GCQ FLAGSHIP FUND | P Class Units

GCQ
GLOBAL CONCENTRATED QUALITY

MONTHLY PERFORMANCE & PORTFOLIO UPDATE

April 2024

Returns	1 Month	3 Months	6 Months	12 Months	Since Inception Annualised (1 July 2022)
GCQ P Class (AUD)[1]	**-4.3%**	**1.6%**	**19.9%**	**29.0%**	**32.1%**
MSCI World Index (AUD)	-3.2%	5.3%	17.5%	20.8%	21.3%
Outperformance	**-1.0%**	**-3.8%**	**2.3%**	**8.2%**	**10.8%**

"If a business does well, the stock eventually follows.

- Warren Buffett

The portfolio's net return for the month of April was **-4.3%**. This compares with the MSCI World Index (AUD), which was -3.2% for the month.

First Quarter Earnings Season Update

We have just completed the first quarter earnings season. Around 80% of companies in the S&P 500 Index beat earnings expectations, which is well above long-term averages.

For GCQ Flagship Fund companies, results were strong across the board, and supportive of our investment theses.

However, in general, the investor response to strong earnings was muted in a month that saw an increased focus on the outlook for interest rates. This resulted in a healthy pullback, with markets down from recent highs.

Prior to April, activity within the GCQ Flagship Fund portfolio had been elevated for several months as we moved to reduce or exit portfolio positions which were approaching our assessment of fair value, or pushed up against our internal position size limits. We simultaneously redeployed capital into more attractively priced opportunities that meet our strict quality criteria and the requirements of the **GCQ Industry Quality Checklist.**

We believe a disciplined approach to selling is particularly important in a concentrated portfolio, and these actions stood us in good stead last month. Later in this Portfolio Update we discuss four key updates from the quarterly earnings season. This includes the earnings of **Hemnet** and **MSCI,** two companies where our approach to risk management had seen us reduce position sizes earlier in the year. We then had the

(continued overleaf)

Portfolio Overview as at 30 April 2024	Portfolio Weight
Hemnet	11%
rightmove	8%
Real estate advertising monopolies	**18%**
Alphabet	12%
Meta	4%
Global online advertising	**16%**
VISA	9%
Mastercard	7%
Global consumer payments	**16%**
amazon.com	11%
Global cloud computing	**11%**
RICHEMONT	10%
HERMÈS	1%
Super-luxury goods	**11%**
S&P Global	4%
MSCI	4%
Moody's	2%
Credit rating agencies & investment index providers	**11%**
FICO	5%
Local monopolies	**5%**
WD-40 COMPANY	1%
Branded consumer goods	**1%**
Other high-quality businesses	**10%**
Total long	**100%**
Shorts	**(3%)**
Net exposure	**97%**
Cash	**3%**
TOTAL	**100%**

1. *Net performance figures are shown after all fees and expenses and assumes reinvestment of distributions.*

opportunity to buy back these positions at materially lower prices on the back of short-term investor concerns.

One of the things that we like about current market conditions is that every time we sell a portfolio position, we have a deep bench of opportunities to buy. This includes several companies that we have been actively researching but have not previously owned.

To this end, members of the GCQ investment team spent a week in Tokyo at the end of April for a series of company meetings, which followed months of research into one industry in particular. This trip cemented our confidence in the long growth runway for this oligopoly industry, and the superior competitive position of the latest company to be added to the GCQ portfolio.

We will provide a detailed introduction to our investment thesis for this new Japanese portfolio company in next month's Portfolio Update.

Set out below are four key takeaways for the GCQ Flagship Fund from the latest earnings season. In addition to company-specific updates on Hemnet and MSCI, we were encouraged by the health of the US consumer as revealed in the Visa and Mastercard results, as well as the continued cost discipline on display at the world's largest technology businesses. These earnings reports have reinforced our confidence that our high-quality portfolio is well-positioned to deliver attractive returns over the medium-term.

Hemnet continues to narrow its product's price-value gap and let its highly attractive business model do the rest.

Hemnet is the monopoly residential real estate advertising portal of Sweden. Hemnet's service is highly valuable to home-sellers as it provides access to a broad and highly engaged audience of potential property buyers.

We began researching Hemnet in 2022. Through comparing its economics and market position with those of REA Group and Domain, Australia's #1 and #2 property portals, we quickly identified that 1) there was a significant gap between the price charged by Hemnet and the value it delivered to sellers; and 2) Hemnet's profit margins (profit generated per dollar of revenue) should be structurally higher.

Hemnet's average listing fee, at the time, represented 0.08% of the average home price in Sweden – around one-quarter the equivalent amount to list your home on realestate.com.au and domain.com.au in Australia. The opportunity we saw for Hemnet was to improve adoption of premium advertising products and to increase the price of its listings. Our early discussions with management gave us confidence that the company saw things the same way we did, and was laser-focused on delivering on the opportunity. We invested with a five-year view that getting this right would see home-sellers flock to the premium advertising product, delivering investors a return of around ~3-5x as profits grew and the share price re-rated to REA's earnings multiple.

Fast-forward almost two years, and Hemnet management has made great progress on the early stages of improving its product range and increasing prices. The share price has responded accordingly (up +129% between June 2022 and March 2023). The high-quality nature of the Hemnet business, and our ability to follow the company very closely over this journey, has given us confidence to hold Hemnet as one of our largest positions.

Hemnet's strong performance extended to the most recent quarter, with revenue growing +33% year-on-year and EBITDA up +37% year-on-year. Importantly, revenue from property sellers (Hemnet's core business, accounting for ~80% of group revenue) grew +49% year-on-year. This was primarily driven by more home sellers purchasing Hemnet's premium packages, reflected in growth in average revenue per listing of +33% year-on-year. Listing volumes also continued to recover, growing +11% year-on-year.

Despite generating strong growth, EBITDA missed consensus expectations by -3% for the quarter. This was attributable to the commission expense Hemnet pays to real estate agents coming in higher than analysts had expected. We spoke with Hemnet management on the night of the result and learned that this was driven by increased adoption of premium listings and Hemnet signing more real estate agents up to commission agreements. Both of these factors are positive for Hemnet's long-term earnings potential.

Commissions from Hemnet have traditionally been a minor source of revenue for suburban real estate agents in Sweden, and as a result, some agents have not bothered to enter into commission agreements. However, these commissions have the potential to be more meaningful as more home vendors purchase premium listing packages, and as the price of premium packages increases. Hemnet is now working hard to sign more agents up to commission agreements, as this incentivises them to be stronger ambassadors for Hemnet's higher-priced premium listings.

This is being done in advance of Hemnet introducing a new agent commission model from 1 July 2024. We expect the new model to reduce Hemnet's real estate agent commission expense over time while further incentivising agents to recommend Hemnet's Plus and Premium listings, driving revenue growth and margin expansion. For context, the last time Hemnet altered its agent commission structure (early 2021), commission expense as a proportion of Hemnet's property seller revenue declined from ~46% to ~29%.

The longer-term benefits to Hemnet of having a larger base of agents with a financial incentive to recommend premium listings becomes apparent when you consider that two-thirds of home sellers follow the recommendation of their real estate agent when selecting a listing package.

The GCQ team saw the selloff in Hemnet post the result as an opportunity and moved quickly to add to our position. We had reduced the Fund's exposure to Hemnet at ~SEK 315 per share in February to maintain adherence with our risk controls, and were very pleased to be able to increase our shareholding at prices as low as ~SEK 282 after the earnings result. Pleasingly, Hemnet has now recovered more than half of the ~9% share price decline that occurred immediately after the results announcement.

Hemnet has been a strong contributor to the GCQ Flagship Fund, but we believe the company is still in the early stages of its monetization journey. Our investment thesis remains unchanged and has a lot further to play out.

Consumer spending remains healthy.

Among our portfolio companies, Visa and Mastercard offer the best read on the health of the consumer, with an unmatched real-time data feed on global consumer spending via credit and debit cards.

Visa and Mastercard's results and management comments continue to demonstrate that consumer spending remains relatively healthy across all segments (low to high spend consumers). Recent commentary from the large US banks (JPMorgan Chase, Wells Fargo, and Bank of America) largely echo this view with mild caution given to normalisation of 1) credit-card delinquency rates; and 2) the balance sheet health of lower income consumers.

During the quarter, Visa and Mastercard reported revenue growth of +10% year-on-year, and earnings-per-share growth of +20% and +17% year-on-year respectively, driven by resilient consumer spending, the continued secular shift from cash to cards, and strong growth in cross-border payments volumes (particularly global e-commerce).

The world's largest technology companies are committed to maintaining cost discipline. In parallel, they are reinvesting into their businesses to capture the return opportunity provided by the application of artificial intelligence.

Alphabet (the parent company of Google) was a strong contributor to performance this month as the company reiterated its commitment to "durably reengineer" its cost base over the long-term.

We believe Alphabet is likely to benefit from multi-year margin expansion as growth in advertising revenues drop to the bottom line at very high incremental margins.

During the quarter, Alphabet's underlying operating margin increased +390bps year-on-year to 33%. Google Services grew revenues +14% year-on-year and operating income +28% year-on-year, +15% above consensus expectations. Market concerns about the impact of ChatGPT on commercial search activity continue to dissipate, with Google's search business once again growing at a higher percentage rate than Bing, despite Google being 15x the size! During the quarter, Microsoft's News and Search Advertising revenue was up +3% year-on-year, while Google Search & Other was +14% year-on-year.

Amazon delivered an outstanding result for the quarter with revenue up +13% year-on-year and operating income up 3x year-on-year, +38% above consensus expectations. Amazon Web Services' (AWS) operating margin of 38% was the highlight of the result. For context, this was the highest operating margin recorded by the business in its history, representing year-on-year margin expansion of nearly 14 percentage points, reflecting the strong operating leverage inherent in the business. AWS' revenue growth accelerated to +17% year-on-year as customers initiate new workloads, also seen by Microsoft in its Azure business. Management indicated that they intend to meaningfully increase capital investment in AWS to capture demand for increased workloads driven both by 1) higher demand for generative AI applications; and 2) the continued secular shift of workloads from on-premise servers to the cloud.

Amazon's North America retail business also continues to perform well as it shifts its fulfilment model from a single national network to regional clusters. The primary aim of the shift is to move warehouses closer to the end consumer which drives 1) lower transportation costs; and 2) increased market share for Amazon due to faster delivery speeds.

We believe the durability of growth and margin potential of Amazon's AWS and Retail businesses are underappreciated by the market. AWS remains the clear cloud infrastructure leader and we continue to believe cloud penetration is in its early innings. Further, the margins generated by the retail business today are far below what we expect to be generated over the long-term.

Meta delivered a solid set of results, with revenue and operating profit growth of +27% and +65% year-on-year, respectively, as management continues to execute on cost discipline initiatives to realise the underlying profit margin potential of the business.

However, Meta took the market by surprise when it raised the 2024 guidance range for capital expenditures (+12% at the mid-point) to $35 billion to $40 billion (+9% above consensus expectations) and qualitatively indicated that they will "invest aggressively" beyond 2024 to support Meta's artificial intelligence (AI) roadmap. Meta's share price traded down -11% following the increased capital expenditure guidance.

The application of Meta's AI investments falls into two categories 1) improving user engagement on existing Family of Apps properties (Facebook, Instagram, Messenger, and WhatsApp) to improve monetisation; and 2) create and scale new products with the goal of providing new properties and products to monetise in the future. In our view, making investments into these two buckets is a prudent move from management and we believe it is likely the company will earn strong returns on the incremental capital invested over time.

AI has already created enormous value for Meta, given it plays an important role in improving user engagement across existing properties – with roughly 30% of posts on Facebook feeds and greater than 50% of the content viewed on Instagram being AI-recommended.

Meta has only provided limited insight into the new products they are creating. We believe the key products include 1) an AI assistant for use by consumers – an early version of this product was recently rolled out to WhatsApp, Facebook, and Instagram; 2) an AI tool to assist content creators in better engaging with their community or fan base; and 3) an AI tool to assist developers with coding tasks. Whilst there is a higher level of uncertainty around the path to commercial success for these new products, we take comfort from Meta's track record of successfully monetising investments.

We continue to hold Meta in our portfolio. We have confidence that management is acting rationally and believe the company to be attractively priced with Meta's core Family of Apps business currently trading at 14x ex-cash.

The market's short-termism continues to deliver opportunities to investors with a longer time horizon.

The GCQ team closely monitors our watchlist of high-quality companies for opportunities to invest when they are temporarily out-of-favour. Temporary hiccups in performance provide one source of buying opportunities, as we saw from MSCI following this quarter's results.

We have long admired MSCI as one of the highest quality businesses in the world, but trimmed our position to ~1% in February 2024, when the company was trading at ~$570 per share – which was close to our assessment of its intrinsic value.

MSCI derives close to three-quarters of its profits from its index business, which provides industry standard equity benchmarks for global investors. The Index businesses' customers can be segmented into two buckets 1) active money managers who seek to compare the performance of their fund to an MSCI index; and 2) passive money managers who seek to replicate an MSCI index. Both active and passive money managers need to pay a fee to MSCI to use its indices. The mission critical and industry standard nature of the company's indices provide it with significant pricing power. Further, the limited operational and capital intensity of the Index business results in it generating very strong profit margins (close to 80 cents of profit per dollar of revenue generated).

During the most recent quarter, MSCI delivered a solid set of results with revenue and EBITDA growing +15% and +12% year-on-year, respectively. The strong growth was overshadowed by a -2% miss to consensus EBITDA expectations, which was driven by a lower-than-expected customer revenue retention rate of 93%, down from 95% in the prior year. MSCI closed down -13% on the day of the result.

The two primary drivers of the decline in revenue retention were 1) rationalisation of subscriptions following the merger of UBS and Credit Suisse; and 2) budget cuts by clients which resulted in team closures or departures and a reduced need for MSCI products.

We believe these events are either non-recurring or cyclical in nature and do not detract from the incredible strength and durable nature of the MSCI franchise. The GCQ team sought to take advantage of MSCI's share price weakness to increase our position to a 5.0% portfolio weight at a discount of ~20% to the price at which we had been selling earlier in 2024, and MSCI's cheapest valuation in many years.

"The market's very emotional but over time, doing something logical and systematic does work. The market eventually gets it right."

\- Joel Greenblatt

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