GCQ FLAGSHIP FUND | P Class Units

GCQ
GLOBAL CONCENTRATED QUALITY

MONTHLY PERFORMANCE & PORTFOLIO UPDATE

October 2023

Returns	1 Month	3 Months	6 Months	12 Months	Since Inception (1 July 2022)
GCQ P Class (AUD)[1]	**-1.1%**	**-2.2%**	**7.6%**	**35.7%**	**38.9%**
MSCI World Index (AUD)	-1.3%	-3.8%	2.7%	11.5%	21.1%
Outperformance	**0.2%**	**1.6%**	**4.9%**	**24.2%**	**17.8%**

"Investing is the only business that when things go on sale, people run out of the store."

- Investor aphorism

The portfolio's net return for the month of October 2023 was **-1.1%**. This was slightly better than the MSCI World (AUD) index, which was -1.3% for the month.

October was a month of heightened volatility for equity markets. Increases in Treasury yields and war in the Middle East were two significant drivers of negative market sentiment.

However, with nearly all GCQ Flagship Fund portfolio companies having now reported their September quarter results, results across the board have been strong, and supportive of our investment theses.

On the following pages, we provide a summary of key themes from the earnings reports of GCQ Flagship Fund portfolio companies.

We are optimistic on the outlook for our portfolio companies, with current market prices representing an attractive discount to our assessment of fair value.

Our portfolio is now trading at slightly over 20x forward free cash flow, and we expect free cash flow will double over the next five years. We see opportunity in the market's current propensity to focus more on negative developments than positive news.

Portfolio Overview as at 31 October 2023	Portfolio Weight
Alphabet	13%
Meta	5%
Global online advertising	**19%**
amazon.com	12%
Microsoft	5%
Global cloud computing	**16%**
Hemnet	11%
rightmove	5%
Real estate advertising monopolies	**16%**
VISA	9%
	7%
Global consumer payments	**16%**
S&P Global	6%
Moody's	4%
MSCI	2%
Credit rating agencies & investment index providers	**11%**
RICHEMONT	9%
HERMÈS	1%
Super-luxury goods	**10%**
FICO	5%
Local monopolies	**5%**
WD-40 COMPANY	2%
Branded consumer goods	**2%**
Other high-quality businesses	**5%**
Total long	**100%**
Shorts	**(3%)**
Net exposure	**98%**
Cash	**2%**
TOTAL	**100%**

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

THIRD QUARTER RESULTS

Despite what was a turbulent month for market indices – with both the S&P 500 and Nasdaq 100 entering a correction, or a fall of 10% from recent highs – GCQ's portfolio companies delivered another strong set of results for the calendar third quarter, with over 80% of our portfolio companies reporting earnings that exceeded consensus estimates. More importantly, our portfolio company results were consistent with our long-term investment theses.

The broader market, as measured by the S&P 500, recorded a +4% year-over-year increase in profits, marking the first quarter of earnings growth in the past four quarters.

This was paired with what appears to be a cautious approach to forward earnings guidance at a time when conflict in Israel and rising bond yields drove negative market sentiment.

Company guidance is highly influenced by events in the first few weeks of the quarter. Negative market sentiment can often become a "circular reference" – where newspaper headlines prompt management teams to take a more cautious approach to guidance commentary. Conservative guidance statements then fuel further negative market sentiment.

We identified this effect as being in play last year when almost all economists were predicting a recession (which never arrived) and major companies responded by predicting an imminent slowdown in demand despite reporting robust activity levels. We believe some companies are again erring on the side of guidance conservatism.

Meanwhile, reported company results show that inflation continues to moderate, while the consumer remains resilient.

Among our portfolio companies, **Visa** and **Mastercard** offer the best read on inflation and consumer spending trends. Their businesses sit at the centre of the consumer payments ecosystem, which provides an unmatched real-time data feed on consumer spending globally.

During the third quarter, Visa and Mastercard reported revenue growth of +11% and +13% year-on-year, respectively, driven by resilient consumer spending and the continued shift from cash to cards. Spend across all customer segments from low spend to high spend has remained stable since March, and payments volume growth was relatively stable in recent weeks between September to October. The labour market remains strong, which is a key driver of consumer spending. Meanwhile, inflation levels have moderated.

Consumer payments growth was driven by stability in domestic volume growth, as well as strong growth in international travel and cross-border e-commerce volumes.

We continue to see substantial runway for growth in carded usage. In addition, Visa and Mastercard have a sizable opportunity to address new payment flows (for example, business-to-business payments), which grew +17% year-over-year, and increase penetration of a diverse suite of value-added services, which grew +18% year-over-year.

Global inflation trends have moderated, and this was reflected in company results.

Companies such as **Amazon** continued to see benefits from lower inflation, primarily within line haul, ocean, and rail shipping rates. In its retail business, Amazon's revenue grew +11% year-on-year, above expectations, while profitability materially surprised to the upside. Lower inflation, higher productivity, and regionalisation – moving from one national network in the U.S. to a series of eight separate regions serving smaller geographic areas – contributed to an overall reduction in Amazon's cost-to-serve, leading to a c.+700bps improvement in Amazon's profitability in its North America retail business over the past six quarters. We believe Amazon has a large opportunity to further improve margins in its retail business – driven by reductions in cost-to-serve, continued advertising growth, and fixed cost leverage – which is not reflected in its share price today.

The largest cloud computing businesses reported strong results, with resilient spending by enterprise customers.

Amazon Web Services (AWS) reported revenue growth of +12% year-over-year, in-line with the second quarter. Importantly, after a period where technology sector customers were looking to reduce costs, AWS reported that cost cutting by customers has "continued to attenuate" as more companies transition to deploying net new workloads. AWS remains a clear cloud infrastructure leader, and we continue to believe cloud penetration is in its early innings, with a long runway of profitable growth ahead.

Microsoft delivered another strong quarter, with revenue growth of +12% year-on-year and earnings per share growth of +26% year-on-year, driven by the continued strength of Microsoft Cloud. Microsoft's cloud computing business, Azure, continued to increase its market share, with growth accelerating to +28% year-on-year. This included +3 percentage points of growth from Artificial Intelligence (AI) services.

Both AWS and Azure will be lapping periods where customers were cutting costs over the next nine months, and we expect to see an acceleration in revenue growth as this occurs.

Google Cloud had a somewhat disappointing quarter, with year-on-year revenue growth slowing to +22% (from +28% in the prior quarter), and operating margins declining -170bps sequentially to 3.2%. Following the result, **Alphabet**'s stock declined nearly 10%, equivalent to a drop of almost $175 billion in market capitalisation. It is important to remember that Google Cloud only represents about 1% of Alphabet's operating profit, and about 5% of our Alphabet valuation – in our view, the subsequent share price decline wiped out more than the entire value of Google Cloud!

Meanwhile, Alphabet's core businesses surprised to the upside. Google Search grew revenues at +11% year-over-year, +2% above analyst consensus expectation, while Google Services – which includes Google Search, YouTube, and Google Network, and contributes the other 99% of Alphabet's earnings – grew operating profit +27% year-over year, +5% above consensus expectations. Market concerns around the impact of ChatGPT and Bing Chat continued to dissipate, with Google's market share of global search engines remaining steady in the mid-90s. Google's Search business also continues to grow at a higher percentage rate than Bing, despite Google being over 14x the size! This demonstrates how difficult it is to compete with Google, even with the introduction of Bing Chat – and the associated media attention. To 6th November 2023, Alphabet's share price appreciation has contributed +5.9% to GCQ's year-to-date return. We continue to see Alphabet's valuation as highly attractive today.

Like Alphabet, **Meta** reported strong growth in advertising, with revenue up +21% year-on-year. In Meta's Family of Apps – which includes Facebook, Instagram, and WhatsApp – revenue grew +24% year-on-year, +3% above consensus expectations. Profitability grew much faster, with operating profit up +91% year-on-year, +17% above consensus. Importantly, daily active users continue to grow, while the short-form video product, Reels, continues to drive incremental engagement on Facebook and Instagram.

Fourth quarter guidance for revenue growth of c.+13% to c.+24% was -1% below consensus at the mid-point, with the wide guidance range driven by volatility at the start of the quarter. Meta observed softer ad spend correlated with the start of the conflict in Israel. That said, coming into the fourth quarter, Meta continued to see strong advertiser demand. In response to a question on Meta's fourth quarter guidance range, CFO Susan Li said: "We widened our guidance range to capture that uncertainty."

As of 6th November, Meta is trading at 15x forward earnings ex-Reality Labs (Meta's loss-making augmented and virtual reality segment). While the stock is up more than +3.5x since it bottomed in November 2022, we continue to view Meta's valuation as attractive today.

GCQ's real estate advertising portal investments continue to demonstrate extreme pricing power.

Hemnet, Sweden's dominant property portal, reported another strong quarter of growth in Average Revenue Per Listing (ARPL), up +28% year-on-year, driven by premiumisation and pricing. Importantly, revenue from Hemnet Premium almost doubled year-over-year, which supports our view that Hemnet has a substantial premiumisation runway ahead. Today, Hemnet's Average Revenue Per Listing is 0.12% of the average home price, which is still only one-third of the 0.40% that an Australian home seller would pay to list on realestate.com.au and domain.com.au.

In a challenging market with rising interest rates, Swedish home listing volumes stabilised, with listing volumes in August and September approximately flat compared with the prior year. Despite a relatively tough listings market environment, Hemnet's EBITDA margin reached an all-time high of 57%, driven by operating leverage and good cost control. In the fourth quarter, listing volumes face significantly easier comparisons, and we expect growth in listing volumes will accelerate to mid-2024. We have seen some early signs of this, with listing volumes up +5% year-on-year in October. As listing volumes grow, we expect margins will follow – as revenue drops to the bottom-line with very high incremental margins. While our investment thesis is mostly predicated on growth in Hemnet's Average Price Per Listing (ARPL), we believe a recovery in listing volumes will be an important driver of near-term earnings and market sentiment.

During the month, **Rightmove**'s share price fell more than -14% on CoStar Group's announced acquisition of OnTheMarket, the third-most visited residential property portal in the U.K. OnTheMarket is quite a small business today but CoStar, the global leader in commercial real estate information services, intends to invest £47 million into sales and marketing in the first full year following the acquisition, with the intent to compete with the dominant property portals in the U.K. – Rightmove and Zoopla.

At GCQ, we are incredibly focused on assessing whether an industry has a structure and growth outlook supportive of sustainably strong shareholder returns. As such, we take all competitive threats seriously.

That said, we have long admired the property portal industry due to the presence of strong network effects between home buyers, home sellers, and agents. We have watched with interest as the strength of these network effects has been tested by new entrants in the past – and we are not aware of any precedent globally where a dominant property portal has been displaced by an upstart.

As such, we remain cautiously optimistic that OnTheMarket will fail to take meaningful market share from Rightmove. Because all the real estate portals are free to home buyers, it is extremely difficult to provide consumers with an incentive to switch to a different website or app. Consumers are reluctant to visit a property portal that does not include all available listings, while agents and home sellers are unwilling to advertise on a property portal that does not attract sufficient eyeballs. Crucially, Rightmove has 86% share of minutes spent on property portals in the U.K. Further, in most markets, the #2 player –in this case, Zoopla – is often most at risk from an aggressive #3, given the entrenched position of the market leader.

Today, Rightmove trades at 18x forward earnings, its lowest multiple since 2015, which is when it traded down on news of OnTheMarket's initial launch. Over the past eight years, Rightmove has delivered high-single-digit growth in revenue and earnings, while OnTheMarket has failed to take meaningful market share. 2015 was an attractive time to buy Rightmove, and we think today offers a similarly attractive opportunity. We have added to our position in Rightmove over the last two weeks, and it now represents 6% of the GCQ portfolio.

Hermès delivered another impressive result, highlighting that the market for its ultra-exclusive goods remains strong – thanks to its premium positioning, classic styling, wealthy client base, and tightly controlled production and distribution. In the third quarter, revenue was up +16% year-on-year on a constant currency basis, despite lapping a particularly high comparison of +34% year-on-year growth in Asia.

This compares favourably to fashion-exposed, aspirational luxury players like Gucci, where revenue was down -7% year-over-year on a constant currency basis. During its earnings call, Hermès highlighted that it has seen "no change in trend" in consumer spending across any markets.

During the third quarter, **S&P Global** and **Moody's** continued to see signs of stabilisation in the rated debt issuance environment. Revenue from S&P Ratings and Moody's Investors Service (MIS) grew +20% and +18% year-on-year, respectively, driven by continued improvements in issuance activity, with S&P subsequently raising its full-year guidance for Ratings revenue growth by +100bps.

WD-40 delivered solid sales growth of +7% year-on-year, driven by sales price increases, while operating profit grew +17% year-over-year. We continue to believe WD-40 has a long runway of geographic expansion and premiumisation ahead, which provides attractive opportunities to grow revenues and margins.

Taking a step back from individual results, in a 'higher for longer' interest rate environment, we have seen investors become more discerning in assessing business quality. We believe companies with pricing power and low capital intensity remain well positioned, and are confident that we are invested in an attractive portfolio of high-quality businesses.

Earnings across the GCQ portfolio have been very strong, and we remain optimistic on the outlook for our portfolio companies – with current market prices representing an attractive discount to our assessment of fair value.

"You know, people tend to like to buy companies that are doing well."

- Walter Schloss

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