GCQ FLAGSHIP FUND | P Class Units

GLOBAL CONCENTRATED QUALITY

MONTHLY PERFORMANCE & PORTFOLIO UPDATE

March 2024

Returns	1 Month	3 Months	6 Months	12 Months	Since Inception Annualised (1 July 2022)
GCQ P Class (AUD)[1]	**0.0%**	**13.2%**	**23.9%**	**40.6%**	**37.2%**
MSCI World Index (AUD)	2.8%	14.1%	19.8%	28.5%	24.7%
Outperformance	**-2.8%**	**-0.9%**	**4.0%**	**12.1%**	**12.5%**

"Investing is a popularity contest, and the most dangerous thing is to buy something at the peak of its popularity. At that point, all favorable facts and opinions are already factored into its price, and no new buyers are left to emerge."
- Howard Marks

The portfolio's net return for the month of March was **+0.0%**. This compares with the MSCI World Index (AUD), which was up +2.8% for the month.

Refreshing the Portfolio

Following an extended period of strong performance for the GCQ Flagship Fund, recent months have seen elevated activity within the portfolio as we have moved to exit or reduce several portfolio positions, while redeploying capital into more attractively priced opportunities that meet our strict quality criteria and the requirements of our **GCQ Industry Quality Checklist**. While stock market indices have been setting record highs, not all companies – even high-quality companies with pricing power - have been going up at the same time. This is providing a wealth of opportunity and we have **added several new companies to the portfolio** in the last two months. One of these new additions – **Verisign** – is discussed on the following pages.

As always, we continue to steer away from companies with significant direct exposure to the consumer economy as we do from all lower-quality commoditised businesses. Instead, we own a portfolio of high-quality established businesses with pricing power. We remain positive on the investment outlook for all eight industries represented in the portfolio. Importantly, these industries are not highly correlated with one another; ranging from local real estate advertising monopolies to credit rating agencies.

(continued overleaf)

Portfolio Overview as at 31 March 2024	Portfolio Weight
Hemnet	12%
rightmove	6%
Real estate advertising monopolies	**18%**
Alphabet	14%
Meta	4%
Global online advertising	**18%**
VISA	8%
Mastercard	7%
Global consumer payments	**15%**
amazon.com	12%
Global cloud computing	**12%**
RICHEMONT	11%
HERMÈS	1%
Super-luxury goods	**12%**
S&P Global	4%
Moody's	3%
MSCI	1%
Credit rating agencies & investment index providers	**7%**
FICO	5%
Local monopolies	**5%**
WD-40 COMPANY	1%
Branded consumer goods	**1%**
Other high-quality businesses	**9%**
Total long	**98%**
Shorts	**(3%)**
Net exposure	**95%**
Cash	**5%**
TOTAL	**100%**

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

Refreshing the Portfolio (continued)

The current portfolio is well-positioned to deliver attractive returns over the medium term. We think about valuation with reference to the weighted-average free cash flow multiple across the portfolio, which is currently **~23x forward free cash flow**. We believe this compares favourably to the market's forward multiple of **~20x**, given that the average position in our portfolio is much higher quality than the market (higher growth, higher margins, higher returns on capital, and less debt). We expect **free cash flow across our portfolio to double over the next five years**. On this basis, we feel that the portfolio is positioned to deliver a return of about **+15% p.a. over the next five years – although these things never happen in a straight line!**

As we refresh the portfolio with new, high-quality opportunities, and our existing portfolio companies continue to deliver earnings growth, it's worth noting that the portfolio's **23x** forward free cash flow multiple hasn't materially changed over the past few months – despite the strategy delivering strong returns. We intend to continue refreshing the portfolio with new opportunities when existing positions approach our estimate of fair value.

We also look at upside to our estimate of fair value based on a discounted cash flow valuation – on what we believe to be conservative assumptions. On a weighted-average basis across portfolio, we see **greater than 50% upside** to our estimate of fair value today.

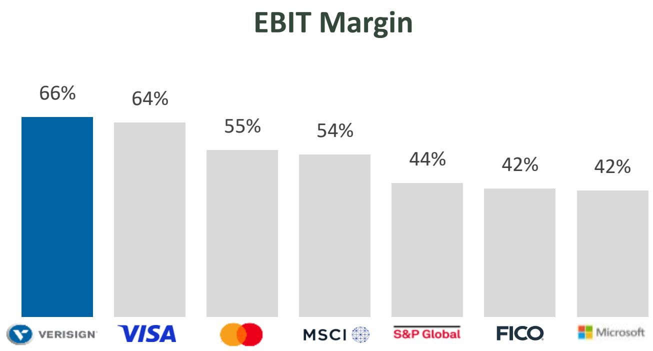
VERISIGN: The Toll Road of the Internet

"All happy companies are different: each one earns a monopoly by solving a unique problem. All failed companies are the same: they failed to escape competition."

- Peter Thiel

At GCQ, we love investing in **predictable**, **high-quality** businesses when they are on sale. A good example of this, and a recent addition to our portfolio, is **VeriSign**. VeriSign is the **monopoly operator of the .com and .net internet domain registries**.

While few people are familiar with VeriSign's brand or business model, it is an **essential piece of digital infrastructure**. To put it in context, if VeriSign's infrastructure were to vanish overnight, we would not be able to navigate to www.google.com. More importantly for GCQ, VeriSign is an extremely high-quality business. These strong quality characteristics are reflected in the company's **operating margins which are the highest of any company in the S&P 500 Index** – even higher than some of the best businesses in the world.



What does VeriSign do?

While people typically think in terms of words, computers operate using numerical IP addresses. VeriSign operates a directory which **translates website URLs ending in .com and .net, such as 'www.YouTube.com', into their unique IP addresses**. This allows a consumer's browser to navigate to the correct server to access the desired internet content seamlessly.

As .com and .net domains make up **~65% of global web traffic**, Verisign is one of the most essential pieces of digital infrastructure in the world.

History

To understand how VeriSign has ended up in this monopoly position, it is helpful to briefly trace the history of the internet.

During the height of the Cold War in the 1960s, the U.S. Department of Defence was interested in creating a decentralised computer network that could access and distribute information in the case of a nuclear event. This led to the creation of ARPANET, a forerunner of the modern Internet.

In 1992, the National Science Foundation began an auction process for private parties to take over the provision of parts of the internet infrastructure. The ***only*** bidder for the "domain registration services" piece was a firm called Network Solutions, which became the **sole** operator of the registries for the .com, .net, .org and .edu domains. Network Solutions was later acquired by VeriSign, which had itself been established in 1995 to provide certification services on the internet, in the year 2000 for **$21bn**.

Today, VeriSign's core business **charges every owner of a .com or .net domain an annual fee of roughly US$10** to secure their place in the domain registry. This is a **very small percentage of the value of a functioning website but is essential to its operation**. We like businesses that deliver substantially more value to customers than the price they charge for their service, as this can be a source of substantial future **pricing power**.

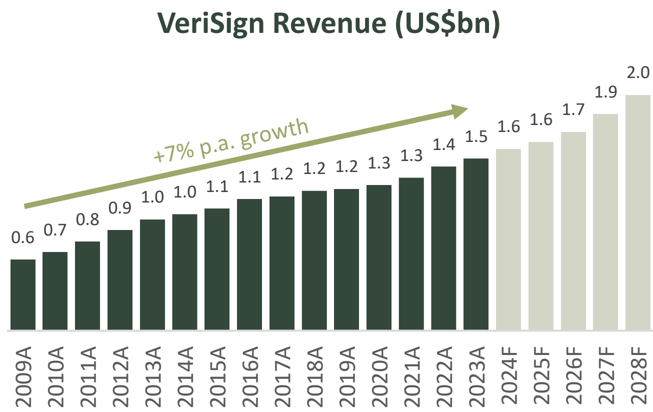
Pricing power

Importantly, **VeriSign has recently started increasing prices**. Under an agreement entered into with the Department of Commerce in 2018, VeriSign can increase price by **+7%** in four of every six years for .com domains, and **+10%** each year for .net domains.

At GCQ, we tend to avoid regulated monopolies, because their shareholder returns are typically capped by the government at rates below what we'd like to achieve. This is not the case for VeriSign, which earns impressive margins (see chart on the prior page) and returns on capital. Regulation over VeriSign's pricing has loosened over time, allowing VeriSign to increase prices at rates structurally higher than inflation.

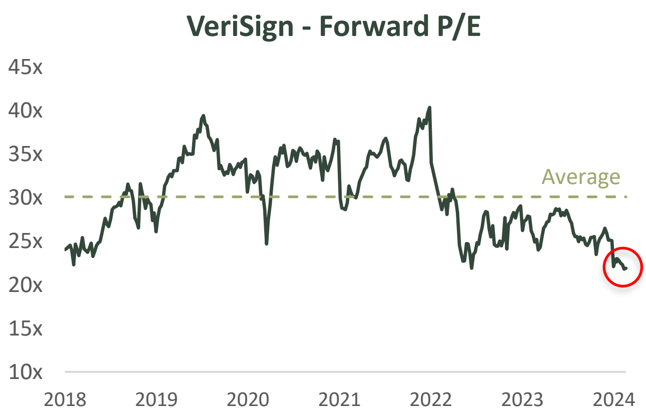
Importantly, **VeriSign's pricing algorithm is evergreen**, meaning it does not have to seek permission from the government before raising prices in accordance with the agreement.

In the period from 2009 to 2023, VeriSign's organic revenue has grown by **~+7% p.a.** Going forward, we think that VeriSign can continue to grow its top line at around this rate, with **~5% p.a. coming from price increases**, and the rest from volume growth in domain names, driven by ongoing growth in the number of businesses around the world wanting an internet presence.



Valuation

VeriSign is trading on its **lowest valuation multiples since 2018** (when it started increasing prices) at only **~21x forward earnings** and **~20x free cash flow**.



When we see a predicable, high-quality monopoly business like Verisign on sale, we always ask ourselves why.

VeriSign has seen growth in the number of domains slow since 2022, driven entirely by declines in China. Purchases of .com and .net domains have been impacted by **regulatory changes in China**, where proof of identity is now required to purchase a domain, in addition to a slowdown in the Chinese economy.

We believe these headwinds are transitory and **expect VeriSign's domain growth to re-accelerate next year**. Today, China accounts for just **5%** of VeriSign's revenue (down from 10% as recently as 2019) – and has become a relatively immaterial driver of VeriSign's business as the issues in China have washed through. We expect VeriSign's future growth to be driven by the **~95%** of revenue generated outside of China, and for VeriSign's valuation multiple to re-rate as group-level volume growth resumes.

We expect VeriSign's share price to **more than double over the next five years** under our base case assumptions, as its volume growth re-accelerates and the multiple normalises. We think this is an excellent outcome for owning one of the world's highest-quality and most predictable businesses.

"Great investment opportunities come around when excellent companies are surrounded by unusual circumstances that cause the stock to be misappraised."

- Warren Buffett

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