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VT Holland Advisors Equity Fund/Farnam Street Capital Limited

17th January 2022

Dear Investors and Friends,

Year-end Investor Letter – December 2021

Performance*: Since last year end letter: Sept 2020-End Dec 2021 +53.0%

Performance*: For calendar year 2021 +12.2%

This letter covers the period since the VT Holland Advisors fund launched on 21st June 2021 until December 31st 2021. It also acts as the final report for the predecessor fund Farnam Street Capital for the period end-September 2020 – December 2021. From now on our year end is a December one.

In June this year our investor letter took the form of an owner's manual. As we started a new chapter with a UCITS fund platform I believed it was a good way to communicate how I thought about a variety of issues that did not just relate to the performance of the fund or how I go about investing your/our money. If you have not read that letter, maybe take a [look](#). This letter returns to a more normal format. Initially I will discuss my investing approach and the market backdrop we are experiencing. Later then looking at examples of companies we own and the rationale for why.

Investment approach

In June when trying to explain my investment approach I penned the following. I see little reason to change a word:

The rationale I use in investing remains steadfast. I try to buy the shares of businesses I think are set to offer us attractive long term compounding potential.

Usually, such businesses make good or great returns on capital and have strong competitive positions. Unusually, they may be hated (or disliked at least) by Mr Market at the time I make our purchase. This last point is perhaps what distinguishes our fund from others that might label themselves as having a 'franchise' approach. I share many of the same philosophies as 'franchise' investors, but instead consider myself as having a 'compounding' approach. The difference is perhaps subtle and one I hope that Mr Munger and many readers will understand.

Admiring great companies, I think is a perfectly reasonable activity. However, over time I think superior returns will be made by investing in such companies when they are priced either for failure, or at least for a fade in their growth, when in fact the business model is actually primed for success. The last key ingredient that goes into our not-so-secret mix is the Owner Manager. Almost always I am looking to invest alongside a CEO/founder/family who are aligned with us. They will have likely demonstrated past powerful compounding by managing and growing the business successfully for a long period through a variety of environments.

An evolving and adaptive process

Whist the paragraphs above continue to capture the essence of what I am trying to do when investing our collective monies all organisms and organisations on this planet that prosper do so by constantly

* All performance figures use the 'I' class share as it was in existence for the entire reporting period.

evolving. We must do likewise. It is perhaps more accurate to talk of my investment approach as ‘evolving’ and ‘adapting’ for each perhaps explains a subtle difference. The ‘evolution’ is by way of self-improvement. If up to now you thought you were invested alongside the perfect fund manager, I have news for you..! Investing is a highly competitive and sometimes complex industry where there is always room to learn and improves one’s approach. Each year I learn volumes from mistakes made and missed opportunities. Whilst the core tenets of my approach are not going to change as I believe they are built on good foundations there is much I can and should be willing to learn.

The ‘adaptation’ I speak of could be looked at differently. This being the need to adapt the investment approach we are taking to best match the opportunity set that confronts us today. Perhaps this is better explained by way of some examples:

Companies like Coca Cola or Fevertree are great businesses. They own loved brands, grow, but require little capital to do so. As such they are businesses, I am happy to state I would like to be invested in. However, the ease of understanding their good business models by other investors results in their price often reflecting their quality and growth prospects. Sometimes the price more than reflects these traits.

“It’s getting very difficult because we have a vast increase in the intellectual horsepower that’s trying to get rich by owning securities. They’ve bid the good businesses up and up and up. In America, at least, almost every great business is selling 35 times earnings or more.” “it is fine holding these great companies but their best value creation is behind them.”

“...There’s no great company that can’t be turned into a bad investment, just by raising the price.”

Charlie Munger, November 2021

Today’s investing markets are interesting (when were they not?). A multi-year love affair with ‘great businesses’ or ‘franchises’ has occurred. This process has been so successful and reinforcing that a mantra of needing to own and pay up for these ‘great’ companies has become widely accepted. To many investors today all other companies are seen as ‘also rans.’ In today’s stock market if you want mispricing’s you will likely only find them in the ‘also rans.’ This area might include: Non-ESG qualifying investments, deep cyclicals, higher capital intensity companies or those with complex/opaque structures or mistrusted managers. This list is far from exhaustive. Conducting a company-by-company search for interesting investments in this area amongst tens of thousands of companies would take an age. Also, if doing so, great care is needed for clearly whilst the Coca Cola’s and Fevetree’s of the world are wonderful businesses, the pool we are now fishing in contain many (un)wonderful ones!

“I used to search for cheap companies. I was unlucky enough to find a few!” **Warren Buffett**

Any readers that have listened to one of my conference presentations will have heard me quote Joel Greenblatt on the importance of knowing what you are looking for in investment before you start your search. #matchinthedynamitefactory

The difference between others using a ‘franchise’ approach and our ‘compounding’ one is maybe just of pragmatism as to where an opportunity might come from. Whilst we admire many branded high return businesses if the price they are offered to us brings little margin of safety we are inclined to look elsewhere. In doing so however we are mindful of the mistakes of our investing past (deep cyclicals and uncertain management turnarounds). Our ears prick up therefore when in the ‘also rans’ we find

neglected companies that also meet our criteria i.e. they are owner managed with proven long term compounding ability.

Business models and mental models

More often than not a new investment may present itself by an opportunity ‘looking a lot like something we have seen before’. This will either be due to your manager taking a different view as to the prevailing one that may be driving a particular stock or sector (a mental model). Alternatively, by making a different assessment as to the power of the model a company is deploying (business model).

A current example of using a mental model, where I believe there is a flaw in other investors thinking toward a company or sector, is the ‘recency bias’ that hit some travel and leisure companies hard during Covid-19. Cash burn, survival and equity dilution must be considered for businesses in this area. However, some share prices discounted traveller caution many years into the future. Something I thought very unlikely.

The very best global businesses are well understood and mostly priced correctly. Finding value in them requires an investor to be thinking differently from the majority of others in the market. Opportunities can occur when a negative view of even a well know company becomes ingrained and widespread. Buffett’s investment in Coke and American Express were good examples. We are hoping that the fund’s recent investments in Facebook, Alibaba and Boohoo are examples too. Time will tell.

Such opportunities are what we might call ‘growth stocks priced to fade’. In truth they are rare to find. As a result, the majority of our ideas more often come from the recognition of a successful business model that we know well but find in a new sector or geography. Whilst we have many such models in our heads our favourite by far is the Scale Economy Shared model.

I had been analysing and admiring the business model of companies like Greggs, Ryanair and JDW for many years. I used to refer to them as flywheel businesses or EDLP (everyday low prices) ones. However, having read the excellent Nomad letters by Nick Sleep and Qais Zakaria a year or two back I have since cloned their use of the “Scale Economy Shared” label. The reason being that it perfectly captures what these companies try to do i.e. share the benefits of the scale economies they get from increased size with their customers:

“In contrast, a business with scale economies shared passes on the benefits of its growth to its consumers. This aligns incentives rather wonderfully, and it turns out to be somewhat difficult for a regulator (or even a set of consumers) to crack down on a business that so consistently passes on its profits to its customers.” Source: Nomad Investment Letters/IGY Foundation

Today c.35-40% the fund assets are invested in businesses that pursue this scale economics shared model. What is particularly interesting to us about companies with such a model are two aspects:

1. Their long-term growth tends to beat the fade anticipated by analysts
2. Quite often, (but not always) these companies’ shares can be mispriced

Beating the fade

Due to these companies’ relentless and consistent investment in price (and service) they are building up a valuable asset that is invisible to investors. This being the loyalty of their current and future customer base. Why do we say ‘future’? Because these are the customers that will turn up when today’s ones tell them what a great deal they are getting. Despite such an asset being hugely powerful in its ability to

drive future sales and cashflow growth for years to come, it is unseeable and unknowable. Indeed, an analyst trying to put this on his spreadsheets would be roundly laughed at. The real-life impact of such an asset however is that such companies are consistently able to grow at much faster rates for much longer than is expected of them as a result. After all, as Mr Sleep alluded to in the quote above, rarely is there any regulatory intervention in such businesses as consumers are seeing pricing being reduced not raised. Additionally low prices and good service levels tend to detract rather than attract new competitors.

As an aside for those that see this as a new-age business model we recommend the book Titan by Ron Chernow. It is the remarkable story of John D Rockefeller's life. He built an enormous US oil empire (Standard Oil) during c.1870-1910 by taking over many competitor oil fields. The secret sauce to his success I would suggest however was his attitude to pricing. These he tried to keep low (not high) despite the near monopoly position he was often achieving.

Mispriced

Having just articulated that these Scale Economy Shared businesses grow for longer and more steadily than many others, why would they not surely be priced higher by the stock market? We think they should, but oftentimes Mr Market disagrees with us. The reason for this often comes down to timescales or what Charlie Munger sees as an understanding of “*deferred gratification*” These businesses are primed for long term growth, but often that comes as a result of being wired to endure some form of short-term pain.

An example can be seen in one of our favourite UK investments – J D Wetherspoon. The pricing differential between it and all other UK pubs is large and growing. As a result, when cost inflation (in wages and utility) occurred JDW could easily have raised its prices as all other pubs chains did to offset these costs and protect margins. Its multi-year reluctance to do so has resulted in profit margins that are half many of its peers and have fallen now for a number years. During this period however its reputation with customers as the out-and-out price leader in this sector has never been stronger. Thus its brand has a future ability to grow and has been reinforced. Having the stomach and determination to pursue such a strategy when all around you (sometimes you author included!) are telling you to raise prices a little requires an enormous amount of discipline, determination and belief in the power of your long-term business model. These traits in the face of lower margins than peers are not always seen as attractive by the short-term weather vane that we call 'Mr Market.'

The economic and investing backdrop

“The purpose of astrology is to make economics look respectable” Ezra Solomon

Each and every year the economic and stock market backdrop will have an effect (sometimes a large one) on the investment performance result we record. As a consequence of this undeniable link many investors spend a great deal of time trying to predict the economic future so as to try and aid their chances of performing better. Whilst there seems logic in this approach, I see it as tantamount to tea leaf reading. Our focus is on trying to develop an all-weather investment approach that is adapted a little to the environment we find ourselves in. Long suffering readers of these letters will have heard me before describe the macro environment akin to the wing mirrors in my car. Whilst I spend the vast majority of my time looking out of the front windscreen in my search for great companies that will offer wonderful compounding opportunities, I do glance in my wing mirrors occasionally. This is mostly just to check a tornado isn't about to hit our car/portfolio from behind. Indeed, it was exactly this reflection that made us take a more cautious view in early 2020, just before Covid hit Europe.

It is important on this point to not be disingenuous. Of course I am aware of the many macro issues that surround investors today and their ever-changing probabilities. However, readers should know that I spend (a lot) less time trying to forecast these issues than many other managers.

Our wing mirrors during 2021 clearly showed signs of potential higher future interest rate and inflation. On both issues there is a great deal of debate from many in each entrenched camp. A few years ago our contrarianism saw us own banks for just such a recovery/normalisation in their returns that would result from higher rates. Today I feel somewhat different. It is not that such companies will/will not benefit from such a change, but instead what is the opportunity cost of me owning them while I wait. Additionally what is my edge in understating these companies over other investors? In truth it is likely 'none'. Today we are super focused on finding great compounding opportunities that are run by exceptional owner managers, looking far and wide to find them. Furthermore, we are finding lots of them and are excited by the compounding prospects they might bring to the fund. So instead of owning companies that *may* benefit from our macro predications (if we were correct) instead we watch out for free options from macro tailwinds. An example is our ownership of Schwab. Schwab is a perfect example of a powerful scale economy shared business that is still heavily influenced by its founder. We use the next label carefully, but we believe it is the 'Amazon of financial services'. Its growth is not set to fade as many of its analysts have regularly projected due to the wonderful value it offers its customers. Schwab however is also a huge beneficiary of higher interest rates due to the enormous amount of sticky customer assets that sits on its balance sheet. This free option was not lost on us when buying into Schwab in the past few years. The power and resulting growth of its business model was its main attraction. But that its profits could be materially higher in a normalised interest rate world vastly improved its margin of safety/attractiveness at the time of purchase. We will openly admit that we would one like to own more Schwab shares than we do. We also have another company in the portfolio with the identical interest rate exposure to Schwab.

Frasers and Biglari Holdings – Method or madness...?

Any that have followed our research in recent years will know that we have been fans of Sports Direct (now called Frasers) since its fall from grace in 2015. Often when admitting our attraction to and ownership of such a company we have been looked at by many a fellow investor strangely. It is the look you might give to someone whom you are thinking of crossing the road to avoid! Mike Ashley's drinking ability, football club ownership and general demeanor seem to have overpowered investors and commentators alike we note, irrespective of their level of experience.

Mike Ashley is undoubtedly a maverick. He is also culturally about as far away from the London financial establishment as it is possible to be. However, our assessment of his business abilities is that he perhaps has one of the best understandings of market power and competitive positioning of anyone we have met. We have attended numerous investor meetings with this company over the last 5 years and a few of them were press/ESG/Union circuses. During one such circus Mike was asked what his customers would think of the company's future elevated store offering (i.e. less discounting/more full price). Mike's six word answer we thought was telling. Its importance was also missed on the audience:

"Where else are they going to go?" Mike Ashley

Earlier we referenced our use of repeatable mental and business models. On hearing the above phrase, one popped into our heads. It was of Buffett describing the permanently improved pricing power that resulted when a local newspaper market consolidated from three players to two. Ashley's decades of discounting saw its relationship with Nike come to head c.5 years ago. His then acceptance of a new way of selling sportwear's that resulted (i.e. more of it at full prices) was clearly influenced by Nike's demands. However crucially the competitive environment he had created prior to this point by killing

off numerous competitors was a critical factor too. Consumers had nowhere else to go. Today we surmise that Frasers relationship with Nike has never been better. In the coming years the company looks set to achieve high gross margin sales via both its Sports Direct and Flannel facias overlaying these on a still super-efficient distribution network. The resulting impact of profitability will surprise many we think. The recovery in the company's share we believe has only just started.

Enter stage left Sardar Biglari

If you think Mike Ashley has a strained relationship with investors you should meet Sardar Biglari. There is no communication with investors outside quarterly SEC releases, the AGM and the annual letter. Even at the AGM Sardar is often prickly when answering a question, he might not see as suitably researched. There have been proxy fights in the past and all manner of unpleasant things written about Mr Biglari from US commentators. (The annual letter by the way is both candid and very open about the company, its businesses and mistakes Sardar may have made).

All of this is Mike Ashley-esq in the disconnect between superficial market commentary and proper business analysis. This interests us because we believe Mr Biglari to be a talented businessman, investor and capital allocator. He is an outright owner of whole businesses inside Biglari holdings (the quoted share that we are invested in), but also an investor in publicly quoted shares. We observe that the purchases he has made over the last c.15years have often had areas of hidden value that others miss. Examples would be oil reserves that produce far more cash than profits due an ongoing depletion charge, but he bought the business out of bankruptcy. Also, the never mentioned, heavy freehold property backing that came with his purchase of restaurant chain Steak and Shake. Unusually Mr Biglari looks to have multiple skill sets in both asset heavy and asset light industries. He also has a great understanding of 'float', having purchased two specialist insurance businesses with very impressive combined ratios. As a result of our multi-year study of Sardar Biglari and the company he holds a c.60-65% interest in we surmise that he has the skill to be able to grow investor capital (his and ours) at a high rate for many years into the future.

Only the half of it

In the Appendix of this letter, you will see a summary of the balance sheet on Biglari Holdings as at end September 2021. We hope that even to the untrained eye a few points stand out:

- That the group has shareholder equity of c.\$599m
- That there is no debt in the company so the vast bulk of this \$599m comes from either '*Property and equipment*' or '*Investment partnerships*'
- There is a large negative number (\$396m) attached to '*Treasury stock, at cost*'

A glance at your Bloomberg, Capital IQ or Google Finance source will then tell you that Biglari Holdings has market capitalisation of c.\$420m (Share in issue x price) at 17th January 2022 prices. Mr Biglari however is shrewd and, like Mike Ashley, is a man to watch what he does more than what he says (which is not a lot). Biglari Holdings over the last 5y+ years has bought back an enormous amount of its own stock and this stock sits in two funds inside the company.

The company however has 66.1% and 92.9%% ownership of these funds (as at 30th June 2021). As a result, the effective shares in issue for this company on a look through basis we believe is almost half the stated level (i.e. the one Mr Market is using).

The upshot of all this is that we have a company run by an owner manager who we think will grow and allocate its capital very well many years (even decades) into the future. But whose shares are offered to

us at maybe a third of their value today. (NB: we think the company is worth more than the \$599m figure considering the earnings potential of different parts of the business).

In modern efficient stock markets how is such a mispricing possible? Partly by the fact that there is no analyst coverage of this company. But also, we think by the confusion of emotion and analysis. Like Frasers in the UK, so many investors have decided to hate/distrust/dismiss Sardar Biglari they have either stopped thinking clearly or more likely just refuse to look at its accounts.

To misquote Buffett's view on bear market pricing "*It is not that we like uncommunicative, unpredictable Owner managers that have a sometimes-strained relationship with investors, but we like the prices that they bring.*"

In closing

The fund is now a daily dealing UK UCITS fund with links to its pricing shown on the [Holland Advisors](#) and [Valu-Trac](#) websites. It is available to invest via most UK wealth managers and many investment platforms. Disclosure of our major holdings and the geographic split of how the fund is invested are show on the monthly [fact sheet](#).

Thank you for your interest and for investing alongside me. As I have stated many times before I cannot predict the return the fund will make in the future. All I can do is work hard to try to ensure we own the best selection of investments that give us the greatest chance of compounding our capital at a good rate many years into the future. Whilst keep an eye on downside risks.

With kind regards

Andrew J Hollingworth, Fund Manager

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Appendix: Extract from Biglari Holding 10Q September 2021

PART 1 – FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

BIGLARI HOLDINGS INC.

CONSOLIDATED BALANCE SHEETS

(dollars in thousands)

	September 30, 2021 (Unaudited)	December 31, 2020
Assets		
Current assets:		
Cash and cash equivalents	\$ 27,795	\$ 24,503
Investments	99,006	94,861
Receivables	23,885	19,185
Inventories	3,102	2,737
Other current assets	6,763	6,492
Total current assets	160,551	147,778
Property and equipment	352,822	316,122
Operating lease assets	44,598	42,832
Goodwill and other intangible assets	77,179	77,661
Investment partnerships	273,089	419,550
Other assets	11,132	14,025
Total assets	\$ 919,371	\$ 1,017,968
Liabilities and shareholders' equity		
Liabilities		
Current liabilities:		
Accounts payable and accrued expenses	\$ 100,898	\$ 90,892
Loss and loss adjustment expenses	13,401	14,652
Unearned premiums	11,303	13,277
Current portion of lease obligations	17,230	17,365
Current portion of notes payable	—	152,261
Total current liabilities	142,832	288,447
Lease obligations	107,949	111,645
Deferred taxes	57,910	41,346
Asset retirement obligations	10,314	10,022
Other liabilities	1,800	1,680
Total liabilities	320,805	453,140
Shareholders' equity		
Common stock	1,138	1,138
Additional paid-in capital	381,788	381,788
Retained earnings	613,351	573,050
Accumulated other comprehensive loss	(1,909)	(1,531)
Treasury stock, at cost	(395,802)	(389,617)
Biglari Holdings Inc. shareholders' equity	598,566	564,828
Total liabilities and shareholders' equity	\$ 919,371	\$ 1,017,968