Adestella
Investment Management

November 26, 2018

Dear Fellow Investors,

Adestella lost 3.0% in the third quarter. Our long holdings were essentially flat (-0.1%), while our short positions and index hedges lost 2.6%. The remainder of the difference was attributable to currency movements. In contrast to the first half of the year, it was our international stocks that outperformed, gaining 3.4% while US-based holdings lost 6.4%. At the end of the quarter, Adestella had gross exposure of 163% and net exposure of 92%.

The third quarter saw an extension of many of the same market themes from the previous one. News on tariffs and interest rates dominated headlines, and US indices and high-growth stocks outperformed while international benchmarks and value equities lagged. By the end of the quarter, the market had completely recovered its losses from earlier in the year and was making new highs (though as I write this, those gains have now been wiped out again). In contrast, our stocks remained out of favor for the most part despite solid business performance; however, periods like this are to be expected for an inherently contrarian strategy such as the one we follow.

An updated performance summary is provided below. Let me repeat, however, that our portfolio is extremely different from any of the indexes listed, that we make no attempt to track them, and that our correlation with them since inception has been minimal.

	3Q 2018	YTD 2018	Since Inception
S&P 500	7.65%	10.37%	61.97%
Vanguard Total World Stock ETF	3.84%	3.72%	34.34%
Russell 2000	3.57%	11.51%	50.98%
HFRI Equity-Hedge (Total) Index	0.36%	1.53%	20.89%
Adestella Investment Management	**-2.95%**	**-2.60%**	**75.52%**

**all index returns include reinvestment of dividends*

An Edgy Discussion

One frequent question active investors receive is "what's your edge?" Said differently – what are you doing that's different from the broader market that will allow you to outperform? It's something all investors should consider when evaluating an investment opportunity. In my view, there are five main categories of edge:

1. **Informational edge** – having knowledge of material information about a particular company that most investors lack. Once perhaps the main source of edge, improvements in technology and the democratization of information have all but removed this as a realistic source of advantage.
2. **Speed edge** – being able to react to news and other developments more quickly than others. The rise of funds that make decisions solely based on computer algorithms has made this edge much more difficult to obtain in the last decade.
3. **Interpretation/perception edge** – having the same facts as other investors but reaching a different conclusion as to their impact on the ultimate trajectory of a stock. Of course, for this to be an edge, you must have a view that is both different and correct.
4. **Attention/size edge** – being aware of an opportunity that has flown under the radar of other investors. Traveling along less followed paths and turning over a lot of rocks tends to present investment opportunities that are not yet well-known by market participants, who may not be able to devote as much time to their search as we do. These are often stocks that are too small for many other professional investors (hence why I combine this edge with size), because they cannot take a position that would move the needle for them and thus simply ignore these opportunities.
5. **Time edge** – being able to take a longer-term view than other market participants, who often miss the forest for the trees. While perhaps the easiest in theory, this can be very difficult to implement in practice. A time edge requires being able to overlook short-term noise and quarterly fluctuations and focusing instead on a company's competitive positioning, secular trends, etc. It also manifests in the ability to compound over longer periods of time, usually in a tax-efficient manner. A time edge requires limited partners to have a similar mindset, as capital withdrawals in the midst of short-term volatility can be ruinous to its exploitation.

Of these edges, I would argue that the first is nearly impossible for anyone to (legally) attain in today's market, as information is freely and easily available thanks to the ubiquity of the internet and free market data sources. The second type, speed, is now dominated by high-frequency trading firms; it is extremely unlikely that fundamental value funds like Adestella will ever be able to attain this type of advantage either.

However, I believe the final three remain viable options. An interpretation edge by definition requires a contrarian viewpoint, but with independent thinking and careful analysis, it is certainly possible to obtain. The attention/size edge is available to us because of our relatively small AUM, which means we have a degree of dexterity and flexibility that is beneficial in widening our opportunity set. Finally, we have a group of investors that realize it is nearly impossible to beat the market in the long term without periodic bouts of short term underperformance. This allows us to capitalize on opportunities in which temporary problems or panics obscure sustainable advantages that will allow a company to outperform over a longer period of time.

“Everybody Knows” – Or Do They?

Most of the edges described above can be obtained independently of the decisions of any other market participants. There is, however, one exception: any sort of interpretation edge requires you to have a contrarian viewpoint that is held by relatively few. Essentially, you must find situations where things that “everybody knows” to be true are, in reality, not.

It can sometimes be difficult to determine what the consensus opinion about a given stock is, and in situations like these, I believe it’s unwise to rely on your interpretation as being an advantage. However, there are also times when nearly everyone – sell-side analysts, guests on CNBC, posters on financial websites – seems to share the same point of view. When that occurs, I have found these areas to be a fruitful ground for further review. Many times, you may simply reach the same conclusion as everyone else. However, you might occasionally develop a variant view that creates an opportunity to act on a stock and profit once everyone else comes around to your thinking later on.

So once you’ve heard enough points of view to determine whether there’s a consensus opinion, how can you vet its accuracy? I believe three things stand out as particularly important:

1. **Use primary data sources.** Relying on information from sources that already have their minds made up is a recipe for disaster, as humans are prone to being subconsciously swayed by assertions that make it sound as though the answer is obvious.
2. **Invert your thinking.** The concept of inversion was popularized by Berkshire Hathaway vice-chairman Charlie Munger and can basically be defined as thinking about or planning for the opposite of what you expect or want to happen. Instead of relying on the conventional wisdom that the consensus depends upon, actively seek out the other side of the debate and know its salient points just as well.
3. **Determine root cause of misperception.** Often times the consensus narrative is something that is relatively easy to grasp onto, which facilitates its rapid spread. If you can determine the sticking point that has created the erroneous perception, it’s much easier to track the signposts that will tell you whether you’re right or wrong and adjust accordingly. Utilizing point #2, inversion, is critical for enabling this step.

In today’s era of highly accessible information, being able to occasionally obtain a perception edge is more important than ever before. Indeed, I believe that it is this edge (along with the time edge) that has created the opportunity in our largest position – the subject of this quarter’s appendix, Fiat Chrysler (FCAU). Please see the pages following the conclusion of this letter for an in-depth investment thesis.

<u>Outlook & Conclusion</u>

After climbing the “wall of worry” throughout Q3, markets lost their grip early in Q4. In October, the S&P 500 had its largest monthly decline since the fall of 2011, and halfway through November, it is now in negative territory for the year. The last few months have proved that stocks and styles can swing in and out of favor in violent fashion. That said, the underlying tenets of our process and strategy have not changed in the past six months, and I believe that they remain solid.

Psychology researcher Philip Tetlock has studied forecasting and decision making under conditions of uncertainty for several decades and written several excellent books on the topic.[1] He and a colleague coined the term “perpetual beta,” a name they borrowed from the software development industry, to describe the thought process that any good forecaster should have. The steps are as follows: try, analyze, improve, repeat.

Adestella has had several recent investments that provided harsh reminders that not every “try” will prove as successful as hoped – but that also underscored the importance of careful analysis after the fact to take the right lessons away from the outcome. For example, I was overly sanguine about the speed and glide path of financial reforms in Argentina, which cost us heavily in several positions (including the subject of last quarter’s appendix, Grupo Supervielle). As a result, regardless of how these investments ultimately turn out, our realized IRRs are likely to be significantly reduced.

The good news is that such situations are fertile ground for “post-mortem” analyses that can benefit us going forward. The lessons learned here, and elsewhere, can and will be applied in the future, and they will allow us to go into the next cycle of this continuous process better prepared than ever before. So, there will be no knee-jerk wholesale changes – after all, changing direction with each gust of wind only throws you out to sea. Instead, we will continue making a series of gradual adjustments and incremental improvements. Over time, I believe we will be well rewarded for staying on this course – even if we can’t know in advance when those rewards will come.

“Learning is an ornament in prosperity, a refuse in adversity, and a provision in old age.”

- Aristotle

Per Ardua Ad Stella,

Andrew Jakubowski

[1] *Superforecasting* and *Expert Political Judgment* are among his most famous titles.

Appendix A: Fiat Chrysler (FCAU) Investment Thesis

Introduction

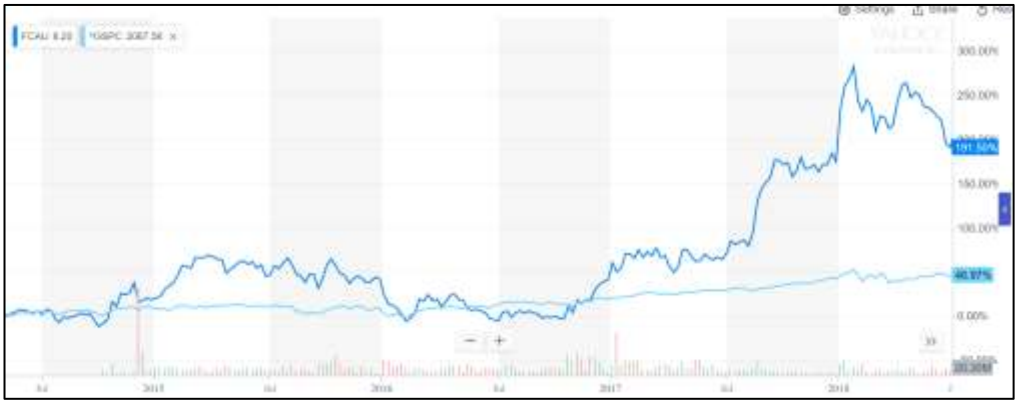
Many of the ideas that I've presented in these appendices over the last year and a half have centered around small-cap stocks that few investors are aware of. But sometimes, value is hiding in plain sight instead; such is the case with Fiat Chrysler (FCAU). In recent years, the company has become a well-known name in value investing circles. Several of the best investors I know have made it one of the largest positions in their portfolios, if not the largest. One famous practitioner has even gone so far as to make it nearly the entirety of his US stock exposure. Given this dynamic, as well as the fact that the company has published detailed five-year financial targets, there is little to write or project about Fiat Chrysler that is particularly novel. With that in mind, I will endeavor to approach the discussion from a slightly different angle, with a particular focus on the valuation assumptions embedded in today's stock price. In this light, the staggering extent of the discrepancies between price/value and risk/reward will hopefully become clearer.

Company & Situation Background

FCAU is a member of the "Big Three" Detroit-area automakers, and is the 8th largest by units. Its business lines are as follows:

- Jeep – SUV and CUV brand with a history dating back to WWII. In my opinion, this brand is the crown jewel of the FCAU portfolio.
- Ram – one of the best-selling and highest rated full-size pickup truck brands.
- Chrysler & Dodge – now that FCAU has decided to stop making sedans under either of their marques, these brands will focus on minivans, a category in which they are the two best sellers.
- Maserati & Alfa Romeo – the company's premium marques, with most price points in the range of $75-150k for Maserati and $40-75k for Alfa Romeo.
- Magneti Marelli (MM) – the company's components business, which has been determined to be non-core to operations. FCAU recently announced a deal to sell this unit to a private equity firm for more than $7 B USD.
- Fiat/Abarth/Lancia – small passenger car brands, sold mainly in Europe and South America, that do not contribute materially to the company's financial results.

After emerging from bankruptcy following the financial crisis, the company made a remarkable turnaround under CEO Sergio Marchionne, more than doubling revenues and increasing operating income by nearly 20x from 2009 to 2017. It then undertook an ambitious five-year plan outlining the financial goals for the final five years of Marchionne's tenure and stunned the financial community by consistently managing to hit the targets that had been set. As the strong numbers continued rolling in, strong stock performance followed. From the unveiling of the plan in May 2014 to the summer of this year, FCAU outperformed the S&P index by a factor of 4x (and even higher when factoring in the impact of its various spinoffs, particularly Ferrari).



Most unfortunately, Marchionne died in July, prior to the completion of the final year of the plan. In stepped Mike Manley, the former head of the Jeep and Ram businesses, who shortly thereafter announced the release of the plan for the five years to come. Once again, analysts appear skeptical – the stock is now down 11% YTD and 34% from its peak in January, despite strong financial performance and a valuation that was extremely cheap even at the highs earlier this year. While this has made for a painful year, I remain very confident that the value here, outlined in detail below, will eventually be realized by the market sooner or later.

Valuation

Anyone capable of doing basic arithmetic can see that FCAU is an incredibly cheap stock – at less than 2x EBITDA and about 2x cash flow, the stock is priced like it might go out of business tomorrow. I once researched a small-cap Mongolian coal miner that had recently exited bankruptcy, and even that traded at higher multiples. While the automaker sector as a whole is cheap, FCAU still trades at a large discount to peers. As I'll explain below, I believe this discount is wholly unjustified as well.

	Currency	Diluted Market Value (M)	2018 Automotive Net Cash	Employee Benefit Liabilities	Other Pro-Forma Adjustments	EV	2018 EBIT Estimate	2018 NI Estimate	EV/2018 Adj. EBIT	2018 P/E
FCAU	EUR	22,110	1,750	(8,545)	4,960	23,945	7,500	5,000	3.19	4.42
GM	USD	51,416	3,837	(17,300)	14,600	50,279	12,296	8,586	4.09	5.99
F	USD	36,520	8,631	(15,539)	(11,000)	54,428	7,610	5,382	7.15	6.79
								FCAU relative to GM/F avg.	*-43.2%*	*-30.8%*

**Note: FCAU PF adjustment reflects sale of MM, GM adjustment reflects value of autonomous driving operations, & F adjustment reflects estimated cost of announced restructuring*

Simply pointing to low multiples and waiting for a re-rating of the stock is not particularly useful, though – plenty of investors have access to stock screeners, and if a low multiple alone were enough, the stock would already be much higher today. So instead, I would like to do a sum-of-the-parts (SOTP) analysis to better illustrate that the assumptions we're underwriting at today's price are very conservative indeed.

First, we'll estimate the company's net cash balance at the end of this year. This balance will be affected both by interim free cash flow generation and the closing of the sale of Magneti Marelli. FCAU has provided guidance (which has historically ended up being very accurate) for a net cash position of between €1.5-2 B at the end of 2018. While the precise timing and the tax impact of the Marelli sale remains unknown, I estimate that this will bring in a further €5 B of net proceeds to FCAU upon its completion (a portion of which will be used to pay a special dividend). To complete the pro forma adjustments, I add to the net debt the company's remaining employee benefit liabilities (also included for each company in the comp set above).

The next part requires a larger range of assumptions, but they too are based on the detailed information contained in the new five-year plan. FCAU has announced it is targeting sales of 100,000 units at a 15% operating margin for Maserati and 400,000 units at a 10% margin for Alfa Romeo, each by 2022. Using these targets, we can estimate the potential financial impact of these premium brands to FCAU. In the calculations below, I bake in small annual average price increases while assuming that the company falls short on both its unit and margin targets (which were reiterated on the Q3 call) for each brand by 10%. There are no perfect comps for premium automakers, as most other marques are either focused on the luxury level (such as Ferrari and Aston Martin) or are part of a group that also has significant mass market exposure (such as the Volkswagen Group and Daimler AG). However, the discrepancies are somewhat balanced out as the higher multiple luxury brands are offset by the lower multiple diversified groups, so the overall median of 14.5x EBIT should be at least a directionally reasonable estimate of premium brand valuations. For further conservatism, I apply only a 10x EBIT multiple to Alfa Romeo (~30% discount to comps) and 12x EBIT to Maserati (a smaller discount to reflect its higher price points and margins). Discounting these figures back at a 10% rate, I estimate that the present value of the company's premium brand segments is about €19 B.

Maserati Avg. Price (EUR)	91,452	AR Avg. Price (EUR)	47,000		
x Units	90,000	x Units	360,000	10%	unit discount
x Margin	13.5%	x Margin	9.0%	10%	margin discount
EBIT (M)	1,111	EBIT (M)	1,523		
x Multiple	12.0	x Multiple	10.0		
EV in 2022	13,334	EV in 2022	15,228		
PV of Segment	8,893	PV of Segment	10,156	10%	discount rate

Putting these three pieces together (less the benefit liabilities) adds up to a value of €17.2 B. Using FCAU's current stock price, we can now back into the implied value of the rest of the company's business.

	Current
Parts Business	4,960
+ Premium	19,049
+ Core	4,896
EV	28,905
- ND	(1,750)
- Employee Benefit Liabilties	8,545
MC	22,110
Implied Core Biz EBIT Multiple	*0.63*

The result is quite staggering. The math above indicates that at the current price, the company's "core" business – comprising FCAU's market leading Jeep, Ram, Chrysler, and Dodge brands – is being valued at about 0.6x 2018 EBIT! These business lines collectively generated over €6 B in operating profit last year and are very likely to continue growing in the years ahead as FCAU executes its plan. But right now, Mr. Market is telling us that these cash flows are worth almost nothing – a conclusion with which I strongly disagree.

But there's even more. Another key facet of FCAU's plan out to 2022 is the creation of a financing arm that would allow the company to offer auto loans directly to potential customers. FCAU is currently the only one of the Detroit Three without a Finco, which both Ford and GM have found to be large profit generators and attractive uses of capital (10-15% pre-tax ROEs). FCAU estimates that in four years, a potential Finco could generate between $100 M in pre-tax earnings (if built from scratch) up to the $500-800 M range (if an existing operation is acquired). Since it remains uncertain which option FCAU will pursue, let's take the midpoint of these scenarios, $375 M USD. At a 10% discount rate, this would be equal to about $250 M in pre-tax income today, or ~$200 M in net income assuming a 21% tax rate. At a 12x multiple, the Finco opportunity is worth potentially another $2.4 B to FCAU today (€2.1 B at today's exchange rate) and would eventually generate incremental earnings worth 10-25% of the core automotive operations.

This works out to roughly a 1.2x P/B multiple based on the midpoint of the company's segment equity estimate discounted to PV at 10%. There are again no perfect comps – most of the large auto lenders are either captive businesses within an automaker (Toyota Financial, Ford Motor Credit, etc.), sub-divisions within a large bank's consumer lending operation (Chase Auto Finance, Wells Fargo Dealer Services, etc.), or specialists in the subprime segment of the market (Credit Acceptance Corp.). However, the average P/B across all public financial firms with more than a 1% share of the auto-loan market is 1.6x, which gives me confidence that this is a reasonable estimate. Again, none of this potential value is being given any credence at the current stock price.

So what's a fair valuation for the stock? I'll explore three cases – a base case that assumes minimal multiple expansion and no value for the financing operations, a bear case that assumes a significant downturn in new car sales, and a bull case that is closer to what I believe true value is. For the base case, we only need to change the value ascribed to the core business operations in the SOTP above. The current average EBIT multiple of the other two members of the Big Three is about 6.1x, and FCAU's historical median is around 6x. What if we take the average of the two, and then reduce it by another 20%? This seems fairly conservative, particularly since FCAU is stronger than ever today (no debt and record sales and margins). The implied 4.8x EBIT multiple that results would be more than a full turn lower than FCAU's (already low) historical average.

Taking the low end of the company's 2018 operating profit guidance, €7.5 B, and applying the 4.8x multiple yields a value for the core business of €37.8 B. Using the low end rather than the midpoint more than accounts for any double-counting from the premium brands' contribution to consolidated EBIT this year, as the guidance range is €7.5-8 B while the premium brands have only generated about €100 M in the nine months to September. For further conservatism, I apply a 25% SOTP discount since the core and premium business segments were valued under different methodologies.

	Base		
Parts Business	4,960		
+ Premium	19,049		
+ Core	36,000	4.8	EV/EBIT
EV	60,009		
- ND	(1,750)		
- Employee Benefit Liabilties	8,545		
MC	53,214		
/ Shares	1,568		
Value	33.93		
x SOTP Discount	*75.0%*		
Price Target	25.44		
Upside	*80.5%*		

As you can see, even with the various discounts applied, I still arrive at a price target that is significantly above the current share price. While views on a fair multiple may vary, I believe any reasonable assumption will imply a much higher value than what is currently being ascribed.

For the downside case, we can refer to the sensitivity analysis provided in FCAU's capital markets presentation over the summer. In it, the company outlines a global industry downturn scenario in which global vehicle sales decline by 30% in 2020 – this would be even worse than the declines seen during the Great Financial Crisis, so it is a highly punitive scenario. In such a situation, the company would still be able to generate €3.5-4 B in EBIT through a reduction of variable labor, manufacturing, advertising, and G&A expenses by around 20%, allowing it to break even on a cash flow basis. Importantly, since the company is now net debt free and will continue to generate cash in the interim, FCAU would also have the necessary liquidity to absorb any changes in working capital without solvency risk.

Taking the pro forma enterprise value from the imminent parts business sale and net cash on the balance sheet, we can calculate that under this draconian scenario (and with no value ascribed to the financing business or premium vehicle lines) FCAU would still be trading at 6.0x 2020 EBIT.

	Bear	
Parts Business	4,960	<-- after-tax proceeds
+ Premium	-	<-- no value ascribed in bear case
+ Core	22,302	
EV	27,262	
- ND	(1,750)	<-- midpoint of mgt. guidance for YE net cash as of Q3 2018
- Employee Benefit Liabilties	8,545	
+ Cash Generation to 2020	1,643	
MC	22,110	
Implied Core Biz EBIT Multiple	5.95	<-- at midpoint of management's 2020 global downturn scenario

**Note that in this scenario, no SOTP discount is necessary since no value is ascribed to the non-core businesses*

For reference, the company traded at an average of about 5.7x EBIT in 2008 in the throes of the crisis (and much higher in 2009 once it became clear that an economic recovery was forthcoming). Were this extreme situation to repeat itself, we could expect to lose about 12% over two years.

	Bear		
Parts Business	4,960		
+ Premium	-		
+ Core	21,375	5.7	EV/EBIT
EV	26,335		
- ND	(1,750)		
- Employee Benefit Liabilties	8,545		
MC	19,540		
/ Shares	1,568		
Value	12.46		
x SOTP Discount	*100.0%*	<-- none applied since no value ascribed to premium segment	
Price Target	12.46		
Upside	*-11.6%*		

There is also a plausible case (in fact, far more plausible than the downside assumptions, in my view) to be made that would push FCAU's value well above the estimate provided in the base case. This case assumes that all non-core segments are awarded their fair value, as outlined above, that the core business is given a multiple in line with peers, and that a slightly lower SOTP discount is applied.

	Bull		
Parts Business	4,960		
+ Premium	19,049		
+ Core	47,275	6.1	EV/EBIT
+ Finco	2,400		
EV	73,684		
- ND	(1,750)		
- Employee Benefit Liabilties	8,545		
MC	66,889		
/ Shares	1,568		
Value	42.65		
x SOTP Discount	*80.0%*		
Price Target	34.12		
Upside	*142.0%*		

Accordingly, my downside case – which assumes a very significant industry downturn – suggests a fair value near the current price, while my base case and (especially) my bull case indicate significant upside. These combine to form what I believe to be the most asymmetric range and skew of outcomes (a reasonable upside estimate 12x that of a reasonable downside) that I've seen in my investing career. In an attempt to fully capitalize on it, I've built my position using a combination of both common stock (which will allow me to profit if the re-rating process takes longer than anticipated) and long-term LEAP options (which I believe are vastly underpricing the change of a 50%+ move, in which they would pay off handsomely even with limited capital at risk.) Of course, your own preferences may vary, but for those who focus on risk-reward ratios, I believe both security types are worth serious consideration here.

Why Does the Opportunity Exist? A Rebuttal of Common Misconceptions

I believe there are several misperceptions about FCAU that have contributed to the opportunity here. Here are the most common bearish arguments I hear, as well as a rebuttal to each:

- **"FCAU needs Marchione to succeed."** Marchionne will certainly be missed – but running a global operation doing €110 B in sales is never a one-person job. There remains a deep bench, and new CEO Mike Manley is a company veteran who has done great work with two of the company's most valuable assets. If FCAU had been trading at a premium multiple due to perceived management prowess this could be a risk to the stock, but there was never any sort of valuation premium ascribed to the business under Marchionne's tenure. And given that the core operations appear to be trading at an implied value of almost zero, we need only competence, not brilliance, to generate satisfactory returns here.
- **"US auto sales are likely to roll over."** – Many analysts were concerned last year that 2017's record US auto sales portended a decline starting this year; given that this is by far the largest market for FCAU, it has caused a good deal of worry. My view at the time was that a deceleration and plateau near the current levels was more likely, and to date that seem to have been borne out in the data – year to date, units have been essentially flat. What's more, FCAU's

product introductions have allowed it to succeed despite the slowdown. As the chart below shows, of all automakers with around a million or more unit sales this year, FCAU is the only one to have actually grown over last year through Q3.

US Auto Sales

		Sep-18	YOY %	2018 YTD	YTD YOY%
1	GM	235,228	-15.8%	2,168,808	-1.2%
2	Toyota	203,098	-10.4%	1,824,235	-0.4%
3	Fiat Chrysler	200,769	14.5%	1,688,396	6.2%
4	Ford	197,404	-11.3%	1,878,653	-2.4%
5	Honda	132,668	-7.0%	1,206,997	-2.0%
6	Nissan	122,819	-12.2%	1,124,682	-6.0%
7	Hyundai-Kia	108,862	-0.6%	953,742	-1.6%

- **"FCAU has poor quality ratings."** – I have heard people argue that FCAU deserves a valuation discount because their products are on average lower quality than peers. But that view is outdated and no longer accurate, as FCAU's ratings have been improving rapidly (above the industry average rate the last three years) and are now not materially different than competitors. For example, Jeep has gone from 113 problems per 100 vehicles to 96, within 5% of the industry average of 93. Meanwhile, Ram's improvement has been even more impressive – from 114 a few years ago to 84 today, which ranks in the top 10. To be sure, there is still work to be done here, particularly with the Chrysler brand, but it is no longer an issue that is material enough to merit weighing on the company's shares.
- **"We're really late in economic cycle now."** – Some investors are eschewing stocks in sectors that tend to be economically sensitive, arguing that the age of the current business cycle means a recession is likely imminent. However, economic data remains strong, and there is no evidence that cycles die of old age – an idea which itself is quite old now. And even if a downturn were to emerge, the downside valuation case presented above suggests that there is a very substantial margin of safety here.
- **"I'm not interested in owning an Italian company at the moment."** – Italian stocks have fared poorly this year thanks to fears about the country's new leadership and the risk that the country may attempt to leave the Eurozone. Given the company's Italian heritage and Milan stock listing, FCAU has often been lumped into this group. But a closer look at the company's segment breakdown reveal FCAU actually has very limited business exposure to the country – about 11% of units at the current run-rate, and likely several percentage points less on a revenue basis. Once the separation of the parts business (which is headquartered in Italy and has a substantial domestic presence) is complete, this exposure will become even tinier and less significant.

Risks

While every investment involves an element of risk, the extent of that risk is largely dependent on the price that the market is offering the shares. At the current prices, it is difficult to envision any sort of plausible risk that has not already been embedded in the stock price several times over. The downside case valuation illustration depicts this – we could have a repeat of the worst recession since the Great Depression and the stock would still be cheap. In any case, an investor worried about another broad market downturn could protect himself by taking advantage of FCAU's liquid options market, which would allow him to generate similar returns with much less capital at risk.

Catalysts

- **Completion of sale of parts business** – The closing of the Magneti Marelli deal will immediately transform the pro forma net cash position described above from a hypothetical to a reality. This will likely help investors to refocus on the minimal value currently being awarded to the core business.
- **Trade war de-escalation –** Many stocks with global supply chains have had their sentiment weighed upon by the potential for an increased cost of doing business internationally, FCAU included. However, a new trade agreement has now been finalized between the North American countries and I continue to believe it's likely that some agreement will be reached with China as well – perhaps rather soon. Once investors shift their focus to something else, FCAU should stand to benefit.
- **Continued execution versus plan, increasing investor confidence and driving multiples down beyond a "breaking point"** – While I believe FCAU's current valuation is currently ridiculous, further free cash flow generation will make it even more so, and at some point, it will become impossible to ignore. As an example, FCAU's 2022 targets call for a net cash position of €19-21 B, which is about equal to the current MC – aka an enterprise value of around zero. Such a scenario is virtually impossible to find in the market, and for a large, liquid enterprise with famous brands and solid financial results, it is exceedingly unrealistic.
- **Sale of entire company –** Although I assume FCAU will continue to operate as an independent firm, this possibility merits mentioning as well. Following the change in leadership and separation of the parts business, the timing for a sale of the entire company appears relatively favorable, particularly given SAAR numbers are not likely to improve materially in the upcoming years. Furthermore, the company has expressed a willingness to engage in transformational M&A in the past.

Conclusion

Fiat Chrysler is incredibly undervalued at current prices. My punitive estimate of fair value is €25, and there is a very credible path to the stock doubling or even tripling in the next eighteen months. Granted, it has taken longer than expected for this valuation discrepancy to be corrected, which has caused us significant pain in recent months. Nevertheless, I continue to believe this is a rare opportunity and remain confident that our patience here will ultimately pay off. Accordingly, I have sized the position as large as I feel I possibly can, and I plan to continue holding for as long as is required for our conviction to be rewarded.

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