HollAnd Advisors

Holland Views – Exor S.p.A (Price: €42.91; MCap: €10,540m)

Cloning Berkshire Hathaway (in Turin)

Two years ago whilst looking at Fiat we were led to **Exor S.p.A.** the holding company that controls Fiat and a number of other groups such as CNH (the former Fiat Industrial), Cushman and Wakefield and Juventus football club. That the holding company then traded on a c.30% discount to the sum of its parts we noted as interesting and likely offering excellent value, particularly against assets that might themselves have been undervalued. (Today it trades on a 20% discount to a much higher NAV). What we found more interesting still was that Exor, via John Elkann the 39-year old Chairman and CEO (in effect Exor's controlling shareholder), was working very hard to transform itself into something very different from its Italian holding-company roots.

As a result of this research, Exor remained very much on our radar both as a possible source of value versus its constituent parts, but also because of the quality of the leadership we think it has in Mr Elkann and how this seems underappreciated by our dear friend Mr Market. Against this backdrop last week we saw a headline that made us sit up and take notice:

"Exor offer to Buy Partner Re in Friendly $6bn offer"

Breaking the Italian mould

To be frank, what interests us the most about John Elkann is his close following and admiration for Berkshire Hathaway which is regularly referred-to in his annual letters. He has been seen at the Berkshire annual meeting many times and has apparently become friends with a few of the US value investors who are close Buffett-followers.

> *"We have a lot of affinity and things to learn from family groups like ours in the Midwest with roots in manufacturing and finance," he says, naming the Pritzkers, Ridleys and Waltons. "I'm very interested in seeing how a family can develop over time and work in a different way"* – John Elkann (quoted in the Financial Times)

Elkann is of course, still a very long way from having Buffett's credibility when it comes to investing but he has been trying very hard to simplify and modernise Exor and the companies it control in a way not seen inside Italian conglomerates for many years. As a result, the holding company structure is simple, i.e. there is now only one type of Exor share that both he and outside investors own. Equally, the individual parts of the empire that the Exor group controls have been improved immeasurably with a focus on profitability – Fiat being the prime example. Elkann was the one who brought Sergio Marchionne in to turn around Fiat (where Elkann is today Chairman) in 2004. The pair seemed to have formed a formidable partnership since. Upon his joining the Exor board in 2003, Elkann displayed his fortitude by candidly conceding the magnitude of the task he faced:

> *"If the situation had been different, I might have had more time to ease into the job but I was forced into the middle of a bad moment. The company was being mismanaged, the family was ageing and sick, the financial community didn't support us any more. At that point you have the choice to let it go or you try to fix it"* – John Elkann

Today all the group's biggest divisions are run under what seems to be high-class managers and have laid out ambitious plans for profits that they plan to make 3-5 years from now.

We will see how each division fares in comparison to these targets in the coming years, but what is being pursued is a clear focus on profitability maximisation and accountability. Simplification of the group with fewer larger investments is the future Elkann has recently outlined. Partner Re, we suggest, is another building block for that process.

John Elkann – the man behind Fiat's rejuvenation

Exor is an Italian holding company long controlled by the Agnelli family who played a central role in Italian society and commercial life over the past century. In the 1990s, more than a hundred years after its founding, few would have argued that Fiat and the Agnelli's seemed to be coming unstuck. Enter John Elkann, the Agnelli-anointed heir who was chosen to take over running the empire in 1997 (when he was just 21!) by his maternal grandfather, the legendary industrialist 'Gianni' Agnelli. Despite his prince-like upbringing in the Agnelli clan, Elkann showed early-on that he was not afraid to get his hands dirty. Notably he worked incognito in production plants in Birmingham and Poland and in a car dealership in France as part of his varied education before ultimately joining Exor in 2003. He is a qualified engineer but also, we suggest, a man with an eye on the best businesses and investment practices across the globe.

Exor today is a company that perhaps very few investors take seriously. Likely it is still perceived as just an Agnelli's holding company and not shareholder-friendly. But we assess Mr Elkann very differently. He is diligent and reportedly somewhat misunderstood by the well-heeled in Italy (some say because he is incredibly hard working!). We also believe that for some years now he has been studying the best conglomerate model in the world – Berkshire Hathaway.

Enter the Trojan Horse – Partner Re

Exor's proposed purchase of Partner Re suggests to us that he is much further down the line in Exor's evolution than maybe many might realise. A number, (albeit not a high number), of investors *really* understand how Buffett uses insurance float to significantly boost the returns that Berkshire is able to make. If you are just investing a pool of capital that has grown to say $1bn on which no leverage is deployed, it soon gets pretty hard to maintain high annual returns (c.20-30%). Yet Berkshire famously still managed to do just that, compounding at that rate right up until the mid-1990s. How did Buffett do it? In a word: Float.

In other words, Buffett controlled businesses that looked after other people's money (mostly insurance). He was able to retain the returns he made on that capital during the time he controlled it. This model has subsequently been copied brilliantly by others such as Prem Watsa and Tom Gayner at Fairfax and Markel. We will be honest it is a model we aspire to have ourselves one day. As such whenever there is an insurance guy at a dinner party we pay special attention to see if he is 'the one'! Studiers of Buffett understand the driver that a growing float (i.e. the use of other people's money) can have in powering extraordinary returns for long periods of time.

To view the remainder of this in-depth report, please contact Andrew Hollingworth, Andrew@hollandadvisors.co.uk for a complete PDF copy.

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