GCQ FLAGSHIP FUND | P Class Units

GCQ
GLOBAL CONCENTRATED QUALITY

MONTHLY PERFORMANCE & PORTFOLIO UPDATE

August 2023

Returns	1 Month	3 Months	6 Months	12 Months	Since Inception (1 July 2022)
GCQ P Class (AUD)[1]	**2.9%**	**7.7%**	**27.8%**	**39.8%**	**46.1%**
MSCI World Index (AUD)	1.5%	6.9%	16.0%	22.5%	27.7%
Outperformance	**1.4%**	**0.8%**	**11.8%**	**17.3%**	**18.3%**

"There are businesses where any manager could raise the return enormously just by raising prices – and yet they have not done it. So they have huge untapped pricing power that they are not using. The ultimate no-brainer."

Charlie Munger

The portfolio's net return for the month of August 2023 was **+2.9%**. This compares favourably to the MSCI World Index (AUD) performance of **+1.5%**.

We were pleased to host two meetings with a senior executive from Hemnet in Sydney in late August. Hemnet operates the monopoly real estate advertising portal in Sweden, and is a 10% position for the GCQ portfolio.

We came away from these sessions incrementally more confident in the outlook for our investment in Hemnet. Notably, after months of declining activity levels, signs of stabilisation in Swedish home transaction volumes emerged in August. While our investment thesis is predicated on a realisation of Hemnet's significant untapped pricing power, we see a recovery in listing volumes as a positive driver for the business and investor sentiment. In the past, pent-up demand has seen volumes recover above prior levels following a period of volume weakness.

On the following pages, we discuss our decision to include Rightmove, the United Kingdom's monopoly real estate advertising portal, in the GCQ Flagship Fund portfolio. Rightmove ticks all the boxes in GCQ's Local Monopolies Checklist and is currently a 5% portfolio position.

Portfolio Overview as at 31 August 2023 Company	Portfolio Weight
Alphabet	14%
Meta	5%
Global online advertising	**18%**
VISA	9%
	7%
Global consumer payments	**16%**
amazon.com	11%
Microsoft	4%
Global cloud computing	**15%**
Hemnet	10%
rightmove	5%
Real estate advertising monopolies	**15%**
S&P Global	6%
Moody's	4%
MSCI	2%
Credit rating agencies & investment index providers	**11%**
Richemont	8%
Hermès	1%
Super-luxury goods	**9%**
FICO	5%
Local monopolies	**5%**
WD-40 Company	2%
Branded consumer goods	**2%**
Other high-quality businesses	**6%**
Total Long	**98%**
Shorts	**(2%)**
Net exposure	**96%**
Cash	**4%**
TOTAL	**100%**

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

RIGHTMOVE

In our latest Investor Letter, we noted we had made an investment in Rightmove, the UK's leading real estate advertising portal.

The GCQ team watches the real estate advertising portal industry closely, as it includes some of the best business models in the world. Real estate portals are simple businesses that sit at the centre of a highly valuable transaction – a home sale. This position gives them substantial pricing power. Property portals typically have high margins, high returns on invested capital, and high conversion of reported profits to cash flow. Their attractive economics are protected by strong network effects between buyers, sellers, and real estate agents.

The leading portal in a market typically attracts all the listings and almost all the eyeballs. Both the home seller and the real estate agent are strongly incentivised to ensure that homes are advertised on the portal with the greatest audience of potential buyers.

As a result of these industry dynamics, Rightmove has 86% market share of time spent on UK property portals, 7x the level of its nearest competitor. Rightmove's traffic is 99.9% organic – meaning Rightmove's brand is so strong it doesn't have to pay Google for traffic.

As with every leading real estate portal, Rightmove.co.uk was founded in the early days of the internet. When it was established in 2000, Rightmove was owned by the top four corporate estate agencies of the day: Countrywide, Connells, Halifax, and Royal and Sun Alliance. For the first two years there was no charge for real estate agents to list homes on Rightmove, with subscription fees introduced for agents in 2002.

Unlike Hemnet (a 10% holding in GCQ's portfolio), Rightmove does not charge the home seller directly, but instead charges a subscription fee to agents for property listings, market data, and advertising products. This is like REA Group's original subscription arrangement with real estate agents, which accounted for the majority of revenue in 2012, before it flipped its business model to premium listing depth products.

Since its commercialisation in 2002, Rightmove has successfully implemented a strategy of package premiumisation and price increases.

Today, real estate agencies pay on average £1,300 (A$2,500) per month for a subscription to Rightmove. Agents subscribe to one of four packages – Essential, Essential Extra, Enhanced or Optimiser. More expensive packages provide the real estate agent and their property listings with greater exposure on Rightmove's website and app. Rightmove's Essential package only includes standard property listings, while Optimiser includes premium property listings, branding products, like "Featured Agent" and "Sold By Me", and e-marketing products.

50% of agents are still on the most basic package – Essential. The Enhanced and Optimiser packages are 20x to 50x the cost of Essential, respectively, with product upgrades driving 60% of Rightmove's revenue growth in its most recent result. We believe that Rightmove has a long runway ahead for premiumisation and pricing.

Rightmove is indispensable for real estate agents, who run their entire businesses on the platform. Rightmove delivers the majority of potential buyer leads, and as a result, 85% of home sellers see Rightmove as the most important website for their home to be marketed on. Despite implementing annual price increases, Rightmove has 90% retention rates, with agents continuing to see Rightmove as crucial to their business. Agents typically only cancel their Rightmove subscription when they are going out of business.

Rightmove still only accounts for 7.5% of the average real estate agents' commission pool, which includes advertising and marketing fees. In the UK, agents typically spend 15% of commissions on marketing, with up to 5% on non-digital local and print advertising. Rightmove is gradually taking share from these legacy ad formats.

An understanding of Rightmove's business model – being paid thousands of dollars to display homes on an app and website – suggests that it has a tremendous business. This is supported by an analysis of Rightmove's financial statements, which show that it generates EBIT margins in the mid-70s, the highest margins of any company in the UK's FTSE 100 Index. Even better, we believe that Rightmove's margins are likely to increase as its revenue grows, given that Rightmove generates incremental EBIT margins in the low-80s.

Over the past decade, Rightmove has grown revenues at +11% annually, yet has required almost no capital to fund this growth; instead pouring off cash, which has been returned to shareholders in dividends and buybacks. In fact, Rightmove has repurchased about 20% of its shares over the past decade, and has no outstanding debt.

Buffett famously denoted a few wonderful businesses as "gross profits royalty" companies – companies that benefit directly from the investments of the businesses they serve, but require very little of their own capital to grow. We believe Rightmove is one such company, benefiting from steady increases in the value of UK housing stock, and the associated growth in the commission pool available to real estate agents.

Of course, such attractive economics would be a concern if they were to attract new competition. A key question we ask ourselves as we complete the GCQ Industry Quality Checklist is whether any new competition has entered the industry over the past twenty years. If it has, then we ask ourselves whether the new entrant failed, and why?

Attempts at starting new competing online property portals have mostly failed. OnTheMarket, which was launched in 2015 by real estate agents, charges agents and developers only 15% of Rightmove's average revenue per advertiser. However, OnTheMarket has less than a 5% share of web and app minutes. It is tough to charge for listings if you only have a tiny audience!

While Rightmove is one of the highest-quality listed businesses in the UK, the stock was trading at only 19x free cash flow at the time we initiated our position in June 2023. This was its lowest multiple in over a decade, dragged down by macroeconomic concerns in the UK. Having followed Rightmove since its listing in 2006, we believe downturns in the housing market often provide an attractive entry point for investing in what is a highly resilient business model.

Rightmove's revenue has grown throughout economic and housing market cycles, and its revenues aren't directly linked to the number of houses bought and sold, or even to house prices. Revenue is generated from fixed subscription fees paid by real estate agents. As long as agents remain in business, they will continue to pay their Rightmove subscription. This results in very stable revenue growth and profits for owners.

Rightmove's share price is up about +12% since our initial purchase in June 2023, and we believe the stock remains attractively valued today. Having historically traded at a high-20s multiple of earnings, vs. 21x earnings today, and with expectations for sustainable high-single-digit revenue growth from a combination of pricing and packaging, we estimate that the investment will generate a return of +20% per annum over the next five years.

"The best business is a royalty on the growth of others, requiring little capital itself."

Warren Buffett

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