



## ZURICH REFLECTIONS

Over the past ten years or so, it has become a tradition for me to spend one week during June in Zurich at a conference known as *The Zurich Project*. It is organised by my friend John Mihaljevič. About 15 years ago, John started publishing an excellent investment journal entitled *The Manual of Ideas* (he later wrote a book by the same name). In doing so, he worked with a number of excellent global investors and over time managed to bring together an incredible community of investors from all around the world. Today, these investors meet at events that John hosts. Some of the events, similar to our *Czech Investment Conference*, which I am co-hosting for the tenth year, are focused on presentations of individual stock ideas. Others, like *The Zurich Project*, aim to facilitate professional investors in sharing their experiences from their businesses and to learn from one another.

I am proud that John has been including me in this community almost since its inception and that I have been able to learn from my colleagues around the world and hopefully pass on some of my own experiences in return. Through these events I have had the opportunity to meet a number of very smart and experienced investors. These range from those who today enjoy almost legendary status, such as Christopher Bloomstran or Guy Spier, to such lesser known but no less inspiring investors as the very meticulous Txomin Zaratiegui or the very talented young brothers Tobias and Jakob Schober. In today's world, where there is more and more talk about artificial intelligence, it is instead the human

intelligence that fascinates me in this community.

*The Zurich Project* itself is organised in such a way that about 50 participants take turns in their presentations over the course of three days. Each chooses his or her own topic as he or she sees fit. About half of the presentations are devoted to how individual investment businesses are set up, organised, managed, or how they deal with particular situations and details. Almost no one talks about individual investments. Instead, the contributions revolve around the processes and thinking that go into running investment funds and companies.

Investing is a rather solitary activity, and the opportunity to draw on the experience of similarly oriented people from different parts of the world is thus of great value to us. These people are all incredibly open, very experienced, and at the same time very humble. Therein lies the uniqueness of this conference. The content is confidential. As they say, what happens in Vegas stays in Vegas. I will not break this rule in any way; nevertheless, the conference has given me the idea to share with you in this letter some of the principles and practices associated with running Vltava Fund. I realised that, although we have long taken these for granted on the inside, we scarcely ever talk about them. Most of our communication with you is about the investments themselves, but you may know less about how we are trying to build our business than you deserve to as our partners. I will try to make up a bit here for that deficit. I am going to focus on three basic things: the



right type of investors, the size of the Fund, and the provision of information.

### **The right type of investors**

Ensuring that the right type of investors invest in the Fund is probably the most important condition for mutually enjoyable and beneficial relationships in the long term. Vltava Fund is a fund available only to qualified investors. These are defined by law, but our ideas of who is an appropriate investor go far beyond this *condicio sine qua non*. A suitable investor in our view is someone who is familiar with what we do, our investment philosophy, our approach to investing, and our understanding of risk. This is someone who not only understands these things but also shares or takes most of our views as their own. We consider all of our investors to be partners, and it would make little sense for us to enter into a partnership with someone who does not know or agree with our views. We do not expect that most potential investors will be willing to learn about our investment views, and we certainly do not expect most potential investors to agree with them. Our fund is open to those others, however, and we are grateful for such new partnerships.

From the very beginning of the Vltava Fund's operation, we have been asking ourselves how to achieve that the Fund would truly attract predominantly just such investors. We are endeavouring to do this in two ways. First, we retain 100% control over who invests into the Fund. We have never outsourced the sale of the Fund to third parties. Anyone who wants to invest in the Fund must contact us directly. The idea that our fund might be made available to investors through, for example, a sales network of financial advisers is quite disagreeable for

us. We could not then be assured that a motivation to sell the Fund would be aligned with the interest of the prospective investor, and, at the same time, we would be taking the risk that a salesperson would embellish things or promise something to the investor that he or she should not merely to successfully close a sale. We want to avoid these unethical practices.

We even believe that investment is not something that should be sold to people at all, and this is related to the second point. We try not to make it completely easy to invest into our fund. It is not that we throw up any obstacles directly, but the potential investor needs to take a certain initiative himself or herself. Potential investors need to find out about the Fund themselves, familiarise themselves with it, and then contact us. We are aware that many people will not go to such lengths, but many others do and this effects a certain natural preselection that actually achieves what we are trying to do. Instead of our trying to sell the Fund to potential investors, they approach us themselves, and when they do, it is very likely that they already have successfully done their homework and have a clear idea of what they are getting into and why. Not only is it very meaningful for us to know that we are working with such investors but this also makes it more pleasant, and it clearly is beneficial to both sides. There is nothing worse than having investors in the Fund who do not really know why they are there in the first place or who have misguided expectations. Such a relationship ends in disenchantment for both parties and we have largely succeeded in avoiding these situations.



### **Fund size**

Our emphasis on having the right type of investors in the Fund is made with full knowledge that we are depriving ourselves of some assets. Our fund would be much bigger if we saw this as a priority. But would you want the Fund's size to be our priority? Would you like us to be more concerned with attracting new investors instead of working better with those we already have in the Fund? I would not like that if I were in your place, nor would I like it from the viewpoint of a person who co-manages the Fund. Instead of chasing new money, I literally wake up thinking about the money we already have in the Fund. In reality, this is about a conflict of interest that goes even beyond just breaking down priorities. It is a fairly well-known and well-documented statistical fact that beyond a certain size that very size itself actually becomes an enemy to a fund's returns. Indeed, the more assets a fund has under management the narrower becomes that fund's room for manoeuvre and the more its hidden transaction costs rise. Unfortunately, most of the funds management industry has been brought up to believe that its main objective is to accumulate assets. Few will admit it, of course, but one needs only to follow the actions of certain funds and managers in various countries. When I see them bragging about the size of their assets under management, I wish them well, but, at the same time, I ask myself if this a plus or a minus for their investors? Most of the time, it is more of a negative. We do not want to work that way. It would be contrary to the interests of the Fund's existing investors. The volume of money in the Vltava Fund is at historic highs. Of course, we are happy about this. However, we are most pleased that this is happening at the pace

and in the way we imagined. We endeavour first and foremost to be better, not bigger.

### **Provision of information**

The information you receive from us about the Fund's investment activities is very broad and detailed. You receive it in eight standard formats. Five of these are periodic – annual reports, letters to shareholders, account statements, fact sheets, and shareholder meetings. The other three are irregular – seminars, investor breakfasts, and individual face-to-face meetings. These information services are unmatched by conventional retail investment funds, for example. This is due to the number of retail investors they have and their inability to individually cover them all in such formats as we are able to utilise in our fund.

We see, however, a big difference in the information we provide inside the Fund to our existing investors from what we provide to the outside world. While there is virtually no limit to the information we seek to provide to existing investors, we deliberately provide very limited information to the outside world. For two reasons: First, to distract ourselves by communicating to a world with which we have no relationship would go against what I have described above. Second, the owners of all our investment information, all of our knowledge and know-how are you, our shareholders. It would be disrespectful to you to provide it to the general public. In our minds, there is a thick line between these two worlds. We devote all our efforts and thoughts to working with existing investors. It comes back to us when we see the high standard of our discussions about investing and the rationality with which you can respond to what is happening in the



markets. This would not be possible without your knowledge of what we do and how we do it, as well as without our ability to sufficiently engage with every one of you. We appreciate the fact that we know you all personally and that we have sufficient opportunities to work with you individually according to your individual preferences. This is only possible if we are able to keep the number of investors at an acceptable level, among other things in view of the fact that our shareholders come from six countries. More would probably not mean better here.

### Changes in the portfolio

We sold Alphabet. We have only held these shares for a few months, and this turnaround after such a short time is quite unusual for us. This is what I wrote when we bought the stock at the end of last year: “The only stock (in the technology sector) that has slipped through our screen so far is Alphabet. It’s a quality business, no question about it. When the price fell to \$90, we cautiously started buying. It’s not yet a price that makes a buyer jump for joy, but it’s a reasonable price for a solid company. We see a lot of future potential (perhaps somewhat paradoxically) in trimming the corporate fat that the company has packed on over the past few years. When revenues were growing rapidly, this could have been hidden, but now it’s proving to be a problem. Costs are rising too fast, the company apparently has too many employees and too many overpaid employees, and it has some other segments, like the so-called “other bets”, that have swallowed up tens of billions of dollars and still produce virtually no sales. Management seems to be realising this and if they start running the company with much greater emphasis on

efficiency, then maybe we will add some more to this position.”

What has happened since then? The stock’s price has risen, and, considering that we had already turned two blind eyes to the price when we bought it, that alone would be reason enough to sell. The imaginary last drop which made the cup runneth over was release of the news that Alphabet’s CEO had received \$226 million in bonuses for 2022. I think there is no need to comment further on that.

The best investments are not in stocks that everyone praises, but in stocks that everyone underappreciates. That in one sentence sums up our investment in Stellantis. This company is itself very young, but its individual components have very long and interesting histories. I will just briefly describe how the company came to be. In 2009, the American carmaker Chrysler went through bankruptcy and the Italian automaker Fiat became one of the main shareholders – at that time with a 20% stake. Under the leadership of its CEO Sergio Marchionne, Fiat gradually increased its holding until in 2014 it came to own 100% of the shares. The newly formed company, called Fiat Chrysler, began trading on the stock exchange. It was clearly underappreciated by the market (including us) even then, but the stock has done very well since – and especially when you add in the performance of Ferrari, which was spun off from Fiat Chrysler in 2016. Two years later, Sergio Marchionne died and John Elkann, the grandson of Gianni Agnelli (Fiat) and CEO of Exor, the main shareholder of Fiat Chrysler, became the prime mover of events. In 2021, John Elkann initiated the merger of Fiat Chrysler with the French carmaker Peugeot, thereby creating Stellantis, the fourth-largest car company in the world.



Ownership control is held by the Agnelli (via Exor) and Peugeot families. The company's CEO is the highly respected automotive veteran Carlos Tavares.

We think we are once again in a situation where the market is deeply undervaluing the Stellantis stock. Consider for yourself: Stellantis is a solid business. It has some of the highest, if not the highest, margins in the industry, and that is before savings from the integration of Peugeot and Fiat Chrysler are fully realised. Management plans to move from the current level of EUR 180 billion in sales to EUR 300 billion by 2030. So, it is a decently profitable and growing business. We can also find net cash (cash minus debt) of EUR 23 billion on its balance sheet. The individual Stellantis brands (Alfa Romeo, Chrysler, Citroen, Dodge, Fiat, Jeep, Maserati, Ram, Opel, Lancia, Vauxhall, Peugeot and others) cover different market segments – from the very low end to luxury – as well as different regions. Peugeot is strong, for example, in France, Germany and Britain,

but also in Argentina. Fiat, for instance, in Italy, but also in Brazil. We consider the management to be excellent and the controlling shareholders to be very responsible. In the capital allocation story, dividends and shares buyback play big roles. That all looks good. So, what is the market telling us through the share price? The stock is trading at three times annual earnings. If you subtract net cash, which is close to half the market capitalisation, you get to 1.5 times annual earnings. That valuation is, in a word, crazy. Add to that a dividend yield of 8.5%, plus share buybacks, and the stock would still be cheap even at twice the price. All in all, after 15 years of watching developments, we have run out of excuses not to buy the stock. It would be a shame not to take advantage of this opportunity.

Together with all my colleagues, we wish you a pleasant summer.

Daniel Gladiš, July 2023

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