November 2024

As we discussed in our mid-year letter, July marked a reversal of the relative underperformance in the Broyhill Equity portfolio. Detailed quarterly reports, including account and benchmark performance, portfolio holdings, and transaction history, have been posted to our investor portal.

PERFORMANCE REVIEW

We define top contributors and top detractors as companies impacting 100 basis points or more on the portfolio's return for the period. The top contributors were Philip Morris, Fiserv, Avantor, and Baxter. There was only one material detractor: Dollar General.

Top Contributors

Shares of Philip Morris gained 21% in Q3. Philip Morris was by far the largest contributor for the quarter. Our core thesis focuses on the shift in business mix from combustible cigarettes towards reduced risk products as well as the company's re-entry to the US market with its acquisition of Swedish Match. This year, Zyn has become wildly popular. So much so that the company can barely keep it in stock, even as it expands production. We recently discussed how youth usage of these products, a common critique of the company, remains under 2%, even as its overall popularity drives higher volume.

Baxter gained 14%. The third quarter was a busy period for Baxter. The company entered into an agreement with Carlyle to sell its Kidney Care segment for $3.8 billion. The proceeds will allow it to pay down debt ahead of schedule, simplifying its balance sheet while it continues to drive operational improvements. During the quarter, Hurricane Helene disrupted supply at the company's facility in North Carolina. Baxter is no stranger to IV supply disruptions, and we expect the current interruption will be immaterial to its long-term results.

Fiserv and Avantor gained 21% and 22%, respectively. We discussed both positions in our mid-year letter, and the companies' theses remain unchanged. Fiserv continues to execute at a high level while Avantor inches closer to recovery in key end markets.

Top Detractors

Shares of Dollar General lost 36% in Q3. Dollar General has historically proven to be a safe haven for investors in uncertain times as consumers trade down and increase their spending with the retailer. While inflation has certainly put pressure on DG's core customer in recent years, the retailer has seemingly lost market share to larger competitors. The most recent earnings report highlighted this dynamic, contrary to our expectation for a weaker economic environment to benefit the company.

KEY TRANSACTIONS

There was a flurry of activity in the third quarter. Our research efforts allowed us to begin building positions in certain companies while changes to prices or fundamentals caused us to exit others. During the quarter, we initiated new positions in Rentokil Initial, Evolution AB, and Nice Ltd. while we exited positions in Danone, PayPal, and EPAM Systems.

Purchases

Rentokil Initial is a UK-based pest control company that grew its US presence by acquiring Terminix in 2022. The industry is largely fragmented and has the tailwind of a warming environment, expanding the seasons and geographies where pests thrive. Trading at a steep discount to its nearest peer, Rollins, we see plenty of room for upside as activist investor Nelson Peltz holds management accountable during the Terminix integration.

Evolution AB is a live casino supplier based in Sweden. Shares have come under pressure as online gaming legalization of additional US states has been slower than hoped, but we believe that the most important factor is the direction of progress more than the pace. The company is a high margin, high growth business trading at what we view to be an inexpensive valuation. With this set-up, we are willing to accept a wide range of potential outcomes, most of which we view to be positive.

Nice Ltd. develops software to run customer contact centers. The company's cloud-based software enables the implementation of greater functionality versus its on-premise competitors. Many of these on-premise competitors, which do not offer cloud-based products, have stopped rolling out new features. This has prompted their customers to switch to companies like Nice where they have wider access to new developments. Artificial intelligence is a large part of this shift and of our differentiated view. The market views AI as a threat to Nice's core operations; we view it as an enabler of additional revenue streams with improved economics.

Sales

Danone. We initially added shares of Danone with the expectation that management could drive accelerated growth from its nutrition business and bring with it a higher valuation. The market has since begun to come around to this story. Valuation expanded even as we became increasingly disillusioned with its recurring "non-recurring" expenses. We exited the position in August with a modest gain to pursue more promising investments.

PayPal. We owned shares in PayPal based on its dominant position in the digital payments industry paired with its reasonable valuation. Following the recent share appreciation on the heels of the rollout of Fastlane, a product whose growth trajectory we see as unclear, we decided to step aside. We exited the position in September.

EPAM Systems. EPAM has long been a best-in-class operator within IT services and one we were happy to add to the portfolio with the noise created by the sell-off from the war in Ukraine. However, as the conflict has dragged on, EPAM has increasingly shifted operations to India and Latin America. We suspect that a shifting labor force could undercut its advantages and introduces a new type of uncertainty that we are less eager to underwrite. We exited the position in September.

BOTTOM LINE

We are grateful for your continued trust and partnership. We come into the office each day striving to earn it, and we realize just how fortunate we are to have such a wonderful group of like-minded, long-term investors who place their confidence in us. You enrich our network, strengthen our competitive advantage, and just make our work all the more enjoyable.

As always, please feel free to reach out at any time with questions. We enjoy hearing from you.

Sincerely,

Broyhill
ASSET MANAGEMENT

ABOUT BROYHILL

Broyhill Asset Management is a boutique investment firm, initially established as a family office in 1980 and guided by a disciplined value orientation. Founded in the foothills of North Carolina's Blue Ridge Mountains, we operate outside of the fray and invest with a rational, objective, long-term perspective.

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The performance of the Broyhill Equity Portfolio illustrated here is representative of a composite considered to be a "carve out" or "extracted performance." This composite has been verified by a third-party firm and reflects the equity returns of actual client portfolios. These results are based on the weighted average performance of the portion of individual accounts invested in the Broyhill Equity Portfolio but may not represent the performance of the entire portfolio. Since many of Broyhill's accounts are invested per a "balanced" investment model, we believe that this extracted performance composite, which includes only discretionary equity holdings of all Broyhill discretionary accounts, is the most accurate representation of Broyhill's long term equity performance. Additionally, since this performance represents a pure equity allocation, it does not include the impact of any cash allocation. Performance figures for the total portfolio composite are available upon request. This data may be useful for an investor evaluating Broyhill, although individual results may differ based on each account's investment objectives, the date of initial funding, the opportunity set available at the time, specific investment vehicles available to the accounts, and individual fee schedules.

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