KNIGHT VINKE

Deep Value. Fundamental Research. Commitment.

Introduction to Knight Vinke in 10 Slides

2021

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Introduction to Knight Vinke

Knight Vinke is an institutional asset manager and a specialist in strategic block investing.

- The firm invests in the equity of large cap public companies taking a corporate finance driven, private market approach to investment. It acquires substantial minority or control positions through a variety of techniques and then works closely with the management, board and other key stakeholders to create long term value.

- Value is created by promoting better performance, more efficient capital structures and effective governance. This often means redefining strategies so as to: (1) focus on businesses that are truly resilient and have the scope to continue creating value for long periods of time; and (2) exit from businesses that are over-competitive, face risks they cannot control or are unattractive for other reasons.

- Value destruction is prevented by promoting the kind of capital discipline one more often finds in family controlled companies.

Brief History

Knight Vinke was founded by Eric Knight, its CEO, in 2003.

- Knight Vinke Institutional Partners (KVIP), its flagship fund, was seeded by the California Public Employees Retirement System as part of its Corporate Governance Program and from 2003 to 2013 the fund played a leading role in restructuring several of Europe's largest public companies.
- CalPERS' interest was bought out by Eric Knight in 2013 and since then the firm has focused on longer term value creation – usually taking a 5 to 10 year perspective – with a special emphasis on energy and infrastructure.

Knight Vinke has recognised expertise in restructuring complex large cap energy companies, having actively participated in:

- the separation of Uniper from E.ON and its subsequent takeover by Fortum;
- the merger of Suez with GDF, following the takeover of Electrabel, to create Engie;
- the separation of State-controlled ENI from its regulated gas networks (SRG);
- the merger of Royal Dutch and Shell Transport to create Royal Dutch Shell.

Investment Philosophy

- We are high conviction equity investors.
- Our returns are driven by long term value creation supported by rigorous fundamental analysis rather than by stock-picking and/or market timing.
- We do not resort to leverage, short positions or derivatives to enhance our returns.
- We view each investment as a standalone project, relying primarily on the depth and intensity of our research combined with our credibility and influence with key stakeholders to manage idiosyncratic (company-specific) risk.
- We seek alignment of interests with our partners through a fee structure that incentivises long term performance rather than market timing whilst keeping fixed costs at a very low level.

Strategic Block Investing vs Private Equity

Knight Vinke's main competitors are the largest Private Equity and Infrastructure funds. These funds collectively have more than $ 1.5 trillion of dry powder to invest but have no mandate to take minority stakes in public companies.

Similarities

- **Extensive due diligence, willingness to engage, value creation, long term commitment**.

Differences

- **Valuation**. Public market valuations are often significantly lower than private market valuations for two reasons. First, because no control premium is generally paid when positions are accumulated in the market. Secondly, because the private equity market has attracted so much capital.

- **Execution Risk**. When bidding for control, private equity investors often run the risk that their bid will be topped, thereby leaving them with nothing to show for their efforts – other than costs. The strategic block investor can generally benefit (regardless of who wins the auction) by virtue of having accumulated a large position in the market beforehand.

- **Control**. Governance arrangements in public companies tend to be more fluid than in the case of private companies; effective control can usually be obtained – even with a minority holding – by building a consensus amongst key stakeholders based on proprietary analysis.

- **Liquidity.** Unlike in the case of private equity, the public market investor can increase or decrease the size of his/ its investment (and even exit) in light of changing circumstances.

Ability to Influence Strategy

Between 2003 and 2013, as one of the longest-standing members of CalPERS' Corporate Governance Program, Knight Vinke's ability to influence the strategy of portfolio companies was largely dependent on its ability to enlist the support of other like-minded institutional investors.

Since 2013, when CalPERS' interest was bought out, Knight Vinke has increasingly relied on three additional key factors:

- **Its ability to generate its own proprietary information.** Not having to rely solely on management information is key to having influence in the boardroom; the quality and depth of Knight Vinke's forensic analysis sometimes yields perspectives that even insiders have difficulty in seeing.

- **Its ability to initiate restructuring proposals as a principal.** Knight Vinke's longstanding relationship with SWFs and other very large institutional investors gives it the firepower with which to initiate even very large transactions.

- **Track record and experience.** Knight Vinke's senior management have been working with the boards and CEOs of Europe's largest companies for 15-25 years in each case (often as financial advisors to the portfolio companies themselves).

Role of Fundamental Research

Fundamental research and forensic analysis lie at the heart of Knight Vinke's investment process. The quality and depth of this analysis sometimes yield perspectives that even insiders have difficulty in seeing.

- Accounting consolidation makes many complex companies look simpler than they really are and often results in highly relevant information – for example, the fact that a very valuable subsidiary might be subsidizing another which is unviable on a stand-alone basis – being overlooked not only by the market but also by the board and management.

- Debt capacity is also a source of confusion for the equity markets, which tend to aggregate (and therefore incorrectly value) subsidiaries that have very different credit profiles.

- Overcoming this requires the ability to rebuild consolidated accounts from private subsidiary accounts that are often in the public domain but are in foreign languages, presented in foreign GAAP and are not easily accessible.

- Creating data with this level of granularity allows Knight Vinke to engage very effectively with the boards and management teams of the companies in which it invests. It also allows the firm to build strategic stakes in these companies at an early stage – and to negotiate with potential industrial or financial partners where appropriate – without having to pay the control premium that is inevitably associated with formal due diligence.

Example: European Energy Conglomerate

We recently reconstructed the consolidated financial statements of a publicly traded energy conglomerate, with more than 800 subsidiaries and affiliates, from the bottom up:

- The process started with the identification of all companies with material shareholders' equity, net income, fixed assets, capital expenditure, employees and other such metrics.
- The financial statements of these material companies were then carefully transcribed from the statutory private company filings (in local GAAP, rarely in English) and were analysed, one by one. 10 years of annual reports were available in most cases.
- Where necessary, additional subsidiaries and affiliated companies were brought into the scope based on disclosures found in the above-mentioned subsidiary accounts.
- Totals were computed for key balance sheet, P&L and cash flow items and these were then reconciled with the group's audited consolidated financial statements and with the (very limited) segmental data included in the group's annual reports.
- DCF valuations were then prepared for each significant asset/ business and, in the case of two key divisions, specialist industry consultants were hired to complete the outside-in due diligence process.

This kind of "bottom up" analysis is rarely, if ever, conducted by public market investors.

Risk Management/ Portfolio Construction

Knight Vinke's funds are designed for value-oriented equity investors seeking long term capital appreciation based on high quality research and a transparent value creation strategy – without relying on leverage, short positions or derivatives to enhance returns.

- **Idiosyncratic Risk**: is addressed through concentration limits (where applicable) and a disciplined approach to buying and selling – but equally through our diligence process, by regularly monitoring and reassessing the situation, and by distinguishing between temporary and permanent impairment in value.

  Additional protection against idiosyncratic risk comes from the firm's ability to engage directly with the portfolio company and its stakeholders to protect the value of the investment (e.g. by blocking value-destructive transactions, changing management, changing strategy).

- **Market Risk**: Knight Vinke does not seek to reduce volatility though hedging, as its management believes this is pointless in markets which are driven by expected policy reactions rather than by the fundamentals themselves. However, the firm may hold cash from time to time so as to acquire or build up positions when short term investors (i.e. most of the market) are selling.

- **Liquidity Risk**: is addressed by only investing in companies with a market cap in excess of €2 billion (and generally far more).

- **Operational Risks**: are managed through careful reconciliation, accounting and the use of external custodians and administrators (State Street, Bedrock which provides shadow accounting). Managed accounts are systematically proposed for accounts of € 100 million or more.

- **Compliance Risks**: are managed through staff training, detailed reporting and internal/ external audits.

The Opportunity in European Energy and Infrastructure

Europe's energy sector faces a tidal wave of restructuring driven by decarbonisation, decentralisation and digitalisation – all secular mega-trends. This wave is rapidly gaining pace and offers the potential to unlock some of the most attractive infrastructure investment opportunities since WWII.

The traditional energy value chain is disintegrating, with major utilities being driven to restructure by:

- Ever increasing political pressure to shut down coal (and in some cases nuclear) power stations;
- Unbundling legislation which significantly limits management control over regulated networks;
- Renewable energy subsidies coming to an end, turning wind turbines and photovoltaic plants into merchant power assets;
- Innovative/ disruptive technologies, which have proven to be low margin businesses to date;
- Significant investment needs to support energy transition (*Energiewende*), shifting growth opportunities along the value chain; and
- Over-leveraged balance sheets including, in many instances, liabilities related to legacy assets.

In light of the above, many utilities are focusing on specific value chain positions/risk categories and disposing of unwanted assets. Recent examples include: E.ON selling Uniper, RWE spinning off Innogy, E.ON acquiring Innogy and selling its wind farms back to RWE.

Large E&P companies face many of the same issues and present similar opportunities.

Management and Board of Directors

Eric Knight, Founder and CEO

1981 - 1989 Merrill Lynch, Corporate Finance, New York, London, Paris
1991 - 1996 Knight Vinke, Founder and CEO (corporate finance/ private equity)
1996 - 2002 Sterling Investment, Co-Founder and CEO
Since 2003 Knight Vinke, CEO, Board Member, IC Member

Glen Suarez, Chairman

1988 - 1994 Kleinwort Benson, UK Govt advisor on privatisation of Electricity Supply .
1994 - 2003 Morgan Stanley, Head European
2003 - 2006 Soditic, Partner and Director
Since 2006 Knight Vinke, Deputy CEO/ Dir (2006-16) then Chairman, IC Member
Edinburgh Investment Trust, Chairman

Trevor Hedden, CFO

2000 - 2005 Fortis Prime Fund Solutions,
2005 - 2008 New Star Asset Mgt, Head of Offshore Ops
Since 2009 Knight Vinke, Director Fund Administration and Reporting (2009-13) then CFO Board Member, IC Member

Jean-Frédéric Bérard, Managing Director

1999 - 2001 L'Union-vie, Portfolio Manager
2001-2005 Standard Life Investments, Senior Equity Analyst (banks, utilities), Fund Co-Mgr.
2005-2019 CDPQ, Senior PM and Dir. of Research Energy & Utilities (2005-12), then MD Relationship Investing $5bn AUM
Since 2021 Knight Vinke, MD Strategic Investments

Danila Gallarato, Board Member (Non-Executive)

2004 - 2007 Hermes Investment Mgt, Director, PM
2007 - 2009 Abu Dhabi Investment Authority, Head of Strategic Investment (Europe)
2010 – 2013 USS, Director, Portfolio Manager
Since 2014 Knight Vinke, Portfolio Manager, IC Member (2014-18) then Non-Exec. Board Member
Since 2018 UBP – Union Bancaire Privée Senior Advisor

Grégoire Boitel, COO

2011 - 2013 Quaker Securities, Equities trading dept.
Since 2013 Knight Vinke, Sales and Marketing (2013-18) then COO since 2019, Board Member

Contacts

Knight Vinke Asset Management (Monaco) S.A.M is regulated by the CCAF (Commission de Contrôle des Activités Financières)

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