been copied brilliantly by others such as Prem Watsa and Tom Gayner at Fairfax and Markel. We will be honest it is a model we aspire to have ourselves one day. As such whenever there is an insurance guy at a dinner party we pay special attention to see if he is ‘the one’! Studiers of Buffett understand the driver that a growing float (i.e. the use of other people’s money) can have in powering extraordinary returns for long periods of time.

Completely separate from our work on Exor some years ago, we also studied Partner Re and really liked their business model (please see appendix below for a recap of our brief thoughts at the time). This included the disciplined approach they had to underwriting and the strong position they held globally, being the 4th largest player in the Global re-insurance market. They, we noted, had made solid returns on equity from reinsurance for many years. Importantly they also looked to be prudent when it came to the all-important aspect of insurance underwriting i.e. provisioning. As shown below in Fig.1, this translated into impressive Tangible Book Value per share growth (c.16% compounded since 2002). It is important to realise that this was largely realised through the under-writing operations, i.e. the very conservatively managed investment portfolio did not contribute materially to Partner Re’s returns.

This is in contrast to Berkshire where the rise in Berkshire's Book Value per Share has seen contributions from both side of the Insurance Balance Sheet – herein lies the opportunity that we suggest Exor sees.

Fig.1 Partner Re Tangible Book Value per share



Source: Capital IQ

Conclusion: all knowledge is cumulative

It is suggested that in investing all knowledge is cumulative and we are just wondering if today is a day we realise some of that sunk knowledge-base.

What we have in front of us is a misunderstood conglomerate with a history that suggests to some it will not be run in favour of all shareholders. We have a young, controlling shareholder who seems driven, incredibly well-connected (Henry Kissinger is his godfather after all!) and who has already understood how to attract and motivate excellent operational managers. In that regard one could argue Elkann has come at the compounding project from a different path to Buffett's, learning how to control/manage companies first and improving his investing skills later. Importantly for us, Elkann has been studying the blueprint on how to make a conglomerate truly great for many years. Interestingly, both companies arguably starting from less than ideal industries – Textiles and Auto's.

Arguably, all Exor is missing two components;

1. A 'Float' to invest
2. The ability to invest it in such a way so as to make NAV-boosting annual returns.

In Partner Re we think he has found the first of those missing ingredients, and we suspect (though cannot be sure yet), that he has something lined up already for how in time he will use that float to Exor's shareholders benefit. The following quote attributed to Elkann suggests that he sees himself as a multi-disciplinarian not necessarily as a pure investor.

“if you are competent in many things, you don't have the depth of knowledge in any one field. I'm more long than deep” – John Elkann

This might suggest that he outsources the investment management function (in itself, no bad thing – if Buffett had just relied on Lou Simpson at Geico, his record would still have been fantastic,

Simpson generated compounded returns of +20% between 1980-2004!). Notably Partner Re's float is \$17bn vs. Exor's shareholder equity of €13bn.

We note with great interest that as we listened to last week's analyst call explaining this deal that the word 'float' was never mentioned. When asked why it wanted to fully consolidate Partner Re, Elkann answered only that "*there are significant benefit to having group like this fully consolidated inside Exor*" – to which we would respond: "indeed there are Mr Elkann, indeed there are."

If we were interested in Exor before this recent news we are now laser-focused on it. Things can yet go wrong before, or after, its purchase as Buffett himself found with General Re. Additionally, (and sadly for us) the boom in the Fiat auto share price of late has taken the Exor price sharply higher with it. So we watch and hope for a bump in the road that gives us a lower entry price to Exor. But today we put a marker down. We suggest that if Mr Elkann can build an empire only half as good as Berkshire in a decade or so it will be the talk of the European Investing world...watch this space. We are.

See attached our earlier comments on Partner Re and our Exor valuation sum of parts valuation.

Andrew + Mark

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P.S. We note with great interest press release that Exor was advised on the Partner Re deal by non-other than BDT & Company, i.e. Byron D Trott – the man known as 'Warren Buffett's favourite banker'!

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Appendix

A 'sum of the parts' on Exor is shown below in Fig.2, and our brief thoughts from 2011 are attached, as are our pieces on Partner re from some years back.

Fig.2 Exor S.p.A NAV

	ticker	% owned	M Cap	Holding Value	€m	% of GAV	% of NAV
1 Fiat	bit:fca	30.04%	19,733	€5928	€5928	39%	44%
2 CNH	NYSE:CNH	27.11%	12,122	\$3286	€3100	20%	23%
3 Cushman & Wakefield		79.79%	0	\$	€852	6%	at 31/12/14
Sales \$	2100						
EBITDA	175						
4 Almacantar		38.29%	830	£318	€442		
Profit	83						
	10x						
5 Juventus	bit:juve	63.77%	314	€200	€200	1%	
6 Banijay		17.09%	500	\$85	€81	1%	
Sales €	350						
EBITDA	50						
EBITDA multiple	10x						
7 Aranella		100.00%			€25		from 2013 report
8 The economist		4.72%			€37		from 2013 report
9 Sequana					€25		from 2013 report
10 Banco Leonardo					€76		from 2013 report
Other					€544		from 2013 report
TOTAL INVESTMENTS					€11310	75%	as of 11/4/2015
Financial investments					€695	5%	
Cash and equiv					€2233	15%	
Treasury stock					€937	6%	
GROSS ASSET VAL					€15175	100%	
Gross Debt					-€1671		as of 31/12/2014
"Ord holding costs"					-€170		
NAV					€13334		as of 11/4/2015
Market Cap					€10763		
Mkt Cap/NAV					.8x		

Source: Capital IQ, Exor S.p.A

Fig.3 Holland Views 2010 – recap on Parner Re comments



Holland Comments by email, February 12th, 2010

Partner Re: A wonderful compounder at a discount to book value

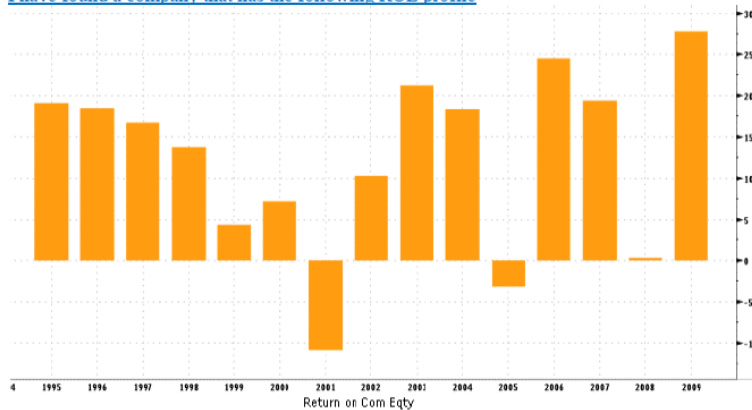
If I offered you more shares in an Investment Trust which had turned £100 of your money in 1994 into £510 today for a 10% discount to its NAV how long would you take to decide to buy them? 10 minutes? If you did, leaving aside the required due diligence, maybe you took 9 mins longer than you should have done!

[Partner Re\(PRE US Equity\) Price =\\$76 . Market cap = \\$ 6.4bn](#)

I have been looking at P+C insurance companies in the UK and US a little of late and will write more on them in due course but I think this is a big company that could be the wrong price and could correct that mispricing very soon. In short a P+C insurer should be valued off of a P/Book vs ROE calculation like many other investments. The simple driver that affect the right P/Book you would pay would be:

- What is level of the ROE /what is it likely to be?
- Importantly what is the length of time good ROE's have been achieved?
- Equally important what size of losses were made in bad years?
- What is the growth in the business?
- Is the source of the insurance good and its underwriting wise?
- Lastly how prudent are the investment decisions that sit behind it?

[I have found a company that has the following ROE profile](#)



Source: Bloomberg

Maybe the scale does not do it justice, but this has turned £100 on NAV in 1994 into £508 today such is the power of compounding and not losing big in the bad year.

- So we have a great ROE, achieved over a long period of time
- That is also achieved mostly not in Catastrophe insurance(ie the bit that is more volatile and easier to get into)
- They have grown mostly organically but also bought PARIS Re last year
- Yesterday they reported yet another good ROE of 22%

The Price

- Clearly we must be careful not to pay for past performance but I suggest we are doing anything but
- Today's share price is \$76 per share. This compares with the Book value they reported yesterday of \$84 share
- This NAV is made up of mostly Fixed Income short dated securities and the liability of past insurance writing, with only 3% of NAV being goodwill.
- So if the company were wound up tomorrow chances are you would get you money back. There are few High ROE companies you can say that about?
- If it carries on making the ROEs of the past you likely to make an average 13%(post tax) return on your money without any re-rating. May not sound much but compounds at one hell of a lick
- If the stock market comes to its senses and revalue's such a compounding machine correctly to say >1.5-2.0x Book value you will clearly make a lot lot more
- The shares rightly rose yesterday in response to this higher book value, they just didn't rise enough. I am not sure I would dally around on this one

Ps.. for a little perspective the historic Price Book is below
PPS. Whilst I have performed a little more due diligence on accompanys like Berkshire, Fairfax and some of the UK names I have not had time to do so on Partner Re as yet, I am letting the ROE and it's long track record guide me significantly at this stage

Partner Re – Price/Book



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Source: Holland Advisors

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