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Eking out unrecognised family value

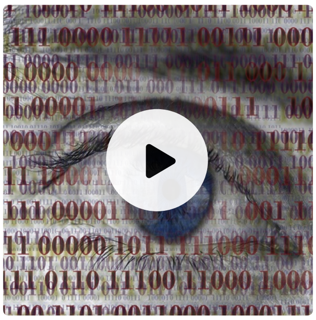
By Leonora Walters

For much of the past decade growth-style investing has done better than value-style investing. And not surprisingly **British Empire Trust** (BTEM), which takes a value approach, has lagged the average return of its peers in the Association of Investment Companies (AIC) Global sector over one, five and 10 years.

"The last few years have been all about growth and for much of that time US growth," explains Joe Bauernfreund, manager of British Empire Trust. "We're firmly in the value camp and tend not to hold much directly in the US, while some of our peers are firmly in the growth camp, which explains a lot of the discrepancy. I'm not sure I have the answer [as to when value-style investing will make a comeback] but I believe that over the long term buying companies that are fundamentally cheap is a sensible investment strategy."

He defines value as companies trading at discounts to their net asset value (NAV). "The discount is the first thing that alerts us as to whether a company is potentially undervalued," says Mr Bauernfreund. "But the discount is not definitive in that sense, because sometimes it is there for a good reason – to alert investors to a value trap or an operationally challenged business. But when we find companies trading at discounts we try to ascertain whether the market is inefficient at pricing these companies or giving us a warning to stay away. The way to avoid value traps is to do as much research as possible, understand the underlying businesses and try to position ourselves in situations where we think the value is going to appreciate."

He mainly targets companies with high-quality underlying assets and strong balance sheets, for which an event is likely to narrow the discount between their NAV and share price. But he admits this approach "doesn't always work and sometimes we get it wrong".



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An example of a holding that hasn't gone as expected is UK-listed hedge fund **Pershing Square Holdings** (PSH). "We have invested a bit early, as since the time of our investment the share price has fallen and the discount has widened," says Mr Bauernfreund. "But we've been adding to it and still believe there's a lot of value that hopefully over time will be unlocked."

And over April Pershing made a NAV return of 3.3 per cent and its discount to NAV reduced from 23.7 per cent to 20.8 per cent, driven by its holding in **Chipotle Mexican Grill** (US:CMG), the share price of which rose 31 per cent over the month. "While it is hard to argue that Chipotle Mexican Grill shares look cheap on a near-term multiples basis, the business has been undermanaged for years and has compelling scope for growth given its relatively limited footprint in its home market of the US," says Mr Bauernfreund.

An area Mr Bauernfreund and his team think is a particularly good place to find value is Japan, and they have added to it substantially over the past year so that it accounts for around a fifth of the trust's assets. And although British Empire Trust mostly invests in other listed funds, it has invested directly in around 18 Japanese companies. In total it has exposure to around 200 underlying companies.

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"In Japan we can find direct equities that really fit our style of investing," says Mr Bauernfreund. "Specifically we are looking at companies that have substantial net cash on their balance sheets, and as investors in companies trading at discounts to NAV, we feel that cash is the primary asset."

British Empire Trust takes what it describes as "active involvement to improve corporate governance and unlock potential shareholder value" with some of its holdings. It has been communicating with the boards of a number of its Japanese holdings, and is making suggestions for ways to improve governance and balance sheet management.

These include **Tokyo Broadcasting System** (9401:TYO), which British Empire is trying to persuade to reduce its holding in another listed company, **Tokyo Electron** (8035:TYO), and return the proceeds to shareholders.

"As yet they haven't agreed," says Mr Bauernfreund. "[Tokyo Broadcasting System's] annual general meeting is due at the end of June when shareholders will be asked to vote on our proposals."

British Empire also invests in holding companies that hold the assets of wealthy families. Examples include its largest holding, **Exor** (EXO:MIL), an Italian company controlled by the Agnelli family who founded the Fiat car company. Exor's largest asset is **Fiat Chrysler** (FCA:MIL) in which it has a substantial stake, and other holdings include car company **Ferrari** (RACE:MIL) and **Juventus** (JUVE:MIL) football club.

"We go for [family holding companies] because in many cases they have tremendous long-term track records that are superior to many broad market indices," explains Mr Bauernfreund. "They contain high-quality businesses, both listed and unlisted. And the market generally is very inefficient at pricing them, so they can trade at wide discounts. We try to capitalise on that inefficiency by buying them as cheaply as possible, aligning our interest with the interests of families whose objective it is to preserve their wealth to pass onto future generations."

As an example, during April Exor's NAV increased 10 per cent but its share price failed to keep up so the discount widened by 3 per cent, taking it to 30 per cent.

Mr Bauernfreund thinks these companies are priced incorrectly because their shares are not as easy to buy and sell as other listed companies, they are controlled by families and the research coverage of them is not as extensive. "They also tend to be very diversified in the nature of their holdings, while many investors like to pick their investments based on certain geographies or sectors," he adds.

Joe Bauernfreund CV

Joe Bauernfreund is chief executive officer of Asset Value Investors and has been lead manager of British Empire Trust since 1 October 2015. He joined Asset Value Investors in July 2002 as an analyst covering European holding companies, and then covered the entire universe of investments the trust invests in and became joint manager with John Pennink until October 2015.

Before joining Asset Value Investors Mr Bauernfreund spent six years working at a real estate investment organisation in London.

He has a Masters in Finance from London Business School.