



March 9, 2023

Dear Partner,

I believe we have the highest quality businesses (including intrinsic value growth) in the fund's history, with a discount that continues to grow as the market fails to realize the improvement in our firms' positions. The Bonhoeffer Fund returned 13.3% net of fees in the fourth quarter of 2022. In the same time period, the MSCI World ex-US, a broad-based index, returned 14.9% and the DFA International Small Cap Value Fund, our closest benchmark, returned 19.4%. For the year ending December 31, 2022, the Bonhoeffer Fund had a return of -20.5%. In the same time period, the MSCI World ex-US, a broad-based index, returned -16.0% and the DFA International Small Cap Value Fund, our closest benchmark, returned -9.8%. As of December 31, 2022, our securities have a weighted average earnings/free cash flow yield of 18.4% and an average EV/EBITDA of 3.5. These metrics are associated with a portfolio that has projected earnings/free cash flow growth of about 9%. The DFA International Small Cap Value Fund had an average earnings yield of 13.5%. These multiples are slightly higher than last quarter, primarily due to share price increases.

Bonhoeffer Fund Portfolio Overview

As described in previous letters, our investment universe has been extended beyond value-oriented special situations to include growth-oriented firms using a value framework. This includes companies that generate growth through transition and consolidation. There have been modest changes within the portfolio in the last quarter in line with our low historical turnover rates. We sold some of our slower-growing names and invested some of our cash into Autohellas, described in the case study below.

As of December 31, 2022, our largest country exposures include: South Korea, United States, United Kingdom, South Africa, Philippines, and Latin America. The largest industry exposures include: distribution, telecom/media, real estate/infrastructure, and consumer products.

We are investigating additional consolidation plays with modest valuations in industries that have attractive returns on invested capital such as chemicals, leasing, distributors, housing, and specialty finance.

Compound Mispricings (32.9% of Portfolio; Quarterly Average Performance -2.7%)

Our Korean preferred stocks, the nonvoting share of Telecom Italia, Wilh. Wilhelmsen, and KT Corporation, all feature characteristics of compound mispricings. The thesis for the closing of the voting, nonvoting, and holding company valuation gap includes evidence of better governance and liquidity. We are also looking for corporate actions such as spinoffs, sales, or holding company transactions and overall growth.

KT Corporation is a compound mispricing which has become more interesting as its price has declined and cash flow has increased. The company is Korea's largest telecom firm that is going through a transformation from primarily a legacy telecom firm to a 5G wireless and broadband firm. Earnings are projected to increase by 10% per year over the next four years. Over the past year, KT repurchased shares and retired treasury shares, in addition to distributing a 6.5% dividend. Below is an intrinsic value for KT based on comparable firm multiples and including a 30% discount for the non-telecom assets KT holds.

KT Corp Sum of the Parts (bn Won)							
	EBITDA	Multiple	Value	% of Value			
Telecom	₩4,274	6	₩25,644	70%			
Real Estate			₩4,300	12%	Value of Excess Real Estate per Management		
Cash			₩2,449	7%	12/2022 cash		
K-bank			₩2,720	7%	8bn IPO estimate (34% ownership)		
Investments & Non-Telco Subs*			₩1,339	4%	Fair Value w 30% discount		
Debt			₩10,006		12/2022 debt		
Valuation (Wbn)	FCF		₩26,446	100%		Hold co Disc	30%
Shares (Bn)	₩1,762		0.235808				
Value Per Share	₩7,472		₩112,151				
Current Price Per share	4.01	FCF Multiple	₩29,950				
Upside			274%			Corp Exp	₩4.9
						Capitalized	₩49.0
EBITDA Multiple			Upside			% Disc	0.2%
4	₩73,054		144%				
5	₩90,498		202%		*Investments & Non-Telco Subs		
7	₩125,388		319%			Carry Value	Fair Value
8	₩142,833		377%				
EBITDA Multiples					BC Card	633,004	633,004 Carry Value
					KT Skylife	311,696	190,999
					KT Powertel	37,419	37,419 Carry Value
Quad Play	10				KTCS	6,427	7,312
European Incumbant Telco	6				KTIS	30,633	30,792
US Legacy	5				LT M Mobile (SIM Cards)	200,000	200,000 Carry Value
Asian Incumbant Telco	3.5				KT HiTel	120,078	164,282
					KT Submarine	24,370	37,321
PP&E	₩14,772				Nasmedia	23,051	93,456
Net Current Assets	₩1,361				KT Music	37,417	127,936
Debt	₩7,299				KT SatCo (FSS Satellite)	390,500	390,500 Carry Value
Net Tangible Assets	₩8,834				Others less KT Estate	418,613	418,613 Carry Value
RoTE	19.9%				Total	1,814,595	1,913,022

Another compound mispricing holding, Telecom Italia (TI), the Italian incumbent telecom firm with wireline and wireless holdings in Italy and Brazil, is still in negotiations about the sale/merger of their core network. There has been some progress in the negotiations and offers over the past few months as the share price has increased once exit/sale plans become more solidified. The asset sales require the approval of the Italian government. A new government was elected last year and their positions on the various asset sales/swaps are becoming clearer over time which should facilitate quicker deal timing.

Public LBOs (42.5% of Portfolio; Quarterly Average Performance -4.0%)

Our broadcast TV franchises, leasing, building products distributors, plastic packaging, and roll-on/roll-off (RORO) shipping fall into this category. One trend I've noted in these firms is growth creation through acquisitions which provides synergies and operational leverage associated with vertical and horizontal

Our television broadcast firms, Scripps and Gray Television, are in a consolidating segment (over-the-air (OTA) television) of a fragmenting media distribution market which includes OTA cable and streaming segments. Both firms are active in all three segments and are developing low-cost access for content owners, in addition to developing ancillary services like datacasting via ATSC 3.0 and sports distribution amongst the decline of the regional sports networks (RSN). The price of our firms has declined as the market is focusing on the mature OTA and cable segments versus the OTA renaissance, the large and low customer cost reach for sports programming, and corporate datacasting via ATSC 3.0.

TIGO					5-yr FCF Growth	24.8%														
	2021	2022	2023	2024	2025	2026	2027	2028	2029		\$19.44 8.6%	2.970801 11.58441	5-yr fwd FCF Earnings/FCF Yield		10% growth PE 21.9					
Revs (Prop)	\$5,468	\$5,746 5.1%	\$6,047 5.2%	\$6,373 5.4%	\$6,726 5.5%	\$7,108 5.7%	\$7,522 5.8%	\$7,972 6.0%	\$8,462 6.1%											
													High Single digit growth of cable		8.0%	39%		3.09%		
EBITDA	\$2,232 40.8%	\$2,356 41.0%	\$2,510 41.5%	\$2,677 42.0%	\$2,858 42.5%	\$3,056 43.0%							Low Single digit growth of mobile		2.0%	61%		1.23%		
													0.5% Economy of scale growth					4.32%		
FCF (Prop)	\$225 4.1%	\$175 3.0%	\$300 5.0%	\$425 6.7%	\$500 8.9%	\$640 9.0%	\$715 9.5%	\$797 10.0%	\$888 10.5%		Shares	176.3 Towers	\$3,427.27 \$1,400.00 \$2,027.27		\$7.94	\$92.71 37%				
FCF/Sh	\$1.28	\$0.99 -22.2%	\$1.70 71.4%	\$2.45 44.1%	\$2.95 20.3%	\$3.87 31.2%	\$4.46 15.1%	\$5.14 15.2%	\$5.93 15.4%											
Revs										Growth										
Mobile	\$3,354	\$3,421	\$3,489	\$3,559	\$3,630	\$3,703	\$3,777	\$3,852	\$3,929	2.0%										
HFC	\$2,114	\$2,326	\$2,558	\$2,814	\$3,095	\$3,405	\$3,746	\$4,120	\$4,532	10.0%				\$30.17	\$17.01					
	\$5,468	\$5,746 5.1%	\$6,047 5.2%	\$6,373 5.4%	\$6,726 5.5%	\$7,108 5.7%	\$7,522 5.8%	\$7,972 6.0%	\$8,462 6.1%											
Buyback Model																				
	176.3	176.3	176.3	173.3	169.4	165.3	160.3	155.2	149.9		Shares Outstanding (net buyback)									
50%	0.00	0.00	3.00	3.86	4.17	4.92	5.10	5.31	5.55		FCF Buyback %									
	40	45	50	55	60	65	70	75	80		Assumed Share Price									

Distribution Theme (36.4% of Portfolio; Quarterly Performance 6.4%)

One of our holdings in the distribution theme is Builders FirstSource (BFS), a clustered building products distribution firm. BFS's growth model is through same-store sales growth (6% per year based upon increased home sales of 1.5 million units from 1.0 million units) and synergistic M&A (4% per year). These are enhanced by opportunistic operational leverage from scale and share repurchases (5% annual growth). Over the past five years, BFS's net income margins are up from 2% to 13%, with a 3x increase in revenues. These factors should lead to about a 16% EPS growth going forward. BFS has had 82% EPS growth over the past five years. Since August 2021, BFS has repurchased 34% of its common stock.

BDR					FCF Gr Rate	26%												
	2021	2022	2023	2024	2025	2026	2027	2028	2029		\$81.49 12.1%	3.147768 5-yr fwd PE 8.250147 Earnings/FCF Yield		10% growth PE 22.5			20	
Revs	\$18,441	\$22,671	\$15,693	\$17,105	\$18,816	\$20,697	\$22,146	\$23,696	\$25,355								\$	401.89
		23%	-31%	9%	10%	10%	7%	7%	7%			4% acquisitions						37.6%
FCF	\$1,456	\$3,259	\$1,281	\$1,454	\$1,693	\$1,966	\$2,215	\$2,488	\$2,789			6% organic SSS growth (1 to 1.5 HB/yr) to 3% LT						
	7.9%	14.4%	8.2%	8.5%	9.0%	9.5%	10.0%	10.5%	11.0%			50bp per year op leverage						
FCF	\$ 10.49	\$ 23.47	\$ 9.88	\$ 12.12	\$ 15.48	\$ 20.09	\$ 25.89	\$ 34.34	\$ 47.67		Shares	138.84	\$11,314					
		124%	-58%	23%	28%	30%	29%	33%	39%									
% BB	50%	138.84	129.69	119.99	109.41	97.84	85.54	72.44	58.50									
Share Price		65	70	75	80	85	90	95	100									

Telecom/Transaction Processing Theme (38.1% of Portfolio; Quarterly Performance -12.7%)

Within this theme, the increasing use of transaction processing in the markets of our respective firms—as well as the rollout of fiberoptic and 5G networks—is providing growth opportunities. Given that most of these firms are holding companies and have multiple components of value (including real estate), the

timeline for realization may be longer than for more mono-industry-focused firms. Most of these firms have been strong given their continued growth in telecom and processing revenues.

NICE Information & Telecommunication (NICE I&T) is the largest credit card processing firm in Korea. The firm provides credit card processing both offline and online. NICE I&T is majority owned by NICE Holdings. The firm also provides transaction processing for all of the NICE Holdings-affiliated companies. Credit card processing firms' fees are regulated in Korea and historically this regulation has reduced the operational leverage of the credit card network as pricing declines have offset economies of scale. Despite this trend, operators have been able to generate growth via transaction volume increases. Historically, NICE I&T has been able to take market share from smaller processors and this continues today. NICE I&T has a 24% market share today which is expected to increase going forward. The table below illustrates the forward-looking economics for NICE I&T.

NICE Information & Technology				ANIPS Growth			9%										
	2021	2022	2023	2024	2025	2026	2027	2028	2029								

The current valuation is compelling based upon the projected net income growth rate of 7% (implying a 22.5x multiple using the Graham formula) or smaller comparable Korean card processing firms whose earnings multiples range from 4x to 33x with an average of 15x.

Consumer Product Theme (13.3% of Portfolio; Quarterly Performance 10.0%)

Our consumer product, tire, and beverage firms comprise this category. The defensive nature of these firms has led to better-than-average performance. One theme we have been examining is the increase in sales of adult products (e.g., tobacco, cannabis, gaming product offerings) and the large consolidation opportunities in smaller convenience stores internationally. Our GS Retail holding is a beneficiary of this trend, as well as more well-known convenience store operators like Alimentation Couche-Tard.

Real Estate/Construction Theme (27.3% of Portfolio; Quarterly Performance 0.6%)

In my opinion, the pricing of our real estate holdings will be impacted by the re-opening of China and Hong Kong from COVID restrictions and its effects on Hong Kong tourism from China. The current cement and construction holdings (in US/Europe via Builders FirstSource and Vistry, and in Korea via Asia Cement) should do well as the world recovers from COVID shutdowns and the Chinese government incentivizes further housing infrastructure programs. Our Hong Kong real estate firm (Asia Standard) should do well if China reverses its COVID shutdown and travel recovers. Even after a 50% rally in its stock price, Asia Standard still sells for 5% of book value including its mark-to-market changes in its real estate and investment portfolio.

More Changes in Interest Rates

In last quarter's letter, we discussed the changes in inflation and interest rates that occurred over the past 12 months. Today, we will further dive into some of the investment implications and paths followed by great investors (Warren Buffett, John Neff, and Benjamin Graham) in similar historical circumstances in the 1970s.

First, Warren Buffett invested in royalty companies in capital-intensive, growing industries. One example was advertising royalty firms like advertising agencies and TV firms that had limited competition in advertising consumer goods. These royalties (revenues for these firms) rose with inflation and were capital light. One example today is our mining equipment dealer, FerreyCorp, which provides equipment to copper mines in South America. Ashtead, our equipment leasing firm, also provides equipment for the rebuilding of the US infrastructure; and Builders FirstSource provides building products to resolve the American housing shortage.

Second, John Neff was purchasing moderate, cyclical, and less-recognized growth stocks at discounted multiples. At the time, Neff was purchasing high RoE firms with 12-20% growth for single-digit price to earnings ratios. He used a relative valuation ratio $(\text{dividend yield} + \text{EPS growth rate}) / (\text{price/earnings})$ to assist in relative security selection incorporating growth. Bonhoeffer has a similar focus purchasing Asbury, Autohellas, Builders FirstSource, and Millicom that have similar characteristics.

Third, Graham was purchasing bonds at a discount to par, savings bonds, and net-nets. Both Buffett and Neff observed times when investing in bonds was better than stocks. Neff purchased bonds if they could be purchased with 5%+ real yields. Today, treasury inflation-protected securities (TIPS) trade for a 1.7% real yield. Buffett recommended municipal bonds when after-tax equivalent real yields were 3.5%. High real yields can be safely obtained today via BDC who hold well-underwritten (covered) floating-rate private debt. Examples include Sixth Street Specialty Lending and Oaktree Specialty Lending.

Consolidation: When is Bigger Better?

Bigger is better when businesses have economies of scale or economies of scope on their side. Local businesses can obtain economies of scale via customer density which can produce higher margins and inventory turns. Economies of scale can result in cash flow growth either organically or via mergers and acquisitions that create local geographical density or functionally similar mergers and acquisitions or a combination of the two.

Mergers and acquisitions in fragmented markets can also increase the profitability within a market by reducing competition. Examples include: auto and building products distribution, specialty chemicals, equipment leasing, and broadband connectivity. The opposite happens (less profitability and more competition) when markets fragment from technological changes or deregulation. Examples include: media content development and distribution and trucking and airlines after deregulation. Every market is either moving to be more fragmented or more consolidated. Avoiding fragmenting markets and focusing on consolidating ones is where future profits can be found.

An interesting question is when to invest in consolidating markets. The investor has two choices early on in the consolidation process (top five firms have less than 15% market share) or later on when market

share is more concentrated. The advantages of early-on investing include: a long investment runway, local synergies being realized, and the longer-term impact of mergers and acquisitions that are not typically modeled in most analysts' estimates. The disadvantages can include higher multiples reflecting future growth prospects. The advantages of investing later on in the consolidation process include: realization of M&A synergies over an extended period of time and a clearer view of the end state of the market. Therefore, more traditional relative value methods can be used in later stages of consolidation firms. There are also some external factors that can either encourage or discourage consolidation; these include: government's regulatory regime in the firm's domicile, economically driven ownership versus non-economic ownership rationale (i.e., size and prestige), and support from suppliers and customers.

Industry Transitions

Another way to find undiscovered growth (or unpriced growth) is in firms transitioning from one industry or industry segment to another. In many cases, firms are transitioning from a declining business or segment to a growing one. An example is media firms transitioning from cable and OTA linear television distribution to streaming television distribution. The market reaction to this transition depends upon when an inflection point is reached—when the growing business overtakes the declining business in terms of cash flow generation. The transition can also be accompanied by consolidation of the legacy business. We see this in both Consolidated Communications and Thryv, which have yet to reach the inflection points in their transitions. Once they do reach the inflection point, they should have favorable tailwinds in that both their cash flows and multiples should increase at the same time. This can result in the Davis double, increasing cash flow, and cash flow multiples as the firm transitions from declining cash flows from the legacy segment to growing cash flows from the new segment.

Conclusion

As always, if you would like to discuss any of the philosophies or investments in deeper detail, then please do not hesitate to reach out. Until next quarter, thank you for your confidence in our work.

Warm Regards,

Keith D. Smith, CFA

CASE STUDY: AUTOHELLAS SA (ASE-OTOEL)

Autohellas is an automotive rental and distribution group located in Greece and the Balkans (and is in the process of buying Hertz's rental business in Portugal). Autohellas has a fleet of 47,100 rental cars with 111 rental locations, 10 parts distribution locations, and 22 dealership locations in eight countries. The rental business has two segments—short-term rentals and long-term rentals/leases/fleet management. Autohellas has the Hertz franchise in Greece, the Balkans, and Ukraine. As a franchisee, Autohellas has access to Hertz's reservation system and can use the Hertz name and know-how in the countries in which it operates. Autohellas's growth in a given country begins by entering via car rentals, primarily at airports. Once a rental fleet is established in a country, a used car sales operation (branded Stock-Center) to sell off lease/rental autos is typically opened. Finally, in some countries (Greece and Bulgaria), distributorships/dealerships are purchased or formed. Thus, automobile rental firms can have up to five businesses in one. These include: rentals, new car sales, used car sales, service and parts, and financing and insurance. Each of these businesses requires a fixed base of costs in each country; thus there is a minimum scale required to reach profitability. Once these fixed costs are covered by one function (let's say rentals), adding additional services like used car sales and distribution have large incremental margins.

Autohellas has five levers for cash flow growth: (1) entering a new rental market; (2) distributing new cars or parts within a country; (3) entering auto or parts distribution in an existing rental country; (4) paying down debt; and (5) distributing excess cash as dividends or buying back shares. Autohellas was founded by an entrepreneur, Theodoros Vassilakis, who opened a Hertz car rental franchise in Crete in 1966 with six VW Beetles. In 1974, Autohellas bought out the Hertz franchises in the rest of Greece. In 1999, Autohellas went public via an IPO in Greece. From 2003 to 2016, Hertz expanded by buying or opening new rental locations primarily in Bulgaria, Cyprus, Romania, Serbia, Montenegro, Ukraine, and Croatia. In 2003, when Autohellas purchased the Bulgarian Hertz franchise, it also became the exclusive distributor of SEAT automobiles in Bulgaria. In 2005, Autohellas formed a joint venture, Eltrekka, a Greek spare parts distributor. In 2007, before the GFC, Autohellas distributed via a return on capital and dividends equal to 28% of its then market capitalization. In 2008, Autohellas formed Autotechnica, a Greek vehicle management, maintenance, and bodywork firm to service its Greek rental fleet. In 2015, Autohellas purchased its Greek auto dealership Velmar and became the exclusive distributor of SEAT automobiles in Greece. In 2017, Autohellas became the exclusive Greek distributor for Hyundai and Kia automobiles. In 2022, Autohellas purchased the Hertz franchise in Portugal and was in the process of buying the exclusive distributor rights for Stellantis automobiles in Greece.

The entrepreneur who founded Autohellas, Theodoros Vassilakis, also founded Aegean Airlines in 1999. Aegean Airlines subsequently purchased the Greek state airline Olympic and today is the largest Greek airline. Autohellas owns 11.8% of Aegean Airlines. In addition, Autohellas has a travel partnership with Aegean Airlines which provides auto rental referrals from Aegean passengers.

Autohellas began in auto rentals and, over time, has expanded both geographically and functionally into related markets. These actions have generated 14% annual revenue growth and 14% annual EPS growth over the past five to 10 years. Over time, Autohellas's return on equity has increased from about 10% in 2015 to over 20% currently. The current return on equity is in line with its much larger competitor SIXT.

Autohellas has purchased firms at good prices and turned them around and added new services over time. An example is Velmar, Autohellas's Greek automobile dealership. Before its purchase by Autohellas, Velmar provided maintenance for some of Autohellas's Greek auto fleets. Before the purchase in 2015, Velmar generated €87 million in revenue and was break-even. Velmar was purchased for €641,000 in Autohellas stock. Over time, Autohellas has added new distributorships and started a parts distribution JV resulting in €394 million in revenue and €24.1 million in TTM after-tax earnings for 1H 2022.

The short-term auto rental market is being disrupted by new business models and technology. Uber and Lyft have provided an alternative to short-term leases for travelers who have limited travel requirements on trips. However, it is uncertain if this will materially reduce rental car demand, as the use cases do have some overlap but are also distinct. Autohellas and other rental firms utilize the internet for reservations and operations, so it has actually enhanced incumbent rental firms versus new start-ups.

The mix of long-term vs. short-term rentals in 2021 for Autohellas was 45% for long-term leases and 55% for short-term leases in Greece, and 58% and 42% outside Greece. Short-term leases are driven by both corporate and personal travel, while long-term rentals are driven by local corporate demand. Electric vehicles (EVs) are being integrated into Autohellas's fleet. Autohellas has also opened a Kineo location in Athens to rent small transportation vehicles like bikes and scooters.

The car rental model is also subject to local economies of scale. In a local market, a car rental and distribution business, like other retailers, can take advantage of economies of scale (density) associated with advertising, logistics, customer acquisition, and local oversight.

Car Rental and Dealership Business

In Greece, Autohellas has a market share of about 11% of the short-term rental market (12,000 cars) and 18% of the long-term rental market (26,500 cars). The total short-term leasing market includes 100,000 cars with the five largest franchised rental firms having 30,000 cars and the remaining firms (70% of the market) having less than 2,000 cars per firm. Thus, the short-term rental market is very fragmented. The long-term rental market is more consolidated with the top three firms having about 75% of the market, or 100,000 cars.

In other markets, Autohellas has a smaller—but growing—market share. The largest auto rental firm in Europe is SIXT. Internationally, the car rental business has consolidated into five large players (Enterprise, Hertz Global, Avis, Europcar, and SIXT) and smaller regional players like Autohellas. This consolidation and recent bankruptcies of Hertz and Avis have led to rationale pricing.

The overall Greek car dealership market is still recovering from recession/depression levels versus the pre-2008 automobile car market. In the late 1990s, Greece purchased about 150k cars per year. From 1999 to 2008, Greece purchased 250k to 300k cars per year. As a result of the GFC and the subsequent Greek crisis, car purchases declined to 50k per year by 2012. Since then, Greek car sales have increased to about 120k cars per year. Given the historical sales level, there is the potential of significant growth once the Greek economy fully recovers.

One source of earnings for rental businesses is the investing/trading of leased assets—in this case autos. Autohellas sells about 5,000 to 6,000 fleet vehicles per year and generates €10 to €15 million of gains on

sale earnings per year. The firm buys new automobiles and gets a discount on the purchase of these vehicles, leases them over a given period of time, and sells them for a residual value. Some firms sign buy-back agreements when they purchase vehicles (SIXT) and others (like Autohellas) assume the residual risk and can receive the return for assuming this risk. Autohellas's average fleet vehicle's life cycle is three to five years.

Sources of growth for Autohellas include geographic expansion of rental car and used car sales franchises, expansion of automobile dealership/distribution franchises, the recovery of the Greek automobile market, and tourism growth in Autohellas's rental footprints of Greece, Portugal, and the Balkans.

Autohellas's dealer group has utilized the local scale model to generate higher margins than (5.6% EBITA) and comparable inventory turns to (7.2x) comparable but larger European automotive dealers (Bilia, Pendragon, Inchcape, Vertu, and Lookers). The higher margins are, in part, due to the clustering of dealerships in geographic locations. Autohellas dealer group also has a steady flow of maintenance business from its Greek rental fleet. Inventory turns are also important in the auto retailing business. Autohellas has one of the highest inventory turns of 7.2 times per year amongst the European car dealers, which range from 5.3 to 7.8 times per year. Quicker inventory turns mean that the dealer is matching the customers to cars more quickly than its competitors. This ability allows Autohellas dealer group to either sell fewer cars than competitors or to lower prices and obtain the same return on invested capital. Autohellas dealer group has the highest returns on equity (40% in 2021) relative to European dealer comparables from both higher margins and inventory turns.

Downside Protection

Auto rental/leasing firm risks include both operational leverage and financial leverage. Operational leverage in the rental/leasing market is based upon the size of the rental fleet at any given time and the scale versus demand volume of local operations. The rental/leasing firms always have the option of buying and selling used cars, so the timing of these purchases/sales can add to the bottom line. Over the past few years, Autohellas's fleet has grown to 49,000. Autohellas has historically sold about 10% of the TBV of its fleet per year. Management has also generated significant gains on sales for these transactions of about 30% of pre-tax profit over the past five years. Some other major competitors (SIXT) have auto buy-back agreements which reduce the risk and reward of these auto sales transactions.

Financial leverage can be measured by the debt/EBITDA ratio. Autohellas has below-average net debt/EBITDA versus other European rental firms (such as SIXT) of 1.7 and versus Autohellas's history. This is one of the reasons for the €48.6 million (€1/share) capital return to shareholders this year. During COVID, Autohellas performed well versus SIXT, with a 14% EBITDA decline versus a 60% decline for SIXT. Autohellas's EBITDA has exceeded pre-COVID levels in 2021, while SIXT's EBITDA is yet to recover to pre-COVID level. The history and projected financial performance for Autohellas is illustrated below.

	12/31/2011	12/31/2012	12/31/2013	12/31/2014	12/31/2015	12/31/2016	12/31/2017	12/31/2018	12/31/2019	12/31/2020	12/31/2021	12/31/2022	12/31/2023	12/31/2024	12/31/2025	12/31/2026	10-yr Growth	4-yr Fwd Growth
Total Revenues	172.71	151.98	151.38	161.12	182.89	264.81	340.63	470.38	555.41	491.72	641.65	724	963	1078	1208	1353	14.0%	16.9%
% Change YoY		-12.00%	-0.39%	6.43%	13.51%	44.79%	28.63%	38.09%	18.08%	-11.47%	30.49%	12.83%	33.01%	11.94%	12.06%	12.00%		
EBITDA	76.83	69.18	70.63	81.05	88.11	104.34	119.13	145.39	152.19	126.62	165.4						8.0%	
% Change YoY		-10.00%	2.10%	14.80%	8.70%	18.40%	14.20%	22.00%	4.70%	-16.80%	30.60%							
% Margin	44.48%	45.52%	46.66%	50.30%	48.18%	39.40%	34.97%	30.91%	27.40%	25.75%	25.78%							
Net Income	13.37	8.1	6.49	16.12	18.63	22.69	31.63	38.25	44.23	15.79	48.99	78	96	107.8	120.8	135.3	13.9%	14.8%
% Change YoY		-39.42%	-19.88%	148.38%	15.57%	21.79%	39.40%	20.93%	15.63%	-64.30%	210.26%	59.22%	23.08%	12.29%	12.06%	12.00%		
% Net Income	7.74%	5.33%	4.29%	10.00%	10.19%	8.57%	9.29%	8.13%	7.96%	3.21%	7.64%	10.77%	9.97%	10.00%	10.00%	10.00%		
Diluted EPS	0.28	0.17	0.13	0.33	0.38	0.47	0.65	0.79	0.91	0.33	1.02	1.62	2.00	2.24	2.52	2.82	13.8%	14.8%
% Change YoY		-39.29%	-23.53%	153.85%	15.15%	23.68%	38.30%	21.54%	15.19%	-63.74%	209.09%	59.22%	23.08%	12.29%	12.06%	12.00%		
BV/Share	2.88	2.82	3.14	3.66	3.78	4.03	4.69	5.11	6.05	5.66	6.56	7.18	9.18	11.43	13.94	16.76		
Return on Equity	9.72%	6.03%	4.14%	9.02%	10.05%	11.66%	13.86%	15.46%	15.04%	5.83%	15.55%	22.61%	21.77%	19.64%	18.04%	16.81%		

Management and Incentives

Autohellas's management has been awarded/purchased new rental franchises or dealership franchises when the right franchise was available at the right price, partially financed by debt, paid down debt, returned capital via dividends when there was excess capital, and invested in and sold its fleet assets when the time was right.

The CEO and his family currently hold 29.2 million shares (€300.8 million), which is more than 15 times his family's (himself, his mother, and uncle) 2021 salary and bonus of €1.9 million. The CEO's compensation is structured €200,000 base pay and up to a €200,000 performance bonus based partially on rental profits before tax. For 2021, the CEO took no performance bonus. The CEO has lower compensation than three other senior executives who are the co-founder, the head of dealership operations, and the head of international rentals. The CEO is also the executive chairman of Aegean Airlines. Autohellas does not grant options.

Valuation

Sensitivity Table						
					Price	Upside
Current Adjusted Earnings *	€ 1.58					
7-year Expected EPS Growth Rate	12%			-1.0%	€ 10.38	0.0%
Historical EPS Growth Rate	14%			5.0%	€ 29.23	181.6%
Current AAA Bond Rate	4.3%		Growth Rate	7.5%	€ 37.13	257.7%
Implied Graham Multiplier **	32.50			10.0%	€ 45.03	333.8%
Implied Value	€ 51.43			12.5%	€ 52.93	409.9%
Current Price	€ 10.38			15.0%	€ 60.83	486.0%
* Normalized earnings (2022 earnings * norm margin/2022 margin)						
* (2*Growth Rate + 8.5)						

The key to the valuation of Autohellas is the expected growth rate. The current valuation implies an earnings/FCF decline of -1.0% into perpetuity using the Graham formula $((8.5 + 2g))$. The historical 10-year earnings growth has been 14% per year including acquisitions, and the current return on equity of 23%.

A bottom-up analysis based upon market growth rates of Greek automotive rental/dealer market results was used to estimate an organic growth rate of 12% for Autohellas. This is based upon a 14% growth rate for the auto dealer business based upon the revenue growth assumption for the 2021 goodwill impairment, a 10% growth rate for the long-term leasing segment based upon unit increases since 2019 including pending orders, and a 5% growth for the short-term rental business. This does not include any future acquisitions. The auto dealer growth rate includes a partial recovery of the Greek auto market which is down 75% from 2008, and the increased market share of Hyundai/Kia in the Greek market which has doubled from 10% to 20% since 2018. This EPS growth rate is conservative given the historical EPS growth rate of 14% and the current 23% return on equity with most of the current earnings being retained. Using a 12% expected growth rate, the resulting current multiple is 33x of normalized earnings, while Autohellas trades at an earnings multiple of 6.5x. If we look at the European comparable of SIXT, which is larger but has slower growth prospects, it has an earnings multiple of 10x. If we apply 10x earnings to Autohellas's estimated FY2023 earnings of €2.00, then we arrive at a value of €20 per share, which is a reasonable short-term target. If we use a 14% seven-year growth rate, then we arrive at a value of €51.43 per share. This results in a five-year IRR of 38%.

Growth Framework

Autohellas											€ 10.30	3.66 5-yr fwd PE		10% growth PE
					EPS Growth Rate	15%					15.3%	6.52 Earnings/FCF Yield		22.5
	2021	2022	2023	2024	2025	2026	2027	2028	2029					
Revs	€ 551	€ 740	€ 963	€ 1,078	€ 1,208	€ 1,353	€ 1,515	€ 1,591	€ 1,655			Impairment calculation		€ 63.29
		34%	30%	12%	12%	12%	12%	5%	4%			9-11% sales growth (5 years)		43.8%
												4% terminal growth		
Net Income	€ 49	€ 76	€ 96	€ 108	€ 121	€ 135	€ 152	€ 159	€ 165			25% NI Car Dealer (12 to 7)/75% Rental (32 to 17)		
	8.9%	10.3%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%					
Cash EPS	€ 1.02	€ 1.58	€ 2.00	€ 2.24	€ 2.51	€ 2.81	€ 3.15	€ 3.31	€ 3.44		Shares	48.1	€ 495.43	
		55%	27%	12%	12%	12%	12%	5%	4%					

Another way to look at growth and the valuation of companies is to estimate the EPS five years into the future and see how much of today's price incorporates this growth. Using the same revenue described above results in a 2026 EPS of €2.81, or 3.7x the current price. If we assume a steady-state growth rate from 2026 on of 5%, then this results in a fair value Graham multiple of 18.5x or €52.2 per share, similar to the five-year-forward valuation above of €51.43 per share.

In addition to the core assets, Autohellas has significant non-operating assets. These include real estate holdings in Greece, including a golf course in Crete, and a 12% stake in Aegean Airlines. These assets have an estimated value of about €100 million or €2 per share. These values are based upon either real estate appraisals or the current market price for the Aegean Airline stake.

Comparables and Benchmarking

Below are the European car dealerships and international firms engaged in the car leasing market. Compared to auto rental firms, Autohellas has less debt and better growth prospects and in-line multiples. Compared to European car dealerships, Autohellas has a market that is still in recovery mode, high inventory turns, and is increasing market share along with purchasing more distributorships.

				Dealer	EBITA				Debt/	EBITDA
	Price	Book Value	Earnings	Inv Turns	Margin	RoE	P/E	P/BV	EBITDA	Int Coverage
Autohellas	10.3	7.14	1.58	7.20	13.0%	22.1%	6.5	1.44	1.68	8.70
Sixt	85.95	41.53	8.64	N/A	20.4%	20.8%	9.9	2.07	1.83	12.84
Hertz	15.39	6.85	3.69	N/A	30.8%	53.9%	4.2	2.25	5.10	4.90
Avis	163.93	Neg	55.02	N/A	101.9%	N/A	3.0	N/A	0.99	4.90
Bilia	114.3	48.65	17.09	7.80	6.0%	35.1%	6.7	2.35	2.50	17.22
Inchcape	8.2	3.23	0.7	5.33	3.0%	21.7%	11.7	2.54	0.00	N/A
Lookers	0.76	1.12	0.15	6.10	2.9%	13.4%	5.1	0.68	0.00	N/A
Pendragon	0.19	0.16	0.03	5.30	3.4%	18.8%	6.3	1.19	0.28	4.30
Vertu	0.54	0.99	0.09	5.90	2.4%	9.1%	6.0	0.55	0.00	N/A

Risks

The primary risks are:

- slower-than-expected market share growth in dealership and rentals;
- lower-than-expected growth in the car market in Greece, as well as tourism growth in Greece; and
- a lack of new investment opportunities (mergers and acquisitions or new dealerships).

Potential Upside/Catalyst

The primary catalysts are:

- higher-than-expected market share growth for car distribution and rentals;
- growth in new markets like Portugal; and
- increased local scale or purchase of local scale in new markets.

Timeline/Investment Horizon

The short-term target is €20 per share, which is almost 95% above today's stock price. If the consolidation thesis plays out over the next five years (with a resulting 15% earnings per year growth rate), then a value of €52 (mid-point of the two methods described above) could be realized. This is a 38% IRR over the next five years.

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