HollAnd Advisors

Holland Views – Exor – Price: E69, Mcap EU14bn

Building Berkshire in Turin – Part III

Last week we attended the biennial Exor investor day in Turin. For those interested in understanding Exor and the detail they revealed about each subsidiary company, we recommend the slides and transcript of that day (see link[1]). We will focus more on Exor as a long term investment and what we think will be the drivers of it. From today's share price, the group offers upside to the Sum of its Parts NAV of 33% (E92). Yet, as we will show, to focus solely on such tangible yardsticks we think is to miss the bigger picture.

The first 10 years - Mission accomplished

Exor with John Elkann at the helm has done great job of achieving its core strategy of growing NAV value per share (actual NAV compounded +19% since 2009). Interestingly this growth has been achieved despite starting with a seemingly challenged group of assets at the outset of this period. This is especially interesting to reflect on today as the current group of assets is one that still keeps many investors away! The early work done to simplify the group's structure and align the Agnelli family interest with outside shareholders into a single share class should not be underestimated either.

Elkann oversaw this rise in value in numerous ways including:

- Appointing and empowering accomplished managers to controlled businesses and tasking them to adopt strategies to seek-out value accretive actions.
- Selling assets well (realising e5.8bn over 10 years), de-merging business or setting challenging profit recovery targets, many of which have overcome many sceptical outsider views (FIAT for years was a 'Sell' amongst most of its analysts and a favourite hedge fund short)

This investor meeting caused us to reflect on a few intangible aspects of the Exor Story

- Exor has a board of remarkable depth and quality[2]. This is also supplemented by an advisory board with equal pedigree, but bringing additional reach. How Elkann and team have and continue to use this available wisdom and contacts is interesting to watch.
- Elkann appointed Sergio Marchionne to run FIAT group and the companies it subsequently became, importantly empowering him to be bold and brave with these businesses.
- That Exor/Elkann could attract, retain and identify a manager like Sergio is interesting to reflect upon. If it can continue to so with future controlled company CEOs, it will suggest that Exor is doing something quite unique. Only time will tell
- Elkann has more recently added to the managerial skill set available to him with senior hires with high level specialist skills in consulting/change management (Suzanne Heywood) and Investing – (Matteo Scolari).

[1] http://www.exor.com/sites/default/files/presentations-documents/2019/EXOR%20Inv%20Day%202019_VFinal.pdf

[2] https://www.exor.com/pages/exor/governance/people

To listen to Elkann is to listen to a careful, considered and thoughtful man; not a salesman-like CEO or an accomplished fast talking investor like Buffett. We must remember too that Elkann is young (only 44) and often presenting in his second of four (!) languages.

Intangibles assets

An adage that comes to mind as we consider the sort of vehicle Exor is and will be into the future is that: " *you can only play the cards you were dealt*".

In Elkann's case, he was clearly dealt quite a privileged hand. However many others in the world are delivered similar hands but play them very very differently. We remind readers of the background work we did to understand Elkann many years ago. What we found then still resonates: Elkann was misunderstood by many Italian popular journalists who then seemed to find his work ethic and disciplined approach to businesses surprising and unusual to one born into such wealth.

Spending greater time with both Elkann and his team suggest to us that Elkann is someone that perhaps a great many people will want to work for. Whist we see the actions of a man unafraid to make big decisions (tackling family interests/selling big businesses/merging Fiat with Chrysler). We also see a modest man who is very keen to empower those beneath him. At 44 and with the controlling stake in Exor this is a man who epitomises alignment of interest. However as we study more and more business with similarly aligned owner managers we find very different management styles. Some arguably are run as benign dictatorships (RYA/SPD), and many are run with a not always healthy adoration of the leader by those that work for them (BRK/FFH). Exor and Elkann fit neither of these descriptions. Elkann does not have the swagger and arrogance of a great industrialist or investor who built the business from scratch. Instead he has a modesty that we think seemingly allows him to delegate to, and empower those beneath him with the actions they undertake and to challenge his thinking.

Similarities and differences

In our study-of and investment-in owner managers we are often struck by many of the similarities each possess. However crucial also is their idiosyncratic differences that we need to study to better understand the DNA of the businesses they are building. In that regard we firstly conclude that Elkann is very different from many of the other owner managers we follow and admire, but also that the more time we spend carefully studying him, his team and the actions they have made the more impressed we are by the combined array of skills being shown.

Additionally, Exor is now also set up as seemingly a constant learning machine, with studies made of areas that include: 'What are the traits of owner managers?' and 'what are the best practices of Holding companies like EXOR?' Impressively, their studies are focused not just on how to improve their business and investing decision making, but also on how to improve themselves (ie the holding company) too.

We observe that whilst every conversation about Exor for investors ultimately ends up discussing it's valuation, none of the intangible factors described above and the ability they may gave the organisation to deploy future capital is quantifiable nor appears on its list of assets. We believe however that to not consider them is to miss the whole point of this company

"What you cannot measure sometimes matters more"- Munger

Value seekers at heart

During the meeting John Elkann paid tribute to Sergio Marchionne remembering that he had the unique ability that F Scott Fitzgerald described:

> "*The test of a first-rate intelligence is the ability to hold two opposed ideas in mind at the same time and still retain the ability to function*" – F Scott Fitzgerald

The legacy that Sergio left at Fiat+ Ferrari is significant and we have little doubt that Exor would have been a better company had his skills been available to Elkann and team for a far longer period.

Looking forward, we note the company's assessment that it expects to have "significant firepower" (aka excess capital) to the tune of EUR1.9bn to acquire new companies in coming years (slide 30). Inevitably, discussions at the investor day moved to speculating as to what sort of business Exor might buy in the future. As part of the discussion, it became clear that Exor shares our admiration for owner manager businesses and we think also well understands the power of superior business models (ie those that are asset light and have secular growth).

However, unlike other global investors who are resolving the conflict of higher prices for better business with a shrug and deciding to pay up, Exor is not. Both Elkann and his wider team are very focused on growth of asset value per share and they realise that to achieve long term superior growth they need to buy assets that are undervalued. Indeed they spoke of wanting to buy undervalued assets albeit ones where they can use levers to improve the business bringing in Exor's skill set. **This we think is an interesting disclosure by the company and one that suggests that our previous analogy with Berkshire is now less useful**.

Exor's past and future suggests a group more like **Melrose** in the UK or **Danaher** in the US is a better peer to consider Exor with. These companies use a "Buy, improve keep", or "buy improve sell" mindset. That Exor itself is showing the Scott Fitzgerald traits in admiring great companies, but maybe thinking about buying cheaper ones we thought notable.

Fig.1: The clue is in the title of the main presentation – "Building Great Companies"

Source: Exor Investor Day, November 2019

What is also interesting to us is the type of assets this might suggest they will consider buying. As assets like the Ferrari, The Economist or Juventus have brands and asset light characteristics we think they will be retained indefinitely. Other more capital intensive assets are being re-structured/merged or even one day sold (Fiat/CNH). The assets they may look to purchase however we think will be in parts of the market where there is value and/or fear. Whilst we and others can make guesses as to potential targets, we feel there is little point to such an exercise.

What is perhaps more interesting is to consider may be the following:

1. If Exor can buy an undervalued asset (one left-field example might be say, an Italian Bank) recapitalise it, improve its management oversight could such a acquisition add real value to the NAV per share of Exor? The answer of course is yes, if it could be executed
2. How will the stock market react to what will be seen to be an esoteric purchase of a perhaps troubled asset? The answer to this question is that it may firstly be highly sceptical and then in time only reward Exor if it proves successful.

Such a combination of factors we think would be highly interesting. We have a company very very focused on prudence at the holding company level, but also intent on developing business management expertise. They are also value seekers judging themselves by the simple yardsticks of compounded growth in NAV per share. Such a company may well have periods where the stock market doubts it. This all suggests future opportunities for diligent equity investors in Exor.

Valuation and Partner RE

We attach our update SOTP for Exor. This is in large part just the mark to market value for the quoted entities it controls. We do note however that this valuation, used by us and the company, still uses an 'independent valuation' of Partner Re. Currently that valuation is an End Dec 2018 value for Partner Re(PRe) of cE7.5bn (c1.15x current Book value).

Exor's stated projection of Partner Re ROE is for a through the cycle rate of 8-10%. We observe once again that PRe as an independent company saw it achieve an average long term ROE of 12% prior to Exor's purchase of it, doing so with an inferior investment return. With PRE's opex now reduced by c.20%, a combined ratio of c95% and significant improvement in the investment returns under Exor's management, such a 8-10% target we feel is surely too prudent. For reference, PRe's ROE's in 2017, 2018 and 2019 were: 4%, -2% and 23% respectively. We remind readers only of the simple fact that if a company like Partner Re makes a 12% ROE and is valued at 1.2x its Equity Value then its implied PE is 10x.

Conclusion

As Exor has evolved since its rebirth in 2009, so too has our understanding of this quite unique investment holding company. As we alluded to above, it's actually the differences rather than the similarities with Berkshire Hathaway that are now interesting. The Partner Re acquisition understandably prompted us to focus on insurance Float but the real value kicker from Exor in time will come in future acquired businesses.

In world where good compounding machines are priced for perfection Exor continues to look interesting. The company now looks to us to have a proven approach of taking value accretive actions with underperforming businesses. It is also a good seller of businesses and allocator of excess capital (ie buy backs). Like all businesses, its deployment of future excess capital to reuse these proven skills on yet to be acquired businesses will be the key determinant of longer term intrinsic value growth. As ever in business and investing such a task is hard to achieve. In Exor's case however we think the combination of permanent capital, a long-term time frame with the right culture and a value centric buy and improve approach positions them well for potential success.

We remain buyers of Exor

With kind regards

Andrew & Mark **firstname@hollandadvisors.co.uk**

The Directors and employees of Holland Advisors may have a beneficial interest in some of the companies mentioned in this report via holdings in a fund that they also act as advisors to.

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Sum of the Parts

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EXOR Price (eur69)	Ticker	% stake	Priced locally in	Local Share Price	# shares in issue	Market Cap (local)	Holding Value (local)		Holding Value $m	% of GAV
Fiat	BIT:FCA	29.0%	EUR	13.30	1,554	20,663	5,988	$	6,587	24%
CNH	NYSE:CNHI	27.0%	USD	10.48	1,363	14,279	3,848	$	3,848	14%
Partner Re		100%						$	7,650	28%
"investments"									€13035	
equity									€6355	
The economist		43.4%					Jun-19	$	395	1%
Juventus	bit:juve	63.8%	EUR	1.28	1,008	1,290	823	$	905	3%
Ferrari	nyse:race	22.9%	USD	152.00	189	28,716	6,579	$	6,579	24%
Other							Jun-19	$	164	1%
			[Fiat + CNH + Ferrari] as % of GAV				63%			

TOTAL INVESTMENTS converted to US$		**$26,128**
Financial investments		$4
Cash	Jun-19	$901
Treasury Stock	Jun-19	$183
GROSS ASSET VAL (US$)		**$27,216**
Gross Debt	Jun-19	-$3,770
NAV in US$		**$23,446**
$ NAV		NAV of $101/share
NAV in Euro		**€21314**
Mkt Cap/NAV		.75x
€ NAV		NAV of €92/share
Market Cap		€16031
	UPSIDE	33%

Source: Holland Advisors

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