Investing with Insight

Half year investment report 2021

August 2021

REQ CAPITAL

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Content

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Dear fellow investors

First and foremost, the entire team at REQ Capital would like to thank you, our investors, for your support. The launch of REQ Capital would not have been possible without you. We promise to manage your capital in the best possible way and will keep you updated on the progress of your investment on a semi-annual basis through investor letters such as this one.

What a journey it has been! We have set up an international fund structure, got regulatory approvals for fund management in different markets, and obtained the necessary international distribution approvals.

The administrative set up and initial investor contact was necessarily done in the digital space, given the extraordinary circumstances in which REQ was launched. Certainly, we look forward to meeting all business partners and investors in person in the coming months as the Covid-19 situation improves and society gradually opens up.

In recent months our team has been strengthened through the addition of several new team members, both on the investment side and in operations. We welcome Synnøve Gjønnes, Fredrik Kalleberg and Ingrid Stene to our team, and are very encouraged to have such talented individuals joining REQ Capital.

Our investors range from Norwegian and international fund of funds, pension funds, organizations and high net worth individuals.

Finally, in June we launched our first fund, REQ Global Compounders . As the name suggests, the fund will invest globally in companies that are able to reinvest and grow with a high return on capital over decades. We have a generational perspective on our investments.

Again, thank you for your confidence and support. We will ensure that we deliver on our promise to find the best compounders and generate significant value for our investors in the decades to come.

Executive summary

We aim to create wealth over decades and manage our investor's capital just like our own. We only invest in our own funds and seek clients that share our values and long-term perspective. A common interest with our investors is crucial for long term success.

When your goal is to compound capital for a generation you focus on other areas than most market participants. We do not have a qualified view on the market returns over the next year and do not know how the macroeconomic picture will look like over the next three to five years.

What we know is that we have invested in companies that will grow and prosper over the long haul, irrespective of market conditions. Ultimately the value creation of these companies will be reflected in the stock prices. We sleep very good at night as owners of these companies. We spend several pages in this half-year report to provide more insight into our portfolio holdings in REQ Global Compounders.

Over the short run the stock market is a voting machine. Over the long run the market is a weighing machine. As you expand your time horizon and invest with a generational perspective you need to get the fundamental return contributors, represented by profitable earnings growth and dividends, right.

The companies in which we have invested have the best prerequisites to create profitable growth over the coming years. They share some common characteristics.

Our companies are led by management teams with excellent capital allocation skills. They are strong investors. They tend to organize themselves in a very decentralized manner to release entrepreneurial energy. Last, but not least, the management teams own a lot of shares just like we do. Incentives matter.

As you head for the beaches, cabins and holiday resorts we provide you some suggested reading material at the end of the report.

The whole team at REQ wishes you the best summer. We look forward seeing you in person during the 2nd half of the year.

Our promise

As a new fund management company, we believe it is very important that investors know what they can expect from us and also know the things that we will not focus on.

What to expect from us	What NOT to expect from us
Generational perspective	Opinions on the market in general
Invest your capital like our own	Opinions on interest rates and the economy
Open about mistakes	Advice on how to time the market
Independent mindset	Short term return expectations
Stock pickers	“Talking heads” in media
Company insight	Monthly “contribution” reports
Common sense	Monthly fund commentaries
Patience & discipline	
Passion, curiosity and inspiration	
Clear investment philosophy	
Sustainability on the agenda	

We hope our investors will judge us by the quality of our arguments and by our reasoning rather than our last 12 months performance figures. Our investments are simply not aware that it takes 365 days for the earth to make it around the sun.

We started REQ with a generational perspective and aim to invest for decades. We will not provide monthly fund commentaries or short term contribution reports. We do not want to try to give short term “arguments” on why a stock has moved in a certain direction in the short term.

One competitive advantage we have is that we will invest your capital just **like our own**. We have set up the funds with investment guidelines that mirror how we would invest our own capital. We do not use benchmarks. We believe that the best way to manage risk is to have skin in the game. In many respects we will ignore conventional fund manager “practice”, as it is our experience that the best fund managers have, paradoxically, learned how not to think like fund managers. Being different can be a significant edge.

We will be **open about our mistakes**. Like the legendary investor Stanley Druckenmiller once said: “*If you are extremely confident in yourself, taking a loss does not bother you*”. Investing is about finding the right balance between conviction and humility. You need conviction because successful investing is often about having an **independent mindset**. On the other hand you need humility and the ability to admit that you have made a mistake and not let that crush your self-confidence. The best investors tend to be of the humble kind and respect what they are up against.

We are **stock pickers.** Our investors should expect us to have **company insight**. But knowing a company is not always about knowing everything there is to know. More information is not always the preferred alternative, as this can lead to decision fatigue. Today the best investors have the best filters of information. Investing is about filtering out what is important and what is not important for the long term investment thesis. The best investors decide on the 5% of factors that matter and ignore everything else. The edge as an investor does not have to be informational (i.e. knowing more than everyone else). It can be behavioural – e.g. remaining calm when everyone else is panicking and adopting a long-term perspective, which for our part is measured in decades, not months.

Common sense is a shortage in the financial world. You do not have to make the business of investments more complicated than it already is. We will apply common sense by only investing in value creators: companies with a proven track record of creating value for shareholders. Value creation stands the test of time across sectors and geographies.

> *"It is a terrible mistake to think that mathematics will take you a long way in investing. And higher mathematics may actually be dangerous and it will lead you down pathways that are better left untrod*" (Warren Buffett)

We have **patience and discipline**. Building values is a marathon, not a sprint. Stocks rarely perform in the time frames we predict, and that is why the market only works for investors who have patience. Most market participants try to win in the short term. But there is far less competition when you truly invest with a generational perspective.

We do not have an obligation to **have an opinion** about anything. We believe we should not have an opinion about things we do not understand. We will therefore not act as **"talking heads"** in the media with comments and views on everything from the direction of interest rates to FX and the economy in general. There are conflicting incentives everywhere in the world of finance. When you see a so-called "expert" voluntarily appear on CNBC, for no payment, ask yourself why this person is appearing on television. The reason is that the person is acting in their own self-interest. We will concentrate our efforts on generating the best ideas for our funds.

> *"The investment business is full of people who got famous for being right once in a row"* (Howard Marks)

We do not have any **short term return expectations**. We try our very best to define what we know and what we do not know. To quote Warren Buffet: "*Know your circle of competence, and stick within it. The size of that circle is not very important; knowing its boundaries, however, is vital*".

Our investment philosophy is clear. We invest in value creators for the long run. There are many ways to manage capital. After managing capital for more than a decade we know there are many ways to succeed and even more ways to fail in the stock market. The more experience you have, the more comfortable you become with your own style of managing capital, and the less you care about trying to convince others that they should invest like you. We are confident that our approach will provide excellent long term results.

> *"The older I get the quieter I get and the more comfortable I get sitting quietly in the back of the room letting others voice their opinions. It is the great thing about investing. Opinions and predictions do not matter. Being right matters."* (Ian Cassel)

We have a passion for investments. This is not our job but our lifestyle. We love the process. We are curious and open-mined. We find inspiration in books, articles, by talking to investors and by meeting management. Even after 17 years in the investment business it is still exhilarating to stumble upon a new investment idea that ticks all the boxes and which makes you stop everything you are doing and clear the calendar. You learn investing by investing – by putting money on the line and feeling the consequences.

Investing capital on behalf of others is all about trust. Our investors trust us to take good care of their capital. As fund managers our job is to find management teams and companies that we can trust. A chain of trust is established from our investors, through us, to the ranks of management of the companies in which we invest.

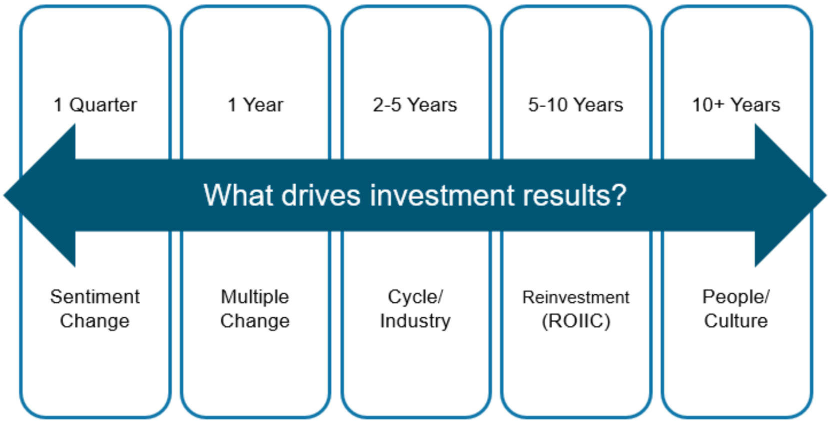
We put sustainability on the agenda. We focus on companies that put governance first. Many of the companies in which we invest are led by the initial founders. It increases the speed of execution and facilitates long-term sustainable decision making. Our experience is that founder-led companies often tend to take social and environmental aspects more seriously than companies that are purely owned by institutions.

Investment horizon

It is deeply relaxing to buy things you plan never to sell. The longer you can extend your time horizon, the less competitive investing in stocks becomes because most of the investment world is committed to a very short time frame.

Speculators who focus on a time horizon of a year or even less don't have to worry about fundamentals or changes in fundamentals. On short time horizons, the only thing that matters to your return is changes in sentiment, such as changes in the perception of the industry in which the company operates, political and macroeconomic sentiment, and other short-term issues. Not many people consistently get this type of speculation right. You might get it right the first time and think you are a stock market genius. But the stock market will prove you wrong after a while. As Jeff Bezos said:

"If everything you do needs to work on a 3-year time horizon then you are competing against a lot of people. If you are willing to invest on a 7-year horizon you are competing against a fraction of those people, because very few companies are willing to do that."



Source: IMC

Shifting your focus from a quarterly or annual horizon to a multi-year horizon increases the impact changes in company fundamentals have on your investment results. The dominant force for your returns on a three-year horizon is multiple expansion. But over the long run, you can't base too much of your future returns on multiple expansion, as there is a limit to how expensive a stock can get.

On a five-year view, fundamental factors start to kick in. On a five-year view, the dominant force behind your returns is still where we are in the cycle and the medium-term industry headwinds or tailwinds. You may have picked the right type of company, but on a five-year view, the impact of industry dynamics and macroeconomics are still important drivers for the company.

As you extend your investment horizon beyond seven years, company-specific factors begin to dominate your returns. The company's reinvestment opportunities and its ability to deploy large amounts of capital at high rates of return become the dominant drivers of return.

On a 10-year view, it's about investing with the right management and in the right corporate cultures. Our experience is that any investment over ten years is more about the people running the business than anything else. Therefore, an analysis of the company's culture and management is essential. The key to investing is to hold your winners for as long as possible and sell your losers as soon as possible. Your holding period is directly related to management execution. It depends entirely on management.

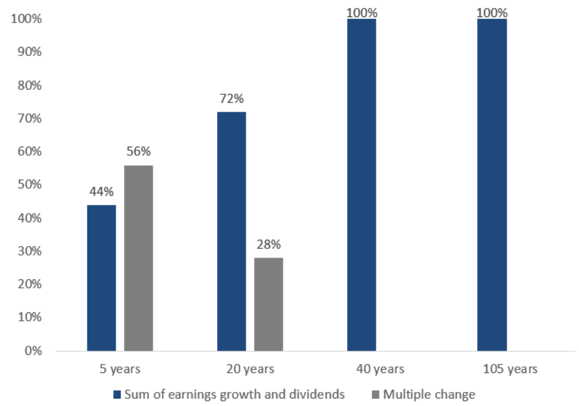
The chart below looks at empirical data from the US stock market over the last 105 years. We separate “fundamental” returns (EPS growth + dividends) from “emotional” returns (changes in the P/E ratio). At rolling five year horizons the average contribution from “fundamentals” is 44% of your stock return. On rolling five year horizons 56% of your return is derived from changes in the P/E multiple. This clearly demonstrates that even on five year time horizons, emotional return is the main stock driver.

If you expand your investment horizon to 20 years you will clearly see that fundamentals are the dominating force behind your returns. At 20 year rolling time horizons 72% of your return stems from the sum of earnings growth and dividends. Still, 28% of your return stems from changes in the P/E multiple. Even on 20 year investment horizons you need to keep an eye on what you pay for a stock.

If you have the intention to invest for 40 years, the effect of “emotions” or changes in the multiple disappear. In the long run the stock market is very rational. Over rolling 40 year investment periods the return you get from your stock stems solely from rational fundamental return drivers, the sum of earnings growth and dividends.

Sources of long-term returns

Contribution to returns



Source: Financial physics, Dr. Rama. S&P500

> “*Investing should be more like watching paint dry or grass grow. If you want excitement, take $800 and go to Las Vegas*” (Paul Samuelson)

With this background it is quite interesting that 62% of professional fund managers invest with a time horizon of 6 months, according to the latest Bank of America Global Fund Manager Survey.

What best describes your investment time horizon at this moment?

3 months or less	47
6 months	62
9 months	24
12 months or more	55
Weighted average	**7.4**
Don't know	6

Source: BofA Global Fund Manager Survey

A big mistake that some investors make is feeling like they should always be buying/selling something. 99% of successful investing is learning, thinking and waiting. The best investors do nothing 99% of the time. They sit on their hands, sometimes for years, and prepare. Reading, thinking, analyzing. Then, when the right opportunity presents itself, they strike with conviction. It sounds simple, but it's not.

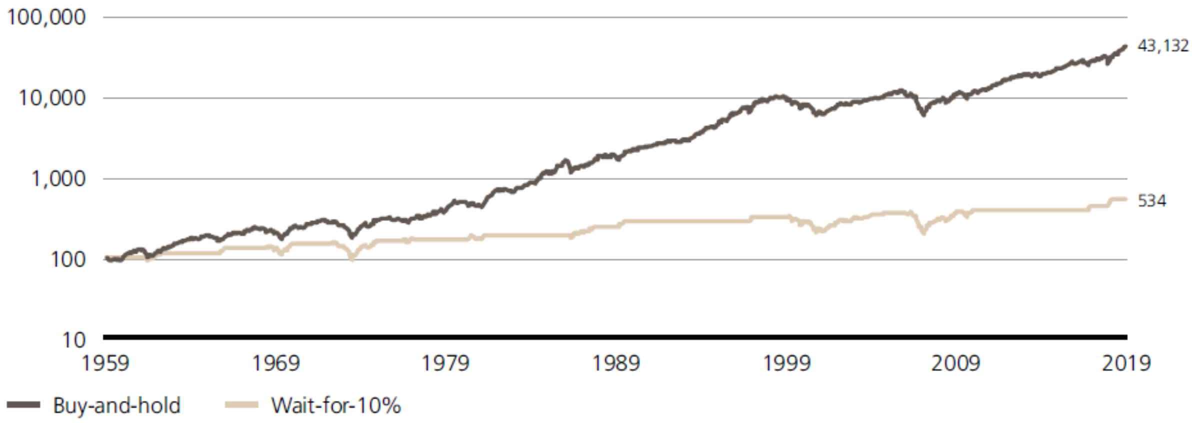
> "*We believe that according the name* "Investors" to institutions that trade actively is like calling someone who repeatedly engages in one-night stands a "romantic"
>
> (Warren Buffett)

When stock markets reach new all time highs we often hear the argument that "I will wait for a correction to enter the market". According to a recent study by UBS, waiting for a correction has proven to be a costly strategy over time. An investor who invested USD 100 in the S&P 500 in 1960 and simply held onto their investment would now have USD 43,132. An investor who employed a "buy the dips" strategy of buying in 1960, selling at new all-time highs, and waiting for a 10% correction before buying back, would be around 80 times less wealthy, with a portfolio worth just USD 534.

Figure 5

Waiting for a correction is a costly strategy

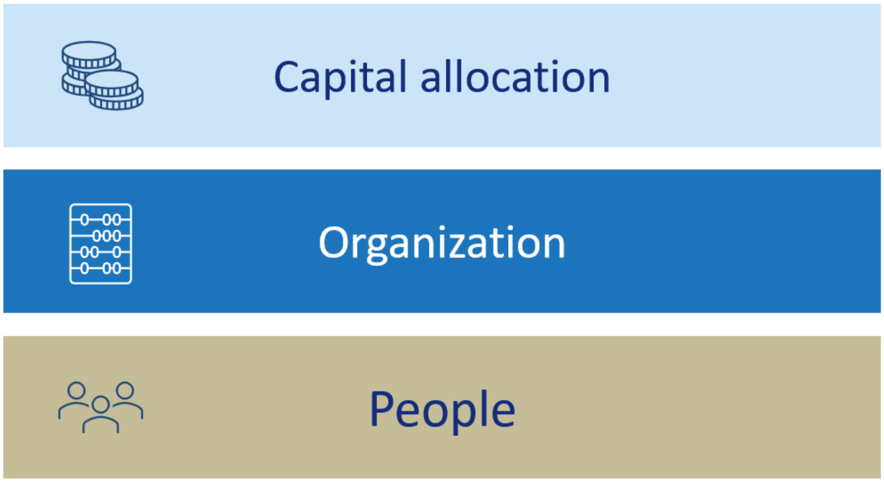
Value of USD 100 invested in S&P 500 in 1960, buy-and-hold vs. wait for 10% correction



Source: Ibbotson, UBS, as of May 2021

Investing in Compounders

Reinvestment is a critical component of any successful investment idea, and our companies have plenty of room to reinvest capital both organically and through acquisitions.
Our companies often compound capital by using free cash flow to acquire small private companies and have the ability to deploy the majority of their free cash flow for acquisitions. They have tremendous future optionality. We often tend to see that this optionality is not captured in the pricing you see today. In our experience, this acquisition-related portion of future value creation is often underestimated by the market. Our strategy of investing in these acquisition-driven compounders could be considered as similar to private equity funds with permanent capital and no fee structure. High-quality companies with tremendous growth potential from plowing back capital into the business also tend to preserve capital in down markets. We invest in high-performing conglomerates like those Warren Buffett has built out of Berkshire Hathaway over many decades. We believe that good investment analysis is about pattern recognition. After years of managing capital, we have identified three patterns that define good long-term investments.
The three key characteristics are excellent capital allocation, decentralized organizations, and management with "skin in the game" that acts like a long-term investors.



Capital allocation

We want to invest in management teams that are outstanding investors. Investing is a chain of trust. We spend a lot of time finding management teams that are exceptional at allocating capital, as investing with these teams can be very profitable.

In our view, identifying management teams with strong capital allocation skills is not enough on its own for a company to make it into our portfolio. We also want these teams to operate in markets where they can deploy a great deal of capital over many decades. Finally, management teams must also have the freedom to deploy capital as they see fit. For example, we would not invest in a company where the board has decided that 80% of net income should be paid out as dividends, regardless of capital deployment opportunities. We want our managers to have the freedom to allocate capital in the best way possible for shareholders.

When we find CEOs who are highly competent in both human/cultural aspects and capital allocation, we pay close attention to them.

Most CEOs rise through the sales or operations ranks, but as CEO you are responsible for capital allocation for the entire company. Capital allocation is a skillset and one requirement is the freedom to act in the best interest of shareholders. Capital allocation has a major impact on the value created by the company and therefore on stock returns. Two companies with the same operating results and cash flow and very different approaches to capital allocation will produce two very different results for long-term shareholders.

There are three sources and five uses of capital:

Sources	Uses
Free cash flow	Invest in the business
Equity	Acquisitions
Debt	Dividends
	Share repurchase
	Debt repayment

The main task in capital allocation is to tap the right source of capital and to deploy that capital at high rates of return, taking risk into account. Over and over again.

The CEO has the ultimate responsibility for making capital allocation decisions. Some CEOs buy back a lot of stock at the right time. Others sell large chunks of the company and invest in new businesses. Some use all the free cash flow to consolidate fragmented end markets. The CEOs we invest in know how to deploy their capital, what source to tap and how to deploy it. The results are extraordinary. Finding, investing in, and sticking with these types of companies is what investing is all about.

The "teenage pressure" in the corporate world is the pressure on CEOs to make the same kind of capital allocation decisions as everyone else. The surest path to mediocrity is to do it like everyone else. We like CEOs who spend a large portion of free cash flow on small bolt-on acquisitions. We like CEOs who pay extraordinary dividends to shareholders when there are no other good reinvestment opportunities. We like CEOs who are willing to sell large parts of the company when there are no good reinvestment opportunities, and effectively shrink the company. The majority of CEOs have no incentive to reduce the size of the company. Our CEOs do not consult outside advisors when making capital allocation decisions.

It is those who have mastered the art of evaluating management that the stock market rewards with gold. That is the reason why we focus on people, as investing with top entrepreneurs and owners gives you a big edge.

Decentralization

Practicing simplicity in the corporate world in terms of organization is actually a very complex undertaking. Our investment philosophy is based on the belief that a decentralized - non-bureaucratic - and independent governance model is the best tool to foster entrepreneurship and performance. It is the belief that individuals can direct the fortunes of the business and should be entrusted and given responsibility for decision making. The decentralized business models we invest in represent independence, accountability and rapid decision making. The focus of these companies is on performance indicators. At the heart of decentralization is that entrepreneurship should be actively nurtured and protected. Top management makes sure that decisions are made as close to the customer as possible. In the figure below they always try to ferret out any kind of bureaucratic creep on the left and seek autonomy on the right.

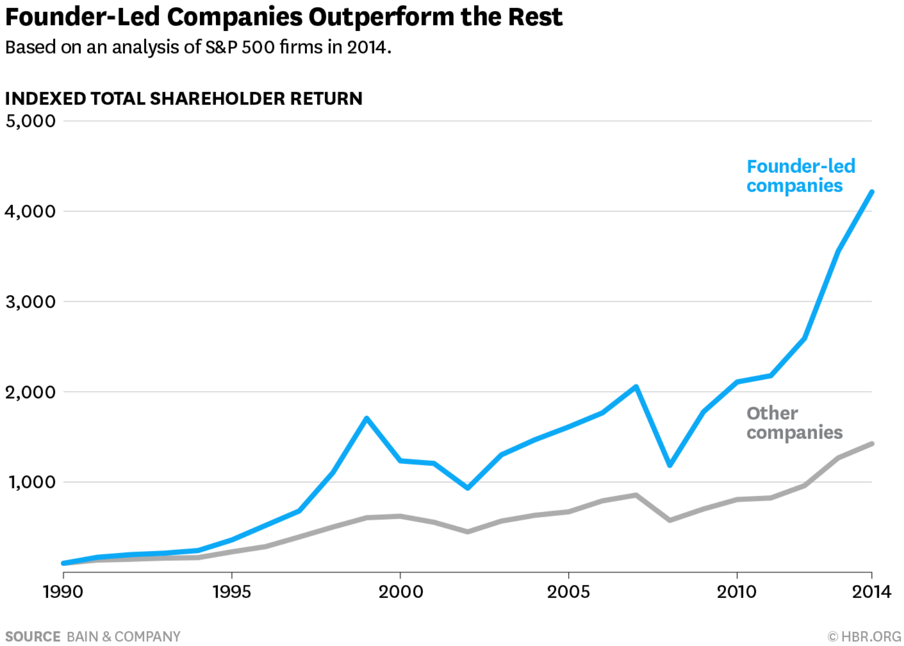
Decentralized business models are on the other side of the scale from the traditional bureaucratic conglomerate, where the entrepreneurial spirit of "I can fix that" is replaced by "That's not my department." Over time, bureaucracy takes its toll on a company's adaptability, morale, and customer loyalty. As a result, sooner or later the entire financial engine of the company is corrupted. Centralization removes decision making from its real economic consequences. The result is often a blame game in which management and field managers blame each other.
When a company grows, it is normal for complexity to grow with it. New employees and processes increase complexity, and psychological biases that prefer hiring to firing also lead to more bureaucracy. Compensation in bureaucracies is concentrated in the C-suite. Conventional hierarchical structures do not incentivize true entrepreneurship, but build power and perks at the top. They foster a short-term mentality because executives have an incentive to achieve quick wins because they are not accountable for the long-term consequences of their actions. These bureaucracies are the antithesis of an ownership mentality.

> *"I am personally happy to trade off the lack of scale with small tight agile teams"*
>
> (Mark Leonard, Constellation Software)

Our companies, on the other hand, operate without the anchor of bureaucracy.
Our companies embrace decentralization and become high-performance conglomerates, far removed from traditional bureaucratic conglomerates. Our companies often organize themselves into small teams where there is a lot of autonomy and earned trust. Individual managers of the various business units are given a great deal of autonomy over their activities. They create incentives for long-term thinking, accountability and ownership. Our decentralized business units have inherently very lean corporate headquarters. They run high-performing niche business units, and individual managers are paid very well when they are able to allocate capital at high rates of return. They are owners and act like owners.

> *"We operate 45 stand-alone niche businesses... So, there is nothing shared across the enterprise. There is no common ERP. There is no HR system. There is virtually nothing shared at the center. There's 55 employees at HQ and about 16 000 people in the enterprise"*
>
> (CEO Neil Hunn, Roper Technologies)

There is much evidence to support the fact that companies in which the founder still plays a significant role as CEO, chairman, board member, or owner perform better. According to Chris Zook in the Harvard Business Review, there are three "founder mentality" practices that characterize superior founder-led companies. First, these companies have a "sense of purpose." They often defy industry norms and act on behalf of underserved customers. Secondly, these companies have a "frontline obsession." They make heroes of those at the front line and the culture gives them power. Finally, these companies have an ownership mentality characterized by quick action and personal responsibility for risk and cost. Lose the ownership mentality and the company becomes complacent, unwilling to act and risk averse.



Sources: Bain & Company and Demesne Investment's article "Ladder climbing and Owner Operators"

During the last few months we have been guiding a brilliant student (Ole Jørgen Sjøvolden) at the Norwegian School of Economics (NHH) in his master thesis. The title of his study was "Founder-CEOs and Stock Market Performance in the Nordic Region". The study covered 1125 publicly listed Nordic companies during the period 2008-2020 of which 184 companies were founder-led in the period.

About nine percent of listed companies in Scandinavia are led by one of the founders. According to Ole Jørgen:

"These companies are different from others in terms of firm valuation and stock market performance. An equal-weighted portfolio containing only founder-CEO firms from the period from 2008 to 2020 has earned an abnormal return of 5.2% annually when controlled for its skewed sector-distribution. This portfolio performs significantly better than the market during the generally challenging period from 2008-2013. These firms have a higher valuation despite no systematic differences in investment levels."

Additionally, his study provides evidence of particularly strong performance during the rough years during and following the financial crises in the period 2008-2013, suggesting that founder-led companies are more efficient with limited access to capital. Overall, the study joins the expanding literature providing evidence of strong performance of founder-led companies.

The decentralized approach is a common feature of our companies. Over the years, we have found some excellent companies in which we have invested, all of which have decentralized organizations. There are many advantages to a decentralized operating structure. Typically, these companies are far more entrepreneurial because those closest to the front line are empowered to make decisions and don't have to wait for orders from the top. This typically leads to greater responsiveness and agility, as well as much deeper customer relationships.

Decentralization and acquisitions
The academic literature on M&A consistently shows that acquisitions are an expensive growth path for buyers.

> "When it comes to great small businesses: Why not own a bunch of them through a holding company?" (Mark Leonard, Constellation Software)

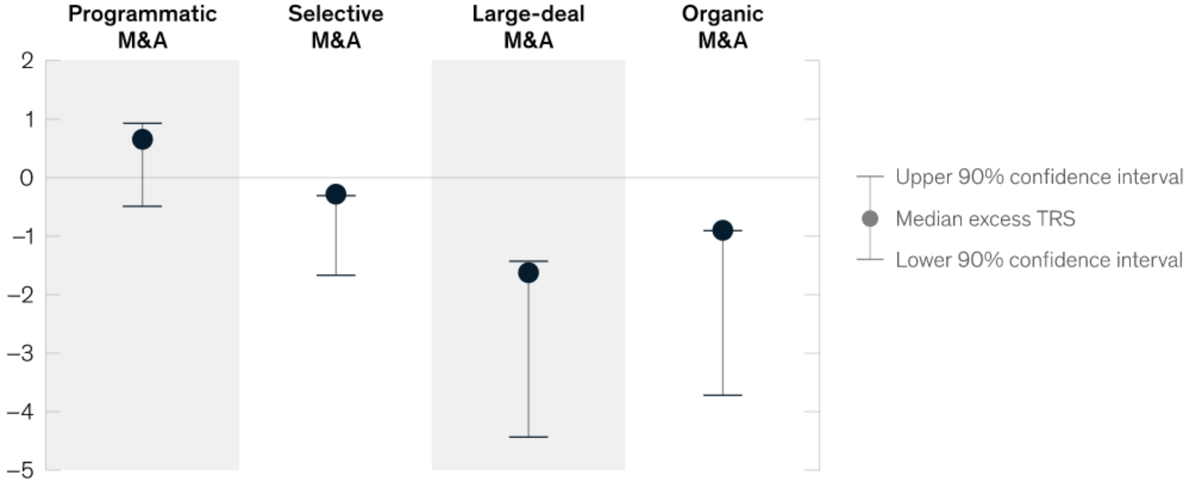
Studies point to overreliance on synergies and management teams that engage in acquisitions to build empires rather than create value for shareholders.
Most of the literature on M&A, however, focuses on large M&A deals in public markets. Serial acquirers, on the other hand, do small and often private deals. Acquisitions of small private companies tend to be priced more favorably than public companies.

Serial acquirers are a different breed of companies than companies that make large "transformative" deals. Serial acquirers differ in both the frequency of deals (many) and the size of deals (small). These programmatic acquirers generate much better returns than any other deal type. Small acquisitions also tend to imply lower risk for the acquirer. In addition, it is reasonable to assume that a repetitive process in acquisitions also builds capabilities in terms of acquisitions.

According to a global study by McKinsey & Company from 2000 to 2017 ("How lots of small M&A deals add up to big value"), programmatic acquirers generate higher excess total shareholder returns than companies using other M&A strategies. Programmatic acquirers build organizational infrastructures and establish best practices in all phases of the M&A process, from deal strategy and sourcing to due diligence and post-purchase monitoring. Acquisitions are at the core of the strategy and it is a systematic process.

Programmatic acquirers achieved excess total returns to shareholders that were higher than the median.

Median excess TRS for companies that remained in the Global 1,000 from Dec 2007 to Dec 2017,[1] %



[1]TRS = total returns to shareholders. Global 1,000 comprises companies that are among top 1,000 by market capitalization; excludes companies headquartered in Africa and Latin America.
Source: Global 1,000, 2017; Thomson Reuters; Corporate Performance Analytics by McKinsey

Sources: McKinsey & Demesne Investment's article "Practice makes perfect".

A decentralised company relies on trust between headquarters and leaders of individual operating companies to do their job effectively. It works because people who feel trusted tend to want to do a better job. It's the power of reciprocation in action. Conversely, there is nothing like the feeling of someone constantly looking over your shoulder, questioning your every move. A centralized company will sooner or later impact morale and motivation.

Decentralization and non-interference works well as long as a business is on the right track. In order for decentralization to work companies need to set concise and clear financial targets and benchmarks. As a manager you are rewarded (often very well) by achieving targets, but you also face the risk of losing your job if you underperform over time. Performance targets are often rational and tied to value creation metrics such as like growth and return on capital. Many incentive models also incentivize minimal use of capital.

Large bureaucracies are a much more common form of organization. Most people got experience from such companananies. The typical characteristics are budget-driven organizations where policies and procedures dominate with lack of independent thinking. Customer needs are not at the forefront of these organizations and risk aversion is common. Therefore, time to market is high and incentives do seldom work as intended which leads to risk aversion.

No one admits it, but basically such structures exist because from the top of the organization down, noone is trusted to do their job.

As large companies grow, they tend to exacerbate the trust issues - more people, more meetings, more policies, etc. At a certain point, these factors outweigh the benefits of larger size, meaning that size becomes an anchor to growth and margins, rather than an accelerator.

We believe strongly in entrepreneurship and autonomy. That's why we invest in companies with a decentralized approach to business. In essence, we think the decentralized approach, properly applied, unleashes the best in all of us and sets the stage for strong value creation. That's why you'll find a large collection of these business models in our funds.

Management

Those who invest with top entrepreneurs and owners have a great advantage. That is why we bet on people.

The leaders we seek and find are not only excellent investors. They are able to maintain a "small business feel" with the absence of bureaucracy, lots of entrepreneurial spirit, quick response times, and calculated risk-taking. These executives tend to act informally. They talk to everyone, regardless of rank. They fly coach and stay in basic hotels. They are always thinking in terms of improvements and have a constant focus on costs. They focus on decentralization, which causes employees to act and think like owners. Owners behave differently than employees. If you own your car, you treat it differently than if you rent the car. Have you ever cleaned your rental car?

The basic principle of empowering entrepreneurs with autonomy and support naturally resonates well with founders. We've talked to a number of founders who have sold their business to our high-performance conglomerates, and there is some common feedback. They have chosen to sell to our companies because they fear that their life's work, colleagues and customers will not be treated well in unfamiliar hands. Our decentralized companies address these messages. They are permanent homes.

The owner-operating mindset of these sellers is not lost. They value the culture of entrepreneurship and thrive on independence. Decentralization is very valuable for what it promotes, but even more valuable for what it prevents.

As an employee in these decentralized operations, you tend to get promoted based on execution. The CEO often spends much more time with employees and customers than with shareholders. We are very happy with that kind of priority, which ends up benefiting shareholders.

Yes, investing is often seen as a math exercise . But because we are trying to look into the future we need to trust people to make good decisions on our behalf. It is paramount to choose the right people and cultures. Portfolio performance is driven by passionate managers, often founders with a deep-rooted interest in success. We do focus all our efforts on finding and investing in this type of companies.

"I built a flamethrower as a kid, which was not acceptable. I do not like anyone telling me what to do"

(CEO Mark Leonard, Constellation Software)

They treat the company as their own and have a long-term view that often doesn't involve giving the market guidance on short-term profit expectations. In many ways, these CEOs can be viewed as outsiders - they are very determined about how they want to run their business and don't care about "conventional wisdom."

We tend to invest in "owner-operated" businesses. An owner-operator is a principal or owner, often a founder, who is directly involved in running the business. This person has the majority of his or her wealth tied up in the business. A management team that owns part of the business never has to fight for control. An owner-operator fights for profitability.

Some investors claim that management doesn't matter. Our experience is that the fastest way to destroy a great company is to put incompetent people at the helm. Adam Smith pointed this out as early as 1776:

> *“The directors of joint stock companies, however, being the managers rather of other people`s money than of their own, it cannot well be expected, that they should watch over it with the same anxious vigilance with which the partners in a private copartnery frequently watch over their own…The failure of taking proper care and profusion, therefore, must always prevail, more or less in the management of affairs of such a company.* It is upon this account that joint stock companies for foreign trade have seldom been able to maintain the competition against private adventurers”
> (Adam Smith, 1776)

When you put your money into a company, you trust it to that chairman, that CEO, that board of directors. It would be nice if they were invested alongside you. Invest alongside talented people. Think of some of the greatest stocks of the last half century and you'll often find an owner-operator behind them.

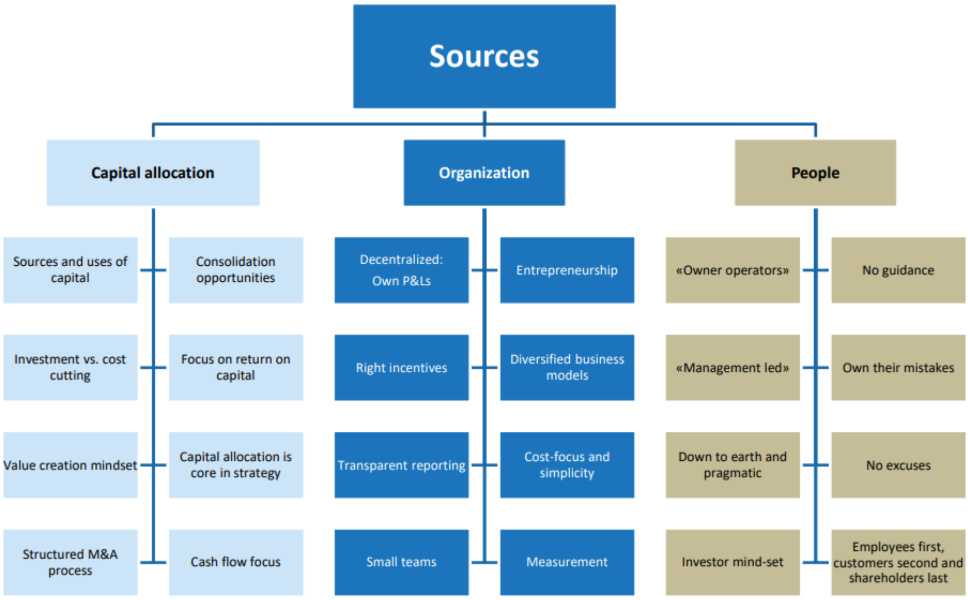
No matter how much work an investor puts into an idea, the future remains uncertain. In a capitalist economy, creative destruction always takes place. The best insurance against creative destruction is to partner with management teams that do the creating. That is, smart, energetic, honest people who act on a vision and who have their own financial future at stake. Over time, great people get the best results in pretty much any endeavor.

It is very difficult for the market to assign future value to the likelihood of consistently superior execution and decision making over many years. We believe we can improve our odds of outperforming by investing behind the best decision makers. And again, we believe that the best decision makers tend to be owners with their own financial futures at stake.

Owner operators with strong capital allocation capabilities and a decentralized organization end up resembling private equity funds with permanent capital without a fee structure.

> “If you ever hear the words conventional and wisdom conjoined, reject them. Because if it is conventional, it isn’t wisdom. And if it’s wisdom, it isn’t conventional”
> (CEO Herb Kelleher, Southwest Airlines)

The following illustration summarizes the most important terms of the investment philosophy and shows which aspects characterize our investments. Further information can be found in our Owner's Manual "Investing With Insight" and in our book "Investing in Value Creators".



REQ Global Compounders

The companies selected in REQ Global Compounders have been carefully chosen according to the principles described above. We invest in great capital allocators, decentralized organizations, and management teams with skin in the game and who act like owners. These three principles are powerful sources of long-term returns. Investing is a reductionist art, and those who can boil things down to the basics will generate strong long-term returns. Great companies are the ones you like more the longer you own them. For us, it's a short list of companies, and you'll find them in the fund.

The table b elow is a visualization of the top 10 companies of REQ Global Compounders.

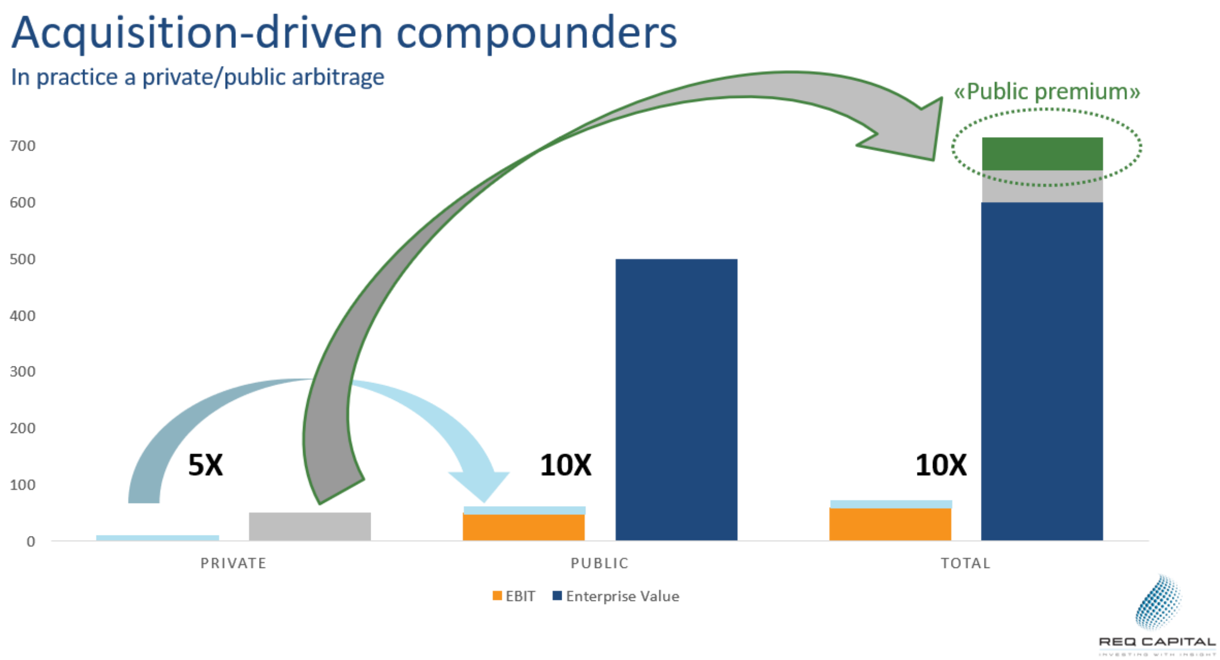
Available for clients

Capital allocation is at the core of their strategy. There is a common theme in how our companies allocate their capital. They primarily use free cash flow to consolidate industries and buy small private companies. That's their skillset and something they've practiced for many years. They have a huge network of relationships with private sellers and tend to buy multiple small private companies every year. We think the leaders of our companies are excellent investors. The return on Capital Employed (ROCE) is high and because our companies reinvest large amounts of free cash flow each year, we enjoy strong and profitable earnings growth. Our companies create significant value for us as shareholders.

Next pages: Extensive details about holdings of the fund
Available for clients

A private/public arbitrage

Our strategy of investing in companies that spend a large portion of their free cash flow to acquire smaller private companies can also be considered private/public arbitrage.



Over many years, often decades, the publicly traded companies we own in the middle of the chart have built a relationship with the private sellers on the left. Our companies provide a "permanent home," to quote the famous investor Warren Buffett. Our companies offer full autonomy but access to capital and growth opportunities.

For the private sellers, many of whom we have spoken to, there are often a lot of non-financial arguments to sell their business to our compounders. Many of these private owners want to continue to own 20% of the company - often with a buy-out mechanism after 5-8 years. Our companies offer strong incentives for the founder to continue to grow profitably. In addition, sellers are guaranteed that the local headquarters will not be moved to another part of the country. Sellers also feel a strong commitment to the employees who are offered to stay with the company after the transaction.

Of course, there are private equity firms knocking on the doors of these sellers. They often have deeper pockets and can offer higher prices. But in many cases, capitalism doesn't always work by the textbook, and fortunately for us, private sellers choose our compounders. They choose the right owners for the long haul.

As part of the holding company, full freedom is offered. Capital is offered and best practices in shareholder value creation are part of the package. Our publicly traded companies are able to acquire these private companies at much lower multiples than the multiple at which they themselves trade. In many ways, our strategy implies holding hundreds and hundreds of private companies under listed umbrellas.

Investing in culture

As we have evolved as investors, we have discovered that qualitative factors have a major impact on investment returns. Historical numbers and "moats" don't provide all the clues. Often, it is qualitative factors such as corporate culture and management's approach to capital allocation, combined with organizations with a great deal of autonomy, that provide investors with excellent long-term returns. Taken together, these elements significantly improve the odds of generating strong long-term equity returns.

If you read Phil Fisher’s book “Common Stocks and Uncommon Profits”, he has a 25 point checklist on how to analyze a company. Of those 25 about 15 are qualitative elements. That is just the reverse of what most people on Wall Street do.

A strong, consistent culture is the greatest competitive advantage in a rapidly changing world. The importance of corporate purpose and culture as a differentiator is as important to REQ Capital's progress as it is to the underlying holdings of our equity funds. A company culture is an asset when your competitors know what you do, how you do it, but they still cannot duplicate it.

We very rarely hear public investors talk about people, culture and leadership. As a result, we think there are great opportunities for investors who take a hard look at this important topic. Our years of investment experience have led us to believe that recognizing super talent before others is one of the most underrated skills an investor can develop. The really big money tends to be made by investors who are right on the qualitative decisions.

A great organization has both great employees and a great culture. Companies that get better over time have both. Nothing is more important or difficult than getting the culture and people right.

Culture starts at the top. The CEO is the Cultural Executive Officer. It has been our experience that executives often do not fully realize the extent to which "who they are" affects all aspects of their business. Investors often do not fully appreciate the importance of management and its impact on culture.

We seek to find management teams that inspire human capital and are excellent investors. These ~~cultures become high performance organizations. People go in the same direction because of~~ leadership. Capital allocation is an important part of strategy and culture. Together, these companies become high-performance companies that outperform over time.

The best companies obsess over their customers, not their competitors. Great companies exceed your expectations. They make it look easy, but it's the result of deep thought, execution, and processes put in place to scale happy customers. Bad companies always have an excuse to miss the mark.

Most companies operate with "standard" cultures. Since no one measures or pays attention to culture, the underlying values and beliefs of leaders become "the way things are done around here."

Leaders whose energies are wrapped up in status addiction, empire building, and internal competition create toxic environments with little or no organizational cohesion. Organizations don't change, people do! The key factor in transforming a low-performing culture into a high-performing culture is leadership. Great leaders have an ability to facilitate high performance in large groups of people who strive for equality and responsible freedom. People want to be held accountable - not micro-managed and monitored every moment of every day.

We conduct our own primary research by talking to many former employees of the companies we consider as candidates for our funds, mainly in the Nordic countries. The insights we gain from a structured process of talking to former employees are underrated. We have yet to discover anyone on the sell or buy side in fund management doing the same type of work, although this is quite common in the private equity sector.

We are surprised by the amount of feedback from this source of primary research. Former employees are willing to talk openly about their experiences, which provides us with a valuable consensus view on the culture of the firm. We have excluded companies from our portfolios based on this source of primary research.

Assessing the corporate cultures of companies outside the Nordic countries is a more difficult task. Nevertheless, we are in the process of developing a powerful Cultural Index Model® using Artificial Intelligence and Natural Language Processing to extract insights from written employee reviews on, among other platforms, the recruiting portal Glassdoor. We are very optimistic about this project and expect it to become an addition to research on International companies.

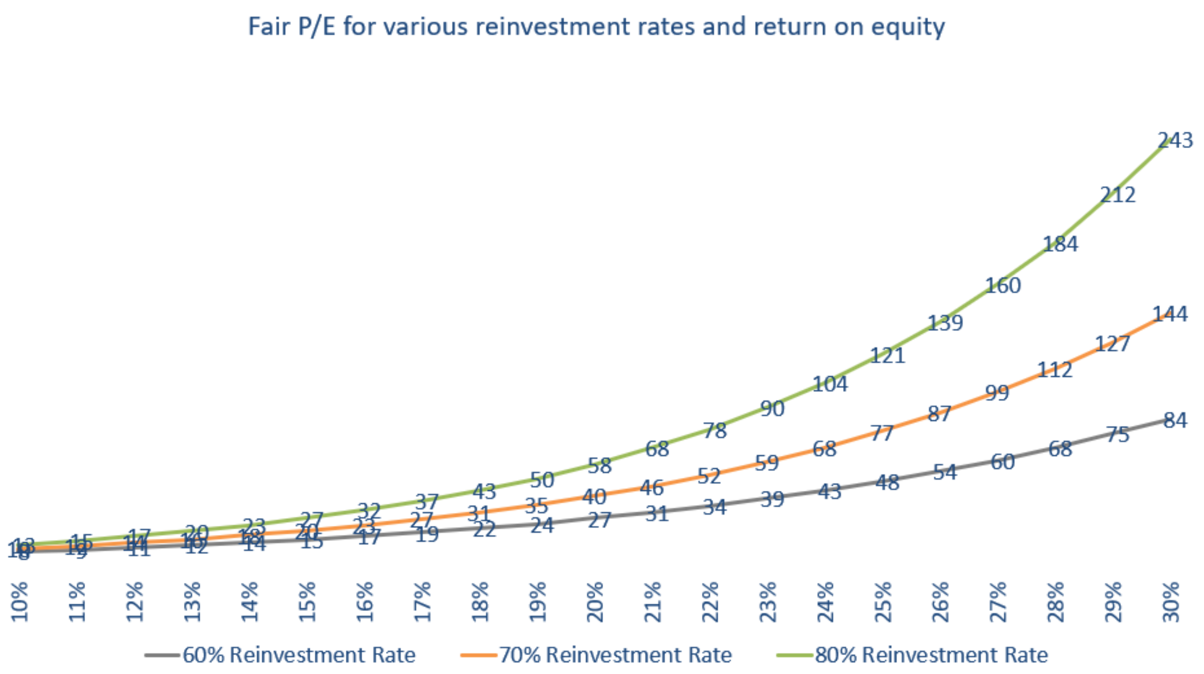
Pricing and valuation

When you are a long-term investor in great businesses, and enjoys the full benefits of compounding, you get used to holding stocks that are not always “cheap” on short term multiples. You only see the effect of compounding earnings after many years. Our businesses are often overvalued in the short term and significantly undervalued over the long term.
The multiples we pay will of course affect our long-term investment results. The key for us is to evaluate long term reinvestment opportunities.

The chart below is an illustration of the correct P/E-multiple you can afford to pay and still get a very decent market return of 8% annually. The inputs are different reinvestment levels, different ROE, and a 20 year investment horizon.

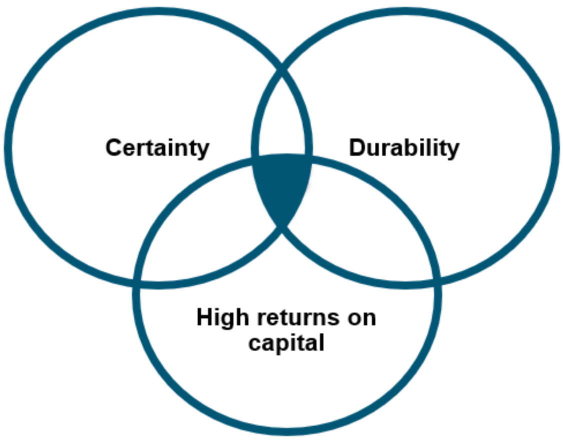
The average ROE in REQ Global Compounders is 20% and the average reinvestment rate is about 73% which gives you a fair P/E of around 45. On average our companies trade at around 30 times P/E. For most of our companies we expect their market position to last at least 20 years.

We are careful on investing in too many companies that reinvest 100% of profits due to the fact that these companies are vulnerable if not delivering on growth expectations. But as you can see from the chart below, if you are able to spot companies that can reinvest 80% of profits at more than 20% return on equity for a very long time, the market will almost always tend **not** to price these business models correctly.



What these calculations really boil down to are the following ingredients behind successful long term investments.

You need a combination of durability in terms of reinvestment opportunities, high return on capital and a high degree of certainty that reinvestments can continue for years into the future. The calculations above tell us that if you combine all these three ingredients, the price you could pay for a stock is normally a lot higher than you could imagine. You have to invest in companies that are getting stronger and which will be stronger in 10-15 years. Any valuation work you do then is just ludicrous.



The calculations also tell us that it is better to make a mistake on the price of a business, than the quality of a business. The lesson is: You do not sell these companies on valuation alone. Investors tend to over-value growth and under-value durability. We would much rather own a business able to

> *"The vast majority of losses in the stock market come from picking the wrong business, not picking the wrong valuation on the right business"* (John Huber)

grow profits at 6% a year for decades, than one that grows rapidly for a few years and then gets into serious trouble.

What you could have paid for our top-10 holdings?
Let us take a look at our Top-10 holdings and ask ourselves the following question: What could we have paid for these businesses 10 years ago and still got an 8% compound annual return? The answer will surprise most investors with a median P/E of 91. We are not trying to justify that P/E-multiple. But it gives some perspective into pricing of stocks. A fair price may be a lot more than you would think if profitable reinvestment really can take place.

We believe that the 3 ingredients described above are very much present today in the whole portfolio. Our investments all have a very long pipeline of growth opportunities. They generate a return on equity around 20%. Since these business models are very diversified by design, we feel comfortable in owning a limited number of "top-co" stocks in our portfolios.

Table of companies
Available for clients

> *"With regard to truly dominant companies that are able to achieve rapid, durable and highly profitable growth, it is very, very hard to overprice them based on near-term multiples*" (Howard Marks)

The great companies that we own keep on working while we are sleeping. They continue to earn more and more. Mediocre companies will not do that. An important part of the work that goes into investing is finding truly great investment candidates. But what is equally important, and not often discussed, is the art of **not** selling these companies.

To us exceptional companies with durable competitive advantages are in fact cheap almost all the time.

Sustainability
We have a close collaboration with the EAT Foundation, a leading global science-based multi-stakeholder platform accelerating change on food systems transformation focusing on the nexus of food, health, social justice and sustainability. EAT has one of the leading roles at the UN Food Systems Summit and provides us with valuable science-based insights to challenge our existing portfolio companies in addition to providing insights on future trends and opportunities. We use this information in our search for sustainable value creators for our portfolios.

REQ Capital is also a signatory of the United Nations Principles of Responsible Investments (UNPRI) where we are committed to incorporate Environmental, Social and Corporate Governance issues into our investment analysis and decision-making process.
The UNPRI has attracted a global signatory base which together work to promote sustainable investments. Our clients know that by signing the PRI, REQ Capital will take sustainability factors in consideration in every investment decision.

REQ Contribution

We use the UN Sustainability Goals actively. Companies that are well-positioned to achieve these goals or companies that are investing capital behind these goals will experience growth. It fits well with our investment philosophy to find companies that grow more than the market as a whole and grow in a profitable way.

We donate 5% of our net profit to associations, foundations and non-profit organizations which contribute to the UN Sustainability Goals.

If feels good to know that the better results we create for clients, the more we are able to contribute.

Save like a pessimist, invest like an optimist

Optimism rules the world. Growth is optimism. People want to be part of growing enterprises and investors who find and invest in companies that grow in a profitable way for a very long time will build wealth over time.

History tells us we should invest like optimists. In the short run we should save like pessimists because there is always the potential for some kind of setback in the economy or our personal lives. We all need a cushion the next time we slide on a banana peel.

Over the long run you should invest like an optimist. For hundreds of years more people wake up every day trying to solve problems than the opposite.

> *"Since progress is cumulative (we don't forget past innovations) but setbacks are temporary (we rebuild), the long-term odds tilt towards growth. And that's all it takes"*
>
> (Morgan Housel)

Time is on your side in the stock market. As shown below, 95% of all rolling 10 year horizons since 1926 in the US stock market have been positive. No 20 year rolling period has been negative. The best way to describe this development is to quote Elroy Dimson and his colleagues: "Triumph of the Optimists"

S&P 500: 1926-2020		
Time Frame	Positive	Negative
Daily	56%	44%
1 Year	75%	25%
5 Years	88%	12%
10 Years	95%	5%
20 Years	100%	0%

Source: Dimensional Fund Advisors

Our investment philosophy is based on an extraordinary long-term investment horizon. Our philosophy of investing in Value Creators stands the test of time and will create significant value for us as shareholders, and of course you as our co-investors.

Summer reading material

As you head for the beaches, cabins and holiday resorts, we would like to provide you with some suggested reading material. Reading a book is just like getting a software update for your brain. Some of the books below are purely investment-related, others are more suited for a dinner conversation.

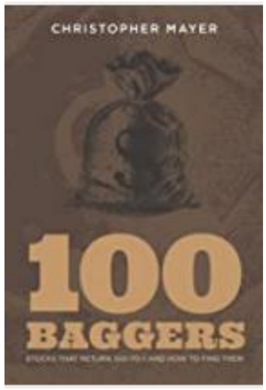
The books below will not only make you a better investor, they are also very inspirational and great to discuss with friends. They also have the potential to make you stop and reflect on life in general.

We think the best filter while reading a book or article is to stop and ask yourself the following question: “Will I still care about this a year from now?” In the books below, the answer is a definitely “YES!”.

Have a great summer holiday!
The REQ Capital Team

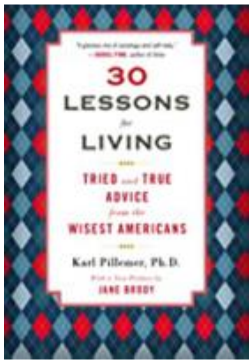
The Outsiders by William N. Thorndike Jr.
What are the key ingredients of the best corporate managers over the last century? The book provides valuable insights into what qualities of a CEO to look for. As Warren Buffett has stated: “It is almost impossible to overpay for the truly extraordinary CEO…but the species is rare”. These CEOs produce superior performance because they do something different.

100-baggers by Christopher Mayer
What are the key ingredients for stocks that return 100 times investment? The “twin engines” of a “100 bagger” are growth in earnings and a higher multiple on those earnings. It is the management alone which is the 100x alchemist. And it is to those who have mastered the art of evaluating the alchemist that the stock market rewards with gold.

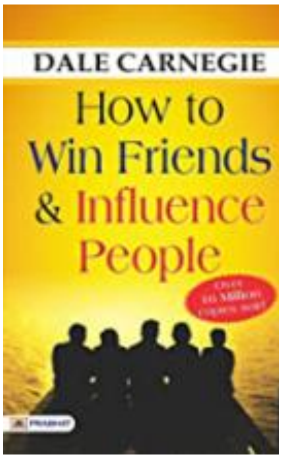


Factfulness by Hans Rosling
This is the “go to book” when you are overwhelmed by negative news about the state of the world. Mr Rosling is able to convey a fact-based illustration of the gigantic progress made by humans over hundreds of years. Whether it is global poverty, epidemics, war or terrorism, we tend to have a dramatic and negative view of the world. But this worldview is wrong. By almost any measure this is the best time to live. The book will basically make you feel more positive about human progress.

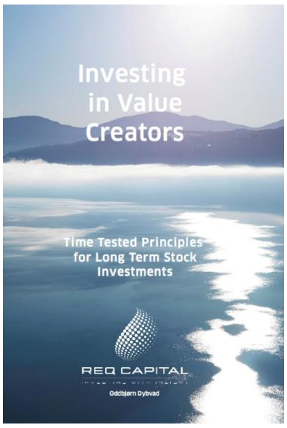
30 Lessons for living by Karl A. Pillemer
Tried and True Advice from the Wisest Americans
The author has interviewed the experts – more than a thousand older people - on how to make the most out of life. What did they say? Happiness is your responsibility, don’t keep score, marry a partner with same values and find happiness at work are some of the 30 lessons these “experts at life” provide us. The experts’ key message about aging is perhaps the most counterintuitive: Do not waste your time worrying about getting old.



How to Win Friends & Influence People by Dale Carnegie
The title of this classic makes you hesitant to touch it. But the book by Carnegie has become a classic due to its timely wisdom. “Talk to people about themselves,” said Disraeli, one of the shrewdest men who ever ruled the British Empire. “Talk to people about themselves and they will listen for hours.” Always make the other person feel important. Did you ever stop to think that a dog is the only animal that doesn’t have to work for a living? A hen has to lay eggs, a cow has to give milk, and a canary has to sing. But a dog makes his living by giving you nothing but love.



Investing in Value Creators by Oddbjørn Dybvad
Our own investment principles. Investing in Value Creators introduces some basic principles and fundamental reasons why some stocks perform significantly better than other stocks over the long run. If you have not yet read our own book “Investing in Value Creators”, please contact us on od@reqcapital.no and we will make sure to send you a copy or a digital version.



REQ CAPITAL

INVESTING WITH INSIGHT

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