East 72 Dynasty Trust

"a portfolio of quality businesses under the aegis of controlling shareholders"

ABN 43 935 022 778

QUARTERLY REPORT #1: PERIOD TO 31 MARCH 2023

Performance and net asset value

Quarterly return: +1.52% NET ASSET VALUE PER UNIT AT 31 MARCH 2023: $1.0152

This is the first quarterly report for East 72 Dynasty Trust. Our aim is to provide a detail on selected portfolio holdings for you to understand the investment thesis, what may be the catalysts for realisation of improved security pricing as well as background to some of the "dynasties" controlling and managing these enterprises.

It is not our intention to provide equity market commentary on banking crises, crypto-currency or the likely direction of 2-10's spreads. We feel you can get that anywhere you choose; in any event, the investee companies are – for the most part - managed on a long term basis by their dynastic controllers. What's important is the ideas which have encouraged our investments in them.

However, we will obviously explain how the fund is progressing whilst reminding you that equities are a long term investment, but that securities of companies with a controller tend to be even longer term investments. Hence, in the absence of major company specific events, you shouldn't expect to see major turnover within the trust, other than to cater for funds flow.

Dynasty Trusts' top twenty positions as at 31 March 2023 as a percentage of net asset value are:

Robertet SA	4.49%	Liberty Broadband	3.61%
Alphabet "C" NV	4.29%	Vivendi	3.57%
Swatch Group Bearer	4.04%	Senvest Capital	3.56%
Societe des Bains de Mer	3.87%	Pershing Square Holdings	3.49%
Companie Financiere Richemont	3.76%	Madison Square Garden Ents	3.48%
FRP Holdings	3.75%	IWG plc	3.43%
Bollore	3.73%	Magellan Financial	3.42%
CK Hutchison	3.66%	Porsche SE	3.38%
EXOR NV	3.64%	News Corp NV	3.26%
Volkswagen Pfd	3.61%	Labrador Iron Ore Royalty Co	3.14%

In that context, for what it is worth, over the quarter, our best performing securities (in A$ terms) were Madison Square Garden Entertainment (+29% after a judicious purchase), Alphabet (+19.8% in line with a significant gain in NASDAQ), SBM (+12.7%), Bollore (+14.5%) and Swatch (+12.5%). Some of our European shares were affected in the short term by the events at Credit Suisse and retraced their strong start to the year.

With interest rates having risen, we are conscious of debt exposures amongst the holdings, but as you would expect, a number of our investees have significant cash balances as a result of asset sales over the past two years, giving them real flexibility to act in the event that asset prices decline, or certain other groups encounter financial distress from tightened banking conditions.

In this quarterly, we review the sole listed Monegasque company and assess the Volkswagen complex. Which is what it is!

SBM: A unique investment in the ultra-rich – with operating leverage and growth

Watch any old footage of the Monaco F1 Grand Prix – the blue-riband event since 1955[1] on the world's biggest travelling circus[2] – and you see signage for "SBM Monte Carlo". Unless you have been to the Principality, the world's second smallest country, you may wonder what SBM actually is. Well, it's effectively the country.

SBM – Societe des Bains de Mer et du Cercle des Etrangers a Monaco SA[3] (BAIN.PA) - is a unique global investment since it encapsulates the key activities of a country with an area of only 2.1sq.kilometres and a population of 38,000 – making it the world's most densely populated. The key activities: renting (living), partying and gaming. Yet with some irony, it is an investment made by SBM outside of Monaco, partly crystallised in June 2022, which has placed SBM in an even more advantageous position.

Before advancing further, it needs to be acknowledged that there are no broker reports on SBM and only two detailed reports (with one update) published on the company by "Undervalued Shares" and its author, Swen Lorenz[4]. I am a subscriber, and have access to the reports which I have used as valuable background, and have tried manfully not to plagiarise Swen's fantastic work which provides a brilliant background to the company's history.

SBM is controlled by the Monegasque Government and its ruling family, the Grimaldi family, who hold 64.2% of the capital (and votes). However, the company has "absence of concerted action" pledges from two 5% shareholders both of whom acquired shares from the State of Monaco after the State's underwriting of the March 2015 rights issue: LVMH and Galaxy Entertainment, a listed Macau based casino owner.

A further 5% of the shares – not subject to restriction - are owned by SCI Esperanza, who crossed that threshold in September 2020. This company is controlled by J.B Pastor et Fils, who own 15 property businesses in Monaco[5] and whose matriarch – the richest woman in Monaco - was murdered in 2014[6] . So SBM is a double rarity – you will rarely find assets of this quality in one company, but just under 80% of the shares are tied up in the hands of four holders who either have concert party agreements or who are unlikely sellers. With 24.517million shares on issue at a current price of €91.80/share, SBM has an equity capitalisation of €2.25billion of which only €450m is in the public domain. At 30 September 2022, SBM have net cash of €445million plus a single stock investment currently priced at €404million. Hence, SBM has an enterprise value of only €1.4billion – before adjustments for working capital – which seems inherently cheap against such a special real asset base.

The history of SBM dates back to 1863 and its foundation by sovereign order to Francois Blanc to "exploit the rights and privileges granted by: the Ordinance of HSH the Prince of Monaco of April 2, 1863...(and various amendments)[7]" – in other words, gambling rights in the Principality and the associated activities.

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[1] The Monaco GP has been run since 1929 was in the F1 (equivalent) in 1950 but has been on the calendar each year since 1955
[2] https://www.youtube.com/watch?v=X_lFFLpHuSQ&t=3s explains how Monaco is transformed from a country to a racetrack
[3] Translates to "The Society of Bathers and Circle of Foreigners in Monaco"
[4] Swen has written two major pieces on SBM: in 2004 and August 2019 plus a quick update in September 2022 after the partial Betclic monetisation
[5] https://pastor-immobilier.com/en/pastor-group/histoire/
[6] https://www.bloomberg.com/news/articles/2014-10-16/monaco-murders-reveal-six-hidden-real-estate-billionaires?sref=7yD6TpQF
[7] 7.3.7.1 Corporate Purpose Page 207 Universal Registration Document 2021/2022

Reflecting the boom and bust periods of the first half of the twentieth century, SBM (and Monaco) went through various ups and downs, but by the early 1950's had lost its glamour and the various properties and facilities were not being properly maintained. The Greek shipping magnate, Aristotle Onassis arrived in Monaco in 1951 to establish part of his shipping empire in the Principality. He discovered SBM was a public company, with no controlling shareholder and trading at a significant discount to his evaluation. Onassis used 48 different shell companies based in tax havens and by 1953 had over one third of the shares, eventually growing to 52% by 1966.

Initially friendly, Onassis and Prince Rainier III eventually fell out over their differing visions for the SBM businesses – Onassis to retain them as exclusive, Rainier to expand to combat a boycott of Monaco by then French President deGaulle, based around Monaco's tax haven status.

The solution to this conflict can still be seen in SBM corporate documentation today, with part of the share capital being 6,000,000 shares "belonging to the Monegasque State, inalienable under Monegasque Law #807 of June 23, 1966"[8] These are the 600,000 shares (after a 10:1 stock split) issued – when the capital was still only 1.2million shares as it had been for decades - to be <u>permanently</u> held by the state to dilute Onassis down to ~30%. Onassis sold his shares to the state in 1967.

With accommodative bankers, including the Monegasque Government and two significant gaming related capital gains, it is stunning that SBM has only <u>raised new capital once</u> since World War II: a 7-20 rights issue in March 2015 to raise €220million (6.356m new shares at €34.60/share) underwritten by the State of Monaco, who sold a part of the shortfall in LVMH and Galaxy, but with "concert party" restrictions. This is despite some hefty capital expenditures on the assorted properties and new builds (below).

Two big Wynns in gaming

SBM has made two significant capital gains – over €680million - from backing early stage gaming entrepreneurs and concepts. In June 2003, SBM subscribed US$45million for 3million shares of Wynns, the (then) new venture of Steve Wynn, with a view to investigating gaming opportunities in Monaco. These opportunities amounted to nothing; however, SBM progressively sold the Wynns shares carefully over a nine year period, and racked up a capital gain of at least €220million (as well as dividends) with stock sales as high as ten times their entry price to recoup upwards of €280million on a €38m investment.

More problematic, since the Wynns shares had already doubled within a year of entry, was the initial €70m investment in Betclic (then Mangas), initiated in May 2009 alongside Stephane Courbit. Betclic became the largest on-line gaming/sports betting company in France. Alongside this, Courbit also founded Banijay, the production company, with high quality outside investment from Exor and Groupe Arnault amongst others. Not many better partners to have.

SBM was forced to subscribe additional capital and guarantee (plus make loans) to Betclic, notably around 2012. In one of the few successful SPAC deals, the merged Betclic/Banijay – called FL Entertainment – raised €250m of new money via a PIPE arrangement, and listed FL Entertainment on the Amsterdam exchange in July 2022.

[8] 7.1.1.1 Capital Breakdown Page 204 Universal Registration Document 2021/2022

In total, we believe SBM invested some €240m in Betclic – which it substantially impaired until Betclic started to make intermittent profits round 2015. By end FY2022 (March 2022), the value in SBM's books was only around €18million, having taken a dividend (€45m) and stock sale (€54m) in cash in FY2022

On completion of the SPAC deal, SBM's investment in FL Entertainment was valued at €850million enabling them to take €425m in cash off the table, making SBM net cash positive and retaining 42.5m shares of FL Entertainment at €10 – the IPO price. FLE currently trade at ~ €9.50/share.

The SBM Businesses

Other than the cash and investments (see valuation table) SBM is made up of three businesses:

- **Rental** with rental income from the ownership of shops and offices (commercial) together with extremely high-end residential complexes, notably Sporting (24 apartments), Balmoral (7 apartments) and One Monte-Carlo (42 residences) plus other incidental properties.
- **Gaming** via operating Casino de Monte-Carlo under a long term licensing and leasehold agreement which currently expires in 2027; the lease has previously been renewed and there is no reason to believe it will not be once more, but in the event it is not, the building reverts back to the Government for zero cost; SBM also operates Café de Paris Monte Carlo which is predominantly a venue for EGM's (420 out of SBM's 566); and
- **Hospitality** through ownership of five hotels encompassing 1,254 rooms if fully available; together with 25 restaurants and bars within Monaco including four with Michelin stars and ancillary activities mainly within the hotel group.

One of the attractions of SBM shares is the fact that two massive pools of capital expenditure have been made in recent times, from which shareholders now benefit, and which have effectively been financed by two spectacular investments in the gaming sector, one of which is only partly realised. SBM spent €284million on a "deep" refurbishment of Hotel de Paris, the flagship 202 room property in Casino Square over the six years to 2020; this was followed by the €395m development of One Monte-Carlo which is a game changer for the whole group.

Rental

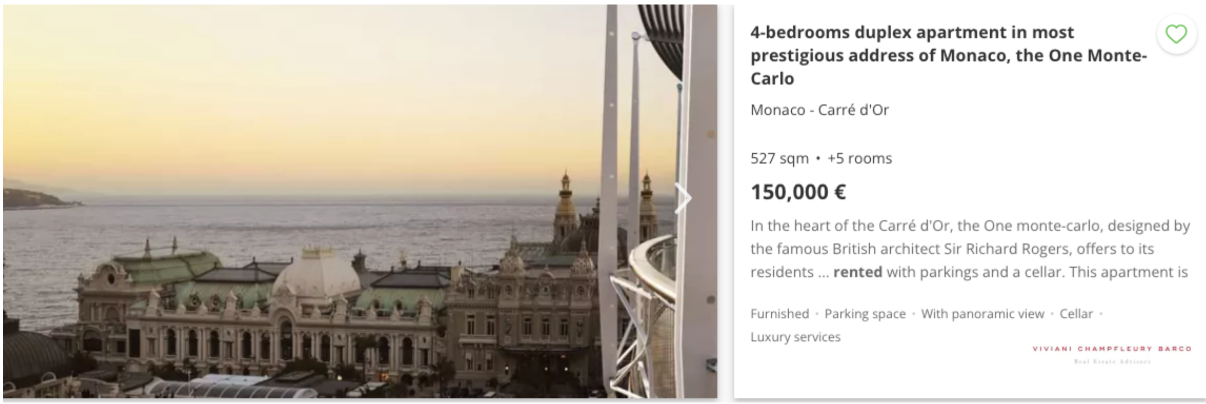
Most assessments of SBM would put gaming up the top; it is famous and easily visible. However, the real story of SBM in recent years is the growth in the rental portfolio to provide the underpinning of the asset value within SBM. More potently, it has been the engine of profit growth – even through COVID – due the completion of new complexes, notably the six One Monte-Carlo buildings. Rental represents the real difference between the SBM of (say) ten years ago, with a revenue base in that business of €25million per annum and today – approaching €130million – 19%pa compound growth. The new buildings comprise both commercial and residential arrangements providing growth for both.

SBM's main residential buildings in Monaco are:

Sporting	2005	4,037m^2	24 rental apartments, 57 car spots, 25 cellars
Balmoral	2012	2,596m^2	7 apartments, 26 car spots, 8 cellars
Sporting Villas	2015		3 villas with private swimming pools
One Monte-Carlo	2019		37 apartments, 6 triplexes, 350 car spots, nine floors offices, 24 retail outlets

Sporting generates an average rent of €1,600/m^2 (excluding taxes and charges which add a further ~40% to tenant costs!) so a 66m^2 studio would cost around €2,200 a week to rent (€9,500 per month). Larger apartments in the vicinity of Casino Square – with 2 bedrooms rent at €13,000 per month (+charges).

Larger apartments in the One Monte-Carlo are on a different planet, given the exceptional location. They rent at ~€3,420/m^2 per annum, or €150,000 per month (including parking space!)



One Monte-Carlo has been the game-changer for SBM given it contains 13,000m2 of residential space together with the retail and commercial space. The table below of the rental business over ten years shows clearly the jump in revenue and high margin profits through the past three years since On Monte-Carlo opened:

€million	Mar-13	Mar-14	Mar-15	Mar-16	Mar-17	Mar-18	Mar-19	Mar-20	Mar-21	Mar-22	Sep-21	Mar-22	Sep-22
Commercial	14.6	15.1	15.6	19	21	23.2	32.7	64.6	63.7	69.3			
Residential	9.1	11.1	13.3	17.1	18.4	17.7	19.2	31.4	42.5	48.3			
REVENUE	23.7	26.2	28.9	36.1	39.4	40.9	51.9	96	106.2	117.6	58.5	59.1	62.8
Op π	15.9	17.6	17.6	20.4	23	23.4	35.5	69.5	71.9	84.4	42.2	42.2	46.3

What would you pay for a property portfolio let to the ultra-rich, with legal[9] and space constraints? **We believe at prevailing prices it is below €900million or <6x EV/EBITDA.**

Gaming

It may be glamourous but the gaming business is NOT the money-spinner it would be perceived from the outside. Operating profits and revenues for the gaming business are shown for the past 10 full years and recent half in the table below

€million	Mar-13	Mar-14	Mar-15	Mar-16	Mar-17	Mar-18	Mar-19	Mar-20	Mar-21	Mar-22	Sep-21	Mar-22	Sep-22
table	79.7	115	100.1	104.7	95.2	87.2	108.4	113.5	41.2	85.7	50	35.7	64.4
EGM	95.3	91.6	88.6	98.7	96.2	102.8	101.9	113	79.6	108.9	59.5	49.4	57.6
Other	1.1	1.3	7.7	10.2	10.3	10.7	12.4	13.4	3.4	6.2	3.1	3.1	9.3
REV	176.1	207.9	196.4	213.6	201.7	200.7	222.7	239.9	124.2	200.8	112.6	88.2	131.3
Op π	-15	5.9	-16.3	-8.6	-20.2	-14.8	-8	-7.5	-46.9	9.5	12.1	-2.6	11.1

The impact of COVID is obvious to see with the 2021 loss including a €7m closure provision for Sun Casino. The casino has suffered from significant volatility in its table games with occasional materially adverse runs against the house (SBM does not publish "theoreticals" unlike Australian listed casino stocks).

[9] To be resident in Monaco requires a bank account with minimum €500,000 deposit to be opened, advance rent, one year lease, proof of ability to pay etc.

The casino is also very seasonal – like the hospitality sector with the summer April to September period significantly outstripping the cooler months; it also includes the Grand Prix (usually May). The EGM's have an average turnover of €204k per annum which is in line with those in Australian gaming areas[10] but appear to be less profitable.

To attempt to value the casino operations, we have the benefit of a recent corporate acquisition in the global sector being that of Crown Limited, based in Melbourne by Blackstone in May 2022 for A$8.9billion (€5.9billion) equity value. Crown was an amalgam of three sets of casino + hotel + entertainment properties in Melbourne, Perth and Sydney which required the Independent Expert (Grant Samuel) opining on the Scheme of Arrangement[11] to conduct a detailed sum-of-the parts assessment. Crown holds 2,628 EGM's (4.6times that of SBM) and 540 tables (>6x that of SBM's 86 in the two operating casinos).

In trying to value the two casino operations, it is material that as with certain of the Las Vegas casinos, Casino de Monte-Carlo effectively operates on a "lease" basis rather than physical ownership of the building, whereas Café de Paris is owned by SBM. Valuations for casino operators with lease type obligations are much lower than those who own the underlying property.

Based on EV/EBITDA multiples of ~7x <u>and</u> assuming a recovery in earnings plus a renewal in 2027, the casino operations (excluding the Café de Paris property) could be valued at just over €100million. Surprisingly low.

Hospitality

There are 8 high-end hotels in Monaco, of which SBM owns 4 as follows:

Hotel de Paris (208 rooms); Hermitage (277) Monte Carlo Beach (40); Monte Carlo Bay Resort (332) and Le Meridien Beach (managed - 397)

SBM do not provide occupancy statistics on a half year basis but it is quite clear from the first six months of FY23 that occupancy has been extremely high in tandem with vastly higher prices; pro-rating the H1 FY23 accommodation revenues suggests revenue per night of ~€515 <u>across the portfolio</u>, against only €211 on a revenue per available (rather than occupied) room in FY22. In tandem with increased visitation, catering revenues across the hotels and 25 restaurants exceeded the whole of FY22 in the first six months of FY23. Ancillary revenues – laundry etc – also rose in proportion to nearly match FY22 in the first six months of FY23.

We are well aware that hotel economics just reflects an aircraft bolted to the ground with double leverage of occupancy and price. The other common issue is the need for renewal and refurbishment, which in SBM's portfolio, given the required standards of opulence, is not a discretionary item. One of the major attractions for SBM is the level of depreciation charged off (~€80million per annum) of which half is in the hospitality sector.

In the Crown documentation, the Independent expert valued the hotel/resort properties at an average of just over 10x EV/EBITDA with a premium for the immature Sydney property[12]

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[10] NSW Department of Enterprise, Investment and Trade Gaming machine revenue, compiled by East 72 assuming 15% return to player.
[11] Crown Limited Scheme Booklet 30 March 2022
[12] Crown Limited Scheme Booklet 30 March 2022 p183-184

€million	Mar-13	Mar-14	Mar-15	Mar-16	Mar-17	Mar-18	Mar-19	Mar-20	Mar-21	Mar-22	Sep-21	Mar-22	Sep-22
Accomodation	86.6	94.8	95.1	88.1	87.9	95.4	104.4	121.3	46.2	95.8	67.5	28.3	116.8
Catering	107.7	113.1	103.8	95.4	98.5	106.2	115.3	124.3	45.2	90.2	55.1	35.1	92.6
Other	28	29.5	27.5	29.7	32.1	33.1	34	38.6	17.5	27.3	17.4	9.9	26
Hospitaility	222.3	237.4	226.4	213.2	218.5	234.7	253.7	284.2	108.9	213.3	140	73.3	235.4
Rooms	1122	1223	1148	1080	1088	1100	1144	1206	1070	1242			
Occupancy	60.5%	59.6%	64.2%	64.3%	63.6%	67.5%	66.4%	63.8%	26.0%	44.7%			
Available	247,766	266,051	269,011	253,471	252,568	271,013	277,260	280,841	101,543	202,639			
Accom/AN	€ 349.52	€ 356.32	€ 353.52	€ 347.57	€ 348.02	€ 352.01	€ 376.54	€ 431.92	€ 454.98	€ 472.76			
Spend/AN	€ 897.22	€ 892.31	€ 841.60	€ 841.12	€ 865.11	€ 866.01	€ 915.03	€ 1,011.96	€ 1,072.45	€ 1,052.61			
Op π	0.9	-1	-6.2	-8.6	-9.8	-5.1	-4.2	-5.1	-61.7	-19.2	13.6	-32.8	52.8

Applying this multiple to annual EBITDA in the area of €80m – allowing for improvement as well as seasonality would provide a valuation of ~€800m for the portfolio. That appears too low given the premium and oligopoly aspects of the portfolio of premises. In any event, as discussed, the Hotel de Paris was refurbished for€240m and the construction cost for Monte Carlo Bay (on reclaimed land) was over €200m twenty years ago. In many cases, the properties have other development potential with some adjacent land, which we note in the rental sector, provides massive uplift in value versus construction costs.

Hence, we view a 15x EV/EBITDA multiple to be more appropriate and value the division at €1150m.

Valuation analysis

We have looked at SBM on a sum of the parts basis but in a different way to ascertain at prevailing share prices what we are paying for earnings from luxury rental accommodation, given its sale value is the most difficult comparable of the divisions. We believe at the prevailing share price of €91.80, we are paying below 6x forecast FY23 (to 31 March 2023 so just ended) EV/EBITDA for the residential and commercial portfolio as follows:

Asset/area	**€million**
Equity capitalisation: 24.517m at €91.80	€2,251
Cash	(569)
FL Entertainment shares (42.5m at €9)	(404)
Working capital (net)	297
Debt	124
Casino	(100)
Hospitality	(1,150)
Capitalised group overhead (12x EBIT charge of $37million pa)	444
IMPLIED VALUE OF PROPERTY	**893**
Forecast EBITDA FY23 (includes €23m of depreciation)	150
EV/EBITDA rental portfolio	**5.9x**

If even part way accurate, this analysis suggests significant potential upside on a post-COVID recovery as the rentals are revalued. We view a more appropriate valuation as closer to €150/share for the group.

In this respect, it is noteworthy that in 2008 (fifteen years ago) Qatari Diar (the property arm of Qatar Investment Authority) sought to acquire 30% of SBM at €725/share (€72.50 spilt adjusted) but pulled away when SBM sought to limit the stake to 10%. Given the massive additions to value since that time, an increase in perceived equity value of only ~ 30% seems spartan. Not a word that can be applied in any context within SBM.

Volkswagen: a heavily discounted treasure trove and potential IPO's

VW has an equity market capitalisation of ~€73billion, apportioned roughly 65/35 to ordinary and preferred shares, which have equal economic rights but the latter have no voting rights. The analysis below suggests that it would not be a ludicrous outcome to value VW equity at 2.5 times this current pricing. We accept that this would require unwinds of some discounts and further moves by management to liberate brand value along the lines of the Porsche AG (P911) float.

It is noteworthy in this context that a year ago, we wrote[13] about the large scale discount versus a sum-of-the-parts valuation at which shares of Volkswagen (VOW.DE/VOW3.DE) were then trading, and highlighted the catalysts of an IPO of Porsche AG (P911.DE) in closing that gap. We were more conservative than the prevailing hype around the P911 valuation, but nevertheless felt there as more than enough upside to provide a stimulus to VW shares.

<u>In the subsequent year, we were wrong about P911 and wrong about VW</u>. The <u>P911 valuation metrics were significantly higher</u> than we felt might be reasonable and <u>despite this, the value of VW shares has declined</u> – even allowing for two subsequent large scale dividends !!

As a guide, we noted that a FT article of February 2022 had surmised that VW would sell off Porsche AG at a €90billion equity valuation, which we thought was too high, and postulated a €60billion value. The P911 IPO in late September 2022 – at €82.50 per preferred share - came in just over half way between the two – a €78bn equity value (€38bn pref; €40bn ordinary). The 43% appreciation in the P911 price to €118 – an implied €112bn equity value has well outstripped our thinking of <u>that</u> time. So taking VW's 75% share of Porsche AG implies just under an €84bn value – €24billion more than we thought, equivalent to about €48/VW share (preferred and ordinary). It is worth noting that in the intervening period from 31 March 2022, many "luxury" goods company share prices have been on a tear with increased profitability from growing margins, China re-opening and the "rich getting richer with inflation" argument. For example, the king of luxury stocks, LVMH (MC.PA) is up close to 28% from €660 since 31 March 2022.

Our VW investment has been in the preferred shares; since 31 March 2022, they have paid €26.62 in dividends (May 2022 €7.56; Jan 2023 €19.06) but even adding these payments back to the prevailing price of €125.64 leaves us about 4% below the price of €157 at end March 2022.

Hence, it is clear that markets have taken an even dimmer view than they did in March 2022 – just after the Russian invasion of Ukraine – about the value of the "residue" of VW's assets. In our view that is an especially pessimistic approach. Since the mid-March release of the VW Group's financial statements, as a result of P911 being separated and other changes in global valuation metrics, an even deeper valuation assessment of VW is possible, and shows that the discount to our estimate of fair value of VW shares has ballooned out to 60%.

Our approach to VW

VW is a veritable treasure trove of assets; our methodology is to value the identifiable components – especially the two listed spin-offs P911 and Traton (8TRA.DE) at market prices – break out the associated companies (with due care given that two are owned by P911 and Traton), assess the potential for a Lamborghini spin out, put a proper (if conservative) value on VWFS and see what are paying for the mainstream branded ICE business. Or rather, what are we being paid to own it.

[13] East 72 Holdings Quarterly Report March 2022

Listed exposures

VW (parent) has shareholdings in four publicly listed companies as follows:

- 75% (341million) of <u>each</u> of the ordinary and preferred shares of **Porsche AG** (P911.DE); only the preferred shares are listed with the "minority" ordinary shares issued to Porsche SE (PAH3>DE) at a 7.5% premium to the preferred;
- 88.7% of **Traton** (8TRA.DE) the manufacturer and distributor of Scania, MAN and Navistar trucks together with selected investments in the space (Sinotruk) and a finance subsidiary;
- An associated investment of 21.5% of equity in **QuantumScape Corp** (NYSE: QS), a battery technology company with whom VW also have a 50-50 JV to develop solid state battery cells in California; and
- 24.7% equity in **Gotion High-Tech Co** Limited, a Chinese EV battery manufacturer which supplies to VW in its China business; Gotion (2074.SZ) is also listed on SIX (Swiss stock exchange) through Global Depository Receipts.

A 10.3% stake in Traton was spun off in June 2019 at €27/share; the shares have subsequently traversed lows below €12.50 but at the prevailing €18, have a market capitalisation of €9billion. However, the company labours under a net debt load – excluding leases and financing for receivables - of €10billion and had constrained cash flow in CY22 due to working capital build despite significantly improved adjusted (for Ukraine) profitability. Traton has strong order books which it is struggling to fill due to supply chain issues; CY23 guidance suggests the company will earn non-finance operating profit of €2.9billion and will be free cash flow positive. On that basis, the shares trade at ~6.6x EV/operating profit.

Traton is three times the size by revenue (€40bn versus €14.5bn) of its European peer Iveco IVG.MI), spun out of CNH International, controlled by Exor, last year. However, Iveco is extraordinarily lowly rated; it has an equity market capitalisation of $2.37billion (271m shares at €8.72) has net cash of €1.7billion (excluding financing debts against receivables), and equity in the finance subsidiary of €760million. On a consolidated basis, Iveco shares trade at around 5x operating earnings.

Equity accounted companies

China exposure declining over time
VW has three joint ventures in China, and is the largest manufacturer in the country with around a 15% market share of the 21.1million unit market as follows:

- 40% of FAW-Volkswagen Auto Co (FAWVW) established in 1988 with 60% owned by the state owned FAW Group (First Automotive Works), China's second largest of the "Big 4" local auto-makers[14];
- 50% of SAIC-Volkswagen Automotive Co (SAICVW), established in 1984, but due to expire in 2030, with SAIC (Shanghai Automtive) as the co-shareholder; and
- 30% of SAIC-Volkswagen Sales Company which sells the SAICVW production

FAWVW and SAICVW both manufacture at six locations; the former has a focus on the Audi, VW and Jetta brands/models; the latter on Skoda, VW and new BEV models. With increased penetration of other foreign manufacturers into the Chinese market together with domestic production, profitability of the JV's has been in gradual decline since peaking in 2015:

[14] In order SAIC, China FAW, Dongfeng Motor and Changan Automobile

€million	Dec-12	Dec-13	Dec-14	Dec-15	Dec-16	Dec-17	Dec-18	Dec-19	Dec-20	Dec-21	Dec-22
sales volume (000s)	2,609	3,038	3,506	3,456	3,873	4,020	4,101	4,048	3,577	3,042	3,122
100% Operating π	€ 8,424	€ 9,569	€ 12,077	€ 11,937	€ 11,094	€ 11,191	€ 11,427	€ 11,110	€ 9,744	€ 8,740	€ 8,827
Proportional VW π	€ 3,678	€ 4,296	€ 5,182	€ 5,214	€ 4,956	€ 4,746	€ 4,627	€ 4,425	€ 3,602	€ 3,026	€ 3,280

The latest three years also reflect manufacturing issues related to COVID, with plant closures, labour shortages and delayed parts availability. We would expect growth in 2023 in unit volumes and profitability, with increasing penetration from the prevailing 5% level of BEV sales (155k in 2022).

VW received around 70% of its proportionate profit in dividends (after withholding tax) in 2022, slightly down on the 77% in 2021.

Due to the vagaries of equity accounting, VW carry their shares of the three China JV's on balance sheet at just above €3.5billion – representing a 65% dividend yield in CY2022!! Given expected improvements in profitability, we have conservatively chosen to value the JV's at 3.5x trailing proportionate contribution, being €11.5billion. Based on normal payout ratios, this would represent a yield of around 22% on improving earnings.

Battery technology
In July 2022, VW unveiled a new initiative PowerCo to eventually build six factories in Europe, commencing in its home base at Salgitter in Lower Saxony, Germany with a factory to commence production in 2025. The initial investment of €1.7billion will be replicated at Valencia in Spain and one other as yet undisclosed but decided location. The aim is to be responsible for the group's battery business, which sits alongside various other investments in the area noted in associated companies and in the e-mobility space

Not mentioned in the 2022 VW Annual Report, but noted on 23 March 2023 by the Chair of Porsche SE was that "we are hearing from VW that interest is extremely high on the subject of PowerCo. That should be a positive case" in relation to a potential IPO. In our view, that would be a significant positive, potentially alleviating negative cash flow from VW and bringing forward the relevant valuation premium to the group.

VW's three existing specific associated company investments in battery technology can be assessed as follows:

	holding	shares	price	€ value	Carry value	Notes
QuantumSpace	21.5%	68.24m	US$8.19	€ 559m	€1123m	Per listed price 31 Mar 23
Gotion HiTech	24.7%	440.6m	¥29.81	€1,776m	€1021m	Per listed price 31 Mar 23
Northvolt AB	23.6%			€ 911m	€ 911m	Per VW annual report Note 15 & p296
Northvolt AB c/note				€ 240m	€ 240m	Per VW annual report p296
TOTAL				**€3,486m**	**€3,296m**	

VW also participated in a 66% subsidiary undertaking with Attestor (27% a London PE manager) and Pon Holdings[15] (7% the Dutch VW franchisee) to successfully acquire Europcar Mobility via the Green Mobility Holding vehicle for an equity value of €2.553billion, with VW's share being €1.685billion.

[15] In 1997, the Pon Family also founded one of the first vineyards of the Uco Valley in Mendoza, Argentina at 1,200m above sea level. I have been lucky enough to visit Bodegas Salentein – a very special place.

The hidden "rich get richer" play: Lamborghini

Lamborghini was acquired by Audi in June 1998 from companies controlled by Tommy Suharto (son of the former Indonesian president) and a Malaysian financial company for an estimated US$111million; the Asian partnership had owned the marque for five years having acquired it from Chrysler in 1993. At the time of the deal, Audi and Lamborghini were in discussions about the adaptation and use of Audi's powertrain to expand production from the then level of just over 200 cars (not a misprint).

In 2021, a group of ex-VW executives operating via Quantum Group AG allegedly made a €7.5billion offer to buy Lamborghini; this was (apparently) flatly rejected by Audi/VW. There was foresight and logic in doing so - the Ferrari spin-out continued to roll on and increase its stockmarket rating and profitability, but also the significant inter-connectedness of Audi componentry in certain of the Lamborghini cars – notably the "Urus" (5500 units sold per annum).

Of course, this makes it an ideal IPO candidate for VW in a similar vein to P911, retaining some semblance of control and with an ongoing co-operation agreement netween the two companies.

So what's Lamborghini potentially worth? The world of luxury cars is very simple – the higher the price, the higher the margin and the higher the valuation. Even Aston Martin (AML.L) has an equity valuation of £1.595billion (equity + £765m debt = enterprise value of £2360m) even though it will not be cash flow neutral on its ~6,500 unit sales at average price of ~€230k until CY2024.

The Ferrari (RACE) story continues to grow with units sold flatlining in CY2023 at the mid 13,000 area but with increased forecast average selling prices – remember there is a waiting list – the company has forecast net profit growth of 20% for both EBITDA and EPS. The shares at prevailing prices have an enterprise value of $49billion and trade at ~22x EV guided CY23EBITDA and 44x EPS.

Lamborghini sits in between AML and RACE with sales of 9,233 units in CY2022 and a revenue base of ~€2.4billion. The VW annual presentation[16] (slide 13) discloses a "return on sales" (ie. operating margin) of 25.2% implying operating profit of some €620million. There is an 18 month waiting list for a Lamborghini.

P911 shares trade at a valuation of ~13.5x EV/forecast CY2023 operating profit (€103.5bn EV; operating profit €7.35bn). In this context given there are no cars available before 2024, and against the cohort, is it unreasonable to postulate that on an IPO, Lamborghini would trade at ~16x EV/CY2023 operating profit and command a valuation close to 11billion? That alone would represent close to €22/share upside to VW, given the abnormally low rating attributed to the "residual assets" (actually the core ICE brands) within the group.

[16] https://www.volkswagenag.com/presence/investorrelation/publications/presentations/2023/2023-03-14_VolkswagenAG_JPK_long_final.pdf

VWFS – dissection suggests a very valuable financial asset

We are strong believers that finance companies attached to car manufacturers are usually extremely valuable conveyances. There is obvious cynicism by many given the symbiotic relationship between financier and manufacturer such that if VW cars are unattractive, then clearly the demand for the various financing options – leases, loans etc – will fall away. In addition, we recognise that there is residual value risk, which in the case of VWFS, has worked spectacularly in their favour during COVID with increases in used car prices across the globe. Demand for cars and high residuals are responsible for the significant lift in profits in VWFS during 2021 and 2022 illustrated in the table below:

VOLKSWAGEN FINANCIAL SERVICES: HISTORIC FINANCIALS

€million	Assets	Equity	Pre tax	Equity/Assets	ROAA	ROAE
2011	97,455	9,785	1,309	10.0%		
2012	111,053	11,312	1,415	10.2%	1.36%	12.5%
2013	115,067	11,582	1,711	10.1%	1.51%	14.8%
2014	137,438	15,184	1,747	11.0%	1.38%	11.5%
2015	157,855	18,607	2,015	11.8%	1.36%	10.8%
2016	170,070	21,178	2,073	12.5%	1.26%	9.8%
2017	186,917	25,634	2,299	13.7%	1.29%	9.0%
2018	207,629	26,298	2,600	12.7%	1.32%	9.9%
2019	223,536	28,428	2,968	12.7%	1.38%	10.4%
2020	225,608	29,406	2,577	13.0%	1.15%	8.8%
2021	235,620	33,381	5,628	14.2%	2.44%	16.9%
2022	240,042	38,257	5,513	15.9%	2.32%	14.4%
2023E			3,500		1.44%	8.9%

It is noteworthy that VWFS on a consolidated basis – including the Porsche Financial Services component which is now within P911 – have been able to step up the level of equity to assets significantly over the past few years which will bolster the business as the level of excess profits starts to wind down to more normal – but still high levels. On a consolidated basis, the company has flagged an operating profit – roughly equating to pre-tax profit of €3.5billion in the 2023 year[17].

Having due regard to our consolidation methodology, and leaving the profits from Porsche Financial Services – approximately €340m or 6% of VWFS - within P911, we believe a capitalisation multiple and cross-check can be applied to a 2023 outcome of ~€3.2bn at the operating level.

Traditional finance companies with additional risks have over recent years tended to trade at discounts to book value and single digit multiples of after tax profit. It is not unreasonable to apply these types of metrics to VWFS. On that basis we believe VWFS could be valued at €23billion, being a 35% discount to book value which would equate to 9x forecast post tax profit in 2023.

[17] VW 2020 Annual Report page 231

Sum of the parts assessment suggests Volkswagen is extraordinarily cheap

We believe VW trades at a 60% discount to a sum of the parts valuation which contains some premium components but also some heavily discounted areas, as follows:

	€million	
Est "parent" net cash	47,100	Includes receivables from associates, P911 and Traton fully adjusted for P911 float
75% P911 at market value	80,623	Assumes NO premium on voting shares
88.3% Traton at market value	7,868	
China JV's	11,500	3.5x proportionate earnings
Associated (battery) companies at market value	3,486	See discussion
Lamborghini at value	11,000	See discussion
VWFS at value	23,000	See discussion
Green Mobility	1,685	66% - owns Europcar Mobility
Pension liabilities ("parent")	(20,738)	Page 362 of 2022 Annual Report less attributable to P911 and Traton
Diesel litigation	(4,200)	Note 38 2022 Annual Report and pages 420-427 for detailed assessment
NET VALUE OF NON-VW CORE BUSINESS	**161,324**	
"Residual" ICE[18] business earnings after overhead including CARAID expenses (€2bn)	19,025	€7,610 estimate at 2.5x EV/Operating earnings – Skoda, VW, SEAT, Cupra, Audi, Bentley
TOTAL EQUITY VALUE	**180,349**	**Versus current €73billion**

If we allocate our estimated equity value in the manner in which VW ordinary and preferred shares have traded in recent times – 65/35 – then a full equity value for each, on the basis of the assumptions above, would be:

	Attributable Value (€bn)	Shares (mn)	Attributable/ share	Current price	discount
Ordinary	117.2	295.1	€397	€158.00	60%
Preferred	63.1	206.2	€306	€125.64	59%

As a cross-check, the consensus **consolidated** forecast for 2023 for VW, which has some higher degree of certainty given the bounce back in China and the pre-order book, is for EPS of €31 per share; on the preferred shares this equates to a P/E of 4.1x and a dividend yield of 7%, for numbers which include the strong attractions of 75% of Porsche AG and Lamborghini. Even at our full valuation of the shares, the P/E on the preferred stock would still be below 10x.

The catalysts to unwind at least some of this discount remain the same: fungibility of the attractive components of the group. VW will continue to control these companies, essential for engineering and other co-operation, so to some degree they will act like tracker stocks. However the clear success of the P911 IPO versus our expectations suggests there is an appetite from non-VW shareholders for the growthier parts of the company.

[18] Internal Combustion Engine but with significant BEV exposure

Porsche SE (Porsche Automobil Holding): double discount but with gearing

Porsche SE is the largest but not controlling shareholder of Volkswagen by dint of owning 53.3% of VW's ordinary (voting shares); however, their full control is negated by the State of Lower Saxony holding a 20% voting stake and under the German Volkswagen Act of 1960, can act to veto major strategic decisions including plant closures, but also takeovers etc.

Porsche SE (PAH3.DE) is the holding company of the Porsche and Pietsch families, who own all of PAH's 153.1m voting shares; the 153.1m listed preferred shares are all non-voting.

Porsche SE was instrumental in pushing for an IPO of Porsche AG (P911) but in doing so, wished to ensure it could keep a handle on its "name". To do so, PAH acquired 25% of P911 voting shares, which were not listed; only P911 preferred shares are publicly traded. To do so, the company agreed to pay a 7.5% premium to the IPO price for its stake which involved an investment of €10.1billion.

To make this investment, PAH needed to raise a significant quantum of debt - initially €7bn – of which €2.7billion has been successfully refinanced in March 2023 via a "Schuldshein" loan – a loan with differing traches and maturities and with fixed and variable rates.

Porsche SE has a very simple balance sheet structure as follows:

	Shares	Price	Value (€mn)	
VW ordinary shares	157.283m	€158.00	24,851	
P911 ordinary shares	113.875m	€118.00	13,437	Assumes no voting premium
Other portfolio investments			116	Inrix, ETS
Cash and receivables			1,067	
Debt at 31.12.2022			(7,093)	
Other liabilities			(276)	
EQUITY AT MARKET PRICE			**32,102**	**€104.84/share**

Assuming no differentiated distribution to voting/non-voting, at prevailing prices Porsche SE has a net asset value of ~€105/share. At the current market price of €52.92, the shares trade at a 49% discount to pre-tax value based on the prevailing VW share price, which we believe is a 60% discount to a sum of the parts valuation.

In our portfolio, we are cognisant of the double exposure, notwithstanding the cheapness of both VW and Porsche SE. In the event that VW shares traded at our valuation of €397/ordinary share, PAH3 would theoretically be worth close to €70billion or €228/preferred share.

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Disclaimer

This communication has been prepared by Andrew Brown and East 72 Management Pty Limited (**E72M**) (ACN 663980541); E72M is Corporate Authorised Representative 001300340 of Westferry Operations Pty Limited (AFSL 302802) of which Andrew Brown is a Responsible Manager.

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