GCQ FLAGSHIP FUND | P Class Units

GCQ
GLOBAL CONCENTRATED QUALITY

MONTHLY PERFORMANCE & PORTFOLIO UPDATE

September 2023

Returns	1 Month	3 Months	6 Months	12 Months	Since Inception (1 July 2022)
GCQ P Class (AUD)[1]	**-3.9%**	**1.0%**	**13.5%**	**41.1%**	**40.4%**
MSCI World Index (AUD)	-3.9%	-	7.3%	21.7%	22.8%
Outperformance	**-**	**1.0%**	**6.2%**	**19.3%**	**17.6%**

"Time in the market beats timing the market – almost always. You don't need perfect timing to achieve marvellous returns."

Ken Fisher

The portfolio's net return for the month of September 2023 was **-3.9%**. This was in-line with the MSCI World Index (AUD), which was -3.9% for the month.

The downturn in global markets during September was triggered by a succession of monetary policy announcements conveying a "higher for longer" message.

On the following pages, we discuss the opportunities we are seeing to refresh the portfolio after a period of strong performance, with the portfolio up +40.4% since inception on 1 July 2022.

Following several recent portfolio management decisions detailed on the following page, we think the portfolio is very attractively set up for the coming years. **We are invested in a portfolio of businesses that we expect to double free cash flow over the next five years, while trading at a weighted average forward free cash flow multiple of just 23x.** We think this is an attractive valuation for a selection of such high-quality businesses.

Also included in this monthly update is a detailed write up of Richemont, which our CIO Doug Tynan presented at a "Global Best Ideas" investor conference last week. We have been enthusiastically buying Richemont, and as of 10 October, it is a 9% portfolio position for the GCQ Flagship Fund.

Portfolio Overview as at 30 September 2023	Portfolio Weight
Alphabet	14%
Meta	5%
Global online advertising	**19%**
Hemnet	11%
rightmove	5%
Real estate advertising monopolies	**16%**
VISA	9%
	7%
Global consumer payments	**16%**
amazon.com	11%
Microsoft	4%
Global cloud computing	**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	**(3%)**
Net exposure	**96%**
Cash	**4%**
TOTAL	**100%**

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

PORTFOLIO UPDATE

While GCQ's portfolio turnover is generally low and we intend to hold our investments for many years, periods of strong performance in volatile markets can provide opportunities to upgrade the quality and attractiveness of our portfolio.

As a result, portfolio turnover over the last six months has been higher than we would typically expect, north of 30% on an annualised basis. This compares with our expectation for average turnover of c.15% per annum over the long-term.

Key changes to the portfolio since the start of the year have included selling down companies that were trading at close to fair value after strong share price performance. This included reducing our exposure to the super-luxury industry from 20% to 5% of the portfolio in May 2023 when Hermès, Richemont, and LVMH were trading towards fair value. We also trimmed the Fund's holding in FICO following a period of strong share price performance, with the stock up +118% since the fund's inception on 1 July 2022.

This aspect of portfolio management is particularly important to guard against the portfolio becoming stale following a period of strong performance.

Additionally, in September we completely exited GCQ's investment in Haleon, the owner of brands including Sensodyne, Panadol, Voltaren and Advil. We started to reduce this investment in August after reaching the conclusion that Haleon was one of the lower quality businesses in the portfolio – with brands that were insufficiently differentiated to meet our quality thresholds.

We have recycled capital from our share sales into several businesses – including Alphabet, Hemnet, and Rightmove – which we believe enhances both the quality and the valuation upside of our portfolio.

We have recently increased our investment in Richemont to 9% of GCQ's portfolio. Only a few months after our decision to substantially reduce the Fund's exposure to the super-luxury sector, the pendulum of market sentiment has swung in the other direction, and Richemont has gone from trading at levels that implied strong growth for many years to come to being out of favour, with Richemont shares having fallen by almost 30% since May 2023.

We relish opportunities to buy high-quality companies that are out of favour, and are prepared to act in size when other investors are overly pessimistic. We have set out our investment thesis on Richemont below.

RICHEMONT

"The only way we know how to maintain a sustainable competitive advantage is to grow the brand equity... because that brand equity creates demand and will result in pricing power."

Richemont Chairman Johann Rupert

Richemont is a French super-luxury company whose suite of 27 luxury houses include everything from Mont Blanc pens to Panerai watches. Many of its jewellery and watch brands are more than 100 years old, and most have iconic collections that are between 40 to 80 years old.

Two of the world's pre-eminent luxury jewellery brands – Cartier and Van Cleef & Arpels – account for almost 70% of Richemont's revenue and 85% of earnings. We own Richemont for these two brands.

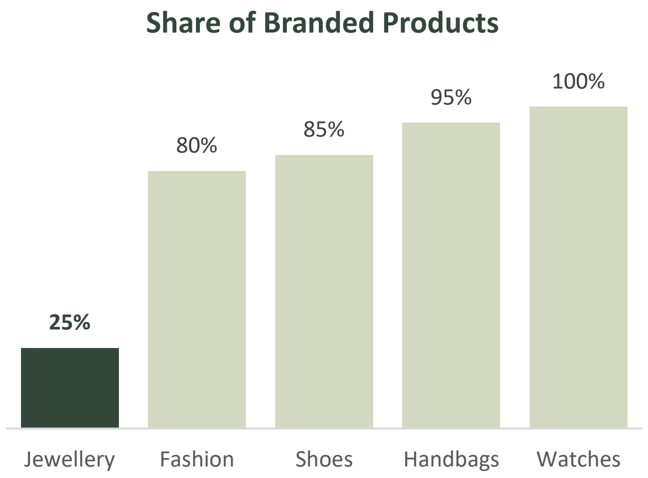
At GCQ, we are laser-focused on owning the world's best businesses in high-quality industries. These are typically monopolies, duopolies, and oligopolies – and firms that own highly valuable brands with extreme pricing power. The super luxury industry is a prime example.

For a brand to become super-luxury, it needs to sell timeless products – with heritage fundamental to a customer's perception of brand value. This is beneficial for the small handful of global brands that have been around for over 100 years. Cartier was founded in Paris in 1847, and soon became the go-to jeweller for European royalty. In fact, around the time he ordered 27 Cartier tiaras for his 1902 coronation, King Edward VII referred to Cartier as the "Jeweller of Kings and the King of Jewellers." Van Cleef & Arpels was founded in 1906, and similarly has over 100 years of heritage. Heritage – often expressed in terms of centuries – creates an insurmountable barrier for new entrants to the luxury industry. As a result, growth of the industry tends to accrue to well-established incumbents such as Richemont.

Within the super-luxury goods industry, we believe jewellery is one of the most durable categories – with high-ticket prices, timeless products, and conservative consumer tastes and preferences leading to limited risk of being on wrong side of fashion trends, which we call "runway risk".

Many of the high-end pieces sold by Cartier and Van Cleef 50 years ago are almost identical to those sold today. Cartier introduced its "Love" ring in 1960, while Van Cleef introduced the Alhambra line of jewellery in 1968. These lines have become timeless – and include some of the most popular products sold by Richemont today. Richemont's affinity for selling timeless products was expressed by Cartier CEO Cyrille Vigneron, who said: "For jewellery brands, it's more about establishing stable designs. In our case, our designs are timeless. You cannot date them; they're still contemporary and still true today."

While all luxury brands benefit from growth in global wealth, there's a second long-term tailwind specific to the jewellery category: the shift from unbranded to branded fine jewellery. Today, branded jewellery only accounts for c.25% of the fine jewellery market, up from high-teens a few years ago, and we believe this trend is likely to continue. We expect the penetration of branded fine jewellery to trend closer to that of leather goods (c.90%) and watches (c.100%) over the coming decades.

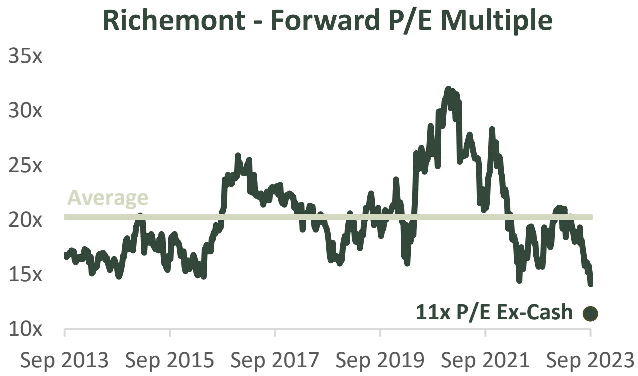


As demand for branded fine jewellery has grown, the number of century-old brands has largely remained the same, with category growth disproportionately benefitting incumbent brands. The branded luxury jewellery industry is highly consolidated between two players – Richemont (the owner of the Cartier and Van Cleef & Arpels brands), and LVMH (which owns Tiffany and Bulgari). Among the major luxury jewellery brands, Richemont and LVMH have over 80% market share – and growing!

While growth in the luxury jewellery market has been strong – at +10% p.a. since 2009 – Cartier and Van Cleef have outperformed the industry, growing +15% p.a. and +11% p.a. respectively over the same period. Google search interest in Cartier and Van Cleef is at all-time highs – an indication of healthy brand equity. While Van Cleef is only one-third the size of Cartier, search interest in the brand has more than doubled in the last 12 months, a positive indicator of its desirability and future growth prospects.

The quality of Richemont's overall business has improved over time. Richemont's Jewellery segment has expanded to 70% of group revenue, up from just 50% of the business in 2013. This is Richemont's highest-quality segment, generating 35% EBIT margins. Richemont has recently cleaned up its portfolio by divesting Yoox Net-a-Porter, an online retailer that was sub-scale and loss-making. As a result, Richemont's group-level margins and returns on capital have significantly improved.

Despite the business becoming higher quality, Richemont's earnings multiple has meaningfully contracted in recent months to its lowest valuation in over a decade – at just 11x earnings adjusting for the excess cash on its balance sheet.



Richemont has traded down recently as investors are concerned over macroeconomic conditions in Mainland China, as well as slowing demand growth in the United States. While a slowdown from record levels of growth recorded in the years immediately following the Covid pandemic appears inevitable, we are confident in Richemont's medium-term outlook. We see clear evidence that Richemont's products are strongly desired by an ever-increasing group of wealthy consumers – and once someone develops a taste for super-luxury goods, it tends to stay with them for life.

Richemont has multiple long-term growth drivers, including outside of Mainland China, which generates one-quarter of Richemont's revenues. Since 2009, Richemont has grown its revenues by 3.3x outside of China.

Cartier and Van Cleef continue to be underrepresented in the U.S., a vast market that represents just 19% of Richemont's revenue today – with opportunities for store openings in the South and Midwest in particular.

It is also worth remembering that Cartier and Van Cleef's core clientele is the wealthy – a demographic that is inherently less exposed to macroeconomic fluctuations. With a medium-term view, we see rising global wealth continuing to buoy demand for Cartier and Van Cleef's jewellery.

The GCQ investment team recently met with a Richemont executive, and one of his key observations echoed our own analysis of the outlook for demand for the company's products: "We don't know what the future is going to hold. But we're not thinking that it's going to reset the base to a previous level because that would require a significant decline in sales over the next five years – and that's not what we're seeing from *any* demographic out there."

Over the next 3-5-years, we expect Richemont's Jewellery Maisons to continue to benefit from the dual tailwinds of growth in global wealth and branded jewellery penetration, which should support high-single-digit revenue growth. We believe this underpins more than +100% upside to the share price today, assuming a return to Richemont's historical average trading multiple of 20x earnings.

Importantly, Richemont does not need to grow its revenue and cash flows at all to justify its current valuation.

At current prices, we think Richemont could be an attractive takeover target. Chairman Johann Rupert controls Richemont with greater than 50% of voting rights. He is 73 years old and has no clear succession plan. Johann Rupert has three children, of which only Anton Rupert is on the board. None of his children hold executive responsibilities. There was speculation earlier this year that LVMH's Bernard Arnault – who is known to covet the Cartier brand – was circling.

For context, LVMH paid between 29x to 31x earnings for Tiffany and Bulgari, which are arguably inferior brands when compared to Cartier and Van Cleef today. Even at a 20% discount to the multiple LVMH paid for Tiffany in 2021, Richemont's stock would have more than +90% upside today.

"Real economic luxury stars need three characteristics: timelessness, exceptional cash flow and solid growth over a very long period. The number of global brands fulfilling these characteristics can be counted on the fingers of one hand; Cartier, Louis Vuitton and Dom Pérignon are among them."

LVMH CEO Bernard Arnault

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