



Farrer Wealth Managed Solution Quarterly Update

Q3 FY2022 Returns Summary

(Quarter ending March 2022)

All values in SGD terms unless otherwise stated, data is as of most recent quarter end

| Model Portfolio Returns* | | | | | Year-to-Date Returns | | |
|---|--------|--------|------------|------------|----------------------|-----------------|---------------|
| | Q1 | Q2 | Q3 | Q4 | Portfolio | Benchmark SGD** | Benchmark USD |
| FY 2022 | -0.20% | -7.40% | -20.47% | | -26.50% | 0.21% | -0.37% |
| | | | Cumulative | Annualized | | | |
| Model Portfolio Return Since Inception***: | | | -26.50% | | | | |
| Benchmark (SGD) Return Since Inception: | | | 0.21% | | | | |
| Top 5 Holdings (Alphabetical Order) | | | | | Key Terms: | | |
| eDreams Odigeo | | | | | Management Fees: | 1% p.a, monthly | |
| Evolution | | | | | Performance Fees: | 15% p.a/bmark | |
| IAC | | | | | Minimum Size: | S\$250,000 | |
| Meta | | | | | High water mark: | Yes | |
| Sendas Distribuidora | | | | | Liquidity: | 30 days notice | |
| Total Weighting of Top 5: 52.99% | | | | | Structure: | SMA | |
| <p>* 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.</p> <p>** 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.</p> <p>*** Inception was 1st July 2021; The Managed Solutions financial year goes from July-June</p> | | | | | | | |

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 medium- and long-term using bottom-up research and asset selection. While the mandate of the Managed Solution is quite 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 assets that we believe will outperform the relevant benchmark over time. Our investment decisions are based on deep fundamental research, much of which we publish on our [website](#). Investments are sector- and geography- agnostic, and instead focus on businesses that are growing market share in markets that are growing. The Managed Solution’s goal is to give our clients outperforming returns so that they do not have to make the individual asset selection themselves. The solution does not short nor use leverage but may buy options from time to time to hedge or express a particular view.

A word on returns

There's no way to sugar-coat that the performance of the Managed Solution was poor this past quarter. Granted, the benchmark also produced negative returns and in general market conditions were bad (inflation, interest rates, Russia/Ukraine), but we are not here to make excuses. The drawdowns in our performance were mostly driven by three positions. We will discuss those below and comment on what we've done with the position since.

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- **Sea Limited:** Sea Limited had been selling off since its peak in early November of ~\$363/share. This was driven by both a general sell off in tech, especially non-profitable tech, and a general belief that its gaming arm (Garena) was experiencing a slowdown due to its flagship game Free Fire. Free Fire has experienced a slowdown for three reasons: it is a victim of its own success, and by the end of Q321, nearly 10% of the world's population already played the game, and thus reaching new users was difficult; A return to normal with people traveling/going out more and spending less time playing games; and the Indian market imposed a ban on the game due to anti-Chinese sentiment (Tencent is a large shareholder in Sea). We believed that these issues, while worth considering, were a bit overblown, and some of the data we saw from 3rd party sources showed that though Free Fire usage was dipping, it wasn't too drastic. Thus, we marginally added to the position throughout the quarter. This was a mistake. During Sea's earnings report in early March, the company guidance for Garena (down nearly 35% yoy) showed that the slowdown was far worse than predicted. Secondly, Shopee (Sea's e-commerce arm) has pulled out of certain markets (in Europe and India), which long-term is probably the right strategy, but short-term hampers the optionality of the business. After considering this information and the guidance from earnings, we decided to significantly trim the position. In our opinion, management does have a bit of egg on its face from an overly aggressive expansion or as one investor called it, "bull market hubris." We think management's moves were mostly logical, it's just that their failures came during an unforgiving market. While we believe that Sea's future is still bright (especially with regards to their e-commerce and financial services), it will take a few quarters of strong earnings for them to regain their momentum, and for now the capital can be better spent elsewhere (see new additions to the portfolio below).
- **Facebook/Meta:** We discussed our thoughts on Meta's earnings in [this blog post](#), so we won't belabour some of the points. But in a nutshell, Meta's stock was hammered post earnings after they revealed the extent to which the iPhones iOS 14 changes impacted both ad targeting and measurement. The market was also unconvinced of Zuckerberg's \$10 billion/year investment into their Reality Labs business, as they work to develop their version of the metaverse. Our thoughts are that while we share the market's healthy scepticism for the metaverse project, the core businesses have shown signs of bouncing back and expanding new revenue streams such as through the monetization of Instagram Reels. We further think the company's valuation (trading at less than 10x next year's EBITDA) are at levels where selling makes little sense. Now certainly that implies that the market doubts Meta's terminal value, so metrics like daily active users and monthly active users need to be watched carefully. We did not add any capital to the position after earnings, and we will reassess capital allocation to the business (or away from it) based on progress made by the company in subsequent quarters.
- **Vizio:** This decline has been the most puzzling. While Vizio did suffer from a general industry/competitor sell-off, we thought earnings were actually pretty solid, and the 'bad' parts had been guided too (i.e. supply side issues). On the Platform+ side, we were informed



that the company had committed revenues of \$100MM for 2022, and it turns out that's how much the company will earn in just the first quarter of 2022. The company is now trading at 0.5x sales. Which put another way means they earn their entire enterprise value in six months of revenue! That said, one criticism we do have is the company's capital allocation has been subpar. They are sitting on 20% of their enterprise value in cash and should be deploying that in the form of buy backs. We have expressed this directly to the CFO of the company and hope to hear positive news on this. We have been adding to the Vizio position given the setup.

The above notwithstanding, it was not all bad, not by a long shot. Our position in Sendas Distribuidora (a Brazilian cash-carry business) is up 56%+ YTD March, and we think it could still double from here and potentially rise even higher if the Brazilian Real continues to strengthen. Our investment in eDreams (Europe's largest airline OTA) continues to work well and has been surprisingly resilient (or perhaps not so surprising given the company's execution) given the war in Europe. Further, we added several new investments this quarter (Google, Atento, and Basic-Fit) which we will discuss below.

Portfolio Churn...

Churn in the portfolio has been more than usual, but that is to be expected when the market is as volatile as it currently is. The volatility is both a short-term risk and a long-term opportunity, and we would be foolish not to take advantage of the latter by not optimising our portfolio.

Exits

- **Amazon:** We had a medium-sized position in Amazon which we exited after the company released its earnings. We thought earnings on aggregate were just fine and were especially impressed to see AWS (Amazon Web Services) start to reaccelerate its growth, up nearly 40% yoy. However, looking beneath the hood a little bit, we noticed a significant slowdown in the 1P and 3P ecommerce businesses that enjoyed a nice covid-bump in previous quarters. The international business also saw negative yoy growth as the covid bump deflated and competition heat up in markets such as Southeast Asia, Latin America, and India. None of these issues individually were a huge cause for concern, but they did force us to lower our internal projections. Given this, we felt the internal rate of return ("IRR") baked into the price post-earnings was not particularly attractive given other opportunities available, and so, we exited the position. None of this is to say that Amazon is in any trouble, and we believe current investors will do just fine over time. We remain big fans of the companies and think Prime and AWS may be some of the best businesses ever created, so we reserve the right to buy back the position at cheaper valuations (or at a higher potential IRR).
- **Block (formerly Square):** We 'adopted' Block's stock after the company bought Afterpay, which we were investors in. We had been trimming the Afterpay position throughout 2021 and trimmed again after the acquisition, so the position was quite small. We held onto that small portion, as we did think the acquisition made sense and were excited to see the two

companies integrate and for Block to create a closed loop network between merchants and consumers. However, the market punished most highly valued tech stocks over the last months, and we saw the position move against us by over 50%. We are firm believers that when a stock goes against you by 50%+, you need to do something about it. Either trim/sell and reinvest or buy more. In the case of Block, the original reason for holding was to see how the acquisition and integration with Afterpay panned out. The market did not give us the time to see this play out, thus we were not comfortable adding more to the position. Further for the stock to recover to our purchase price, we felt the company's valuation would need to command a future exit multiple that the market would be unlikely to pay in this environment. Given this, we exited the remainder of the position.

- **Par Technologies:** Par Technologies is a leader in the enterprise POS space, servicing restaurant chains such as Arby's, Dairy Queen, and Five Guys. The company was in the hardware space for most of its existence, but when a new CEO, Savneet Singh, was installed a few years ago, he refocused the company on a newly purchased software called Brink. Singh had done a decent job of shifting the company's focus to software sales, removing the technical debt inherent in Brink, and making smart acquisitions such as Punchh (loyalty platform). However, our conversations with management led us to believe that the strategy Par was employing was difficult, as re-writing the DNA of a company takes time. Thus, it started to become one of those investments where we kept saying to ourselves "let's give them one more quarter" which in hindsight, should have been an internal red flag. Our patience ran out these past few months and given the drawdowns and other opportunities in the market, we sold our position. That said, we never built Par into anything but a small position, and it was our smallest position at the time of sale. Considering most of our clients owned the stock from anywhere from \$10-25 the end outcome was reasonable despite our thumb sucking. We do think Par will eventually be quite successful in their space, however we think it best to put our money elsewhere for now. We wish the company and management the best and will root for their success from the side-lines.

The combined net losses from these positions were roughly a 2.56% drag on the portfolio.

Additions:

- **Alphabet:** We won't waste much time trying to explain to our clients why Alphabet is such a phenomenal business, we believe that is quite self-evident. The better explanation is why we never bought Alphabet before. The reason was a personal bias we held based on three beliefs (which we now believe to be incorrect)
 - Growth in YouTube would stall as the increased ad-load would turn-off viewers (the double ad-load at the beginning of videos for example)
 - Consumers will focus on discovery rather than search to purchase new items. For example – using Instagram/TikTok to decide what new clothes to buy instead of 'googling' for clothes.

- Other Bets: In general, we felt that capital spent on “Other Bets” has been a bit wasteful with the segment earning just around \$3.1bn in revenue versus nearly \$21bn in operating losses over the last five years.

However, the most recent earnings call and the decline in stock price, and thus valuations, made us look at the company again. We decided to purchase stock in the company for a few reasons:

- Change in thinking: The recent earnings demonstrated that our three assumptions were quite wrong. Not only has YouTube ad growth accelerated in 2021 vs 2020 (growth of 45% in 2021 versus 30.5%) but users continue to grow, with online data showing that 1.7bn unique users visited the site in 2021, second globally only to Google itself. Now revenue growth is certainly related to increased ad-loads, but the growth in users shows that more ads is not turning off users. Our personal consumption of YouTube backs this up, and now that we are shareholders, we feel less guilty about how much time we spend on the site. Further, while the likes of TikTok and Instagram are taking share with regards to search, Apple’s IDFA changes illustrate how effective search engines are with regards to advertising. Searching for something immediately illustrates interest in a way scrolling does not, and thus attribution and measurement become significantly easier for advertisers. Lastly, while Other Bets still appears inefficient, losses make up both a very small percentage of cash and market cap. Given that Alphabet’s biggest Other Bet – Waymo, is rolling out self-driving vehicles in major US cities, we could see a tipping point soon.
- Valuation: The market dislocation allowed us to pick up shares of Alphabet at a near 5% free-cash flow yield, the highest it has been since 2017. Further on a comparative basis to Amazon (which we sold), Google trades at a 13x next year EBITDA versus 19x for Amazon, despite similar top-line growth profiles moving forward. Thus, we felt we were getting a better deal.
- Exposure to cloud services: The one part of Amazon that continues to impress is AWS, and as stated above, its growth has been accelerating. Google Cloud competes with AWS and while it is yet to become profitable, it is growing faster (44% yoy). Thus, while we sold Amazon, our investment in Alphabet allows us to maintain cloud infrastructure exposure.
- **Atento:** Atento is a bit out of left field for us with regards to the industry, and thus, is one of the most unique positions in our portfolio. Atento is a player in the BPO (business process outsourcing) space, and predominantly operates in Latin America. It used to originally be part of Telefónica (largest Spanish telecom company, also still their largest customer) to deal with customer relationship management (CRM). Atento was spun out of Telefónica and sold to Bain capital in 2012 for \$1.3bn. This deal was backed by lenders, who in May 2020 (five years after IPO) were handed the share via a payment-in-kind note when Bain wanted out. The lenders (GIC, HPS, and Farallon) are now stuck with the shares until the middle of this year when their lockup expires. We think that to get an adequate return on their investment they would need

to sell the shares for \$55 (current share price is around \$25). Considering the lenders own over 60% of the company and liquidity of the stock is quite poor, selling their share in the open market is out of the question, they must find a buyer for the company. Now the question becomes why anyone would want to buy Atento, so we'll touch on the business fundamentals below.

Atento offers services including sales, customer care, technical support, collections, and back office. The company initially started serving Telecom and Financial services. However, over the last few years they have begun to service other industries, including “Born Digital” companies that result in high margin contracts due to the automation involved. Atento is a recognized leader in the CRM BPO space, and on February 16, 2021, the company announced that they have been positioned among the top 4 leading global players in Gartner’s Magic Quadrant for BPO Customer Management. In 2020, the Everest Group has selected Atento as one of the leading companies in Customer Experience Management (CXM) in its annual IPEAK Matrix Assessment 2020 report. This recognition is based on the company’s ability to improve and evolve through the pandemic.



Taking a step back, it’s important to note that the BPO industry was essentially a people-heavy, low margin, sleepy business. However, a few things have changed over the last several years to make BPOs far more efficient. These efficiencies have been driven by 1) Management Tools that allow teams to work from home (thus less need for physical spaces) 2) Cloud computing – replacing expensive onsite servers 3) Multi-tasking; such as offering services beyond just basic customer care 4) Increased measurement and data to drive efficiencies 5) Artificial Intelligence – essentially allowing for bots to take over human functions.

Atento has seized these changes and implemented a “Three Horizons Strategy” which is as follows.

- Operational Improvements (sales and operational efficiencies, and a reduction in SG&A)
- Digital Acceleration (High Value Voice, Integrated Multichannel, and Automated Back Office)

- New Growth Avenues (Expanding in non-LATAM markets such as the US and focusing more on high-margin industries such as tech/retail/healthcare).

This strategy was implemented by new management that was installed in late 2019 headed by CEO Carlos López Abadía and CFO José Azevedo. Their strategy has been showing results, and while revenue has been declining through a roll off lower-value contracts, EBITDA margins are increasing significantly as the current/new contracts are much more profitable. This increase in margin is offsetting the revenue decline, and as margins continue to improve and revenue recovers the company will see record EBITDA figures. Further, 2019 EBITDA (post-IFRS 16) was 9.0% and we suspect that the company will do an EBITDA of close to 14% by the end of this year, and a few points higher next year. This will bring it just shy of the industry average of around 17%. But the interesting part here is that Atento trades at a 4x EBITDA multiple whereas the industry trades at close to 12x. Thus, as Atento continues to improve its metrics, and brings on higher-value contracts, it should make a juicy acquisition target, as currently even at double the current multiple, it would trade at a discount to its peers. Further, management is well-incentivised to kick off a sale with RSUs worth around \$40MM and additional share-based comp based on EBITDA margins, in line with turnaround targets.

Now, a fair question investors should ask is what we are doing investing in a business like this. We have long stated that we look far and wide for interesting investments, and the only real common thread is we look for a company's growing market share in markets that are growing. Atento fits that definition and is the market leader in LATAM. Pre-covid, they had a 15%+ share of the market, almost 5% higher than the next competitor. It also has a growing market share in the US where new business means less exposure to Emerging Market currencies. Hard currency exposure (ie USD/Euro) now makes up 26% of EBITDA.

As highlighted, there are two parts of this setup. First a proven turnaround story trading extremely cheaply and second, majority investors looking for a sale. There is also a third element, via an activist investor, where Kyma Capital (a UK based fund who owns more than 5% of Atento) and a few other investors are banding together to make changes on the board level, and push for a sale based on Luxembourg Takeover Bid laws (Atento is domiciled in Luxembourg). This third element will hopefully push the board to take strategic action sooner rather than later (Bloomberg has reported that Atento has hired Goldman to explore a sale).

As 'juicy' as this investment sounds, it is not without risk. For one, as highlighted, most of the business comes from LATAM which has its own geopolitical and currency risks. Second, toward the end of last year the company suffered a cyberattack which will limit growth in the short-term (but should recover by the second half of this year). Lastly, as mentioned, liquidity is poor. Considering this, and for the sake of discipline, we have sized the position modestly.

- **Basic-Fit:** This company has been getting significant buzz lately, especially after it was featured in the Business Breakdown podcast (we promise our research started much before the

podcast was released!). Basic-Fit is the largest fitness chain in Europe with over 1000 clubs across Europe and over 2 million members, focusing on providing a low-cost and convenient gym experience. Researching Basic-Fit reminded us of the quintessential beginners to business example, where a single “lemonade stand” generates strong profits reinvested to create a chain for lemonade stands. Similarly, the average Basic-Fit club has a post-tax ROIIC of 20%+ (our calculation), driven by a lean operating model of minimal staff per store, bulk equipment discounts due to scale, and an ability to spread market costs over several stores via their cluster strategy.

Basic-Fit is run by René Moos, a former professional tennis player, who started HealthCity in the Netherlands in 2004. What was originally a mid to premium gym concept merged evolved into Basic-Fit (via additional mergers and spinouts) which focused on the low-cost end of the market following the success of Planet Fitness in the US.

The company operates in France, Netherlands, Belgium, Spain, and now Germany. It has significant scale advantage over its competitors in most of its markets and is implementing an aggressive cluster strategy. This means opening several clubs in a particular region over a short period of time, increasing club accessibility for gym-goers.



We feel that this increase in accessibility will also increase gym-goer penetration in Europe which significantly lags that of the US (8% vs 20%+). This has been proven via real examples of Basic-Fit entering markets and increasing gym-goer penetration in the cluster (so not only taking a share but also growing the pie).

When we spoke to the company one of the big questions we had was why any of their competitors can't copy them – and the company admitted that what they are doing is not rocket science. But after further conversation with the company, other investors, as well as our internal discussion, we came to two conclusions. For one, an aggressive expansion strategy (goal is to reach 3000+ clubs by 2030) takes a few special ingredients 1) solid execution 2) access to capital and 3) an aggressive but competent leader. We feel Basic-Fit has all three.

Second, we feel that their scale just makes them hard to compete with. In the chart below, you can see we compare a single Basic-Fit club with two hypothetical competitors' clubs, first

(Competitor A) who tries to compete on price and second (Competitor B) who tries to copy Basic-Fit exactly. We assume similar rent/personnel cost/other opex (although due to its scale Basic-Fit does get discounts on rent in certain markets and because of the way its clubs are set up they can run on skeleton crews). We then build in advantages for maintenance capex and initial capex required because, according to industry experts, Basic-Fit enjoys at least a

| EUR (000s) | Basic-Fit | Competitor A | Competitor B |
|--------------------------------------|-----------|--------------|--------------|
| # of members | 3.3 | 3.3 | 3.3 |
| Average member fees/4-weeks | 20.0 | 16.0 | 20.0 |
| Revenue | 857.6 | 686.4 | 857.6 |
| Rent | (160.0) | (160.0) | (160.0) |
| Personnel cost | (125.0) | (125.0) | (125.0) |
| Other club opex (ex D&A) | (150.0) | (150.0) | (150.0) |
| Underlying club EBITDA | 422.6 | 251.4 | 422.6 |
| Underlying club EBITDA margin | 49% | 37% | 49% |
| Maintenance CAPEX | (65.0) | (81.3) | (81.3) |
| Underlying club EBITDA - maintenance | 357.6 | 170.2 | 341.3 |
| Incremental overhead (% of revenue) | 3% | 3% | 3% |
| Underlying EBITDA - maintenance | 331.8 | 149.6 | 315.6 |
| Initial CAPEX required | 1200 | 1500 | 1500 |
| Profit after tax (~25%) | 248.9 | 112.2 | 236.7 |
| ROIIC | 20.7% | 7.5% | 15.8% |

30-40% discount versus mom-and-pop gyms and 20-25% discount versus other decent-sized players. As one can see the ROIIC are significantly lower for both hypothetical competitors. So even if competitors arise (which is always a possibility) we doubt they will do nearly as well as Basic-Fit.

Now, investing in Basic-Fit carries certain risk. For one, the company has about Euro 550bn in net debt over an equity base of 410bn.

Further, we think the company will need to borrow more over the next 3 years to meet their expansion goals of around 250-300 clubs per year. That said, we believe that despite the high level of debt, gearing ratios will actually decrease as clubs start to generate EBITDA post covid-closures. Secondly, a lot of our internal IRR numbers (which are in the mid 25%) are based on the company hitting their 2025 goals of ~2000 clubs and 2030 goals of ~3000 clubs. What we've learned through the last few years is that a lot can happen between now and then. Thus, we will scale into the position slowly as the company executes.

Should our clients want to know more about this investment we have pages of research that we can send across. This research was compiled by Nigel Ng, a student at NUS, who worked with us on Basic-Fit. We thank Nigel for his great contribution! (You can also check out Nigel's YouTube page [here](#) where he discusses stocks).

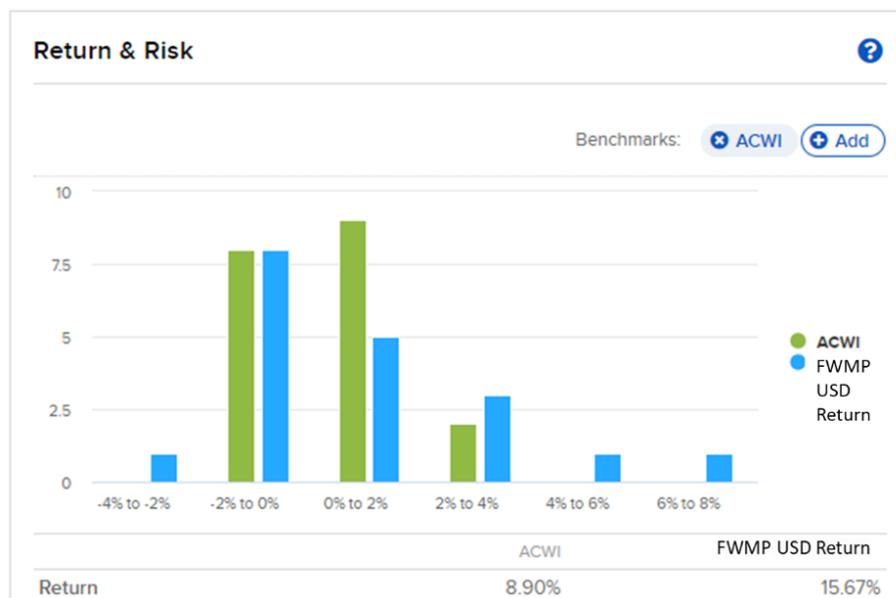
We also have a starter position in one other company, however since we are still completing our research and building the initial position, we will hold off commenting on it for now.

A quick word on hedging...

Clients may have noticed various hedges in the portfolio over the last two quarters. As stated in the prospectus for this Managed Solution, that we may from time-to-time use options and commodities as a hedge. Depending on a number of factors including purpose, cost, time value you may see options on indices or ETFs relating to commodities (i.e. gold or oil) in the portfolio. We will be trading in and out of those as market conditions change, so do expect a high degree of churn on those positions.

Recovery and call for capital...

This quarter was tough on the managed solution, and while we always expected the portfolio would suffer 30%+ drawdowns at some stage, we never thought it would be in the first nine months of launching! That said, this is the nature of a concentrated portfolio. When markets are declining, it will likely sell off more than the benchmark, but in good markets (which occur far more often than bad markets), it should outperform. We now have evidence of this. The benchmark bottomed on 8th March, and since then has returned 8.90% whereas our Managed Solution has returned 15.67% (the below in USD; 8th March to 1st April 2022). As you can see from the image below, our returns, due to concentration, will usually be skewed toward the tails of the distribution curve. When markets are in decline, we will have more results toward the left tail of the curve as compared to the benchmark, whereas when markets are in recovery or in a boom phase, you should see far more results to the right of the curve.



Sample Daily Return Distribution of the Managed Solution portfolio from 8th March to 1st April

While we don't know if the market has bottomed, we do know that participants continue to be bearish, and the scary news on the horizon continues to depress any optimism. We also know two things 1) every bear market of the past looks like an opportunity and every one of the future looks like a risk and 2) fortunes are made when investing in bear markets, because very few do. Recoveries can also be swift. For example, our position in Sendas Distribuidora collapsed 45% toward the end of last year and has rallied 78% this year (YTD 20th April). Given this, and the recovery in our portfolio, we are calling for capital. Thus, if you were looking to top up your account or looking to deploy some capital, this, in our humble opinion, is a decent time to do it. That said, we continue to remind investors about a few characteristics of this managed solution.



- Any amount invested should not be required for at least 3 years, preferably 5 years
- You should not expect smooth returns
- We have experienced 30%+ drawdowns, and likely will do so again in the future

We've said this before, and will repeat it often, but it is an immense privilege to manage our client's hard-earned money. It is a privilege we do not take lightly and work daily at earning and keeping our client's 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 Singapore and must be Accredited Investors (as per MAS's definition).

A handwritten signature in black ink, appearing to be "PR" with a stylized flourish.

Pratyush Rastogi
CEO – Farrer Wealth Advisors