Investing with Insight

Half Year Investment Report 2024

July 2024

Picture source: Unsplash.com: Magnus Olin

Table of contents

Dear Fellow Investors 3
REQ Global Compounders 5
REQ Nordic Compounders 6
The Private Market Superinvestors 7
The Swedish legacy of Decentralization 15
International Runway of Growth 18
Lifco – A Successful Acquisition-Driven Compounder 20
Anecdotes from Talking to Entrepreneurs 21
Underwriting Process and Look-through Statistics 22
Cash Flow in Downturn Scenarios 24
Podcasts and Other Resources 26
REQ's Summer Lunch in Stockholm 26
Suggested Reading Material 27

Dear Fellow Investors

First, we want to thank all our investors for their continued confidence in our strategy and team. We are fortunate to have investors in our funds who believe in our long-term approach of investing in acquisition-driven compounders.

REQ Capital invests capital through two open-ended funds for family offices, institutions, and fund-of-funds. We are based in Oslo and Stockholm and manage capital for clients worldwide. Our clients are long-term-oriented investors who gain exposure to companies led by strong capital allocators in decentralized organizational structures where managers and owners have a lot of skin in the game. REQ manages two distinct funds: REQ Global Compounders and REQ Nordic Compounders.

June 15th, 2024, marked the three-year anniversary of the REQ Global Compounders fund. Over this brief period, stock prices have been much more volatile than the underlying fundamental development of our companies. Moreover, three years is way too short to conclude the success of any investment strategy. However, we are happy that the investors who invested three years ago have gained a 50% return[1] over the period, translating into a 14% compound annual return.

Compounding capital

Our investment strategy revolves around ultra-long-term, unconstrained, and concentrated equity funds. We focus on publicly traded companies that consistently generate high free cash flows, demonstrate exceptional capital allocation skills, and have a proven track record of delivering substantial shareholder value. We refer to these companies as "Acquisition-driven Compounders" because they can reinvest significant cash flows into small private acquisitions and organic growth each year, achieving highly attractive returns. We believe this approach offers the best of both worlds: sustainable, long-lasting growth and intrinsically diversified operations, which reduce single exposure risk.

Compounding knowledge

During the year's first half, we dedicated our time to meeting with management teams, attending Annual General Meetings and speaking with former employees of key holdings.

We find great value in independently sourcing these conversations, which is easier when we are located just a few blocks away from the management teams and sellers of the companies our portfolio companies eventually acquire. These local insights provide more value than standard expert calls, which are often influenced by participants' agendas, differing time horizons, and varying perspectives.

As specialists rather than generalist managers, our competitive advantage is driven by a self-reinforcing growth flywheel. This flywheel is fueled by our deep specialist knowledge about a subset of the investment universe, particularly acquisition-driven compounders. This attracts like-minded investors, management teams, and clients pursuing this specialized knowledge, accelerating the flywheel even further. Over time, we develop deep insights into these business models, ultimately resulting in strong performance for our clients. We are excited about the future compounding effects we can achieve as this flywheel continues to spin.

[1] Return in NOK for the “A” class. The fund has share classes in NOK, SEK, EUR, USD, CHF and GBP

Research

We published our deep dive into acquisition-driven compounders at the beginning of the year. The research has led to several interesting discussions with investors, management teams, and boards. It provides a comprehensive understanding of our strategy. Throughout the last six months, we were invited to present to several leading boards of acquisition-focused compounders. During these sessions, we shared insights and strategies learned from our experiences in the field, aiming to prevent common pitfalls. Additionally, we gained insight into how the boards of our portfolio companies think about strategy and execution, which is highly valuable for our research process.

Thank you for your trust and support.

The REQ team

REQ Global Compounders

In the first half of the year, the fund's A-class shares in NOK appreciated by 14%[2]. Since the fund's inception in June 2021, the fund has increased by 50%[3].

The fundamental performance of REQ Global Compounders has been strong, highlighted by healthy organic growth rates and strong acquisition activity.

The companies in the portfolio thrive on two growth engines: organic expansion and acquisitions, which form a core strength. Our portfolio consists of B2B companies offering critical products and services needed across the entire business cycle, giving them a competitive advantage over those in consumer-facing markets. Strong decentralized cultures prevail across our holdings, empowering operating companies to control their cost bases, vital for flexibility, cost management, and earnings in volatile times. Management outlooks predominantly emphasize a business-as-usual approach, foreseeing growth from organic initiatives and acquisitions.

Our portfolio companies maintained a rapid acquisition pace, announcing a total of 99 transactions during the first half of 2024. Constellation Software Group led the way, driving transactions across group companies like Volaris, Harris, Jonas, Vela, Perseus Group, Topicus, and others. The ebb and flow of reported acquisitions is inherently unpredictable, and we do not dedicate extensive efforts to pinpointing these fluctuations throughout the year.

A notable acquisition in the 1st half of 2024 was the UK-listed Diploma's purchase of US-based Peerless Aerospace Fastener LLC, a top distributor of specialty fasteners with value-added solutions, mainly to the US airline industry. Peerless has a robust financial history, including a 9% organic growth rate over the past decade, with EBIT margins of 30%, and high returns on capital. The acquisition is valued at USD 236 million, or approximately 7 times FY24 EBIT. Peerless is expected to contribute significantly to Diploma's earnings, with an 8% accretion to Group EPS and a 15% return on capital anticipated in the first 12 months of ownership.

We've seen promising developments in Diploma's strategy under CEO Johnny Thomson since 2019. Our recent discussions have reinforced our optimism towards its approach of blending larger acquisitions with smaller bolt-ons while still emphasizing price discipline and return on capital. This marks a shift towards more organic growth compared to the era of Bruce Thompson.

In June, Judges Scientific announced its subsidiary Geotek's acquisition of Rockwash Geodata Ltd, specializing in digitalizing rock cuttings. The transaction, capped at 6 times EBIT with total consideration up to £6 million (cash and earn-out). We recently met Judges Scientific's CFO, Brad Ormsby, and were impressed by Geotek's 2022 acquisition performance and Judges' effective execution of accretive small acquisitions. We also had a productive meeting with Valerie Diele-Braun, the new CEO of IMCD, who succeeded Piet van der Slikke. Judges Scientific and IMCD have been long-term holdings since the fund's start and even before that in previous roles.

Moreover, our research pipeline of new ideas is robust, and we continue to work diligently on maintenance due diligence for our existing holdings as well as on our pipeline of new ideas. The underlying performance of the companies in the portfolio is strong. Cash generation is high, and we know from experience that our companies reinvest that cash flow at highly attractive rates of return, which translates into strong, profitable growth. Over the long run, this will translate into attractive compounding for the investors in our fund.

---

[2] Return in NOK for the “A” class. The fund has share classes in NOK, SEK, EUR, USD, CHF and GBP

[3] Return in NOK for the “A” class. The fund has share classes in NOK, SEK, EUR, USD, CHF and GBP

REQ Nordic Compounders

Year to date, REQ Nordic Compounders fund's A-class shares in NOK has increased by 15%[4]. Since inception in January 2022 it has increased by 32%[5]. The portfolio consists of 23 holdings.

During the first six months of 2024, our companies have announced 68 acquisitions, compared to 75 acquisitions announced in the same period the previous year. Our companies continue to announce acquisitions at a similar pace compared to recent years, even though M&A is lumpy and can vary from quarter to quarter. The general trend regarding acquisitions is unchanged. When speaking to our companies, they are optimistic about their pipelines, which is also supported by the strong balance sheets of ND/EBITDA, which are below 1.5x on average.

One of the most noticeable acquisitions was Lagercrantz's acquisition of Prido, a Swedish manufacturer of high-quality industrial doors and gates that has organically grown sales from EUR 3.8m in 1997 to EUR 34m in 2023, while operating margins have expanded from 10% to 21%, representing a sales and operating profit CAGR of 9% and 12%, respectively, over 26 years. Lagercrantz acquired the company at EV/EBITA 7.0x. The company added c. 4.8% to Lagercrantz's sales.

Another noticeable acquisition during the year was Lifco's acquisition of Cardel Group in the UK, a producer of secure ID documents and payment cards. Around 60% of identity cards/passports and 40% of Smart Cards utilize a Cardel product in manufacturing. Cardel Group was founded 25 years ago and generates annual sales of GBP 16.5 million. The company added c. 0.7% to Lifco's sales.

In addition, the largest acquisition announced by our holdings was Beijer Ref's acquisition of Young Supply. Young Supply is an American distributor of refrigeration and HVAC in the Midwest United States. This acquisition complements Beijer Ref's adjacent territories in the Midwest, and the company has annual sales of SEK 1.4 billion and operates through 18 branches. The company added c. 4.4% to Beijer Ref's sales. These types of family-owned business acquisitions are what we typically see across our portfolio.

The most robust performance in the first quarter was displayed by Medcap, which increased sales by 21% (of which 12% organic) and EBITA growth of 46%. The company with the weakest performance was Nibe with sales growth of -18% (of which -24% organic) and EBIT decrease of -71%, affected by a weak market due to continuous de-stocking.

Despite the persistently challenging market conditions and uncertain outlooks that remain a concern, our portfolio companies have adeptly navigated through these difficulties, showcasing their resilience and adaptability. For the first quarter of 2024, our companies, on average, displayed a sales growth of 4%, of which -4% organic and an EBITA growth of -3%. As we have seen in other periods when the economy slows down, our companies produce a lot of cash flow, and this time is no different. Despite EBITA growth being negative for the first quarter, operating cash flows for our companies are +14.5% year over year in the first quarter.

The cash flows of our companies are also at record high levels, supported by the unwavering focus on generating reliable and consistent cash flows among our companies. We appreciate your ongoing support and look forward to sharing our progress in the future.

[4] Return in NOK for the "A" class. The fund has share classes in NOK, SEK, EUR, USD, CHF and GBP

[5] Return in NOK for the "A" class. The fund has share classes in NOK, SEK, EUR, USD, CHF and GBP

The Private Market Superinvestors

Our upcoming book, 'The Private Market Superinvestors,' presents a case study of ten successful acquisition-driven compounders globally. Here, we highlight some of the overarching DNA traits observed among these Superinvestors.

After studying the best private market Superinvestors, we've learned that the most successful ones seldom define themselves solely by acquisitions. Instead, they can be considered high-performing conglomerates whose focus and scope extend beyond transactions. In addition to a successful private acquisition strategy, they build the right culture for organic expansion, fostered by a strong "cash culture," embodying a deeper sense of purpose beyond mere deal-making. These private market Superinvestors often evolved from industrial backgrounds, viewing the business landscape through the eyes of an entrepreneur in the trenches rather than as executives looking to make quick profits through rapid deal-making. While they eventually shifted to a growth strategy that included acquisitive expansion, their foundation often rested on a heritage of industrial value creation. They proceeded not in haste but methodically, building brick by brick while instilling a strong sense of cash culture through trial and error. The Superinvestors typically prioritize company building before acquisitions.

Arriving at the broader DNA of why these high-performance conglomerates have been so successful often involves a mix of the following core characteristics:

- People and Capital Allocation: Exhibiting a higher sense of shareholder stewardship through strong alignment among the senior management team, including creating proper incentive systems across the group, often in collaboration with a dedicated long-term shareholder.

- Compounding Vehicles: Operating with dual growth engines across multiple end-markets and not reliant on a single engine of organic growth constrained to a single industry.

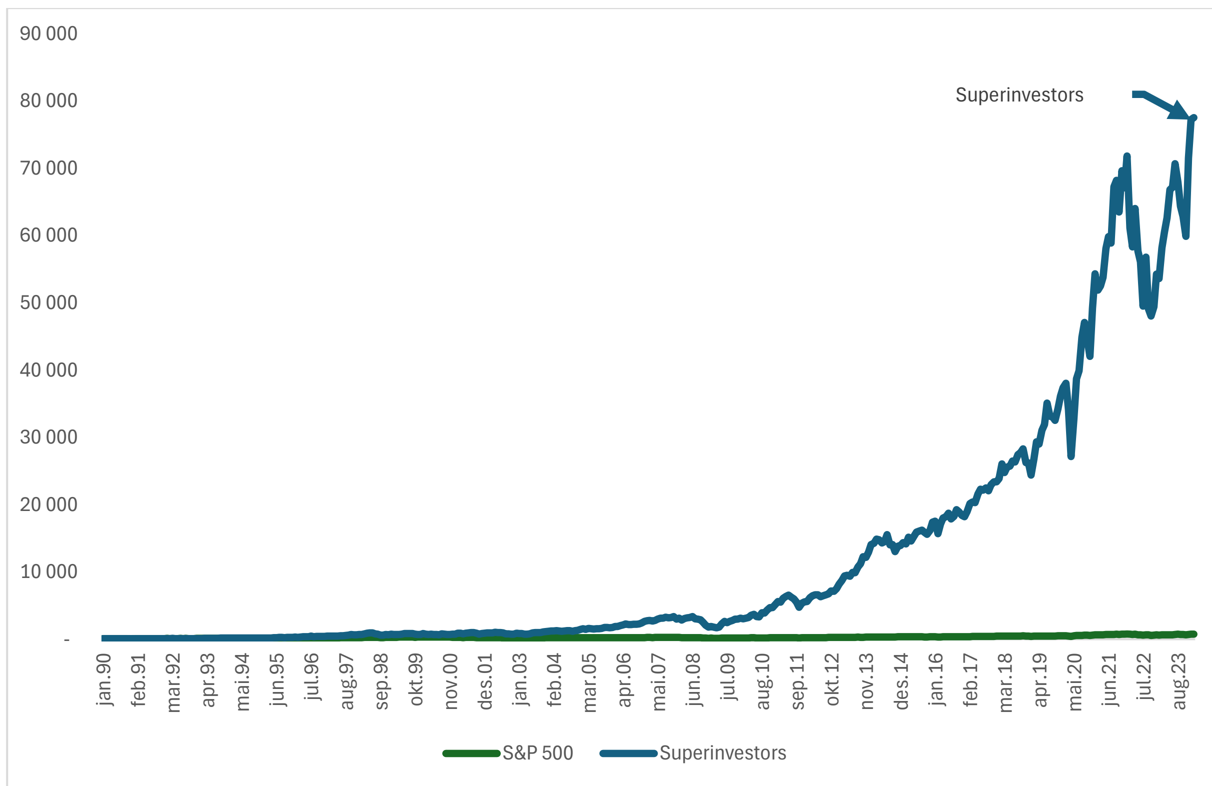
- Growing big by staying small: Superinvestors thrive by maintaining a decentralized, entrepreneurial culture that allows for scaling without losing the agility and close customer relationships of a small business.

- The Private market Superinvestors excel by fostering a decentralized, cash-focused culture, emphasizing sustainable, self-funded growth through both acquisitions and organic expansion.

These characteristics define the operational ethos of the best Superinvestors and serve as the bedrock for their sustained success and resilience in changing market dynamics.

Avoiding “leakage”

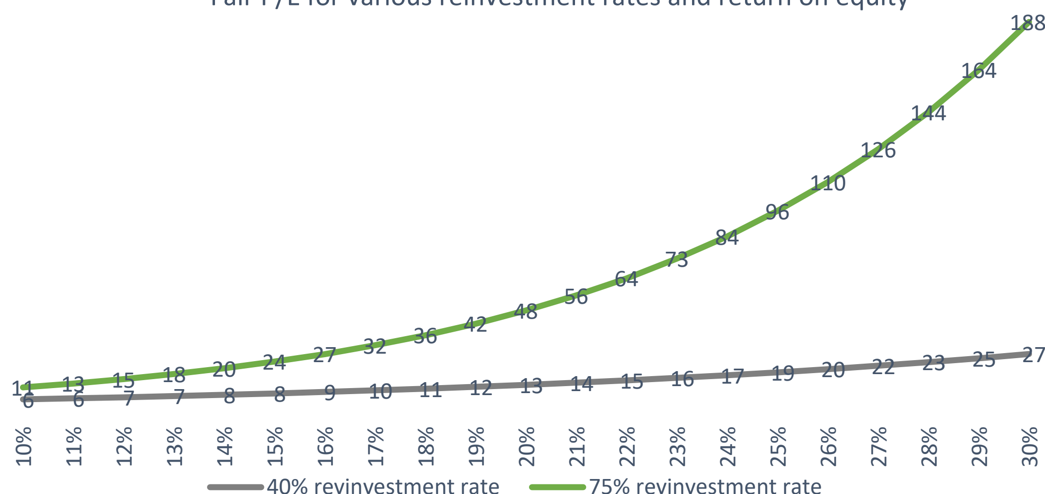
The performance of the Superinvestors, as illustrated by the graph below, showcases the real power of compounding when allowed to continue over a long period. The illustration is the equal-weighted total return of the ten companies we dive into in the upcoming book “The Private Market Superinvestors”



If compounding were to have a sibling, it would likely be a high-performing, acquisition-driven compounder. This analogy aptly describes how the best among these entities have mastered the essential components for effective compounding. At their core, the fundamental elements amplify the critical aspects of compounding business value: the amount of capital that can be reinvested, the return on that capital, and the duration.

Initially, most observers are drawn to the return aspect of the compounding equation, captivated by the HPC's dual engines for growth: organic expansion and acquisitions. However, many market participants focus predominantly on current growth rates and historical returns on capital, often overlooking the sustainability of these performance levels and the real multiplier effect of returns over time. The longevity of stock ownership and the company's ability to sustain above-average compounding rates are vital. A business that fails to sustain a high compounding rate suggests that an investor's long-term strategy, despite good intentions, may not fully realize the potential for exponential gains.

Imagine a business that generates a 20% return on incremental capital and can consistently reinvest 75% of its earnings, thereby compounding its business value at an effective rate of 15%. Now, compare this with a business that also historically returns 20% on capital but distributes 60% of its cash flow due to a lack of sufficient reinvestment opportunities, only able to reinvest the remaining 40% at a 20% return. Value is only generated when a company reinvests at a rate exceeding its cost of capital. In this scenario, the investor's fundamental return would be confined to the dividends received and an earnings growth of 8%. The P/E multiples you'd be willing to pay for these companies, to achieve market returns over a 20-year investment horizon, vary significantly, as illustrated below. On the X-axis, we display varying levels of incremental ROEs, and the lines represent P/E multiples for reinvestment rates of 40% and 75%, respectively.



This underscores the importance of considering both incremental economics versus legacy operations and the multiplier effect when evaluating long-term investments. The essence of achieving significant returns lies not just in the high initial rates of return but in the sustainable reinvestment of capital at these rates over an extended period. The latter also explains why we emphasize the people and ownership structure, in addition to diversified businesses/cash flow streams. In setups where reinvestment is a fundamental driver of returns, the individuals driving capital allocation decisions become critical to the company's success.

Navigating Investor Returns Beyond Business Compounding

In reality, an investor's return is influenced not only by the underlying business's compounding abilities but also by the expectations (multiples) embedded in the stock price and their change over the holding period. Mathematically, the higher the compounding rate and the longer the holding period, the less significant the impact of multiple changes on investor returns. After all, while the multiple is a one-off, earnings growth, assuming the necessary foundational elements are in place, compounds over time.

Reinvesting as the Core Driver of Investor Returns

The critical role of the reinvestment ratio, including all growth capital, becomes apparent as the "leakage" component enlarges—i.e., when a business distributes more of its generated cash instead of boosting its reinvestment ratio. As leakage swells, the high returns produced by the business on its legacy capital do not benefit investors. Investors gain from the incremental economics generated by the business, not its historical performance. Essentially, past returns are only indicative of future potential if new capital can be reinvested at comparable rates. This highlights why the primary valuation driver for long-term investors is the extent to which a business can reinvest new capital at high incremental rates. As leakage increases, the investor's return increasingly depends on the price paid relative to the dividends received, making the price paid the key valuation driver.

Long-lasting growth and avoiding single exposure

High growth is appealing, but sustained growth is paramount. The durability of growth speaks to both the dual engines of growth—the reinvestment ratio—and the diverse dynamics of the cash flow streams, ensuring reliance is not on a single customer, end-market, or geography. This resilience to

avoid meltdowns recognizes that investing is as much about avoiding the bad as it is about selecting the good. As long as the underlying business maintains above-average compounding, staying invested over time places you among the top percentile of investors. Avoiding singular exposure and the bottom half of outcomes is crucial; given enough time, even low-probability events will occur, highlighting that a long-term horizon as an investor is dictated by the business's performance distribution.

Contrasting high-performance compounders with companies focused on a single exposure quickly illustrates the advantage of having dual engines of growth that balance each other across business cycles and expand the total growth runway. This approach asserts that reliance on a single growth engine, limited to organic expansion within a single industry, can only sustain compounding to a certain extent, impacting the critical components of compounding: the reinvestment rate, return, and duration.

Resilience Through Diversification

The dual engines of growth, spanning various end markets, resemble a tree with roots extending in all directions, providing diversified cash flow streams without compromising compounding or returns. The analogy of a tree's growth symbolizes the reinvestment opportunities harvested over time, reinforcing that avoiding losses is as crucial as achieving high returns. This perspective shifts focus from seeking the highest rewards to evading catastrophic failures, embodying resilience and diversification over maximal immediate gains.

Above-Average Entrepreneurship and Cash Culture: The True Differentiator

What distinguishes a mere serial acquirer, mostly focused on deal-making, from a high-performing conglomerate is a strong decentralized culture combined with a long history of cash culture that runs through the group as an operating system. This fosters an efficient internal capital market where the return on capital and entrepreneurship thrive, which has the added benefit of healthy organic growth in the underlying companies in the group. This ecosystem allows new companies to maintain their entrepreneurial spirit while integrating into a system that encourages competition and strives for healthy levels of competitive spirit among the companies. The emphasis on cash flow, a self-funded growth model, and a clear understanding of the levers to pull for value creation underscores the importance of balance in achieving long-term success.

High-performing conglomerates excel not just by focusing on acquisitions but by building businesses with a purpose, supported by a legacy of industrial value creation and a commitment to operational excellence. Moreover, we would argue, in agreement with the principles outlined by David Barber (founder of Halma and earlier long-time CEO), that acquisitions financed through internally generated funds and assessed via a rational investment framework based on cash flow, akin to the methodology used for calculating expected returns from organic projects and their associated cash flow economics, should be considered equivalent to organic growth for these companies[i].

Yearly gatherings and academies sharing best practices on pricing, working capital, sales, business acumen, and numerous other topics help generate organic uplift—an important contributor to overall growth. Simple profit goals related to cash flow conversion and predictability teach everyone that sales growth must be balanced with the cost of deploying capital. Furthermore, among the best, we often see a well-developed pricing culture and a keen awareness of what contributes to cash flow growth and what does not (e.g., discounts). Hence, one typically finds value-based pricing replacing the legacy of cost-plus pricing after onboarding new companies. Moreover, testing and failing are also allowed, supported by the confidence boost that comes with being part of a larger unit. The aim is to maintain entrepreneurial drive while prioritizing cash flow and a self-funded growth cadence; striking the right balance is paramount and a key differentiator. Tapping into this ecosystem and internal capital market is where 1+1 becomes 3.

A notable example is the Lagercrantz Group, particularly illustrated through our visit to Radonova, a subsidiary of the company. During our visit to Radonova's headquarters, the first thing that caught our attention was a wall adorned with diplomas. These were not just any awards; they represented victories in their internal "Champions League," where subsidiaries vie against each other to achieve cash flow-related objectives as outlined in their focus model. This unique competition, ingrained through their internal entrepreneurship handbook, illustrates a deep-seated culture of excellence and achievement. The wall not only displayed a sense of pride in surpassing these milestones over various years but also symbolized the ingrained ethos of prioritizing cash return goals. Far from being mere bullet points on an investor presentation, these objectives permeate the very essence of the organization, embodying a commitment shared by every employee across the Lagercrantz Group, ultimately producing above-average entrepreneurs.

The strong emphasis on a self-funding business model ultimately translates to a low-risk growth model by inherently limiting the pace of growth. Only so much cash flow in a given year is available to finance growth, either organic or acquisitions, in a self-funding manner, ensuring that the growth is sustainable. In effect, the built-in features of a self-funding model avoid reliance on equity raises and excessive leverage, emphasizing the importance of capital efficiency in generating cash. This is why the Superinvestors put in enormous efforts in developing a deep seated “cash culture”, which often becomes a multi-year mindset shift, after being independly run and after tapping into these groups.

Furthermore, maintaining price discipline for acquisitions is crucial for acquisitive growth because these factors are interconnected for the model to work. The higher the price paid, the greater the need for cash conversion to support self-financing growth.

Consequently, common pitfalls that often lead to failure in acquisition-driven companies—such as overly rapid acquisitions and overextended balance sheets—are naturally avoided by adhering to a self-funding model. A deeply nurtured cash culture and simple profit goals sustained over decades, like profit over working capital (P/WC) or other cash-return equivalents, is essential for the model to work and is the true differentiator between transactional players chasing “deals” and the Superinvestors who caters to a low-risk approach to growth and who master the art of “building” not only the ”buying” side of the equation. These risk-mitigating characteristics built into the self-funding model explain why many of the Superinvestors boast multi-decade track records of uninterrupted compounding.

Growing big by staying small

The private Superinvestors' DNA reveals a deeply ingrained cultural framework rooted in a decentralized model, honed through years of trial and error. Scaling while maintaining a small-business mindset is facilitated by an entrepreneurial culture and close customer relationships. Without granting autonomy to each business unit or platform, the acquisition process at the holding company level would inevitably slow down. Bringing on board multiple new private companies annually could overwhelm management resources if bogged down by excessive integration efforts and micromanagement. Therefore, decentralized decision-making isn't merely a preference for conglomerates; it's a prerequisite for scaling and retaining the agility and speed of a speedboat within a tankship-sized group.

A thriving entrepreneurial culture involves treating individuals within business units as true owners, affording them substantial autonomy. This approach nurtures a sense of ownership and entrepreneurship, often compensating indirectly for any potential loss of synergies and efficiency gains.

Furthermore, small, niche businesses inherently require close customer relationships. Decentralized decision-making, leveraging local insights, positions these nimble businesses to make the best

decisions regarding marketing, products, customers, and suppliers. Collecting these niche businesses at scale necessitates maintaining Decentralization and proximity to customers.

This distinction often sets Superinvestors apart—they understand that growing big requires staying small. They strike a clear balance between maintaining an entrepreneurial spirit and the temptation to reap synergies, encouraging founders of subsidiary companies to stay engaged well beyond their initial earn-out period.

Pivots and Internal Capital Markets
In the 2004 annual report of Berkshire Hathaway, Warren Buffett reflected on the less-than-favorable reputation of conglomerates among investors and explained why Berkshire represented a departure from this perception. He discussed the business climate for conglomerates during the 1960s, a time when they became popular through questionable accounting practices, promotion, and leadership strategies aimed at inflating stock prices. CEOs of that era financed acquisitions of lower-quality, lower P/E ratio companies by issuing shares, then utilized "pooling" accounting to artificially boost per-share earnings, presenting this as a testament to their management prowess. These practices, they argued, warranted high or rising P/E ratios, with the promise of continued earnings growth through the continuation of such strategies.

Buffett contrasted this with his view on Berkshire, emphasizing how the conglomerate structure, when applied wisely, enhances the rational allocation of capital. Furthermore, a particularly noteworthy insight from this letter is how the conglomerate structure, "*if used judiciously, is an ideal structure for maximizing long-term capital growth*." The discussion emphasizes that internal capital allocation often falls short of rational allocation due to structural constraints and natural biases concerning the single-exposed nature of most single-engine companies' business. Examples include companies exposed to a single market or industry where management, often guided by self-interest, overlooks more rational choices for allocating capital. This is because they lack the flexibility to reallocate funds to other businesses and markets, or their decisions are influenced by biases related to commitment and consistency, leading them to continue investing in suboptimal areas because they are incentivized based on inappropriate metrics.

Furthermore, compounding the trouble in such single-exposure businesses, it's often the case that the particular CEO may not be the right fit for the task of capital redeployment. The CEO, who fulfills both the operator and capital allocator roles, is often overly biased and lacks the necessary external perspective to reassess available options rationally. This is often why separating the capital allocation responsibility at the HQ level and decentralizing operations throughout the business units allows for more flexibility and the many pivots that run through the companies featured in our upcoming book. Hence, being industry-agnostic enables these conglomerates to evaluate risk and reward across a wide spectrum of industries and to pursue acquisitions outside their core competencies without the biases inherent in firms with a narrower focus.

The flexibility provided by separating the holding company level, where capital allocation occurs, from the operating company level, where operations are managed, allows the Superinvestors to pivot and change, often dramatically, in pursuit of value creation. The flexibility and unbiased approach enabled by these structures are similar to the philosophical puzzle known as the Ship of Theseus[6]. This thought experiment involves the ship of the hero Theseus, which underwent a gradual replacement of all its wooden parts. The central question is whether the ship, after all its parts have been replaced, remains the same "Ship of Theseus.". Most of the Superinvestors underwent similar transformations and pivots while retaining their original names, simultaneously extending their runway of growth and becoming

[6] The Ship of Theseus metaphor was first seen in this blog post: https://www.libertyrpf.com/p/401-stock-indices-and-the-ship-of and also inspired by this article: https://www.scienceabc.com/social-science/the-ship-of-theseus-paradox-who-are-you.html

more intrinsically diversified in the process. Stepping back a bit, we believe that applying the conglomerate model with the right ingredients facilitates renewal and successful pivots. This approach defies base rates among corporations and ensures not only survival but also extends the runway for profitable growth.

This sentiment aligns with our observations, reinforcing the notion that a rational framework for capital allocation is crucial for high-performing conglomerates. We hold the conviction that the most successful conglomerates provide the best allocation of capital and epitomize the essence of true compounders. Their ability to judiciously deploy capital not only fuels sustainable growth but also exemplifies the acumen necessary for long-term success in diverse market environments. Properly configured—with the right organizational structure and incentives—they are exceptionally equipped to allocate capital efficiently and impartially to where it can be most productive.

Beyond this, high-performing conglomerates, leveraging dual engines of growth that span multiple end markets and geographies, possess the ability to scale significantly beyond the reach of single-industry businesses. They defy the conventional base rates often associated with companies exposed to a single sector, operating without the constraints typically imposed by focusing solely on one area of business. This versatility enables them to tap into diverse growth opportunities, mitigating risks and capitalizing on the strengths of varied markets to achieve exceptional growth and resilience.

This ethos highlights what sets the Superinvestors apart: a robust cash culture meticulously honed through persistent trial and error. While acquisitions are within reach for many, the true challenge emerges in the careful nurturing of acquired companies and the cultivation of a robust internal cash culture. Smart incentives and nurturing a collaborative culture with opportunities and a well-functioning internal capital market, while still balancing entrepreneurial drive and enabling natural synergies, is what drives founders in the underlying subsidiaries to stay beyond their earn-out period.

The Cold start problem

Another factor to consider is the choice between investing in smaller companies with shorter track records, which might offer the dual benefits of multiple expansion and organic growth from a lower base, and investing in a more mature company. New ventures often face "cold start" challenges, lacking the momentum of established businesses that have already scaled successfully, either internationally or across different verticals. Mature companies benefit from a "warm machine" effect: they have a proven track record and a developed cash-flow-positive culture and are integrated into an ecosystem that supports and amplifies their operations. This makes them potentially more resilient and capable of incorporating new ventures into their existing successful framework. However, the allure of investing in newer companies lies in the potential for higher returns, given the lower base from which they start. But this comes with increased risk, as success in such ventures requires overcoming more obstacles or "*winning more variables*."

In contrast, investments in established entities typically involve fewer variables. Their proven systems, market presence, and operational efficiencies reduce the number of unknowns and, consequently, the risk associated with the investment. Therefore, deciding between investing in a new versus an established company involves balancing potential returns against the risks and challenges of each option. While newer companies may offer higher growth potential, they also require navigating more uncertainties. In contrast, mature companies might offer more stable and predictable returns, benefiting from their established operations and market presence. In the latter group your ability to stay invested is higher, ultimately increasing your odds of arriving at the second half.

Minimizing the Odds of Mistakes

As an investor in a single-exposure company, you need to regularly win multiple variables for a good outcome. Your returns are a function of the cumulative probability of getting all these variables right.

Each time you have to exit a single-exposure company is a new opportunity to be wrong. Investing in single-engine companies constrained to a narrow market or industry means you not only need to be right about the management team but also need to be more accurate in predicting the distribution outcomes for the industry to which the company is exposed. Furthermore, you need to understand the probability distribution of capital allocation at the company level: What will the management do with the cash? How will they raise cash? Will there be a new leg of growth? The more variables you need to win, the less likely you are to achieve a favorable outcome as an investor. Additionally, selling introduces reinvestment risk at the investor level. In contrast, conglomerates with an internal capital market and the ability to reinvest and pivot across a longer runway inherent in the dual-engine approach mitigate these risks. The ability to stay invested reduces the number of variables an investor needs to win and is crucial for reaching the "second half of the chessboard"—the stage where exponential growth truly accelerates and significant compounding occurs.

The Swedish legacy of Decentralization

Our investment philosophy is built on three key pillars: Capital allocation, Decentralization, and People. We strive to identify exceptional capital allocators who decentralize their operations and embody true ownership. This approach is fundamental for securing superior long-term investment returns.

Decentralization is an organizational structure where management delegates responsibility down in the organization. This organizational structure is based on the belief that top management does not have all the correct answers about how underlying departments and subsidiaries should deal with products, customers, suppliers, and competitors.

With responsibility comes the power of increased motivation, knowledge sharing, and better customer relations because the decision-makers are close to customers. It is a management philosophy of using the carrot rather than the stick. Our companies operate without the anchor of bureaucracy. Our decentralized businesses have lean corporate headquarters by nature.

We often encounter the question, "Why does Sweden have a significant number of acquisition-driven companies?"

There is not a single answer, but several factors collectively weave a history explaining why Sweden has successfully fostered numerous companies, many of which have thrived on decades-long acquisitions.

Sweden's rich industrial heritage dates back to the 19th century, with industrial pioneers such as Sandvik, Atlas Copco, Electrolux, Ericsson, Tetra Pak, Asea, and Trelleborg. As a relatively small and geographically isolated country, Sweden quickly adopted trends in innovation and globalization. Many industrial firms initiated their international journeys through acquisitions in the mid-20th century. Companies such as Bergman & Beving (with its first acquisition being Lagercrantz in 1967), Electrolux, and Atlas Copco, backed by financially robust families (like the Wallenberg family), embarked on acquiring companies to grow their operations.

The 1970s witnessed the rise of a decentralized governance model influenced by Jan Wallander, the former CEO of Handelsbanken, and Hans Werthén, CEO of Electrolux. This decentralized corporate governance model was adopted widely, becoming deeply ingrained in Swedish business practices. Inspired by models like Electrolux, Atlas Copco, and Bergman & Beving, companies like Indutrade emerged in 1978, founded on similar decentralized principles. The success of these ventures inspired other Swedish companies to adopt similar models, creating a model that proved to be scalable globally.

By the mid-1970s, Atlas Copco, under the leadership of Tom Wachtmeister, began to embrace the decentralized structure:

"The role of Atlas Copco AB as a parent company of the Atlas Copco Group was more closely identified in 1976. As a result of a reorganization which was made in the course of the year, the responsibility for a number of operative functions has been transferred to other companies in the group. /.../ As a consequence of this reorganization /…/, the number of employees in group management functions has been reduced to about 200.

The Decentralization has meant that several service functions have been moved closer to the actual users, cost accountability has been linked directly to needs, and the central corporate management has

been relieved of several routine matters in order to allow more time for strategic management questions."[7]

Organizational transformation of Electrolux

In his book, "You Don't Sell Any Christmas Trees the Day After Christmas – A Book About Hans Werthén[8]" Carl Uggla explores the impactful tenure of Hans Werthén as CEO (1967-1974) and Chairman (1974-1991) at Electrolux. Uggla identifies Werthén as an early advocate for Decentralization towards the end of the 1960s, a significant shift from the company's previously bureaucratic and middle manager-heavy structure. Werthén fundamentally transformed Electrolux's culture by implementing a decentralized framework, wherein all operational responsibilities were delegated except for acquiring companies, making large capital expenditures (greater than USD 1 million), and purchasing properties.

When Hans joined Electrolux in 1967, one of his first actions was to sell the fancy office in central Stockholm and move to a more outskirt location, while all unnecessary staff at the time was adjusted to a minimum. Budgeting and forecasts were useless in Hans Werthén's playbook, and unnecessary internal meetings closed. As stated in the book: "*Forecasts are only interesting when you look at them in the rearview mirror*."

Leif Johansson, former CEO of Volvo Group, and at that time 28-year-old Head of Motorbikes at Husqvarna, in the book describes Electrolux's Decentralization when he called headquarters to ask about advice about restructuring production units, he was answered, "*We have hired you with a high salary – take your own decisions!*[9]".

In Hans Werthén's decentralized structure, he implemented simple ways to measure profitability as profit before tax, which every manager was measured against. He also implemented the same accounting system and monthly follow-ups, which was unusual. As we also see today, among many decentralized organizations, managers are given a lot of freedom as long as the business performance is satisfactory. The book also describes how top management thought it was "*poetry to hear the managing directors talk about return on assets.*" Words like corporate culture and delegation were never mentioned; they were embedded in the Electrolux culture.

A management philosophy in accordance with human nature

Dr. Jan Wallander, the long-standing CEO of Svenska Handelsbanken, stands tall among visionary business leaders, earning his place among the influential figures during his tenure at Svenska Handelsbanken. His transformative journey with Svenska Handelsbanken turned the bank into one of the globe's consistently successful banks at the end of the century and redefined the essence of effective management.

In the early 1970s, when corporate empires were built with strategic planning departments and centralized control systems, Dr. Wallander dared to be different. He orchestrated a series of groundbreaking changes, steering Handelsbanken into uncharted territory by adopting controversial measures at the bank. Facing resistance to Decentralization, Dr. Wallander acknowledged the time-consuming process, taking about five years to achieve the goal of becoming a decentralized organization.

---

[7] Directors' Report To the Shareholders, Atlas Copco Annual Report 1976

[8] A translation from the Swedish original title "Man säljer inga julgranar på annandagen – en bok om Hans Werthén."

[9] Translated from Swedish "Här har vi anställt dig för dyra pengar. Fatta dina egna beslut!".

In his book "*Decentralisation – why and how to make it work: The Handelsbanken Way*", Jan Wallander states his management philosophy: "*Decentralization is a management philosophy that can release the full potential of the people in any corporation, because it is in accordance with human nature, not against it. People are the only sustainable competitive advantage*. *Bringing about Decentralization is a very time-consuming process. One has to begin with oneself.“*

Wallander abandoned the tradition of bank management when he took over as CEO. He tossed aside annual plans and budgets, breaking free from the fixed performance contracts that stifled innovation. Branch employees were bestowed with independent lending authority, embracing autonomy and responsibility. Despite initial skepticism, Handelsbanken's credit risks diminished as decisions were made closer to customers, and the bank abandoned centralized risk assessments. Dr. Wallander's mantra was clear – decentralize, empower, and trust the frontline. Headquarters' role shifted from control to being a service provider for the front line, emphasizing a customer-centric approach. The head office saw a 33% reduction in employees, challenging the perception of superiority over branch staff. Local branch offices became primary profit centers, challenging the traditional pyramid structure. The marketing department saw a drastic reduction from 40 to just one person, emphasizing efficiency over bureaucracy.

A transparent steering system ensured every branch's performance was visible, fostering healthy competition. From an incentive point of view, Wallander introduced "*The Octagon*," a long-term profit-sharing system that prioritized better profitability and return on capital over the competitors, while aligning incentives with sustainable success.

In conclusion, Dr. Jan Wallander's legacy at Handelsbanken is a testament to the enduring power of decentralized, human-centric management. By challenging the status quo, he revolutionized a bank and provided a blueprint for success that transcends time. In a world of constant change, Wallander's principles remain a guiding light for leaders seeking a path to sustainable and resilient organizations.

A country built upon transparency and trust

Moreover, Sweden is home to many small and medium-sized businesses, often family-owned, making it fertile hunting grounds for acquirers and small private companies. Sweden is also known for its open society and data accessibility, contributing to high transparency. Annual reports for all companies are open to the public in Sweden, fostering trust and reliability in the companies' financials and decreasing unpleasant surprises post-acquisition.

As acquisition-driven compounders have demonstrated the practical value of their models and maintained an entrepreneurial spirit within the acquired entities, trust between sellers and buyers has flourished over the years. Today, Sweden boasts one of the highest levels of interpersonal trust globally. The country also ranks favorably on international indices measuring parameters such as ease of doing business, global innovation, perceptions of corruption, and human development.
Another crucial factor is that successful acquisition-driven strategies, with small private transactions at the heart of their strategy, have established a simple, efficient, and standardized way of conducting business, employing simplified, short, and concise deal-making and deal documentation over time.

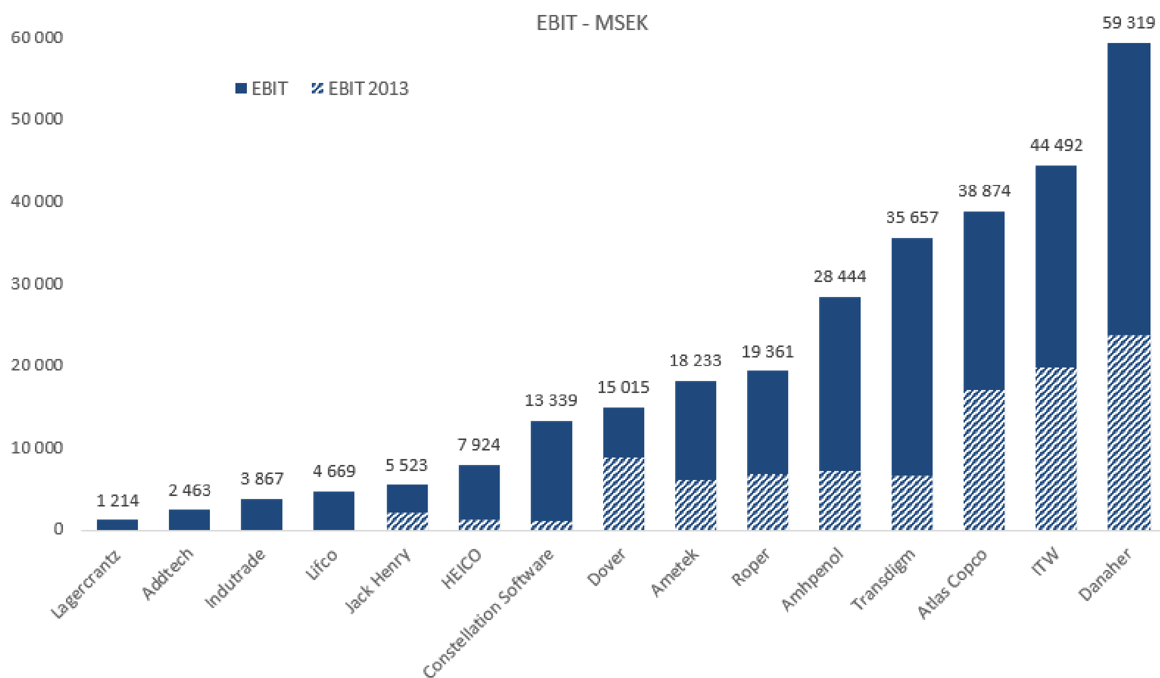
As evidenced by the histories of Electrolux, Atlas Copco, and Svenska Handelsbanken, the decentralized approach to management has a long legacy in Sweden. Building a decentralized culture and harnessing the strong benefits of autonomy and local decision-making takes time. We believe the decentralized approach adopted by the companies we invest in represents a strong competitive advantage in a rapidly changing world.

International Runway of Growth

Sweden is home to many successful acquisition-driven compounders. Over decades, these companies have mastered the craft of acquiring small private niche companies in the Nordics.

However, over the last few years, some of these companies have reached the European continent and acquired companies in countries like the UK, Germany, Netherlands, and Italy. The runway of growth opportunities for these companies in Europe is considerable, given the size of the European SME (Small and Medium Enterprises) market. When you combine the size of the European market and look at the (small) size of the companies that have started to explore the continent, you get an interesting opportunity set for the best acquisition-driven compounders in the Nordics.

To put some perspective on the size of some successful Swedish acquisition-driven compounders, we have looked at the EBIT today compared to ten years ago. We have also compared the size to large North American acquirers. The Swedes are still small in an international context.



We believe the runway of growth opportunities for the companies on the left hand is different today compared to a few years ago. The acquisition-driven model these companies deploy has proven to work outside Nordic borders. The European continent has become the target area for acquisitions for many of these small companies. And with Europe comes a very different fishing pool of acquisition candidates with maintained quality of companies targeted.

When looking for new acquisitions, these companies are not constrained by the size of an end market, particular sector, or geography. For most of these companies, the European SME market is their target.

Small private businesses are the backbone of the economy. In Europe, 99.8% of all companies[10] are small and medium-sized enterprises with fewer than 250 employees. This group of companies comprises a total of 23.5 million companies. 94% of these companies are "independent," meaning large corporations do not control them. Families and founders own these companies. In Europe, about

[10] https://ec.europa.eu/growth/smes_en

15,000 companies are sold each year[11]. Some are acquired by large corporations or strategic buyers, some by private equity firms, and some by acquisition-driven compounders.

Small family-owned companies in countries like the UK, Germany, and Italy face the same challenges as companies in the Nordics. Transitioning from one generation of entrepreneurs to the next brings challenges and opportunities. Family ambitions may differ from business rationale and threaten a company's competitiveness, which can lead to a transaction and a new owner. Given the cultural importance of close personal business relationships with potential buyers of these firms, some acquisition-driven compounders have established a local presence in different European markets over the last few years. In that regard, we are now seeing the fruits of the seeds planted a few years ago. For example, Lifco made its first Italian acquisition in 2018 and has since acquired 15 companies in Italy. From 2018 through 2024, Italian acquisitions have comprised 20% of all acquisitions. Since IPO in November 2014, 60% of Lifco's acquisitions have been outside the Nordics (75% since 2020).

In Germany, there are 2.4 million small and medium-sized enterprises. A study by the "Institut für Mittelstandsforschung"[12] shows that around 95% of all companies in Germany are family-owned. The UK is one of the most active M&A markets in Europe. Private equity buyers continue to drive the deal activity, but the UK is also becoming an increasingly attractive market for acquisition-driven compounders. We are seeing increasing private acquisitions by our businesses in the UK.

In summary, investing in companies with long-term growth opportunities and high returns on capital is necessary to achieve high long-term stock returns. We think the European market opportunities for our Nordic companies are significant. An extensive pool of acquisition opportunities is a perfect starting point for our acquisition-oriented compounders.

We observe that our companies remain disciplined in finding and closing attractive acquisitions at attractive multiples, which keeps returns on capital high. As long-term shareholders, we enjoy substantial value creation in this process.

[11] "Statistics on small and medium-sized enterprises" by George Papadopoulos, Samuli Rikama, Pekka Alajääskö, Ziade Salah-Eddine (Eurostat, Structural business statistics), Aarno Airaksinen, Henri Luomaranta (Statistics Finland)

[12] The Environment for Business in Germany" (CVJ Simpson Associates)
https://www.cbw.co.uk/2022/01/ma-activity-in-the-uk-sets-new-records-in-2021/

Lifco – A Successful Acquisition-Driven Compounder

In June, we joined the Business Breakdown podcast, where we presented one of our core holdings, Lifco. You can find the link to the podcast here and the transcript here.

Lifco is a USD 11bn market cap Swedish high-performing conglomerate that invests in primarily private family-owned businesses in perpetuity. Revenues are USD 2.5bn with an EBITA margin of 23%. The company hase demonstrated an extraordinary FCF per share CAGR of 25% and a total share return of 14x since the IPO in 2014.

Carl Bennet, a Swedish industrialist, is the largest owner, holding 68.9% of the votes and 50.2% of the capital. Bennet has a successful track record of building Swedish industrial companies, and the former CEO Fredrik Karlsson played a crucial role in developing Lifco into its present form during his tenure from 1998 to 2019. During his tenure as CEO, Fredrik Karlsson compounded earnings by 100x.

After a bonus disagreement in 2019 between Fredrik Karlsson and Carl Bennet, the current CEO, Per Waldemarson took the helm of Lifco. One of our team members was standing in the elevator on his way up to Fredrik Karlsson the day he left the company, and it was announced that Per would be the new CEO. Shares of Lifco fell 8% on that day, and while one of our team members was in Fredrik's room, he called his broker and told him to buy Lifco shares, and he has not sold since. That tells a lot about the Lifco culture and the knowledge around the system's robustness when the CEO who left bought even more shares.

Per has been employed since 2006, starting as the Managing Director for Brokk and later becoming head of Dental and ultimately CEO in 2019. Since Per Waldemarson took the helm of Lifco, the share price has performed 280%, outperforming the general market by almost 200%. Per has brought structure and scaled the organization, preparing Lifco for future growth opportunities without changing the overall strategy or culture of the company.

Lifco is also one of the most decentralized businesses we have encountered, with three people at HQ and only a handful of people on finance functions, in addition to 15 group managers who drive the business forward. Lifco is so decentralized that the CEO has no secretary or assistant, and the last time we visited the company, the CEO made us coffee.

Lifco's business model is to acquire and develop market-leading companies with robust financial performance and strong cash flow generation. They do that by focusing on companies within small niches with high pricing power and, thus, high margins. The company emphasizes simplicity and minimal bureaucracy through a highly decentralized organizational structure where MD's of all 235 subsidiaries have full P&L responsibility. The group thrives through its unique performance culture, where leaders are incentivized to grow profits yearly, but only if they generate an attractive return on capital.

The group is divided into three business areas: Dental (25% of sales), Demolition & Tools (28%), and System Solutions (48%). Through the business area Dental, Lifco is Northern and Central Europe's leading dental materials and equipment distributor and manufacturer. Demolition & Tools develops, produces, sells, and distributes remote-controlled demolition machines through its subsidiary Brokk and various tools and accessories for cranes and excavators through the company Kinshofer. Systems Solutions is a sector and industry-agnostic business area that comprises multiple highly niched and market-leading businesses that deliver B2B solutions.

A fundamental part of their business is to drive organic profit growth. The incentive structures are built upon profit growth each year with an implicit return on capital metric. For example, one of the CFOs

in one of the subsidiaries we talked to told us that all account receivables older than 30 days were written down to zero at reporting. In other words, you make sure, as a CFO, that clients pay their bills.

Lifco has a strong cash flow generation with FCF/Net income of over 100%, contributing to the ability to grow through acquisitions. Lifco has since 2006 deployed SEK 21bn in acquisitions and generated an incremental return on capital of more than 20%. 60% of the market cap since the IPO been paid out in dividends, further demonstrating the strong cash flow generation of the business.

Lifco is unique because it knows how to run a distribution business, scale and grow sales globally, and run small niche businesses. Lifco leverages these strengths by sharing knowledge between divisions through its group managers and Boards in the subsidiaries, where directors can have Board responsibilities across divisions, making the group even more robust.

Anecdotes from Talking to Entrepreneurs

An essential aspect of our investment philosophy is acquiring insights and information beyond public reports or records, enabling us to understand our companies and their culture more deeply. We believe in engaging with entrepreneurs who have sold their life's work to our companies, gaining insights into their strengths and unique value propositions. We have engaged with several entrepreneurs throughout the year who have provided invaluable perspectives on our companies.

One fascinating conversation was with an entrepreneur who sold his company last year. Upon scheduling a call, we spoke with him at 7 AM. When asked, "Are you on your way to work?" he responded that he had been in the office since 5:30 AM. He explained that although the buyer of his company did not offer the highest bid compared to private equity and an American industrial buyer, it stood out due to its deep understanding of the entrepreneur and his employees. The decisive factor was the commitment to maintaining their independence post-acquisition without cost-cutting or synergy extraction. This assurance of independence in a decentralized structure fostered the entrepreneur's ongoing support for the company he built, as evidenced by his dedication to being the first at the office each day despite selling his company.

Other entrepreneurs, we have talked to have told us that they prefer selling to acquisition-driven compounders with perpetual ownership horizons as they deem it essential to maintain the culture and the spirit within their companies for employees, customers, and suppliers. They also told us that they appreciated the hands-off approach of not driving cost synergies nor changing the name of the company or firing people – but instead driving the company's future development through carrots rather than sticks. They told us this is the contrary to private equity buyers who seek to optimize for short-term gains.

Additionally, entrepreneurs noted that these acquisition-driven compounders typically focus on raising prices post-acquisition, supported by historical evidence of successfully doing so. Initially hesitant to raise prices due to the potential impact on their businesses, they felt more confident doing so when supported by a larger group without fear of losing customers. Furthermore, these compounders provide support and serve as strategic partners, helping companies improve efficiency and drive growth through investments that would be too large for smaller companies to undertake independently.

These insights are common in our discussions with entrepreneurs and owners who have sold their life's work to our portfolio companies. Many have also shared that they had established relationships with the buyer over several years before selling their companies, highlighting buyers' patience and long-term perspective with a perpetual ownership view, which resonates well with sellers.

Underwriting Process and Look-through Statistics

In this half-year letter, we want to take the opportunity to present a snapshot of some fundamental statistics of the portfolios, and we will look at the portfolios as if they were one single company. We have divided the look-through into four sections based on the general portfolio overview and our three key investment pillars: capital allocation, decentralization, and people.

At REQ, our investment pillars are principles we not only preach but also diligently practice. This is exemplified by the practical implementation of our strategy. Behind the scenes, our key strategy pillars are further broken down into over 80 questions that blend qualitative and quantitative checklist items based on past insights and mistakes. We rate each component and ultimately arrive at a score for each individual checklist item, culminating in a weighted score for each company in the portfolio and on our watchlist. Furthermore, we subject each company to scenario analysis based on expected returns, with a particular focus on the assumptions that underpin the terminal value. This portfolio framework not only supports the initial underwriting of new companies but also provides critical insights for reevaluating cases where the investment thesis evolves.

Furthermore, it allows us to explore different scenarios and compare new opportunities with our existing portfolio. Some of the quantitative output is extracted into the look-through table below. The statistics clearly demonstrate high reinvestment rates with attractive returns, significant insider ownership aligning interests with shareholders, and a focus on decentralization to maintain entrepreneurship within small business units.

The mathematical reality of compounding curves is that they are convex with respect to time, meaning returns are heavily back-end loaded. This underscores the importance of avoiding fundamental setbacks and blowups along the way. A seemingly high expected IRR in isolation won't help us if the estimates and terminal assumptions are built on shaky foundations. High growth on top of a fragile base—such as unpredictable sales or growth stemming from a limited number of markets, products, and customers—is not valuable to us as long-term investors. Given enough time, fragility of this nature eventually surfaces and poses a genuine risk to long-term investors. This is why we favor dual-engine growth—organic expansion and acquisitive growth across many different end markets—and why our analysis always starts with assessing durability through our three key pillars.

Moreover, as long-term investors in acquisition-driven compounders, we are particularly exposed to the people who serve as the primary drivers of capital allocation and decentralization, and ultimately the creators of value. Nonetheless, we still need to compare the expectations embedded in the stock price with our assessment of the company's compounding potential. Thus, the framework's role is to establish a process-oriented approach to evaluate the elements of durability and the factors contributing to returns that are not already reflected in the market price. Our experience, and the purpose of our portfolios, is that the market generally fails to properly value profitable long-lasting growth.

In our process, we dedicate significant effort to understanding decentralization and its nuances. However, quantifying the decentralization investment pillar reveals that our companies not only grow but also maintain their small and agile structure. This characteristic enables them to scale effectively and continue growing. Yet, decentralization is challenging to quantify because it is deeply embedded in the cultural fabric of our companies and should be viewed through qualitative lenses. We believe that granting autonomy to each business unit or platform facilitates an entrepreneurial culture and close customer proximity. Without this decentralized platform, the acquisition process at the holding company level would inevitably slow down. Bringing multiple new private companies on board each year could overwhelm management resources if bogged down by excessive integration efforts and

micromanagement. Therefore, decentralized decision-making isn't merely a preference for conglomerates; it's a prerequisite for scaling and retaining the agility and speed of a speedboat within a tankship-sized group.

REQ Nordic Compounders portfolio:

REQ Nordic Compounders - MEUR	Portfolio - Weighted average	Average	Median
# of holdings	23		
Market Cap (bnEUR)	5.7	6.3	1.4
Years listed	18	19	20
Total shareholder return 10Y		942%	996%
Capital Allocation			
Reinvestment rate 5Y	74%	78%	79%
Reinvestment rate 10Y	70%	75%	77%
ROE (Net income / EQ)	20%	20%	19%
ND/EBITDA	1.4x	1.5x	1.4x
EPS CAGR 5Y	18%	21%	18%
Cash conversion 5Y (FCF/Net income)	89%	90%	88%
Organic sales growth 5Y	6%	6%	6%
Average # of acquisitions / year - L 5Y	6	6	4
Average deal size (MEUR) - L5Y	12	14	9
People			
Total insider ownership	21%	27%	
CEO Ownership (times base salary)	65.5x	84.6x	10.5x
CEO Tenure (Years)	7	9	6
Decentralization			
# of subsidiaries	88	93	41
Average subsidiary sales (MEUR)	13	15	12

REQ Global Compounders portfolio:

REQ Global Compounders - MUSD	Portfolio - Weighted average	Average	Median
# of holdings	23		
Market Cap (bn USD)	17.3	17.3	7.1
Years listed	40	48	34
Total shareholder return 10Y		754%	534%
Capital Allocation			
Reinvestment rate 5Y	69%	77%	78%
Reinvestment rate 10Y	68%	76%	78%
ROE (Net income / EQ)	20%	19%	19%
ND/EBITDA	1.3x	1.5x	1.5x
EPS CAGR 5Y	13%	16%	17%
Cash conversion 10Y (FCF/Net income)	105%	120%	120%
	4%	4%	5%
Average # of acquisitions / year - L 5Y	12	9	5
People			
Total insider ownership	17%	14%	
CEO Ownership (times base salary)	364.8x	230.8x	17.6x
CEO Tenure (Years)	14	14	8
Decentralization			
# of subsidiaries	149	146	70
Subisidary size (sales in USDm)	44	56	33

Our portfolios consist of high-quality companies with a long history and track record of value creation. This is demonstrated by the average years on the stock market of 19 years (Nordic portfolio) and 48 years (Global portfolio). We believe that combining a long history and value creation track record, combined with the smaller size of these companies, presents attractive long-term opportunities. The median size of the companies in the Nordic portfolio is 1.4bn EUR while it is 7.1bn in the Global portfolio. Ultimately, we want to leverage the knowledge and lessons from the larger and successful acquisition-driven compounders that have multi-decade track records and apply those learnings to find which smaller companies will have a similar growth runway.

Our portfolio holdings have demonstrated exceptional capital allocation skills, having reinvested approximately 70%-75% of their operating cash flow to 20% returns over many years, resulting in above 15% EPS growth. This success is underpinned by a strong focus on cash flow generation, with a high cash conversion rate (Free cash flow/Net Income) exceeding 100% for many of our companies. With robust balance sheets and a long-term disciplined mindset, this supports a consistently active M&A agenda and earnings growth.

Ultimately, we prioritize aligning with management teams and owners with significant insider ownership, a multi-decade mindset, and a shared interest with shareholders in the success of the companies. This is evident from the substantial insider ownership, with large families, board members, and management teams collectively holding an average of 27% of the portfolio companies in the Nordic portfolio and 14% in the Global.

The CEOs of our portfolio holdings typically hold substantial equity amounts in their companies compared to their base salaries, which we view as a strong alignment of interests. For the Nordic portfolio, our CEOs, on the median, hold more than 10x their annual base salary in equity, while the CEOs in the Global portfolio hold 17x. Additionally, our CEOs tend to have long tenures, as illustrated by many of our companies. Some examples in both portfolios are Indutrade, which has only had its third CEO since 1978, and Lifco, which currently has its second CEO since 1998. Also, one great example is Atlas Copco, which soon had its 13th CEO since its foundation 150 years ago.

Our portfolio companies foster above-average entrepreneurship through decentralized organizational structures that emphasize accountability and responsibility, supported by proper incentive structures. To maintain entrepreneurial agility, our companies keep their teams small, enabling quick adaptation to changing conditions, opportunities, and challenges. This is exemplified by the small size of subsidiaries, with a median sales of EUR 12m across our portfolio subsidiaries in the Nordic fund and EUR 33m in the Global fund.

By the end of June 2024, the REQ Nordic Compounders fund consisted of 23 quality holdings, and REQ Global Compounders of 22 quality holdings.

Cash Flow in Downturn Scenarios

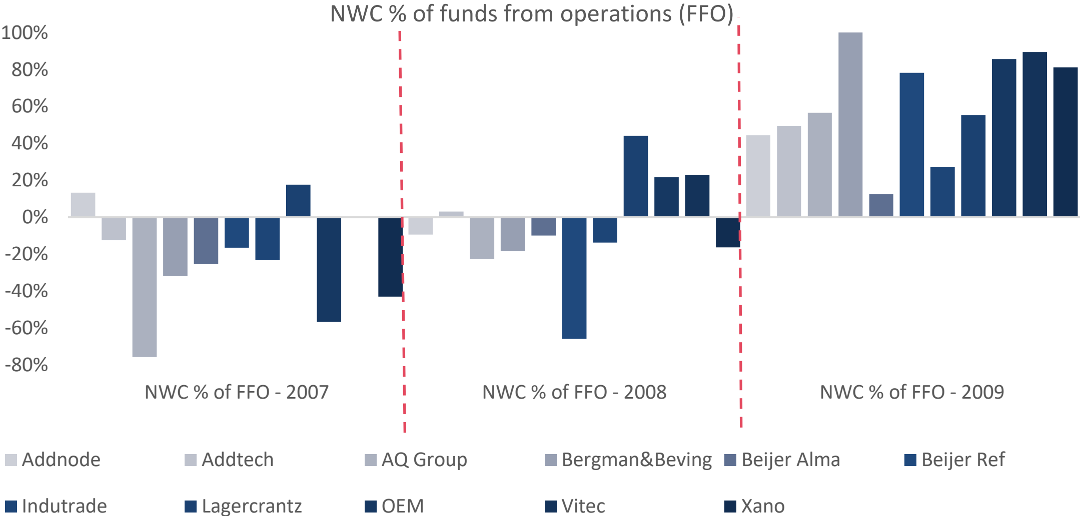
By adopting a prudent risk approach alongside a strong balance sheet and high cash flow generation, acquisition-driven compounders endure challenging economic conditions and thrive, propelled by the possibilities offered by their dual growth engines. This becomes particularly significant for our portfolio of companies, where acquisitions are central to the strategy. Strong cash flows during downturns, supported by the release of net working capital, enable these companies to consistently pursue M&A-driven growth when organic growth decelerates, thereby sustaining overall growth.

In slowed or negative organic growth periods, operating cash flow reductions are typically mitigated through NWC reductions. This allows them to continue their M&A initiatives, capitalizing on the strengths of having dual growth engines, even in economic downturns.

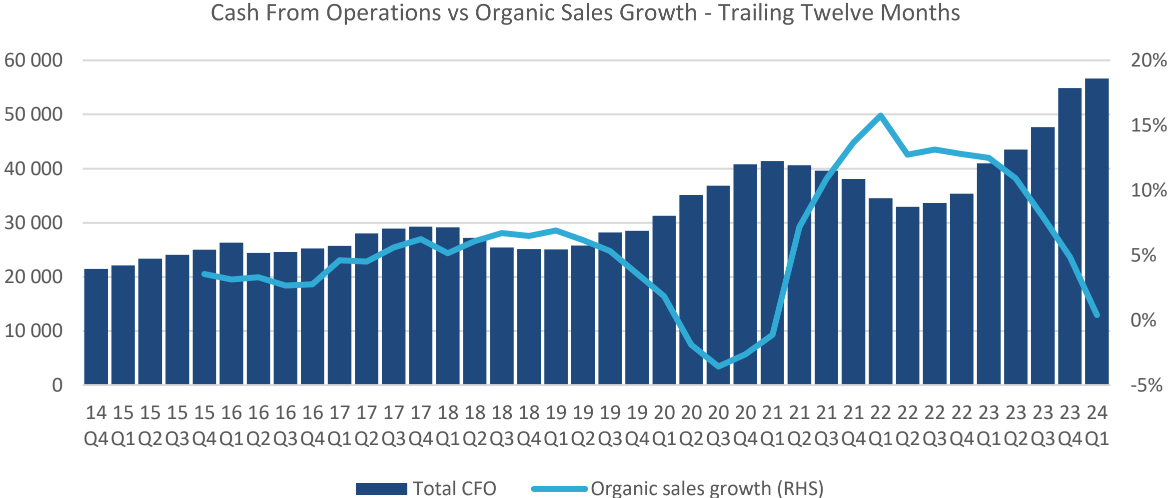
Jörgen Wigh, the CEO of Lagercrantz in a Redeye 2023 Q3 interview, illustrates this:

"I've been doing it for quite some years now, and when we see a slowdown in our topline, which have happened during the financial crisis, we see strong cash flows. We release quite a bit of working capital, and this is sort of the fuel for making more acquisitions."

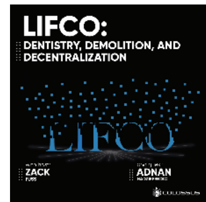
During the Great Financial Crisis (GFC), it was evident that when the economic sentiment worsened and companies displayed negative sales growth, they were also highly cash-generative. On average, net working capital releases on average fully compensated for the fall in operating cash flow before NWC changes, which supported a continuously active (even though somewhat lower) M&A agenda. As we can see from the chart below, during the growth years in 2007 and 2008, most companies tied up cash in net working capital, whereas every company released cash flow due to net working capital reductions in 2009.



For example, the companies in the REQ Nordic Compounders Portfolio, as shown by the chart below, illustrate what was also evident during the GFC; when organic growth declines, the companies display a strong cash flow generation. From the chart, we can see that when organic growth declined both during 2020 and during 2023 and at the beginning of 2024, our companies produced record high operating cash flows, which supports the active M&A agenda for the companies.



Podcasts and Other Resources



During the first half, the team participated in a US podcast ("Business Breakdowns"). In the podcast, we dive deep into one of the most significant holdings in REQ, Lifco. You can find the podcast here: Link

We also share more perspectives on our strategy in another podcast by Troy Asset Management ("Far from the finishing post"). You can find the podcast here: Link

The team participated in the Swedish podcast "Aktiesnack" (Swedish only), where we talk about acquisition-driven compounders through a Nordic lense: Link

REQ's Summer Lunch in Stockholm

On June 4th, REQ had the pleasure of inviting investors to our summer lunch in Stockholm. We enjoyed sharing insights into REQ's investment strategy. A special thanks to CEO Magnus Söderlind for presenting Bergman&Beving, a company in which REQ has invested.

We look forward to our Christmas lunch taking place in Stockholm in November.

From left: Adnan Hadziefendic (PM REQ Nordic Compounders), CEO of B&B Magnus Söderlind, Petter Østbye (REQ), and Oddbjørn Dybvad (CIO and PM REQ Global Compounders)

Suggested Reading Material

As usual, we will provide some book recommendations at the end of this report. We have found these books inspiring and highly recommend them as summer reading material. Most of the books we recommend in our reports will not just make you a better investor, but they are also very inspiring and great for discussing with friends. They can also make you pause and think about life in general.

We wish you all a great summer holiday!

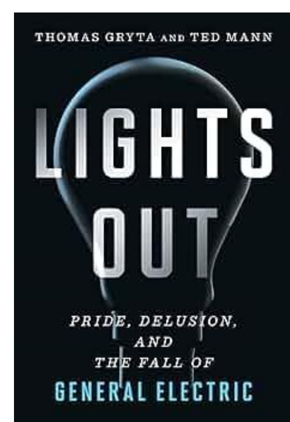
The REQ Team

”Man säljer inga julgranar på annandagen”
(English: ”You don’t sell any Christmas trees the day after Christmas”)
By Carl Uggla

Carl Uggla describes how Hans Werthén went from being a relatively unknown person in his early career to taking over Electrolux that during the 60’s was in a crisis. The book describes how Hans Werthén implemented a decentralized approach to Electrolux and how he together with Gösta Bystedt and Anders Scharp (referenced as The Troika of Electrolux) in three decades built Electrolux from a small company with SEK 1bn in sales to one of the largest appliance companies with SEK 80bn in sales.

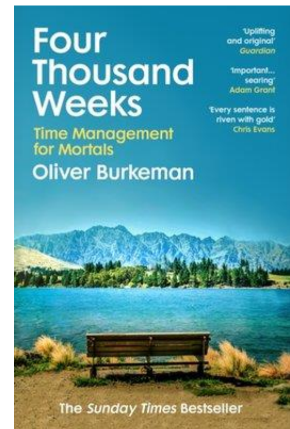
Lights Out – Pride, Delusion and The Fall Of General Electric
By Thomas Gryta and Ted Mann

Thomas Gryta and Ted Mann tell the story the rise and fall of General Electric. The book explains GE under the leadership of Jack Welch but focuses mostly on the leadership under Jeff Immelt, which was Welch’s handpicked successor, and reveals the stories and what was happening withih the company and how GE tried to reinvent itself to becoming the great company it saw itself to be historically. The authors tell the story of the importance of GE Capital as earnings saviour as well as the thinking behind other important decisions that formed the company.



Four Thousand Weeks – Time Management for Mortals
By Oliver Burkeman

In 'Four Thousand Weeks,' Oliver Burkeman explores time management from the perspective of our average lifespan of 4,000 weeks (76 years). He offers practical advice on how to spend time meaningfully, emphasizing our limitations. He argues that most of us treat time instrumentally, seeking future happiness and control. This mindset blinds us to the present, so we should embrace life now rather than waiting for a perfect future. Burkeman also challenges mainstream productivity advice, highlighting 'productivity debt'—the idea that relentless efficiency only creates more tasks. He emphasizes that we will all die with unfinished tasks, urging us to focus on what truly matters and accept our limitations within the context of our finitude.



Disclaimer

This presentation (the "**Presentation**") has been prepared by REQ Capital AS (the "**Manager**") and provides information about the strategies for the Irish UCITS funds REQ Global Compounders and REQ Nordic Compounders (collectively the "**Funds**"). The Manager, in the capacity as an investment firm, conduct portfolio management of the Funds on a delegated basis with Waystone Management Company (IE) Limited being the UCITS management company of the Funds. For more information and access to relevant fund documents, please see the website of the Manager.

This information is intended for general information purposes only and does not constitute solicitation of or an offer to participate in any investment. This information does not, nor does it purport to, constitute any form of investment advice, recommendation, or independent analysis. Consequently, it has not been prepared in accordance with the rules and regulations governing such publications, including but not limited to any prospectus requirements. This information is not, and does not purport to be, complete. The information is strictly confidential and should not be copied or circulated to anyone but the addressed recipients. The complete offering documents for the Funds should be read carefully and potential investors should seek independent investment advice and tax and other legal advice before potentially making an investment. No assurance can be given that the stated investment objectives will be achieved, and the value of investments may fall as well as rise. Past performance is no guarantee for future returns.
An investment in the Funds are solely for investors who are qualified to invest in the Funds in accordance with applicable laws in the relevant investor's home jurisdiction. The Funds are unsuitable and unavailable for any person or entity not meeting such qualifications. An investment in the Funds are only intended for investors who understand the investment strategies of the Funds, who can accept the risks associated with such an investment and who have no need for *immediate* liquidity in their investment. Investments may be subject to strict limitations on redemption and transferability. There will be no secondary or public market. The foregoing list of risk factors is not complete. If you are unsure as to whether or not you qualify, please contact the Manager or a professional advisor.

The Manager makes no warranties that the material in this presentation is appropriate or available for use in countries other than Norway. Persons receiving this information are obliged to investigate whether there are any restrictions in their jurisdiction, and if so, to comply with any such restriction. The Manager does not accept any responsibility for any failure to comply with any such restriction. For further information, please contact the Manager or a professional advisor.

This Presentation may include certain opinions, forward-looking statements, forecasts, and/or beliefs. These opinions, forward-looking statements, forecasts, and/or beliefs reflect the Manager's subjective beliefs and opinions, and no representation is made that any of these opinions, forward-looking statement.

The Funds are subject to Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector (“**SFDR**”). It is the understanding of Waystone Management Company (IE) Limited and the Manager that the reporting requirements set forth in accordance with SFDR Article 8 shall apply with respect to the Funds. Subsequently, reporting will be made in accordance with these rules. Please note that changes in the SFDR regime and associated regulations may result in a different classification for reporting under SFDR.

The Manager, its directors, employees, and consultants do not accept any form of liability (whether arising in contract, tort, negligence or otherwise) for any error, omission, or similar misrepresentation in this general information or for any loss or damage (whether direct, indirect, consequential or otherwise) suffered by the recipient of this information or any other person.