GCQ FLAGSHIP FUND | P Class Units

GCQ
GLOBAL CONCENTRATED QUALITY

MONTHLY PERFORMANCE & PORTFOLIO UPDATE

October 2024

Returns	1 Month	3 Months	6 Months	1 Year	2 Year (p.a.)	Since Inception (p.a.) (1 July 2022)
GCQ P Class (AUD)[1]	**0.6%**	**0.9%**	**11.1%**	**33.2%**	**34.4%**	**30.2%**
MSCI World Index (AUD)[2]	3.6%	1.9%	9.8%	29.0%	19.9%	21.1%
Outperformance	**-3.0%**	**-1.0%**	**1.4%**	**4.2%**	**14.5%**	**9.1%**

"The beauty of a great investment is that it keeps working when you're not. A great company will eventually earn more and more and more and more while you're just sitting doing nothing. A mediocre company won't do that."

- Charlie Munger

The portfolio's net return for the month of October was **+0.6%**, which compares with the MSCI World Index (AUD) return of +3.6%. This brings the net return for P Class units to **+85.0%** since inception on 1 July 2022 (**+30.2%** annualised).

Third Quarter Earnings Season

We have just completed the third quarter earnings season. Results for GCQ Flagship Fund companies were generally strong and supportive of our investment theses.

The biggest detractors to the Fund's performance for the month were Hemnet and Money Forward. Importantly, we remain optimistic on the long-term outlook for both Hemnet and Money Forward, and have taken advantage of recent share price weakness to add to our investments in both companies.

Our key takeaways from the earnings season are set out below.

We have high conviction in Hemnet's long-term earnings trajectory and in the Fund's exposure to real estate advertising monopolies.

Hemnet is the monopoly real estate classified business in Sweden and has been a material contributor to the Fund's returns over the past two years. Hemnet's share price declined -10.5% in October after the company's growth in revenue per listing came in lower than expected, driving a -4% miss at the revenue line.

Portfolio Overview as at 31 October 2024	Portfolio Weight
VISA	11%
	8%
Global consumer payments	**19%**
Hemnet	11%
rightmove	7%
Real estate advertising monopolies	**18%**
Alphabet	11%
Meta	2%
Global online advertising	**13%**
RICHEMONT	10%
HERMÈS	3%
Super-luxury goods	**13%**
amazon.com	10%
Global cloud computing	**10%**
MSCI	8%
Index providers	**8%**
WD-40 COMPANY	1%
Branded consumer goods	**1%**
Other high-quality businesses	**17%**
Total long	**99%**
Shorts	**(3%)**
Net exposure	**96%**
Cash	**4%**
TOTAL	**100%**

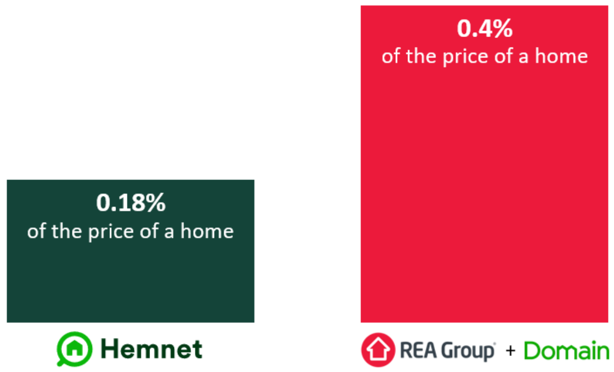
1. *Net performance figures are shown after all fees and expenses and assumes reinvestment of distributions.*

Lower-than-expected growth in revenue per listing was a result of Hemnet management's decision to not raise the price of its advertising packages during the quarter. Coupled with higher-than-expected agent commission expense, EBITDA fell -8% short of consensus expectations.

These misses are due to factors within Hemnet's control, and we believe they will be remedied over time.

We spoke to Hemnet's management team on the day of the company's earnings release, and were assured the company's long-term pricing strategy is unchanged. Hemnet informed us the generous nature of the new agent commission structure (introduced at the start of the quarter) is designed to incentivise agents to actively recommend that home-sellers take up more expensive (and margin-accretive) Premium packages. We expect agent commission expense to decline as a proportion of Hemnet's revenue over the longer-term.

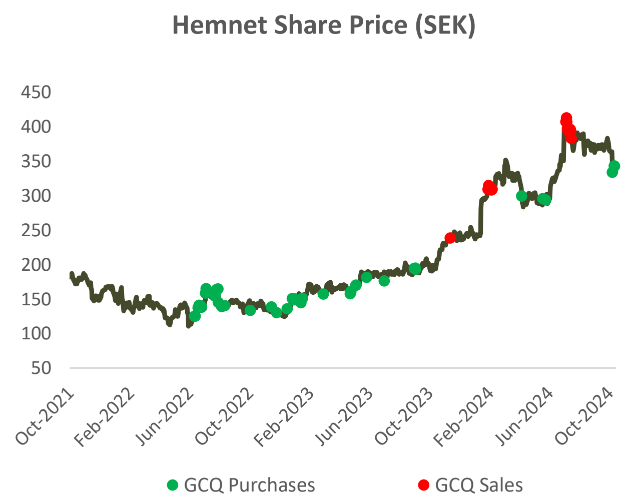
We believe Hemnet's underlying drivers remain intact. Hemnet is still early in its monetisation journey, with significant untapped pricing power. The average price of a Hemnet listing is equivalent to c.0.18% of the average Swedish home price – roughly half what an Australian home seller pays to list on realestate.com.au and domain.com.au. Hemnet still has a long runway to go on premiumisation of its packages given the cheapest package still accounts for c.40% of listings.



The biggest piece of good news from Hemnet's result – and something we have been hoping to see for some time – is that Hemnet has decided to add a new "super-premium" option to its package suite in 2025. Adding a new, more expensive listing product is straight from the playbook of successful online classifieds businesses globally such as realestate.com.au. We expect the addition of a new package to add materially to Hemnet's average revenue per listing, earnings and cash flow over time.

On 8 November Hemnet announced that Jonas Gustafsson will take over as CEO on 10 February 2025, replacing Cecilia Beck-Friis, who had previously announced that she would be stepping down from her role. We look forward to meeting with Jonas early in the new year to confirm his commitment to the current corporate strategy, and to continue the constructive ongoing dialogue that we have enjoyed with prior management.

We added to our position in Hemnet when the share price fell on the back of short-term concerns. We did this at prices that were c.21% lower than when we reduced the portfolio's exposure to Hemnet in July 2024 for risk management reasons after the share price rallied c.+19% on stellar 2Q24 earnings. Our recent purchases and sales are shown in the below chart.



We anticipate volatility in the share prices of all companies in the portfolio, and always look to generate returns through well-timed adding and trimming of positions when the pendulum of the market throws us opportunities – volatility is our friend.

Cloud accounting software is an attractive industry with strong secular tailwinds

Money Forward is the dominant provider of cloud-based accounting software for small-to-medium-sized businesses in Japan. Cloud accounting software enables businesses to manage their records of income, expenses, assets and liabilities online.

Cloud accounting software industry structures tend to be highly concentrated (monopoly, duopoly or oligopoly) on a national level. This is the case in Japan with Money Forward (the larger player) sitting in a duopoly with Freee.

Japan is in the early stages of its transition from on-premise to cloud accounting software, with less than 20% of small businesses having made the shift. This level of penetration is low relative to other developed markets globally. We believe the transition to cloud will drive structural growth for Money Forward over the medium-to-long-term.

Of note, in October Money Forward announced a c.+30-50% price increase for Small and Medium Businesses (which account for c.50% of Annual Recurring Revenue in Money Forward's Business Domain), effective from June 2025. This is the first time that Money Forward has raised prices in more than two years. We believe Money Forward has substantial ability to raise prices over time.

Despite growing revenue +31% year-on-year, Money Forward's result missed consensus revenue expectations by -3.5%, driving a c.-10% decline in the share price. The revenue miss was primarily a function of an increasing number of customers opting to subscribe to annual cloud accounting subscription plans, which are approximately 15-20% cheaper than monthly plans. We believe the shift to annual plans is actually better for the business in the long-term given that customers on annual plans tend to be more loyal, while also requiring a full year subscription fee to be paid to Money Forward up-front.

We took advantage of share price weakness to add to our position in Money Forward. We don't always get the bottom, but we believe that our thesis on Japan's cloud accounting industry will work out in the long-term and will deliver strong returns for the fund.

Consumer spending remains stable across all segments

Among our portfolio companies, **Visa** and **Mastercard** offer the best read on the health of the consumer.

Both payment networks delivered solid results, with Visa and Mastercard growing revenue +12% and +14% year-on-year on a constant currency basis, respectively.

In its 3Q24 earnings call, Mastercard said, "We continue to see positive trends from a consumer health standpoint. They're spending in a very healthy manner."

This view regarding the broader economy was reiterated by Alphabet, which saw "broad-based strength across all verticals".

The performance of global luxury houses continues to bifurcate

At GCQ we differentiate between "super-luxury" companies that have ultra-wealthy and more economically resilient consumers, and "luxury" companies that sell to more aspirational consumers. Super-luxury companies build enduring brand heritage over centuries and operate in high-value categories like jewellery and leather goods that are less exposed to "runway risk" (i.e., changes in fashion trends). "Super-luxury" companies restrict supply growth, increase prices regularly, and control their distribution. We currently hold positions in two companies that meet these criteria – Richemont and Hermès.

By contrast, mere "luxury" companies tend to operate in more challenging categories (e.g., fashion), where performance is often tied to a creative director's success in anticipating trends. These businesses do not meet the hurdles imposed by the GCQ Quality Checklists.

Recently, we have seen the performance of "super-luxury" companies far surpass that of mere "luxury" companies. In particular, while the broader luxury industry saw organic revenue decline c.-2% in the quarter, Hermès grew revenue +11% year-on-year. This is despite a particularly challenging macroeconomic environment in China (an important luxury market).

Further, Richemont's Cartier and Van Cleef & Arpels jewellery businesses (c. 90% of EBIT) grew sales +4% year-on-year in the quarter. Pertinently, the business saw no deceleration in growth relative to the prior quarter which is remarkable in the context of an environment in which most luxury brands (including LVMH's Watches & Jewellery business – owner of Bulgari and Tiffany & Co) saw a weakening in the rate of sales growth between quarters.

During the same period, businesses which achieve a fail grade on the GCQ Quality Checklists significantly underperformed the industry. Revenue at Kering, whose flagship brand is Gucci, declined -16% year-on-year. Gucci's DNA includes over-the-top designs, leaving it exposed to fashion risk when consumer preferences change. Similarly, more challenged and less premium brands such as Burberry saw sales decline -20% year-on-year.

Amazon's retail margins continue to surprise to the upside

Amazon posted a solid 3Q24 result, with the stock price rising +5.5% immediately after reporting.

Most investors, including us at GCQ, own Amazon primarily for the Amazon Web Services business. However, this quarter the key surprise was Amazon's retail business, which delivered operating profit (EBIT) +23% ahead of consensus expectations.

The opportunity for retail margins to rebound has always been a secondary, but important, component of our Amazon investment thesis.

We built our position in Amazon in the aftermath of COVID-19, during which Amazon's retail margins were understated as it invested heavily via its income statement to build out additional delivery infrastructure. This involved a structural shift from a single national fulfillment model in North America to many regional clusters. The main aim of this was to move inventory closer to the end customer, which would in turn lower transportation costs, increase units shipped per box and increase market share through faster delivery times. From 2020 to the end of 2022, Amazon's retail EBIT margin averaged c.0.6%.

Amazon's investments have proven to be accretive to its retail EBIT margin, which improved to 5.3% in the latest quarter. We believe that as Amazon continues to lower its cost to serve customers, its retail margins will continue to surprise to the upside.

Amazon's Retail segment growth also continues to be driven by its highest-margin revenue lines.

Amazon's high margin advertising revenue continues to grow, up +18% year-on-year in the quarter. Most of Amazon's advertising revenue comes from sponsored products, which are keyword or product targeted advertisements promoting a seller's individual listings at the top of shopping results. Amazon's sponsored ads are increasingly become a cost of doing business for sellers who want to reach Amazon's massive base of online shoppers.

Amazon also benefits from growth in third-party revenue (i.e., Fulfillment by Amazon), which provides logistics services to sellers including the storage and packaging of customer orders. Amazon requires sellers who want their products to be Prime eligible to use its fulfillment service.

Finally, subscription revenue from Amazon Prime and Prime Video continues to grow at a rate of +11% year-on-year.

We believe Amazon's business has numerous untapped profit growth levers and remain happy shareholders here.

Alphabet continues to durably re-engineer its cost base, driving operating margin expansion

Alphabet delivered a strong result, with the magnitude of operating margin expansion positively surprising the market. The stock was up c.+5.5% on the result.

Group level revenue growth accelerated to +16% year-on-year on a constant currency basis.

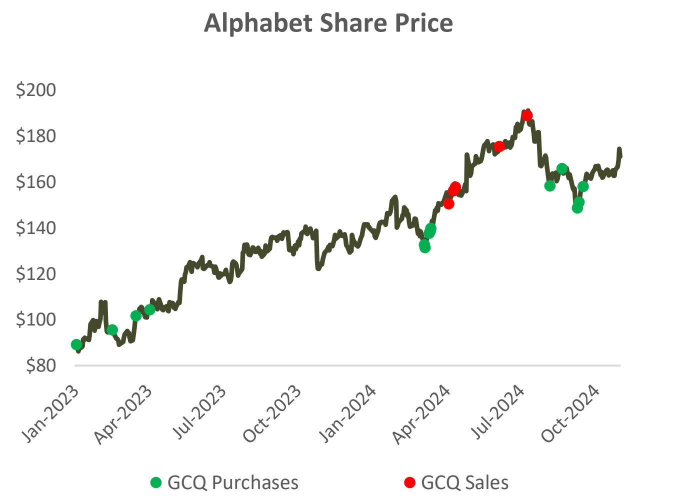
In recent quarters, Alphabet has been focused on "durably re-engineering" its cost structure (i.e., cost cutting), which has led to record high EBIT margins. The core Google Services segment (which includes Google Search and YouTube) posted a record EBIT margin of 40% in the quarter, while Google Cloud posted a record EBIT margin of 17% (up from just 3% only a year earlier).

On the company earnings call, Alphabet's new CFO Anat Ashkenazi alluded to further future cost cuts, saying:

"Sundar, Ruth and our leadership team started on important work to reengineer our cost structure, including efforts such as optimizing our head count growth, our physical footprint, improving the efficiencies of our technical infrastructure and streamlining operations across the company through the use of AI. <u>I plan to build on these efforts, but also evaluate where we might be able to accelerate work</u> and where we might need to pivot to free up capital for more attractive opportunities."

Leading into these results, we believed we were buying Alphabet "on sale". From July, Alphabet's share price declined by approximately -20% from peak to trough in September 2024 on the back of investor concerns following a judicial ruling in an antitrust suit brought by the US Department of Justice.

This provided us with a swift opportunity to recycle capital back into the stock – not long after we trimmed our position in Alphabet from 14% of the fund in April 2024 to 5% in July 2024. On the back of this share price weakness, we took our position in Alphabet to 10% of the fund, where it sits today. We continue to see material upside in Alphabet, and believe it is well-positioned to deliver a high-teens compound annual return over the next five years.



GCQ took its positions in S&P Global and Moody's to zero

At GCQ, we have long admired the Credit Ratings Agency industry. The industry is a duopoly between S&P Global and Moody's, where both receive a growing royalty on global debt issuance. S&P Global and Moody's opinions on the creditworthiness of companies and countries are treated by institutional investors as essential stamps of approval before making investment decisions. S&P Global and Moody's have both been part of the GCQ portfolio since the inception of the Fund.

S&P Global and Moody's posted strong results, with revenue growth up +16% and +23% year-on-year, respectively. Both companies raised guidance, on the back of stronger than anticipated issuance growth and expectations of continued strong issuance activity into 4Q24.

Despite this, the share price reaction for both companies was muted – an indication that investor expectations have caught up with the strong performance of these businesses. We take sell discipline seriously at GCQ and following their results, we have sold down our positions in S&P Global and Moody's to zero, believing the companies to be fully valued at current levels and that we can invest capital more profitably in other portfolio holdings.

We are pleased with the portfolio today, and believe the current portfolio is well-positioned for future performance.

"Invest for the long haul. Don't get too greedy and don't get too scared."

- Shelby Davis

GCQ Funds Management[1]	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
2022							8.9%	-4.1%	-4.8%	2.9%	5.9%	-5.7%
2023	10.0%	1.6%	8.2%	4.4%	5.1%	2.5%	2.2%	2.9%	-3.9%	-1.1%	8.7%	1.8%
2024	6.7%	6.0%	0.0%	-4.3%	1.9%	2.5%	5.4%	-0.3%	0.6%	0.6%		

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