A Deep Dive into Shareholder Value Creation by Acquisition-Driven Compounders

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Adnan Hadziefendic
Portfolio manager
ah@req.no / +46-76 235 25 83

Kjetil Nyland
Portfolio manager
kn@req.no / +47 47 20 23 57

Oddbjørn Dybvad
CIO / Portfolio manager
od@req.no / +47 98 84 17 01

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Introduction to Investment Strategy and REQ Capital

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REQ Investment Approach

Two funds – one strategy

REQ Global Compounders

REQ Nordic Compounders

Our investment approach is centered around ultra-long-term, unconstrained, and concentrated equity funds that focus on investing in publicly traded companies known for consistently generating high free cash flows, demonstrating exceptional capital allocation skills, and boasting a solid history of delivering strong shareholder value.

The portfolios consist of acquisition-driven compounders – companies that have the acquisition of smaller private firms at the heart of their strategy.

These organizations excel at identifying, negotiating, and completing acquisitions in private markets at highly attractive valuations.

At REQ, our primary objective is to deliver best-in-class long-term performance for our investors, achieved through rigorous fundamental analysis and in-depth qualitative research.

We firmly believe that long-term investing success hinges upon investing in strong capital allocators, decentralized structures, and people with ownership.

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Strategy in Brief

- We invest in **high-performing acquisition-driven compounders**
- These companies are **excellent at sourcing and closing acquisitions in the private market at highly attractive multiples**
- **Strong cash flow generation**, which in turn is reinvested at **high returns on capital**
- Management teams are **excellent capital allocators** and often **own a significant part** of these companies
- We invest in **decentralized business models**
- Exposure to a diverse array of **small private companies** spanning **multiple end-markets**
- **Dual engines of profitable growth** (organic and through acquisitions)

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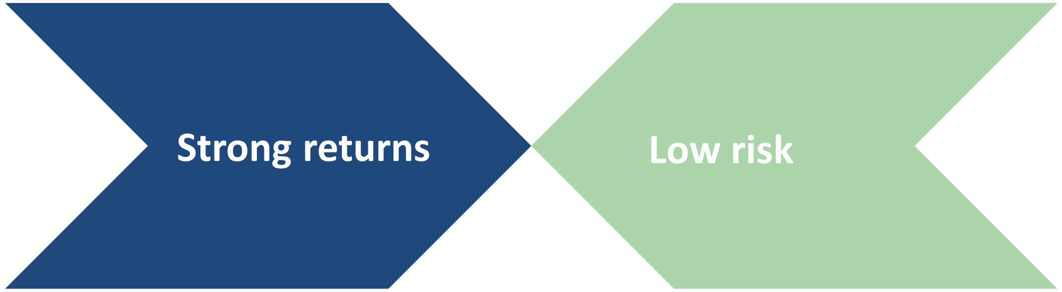
Investment Experience

Lessons learned

Finding rockets	→	Avoiding meltdowns
Structured idea generation	⟳	Qualitative idea generation
Financials	⟳	People

The Best of Two Worlds

- High reinvestment rate
- High return on capital
- Dual engines of growth



- Diversified cash flow streams
- Low debt
- High insider ownership

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Sources of Extraordinary Performance

Three key ingredients

Capital allocation

Decentralization

People

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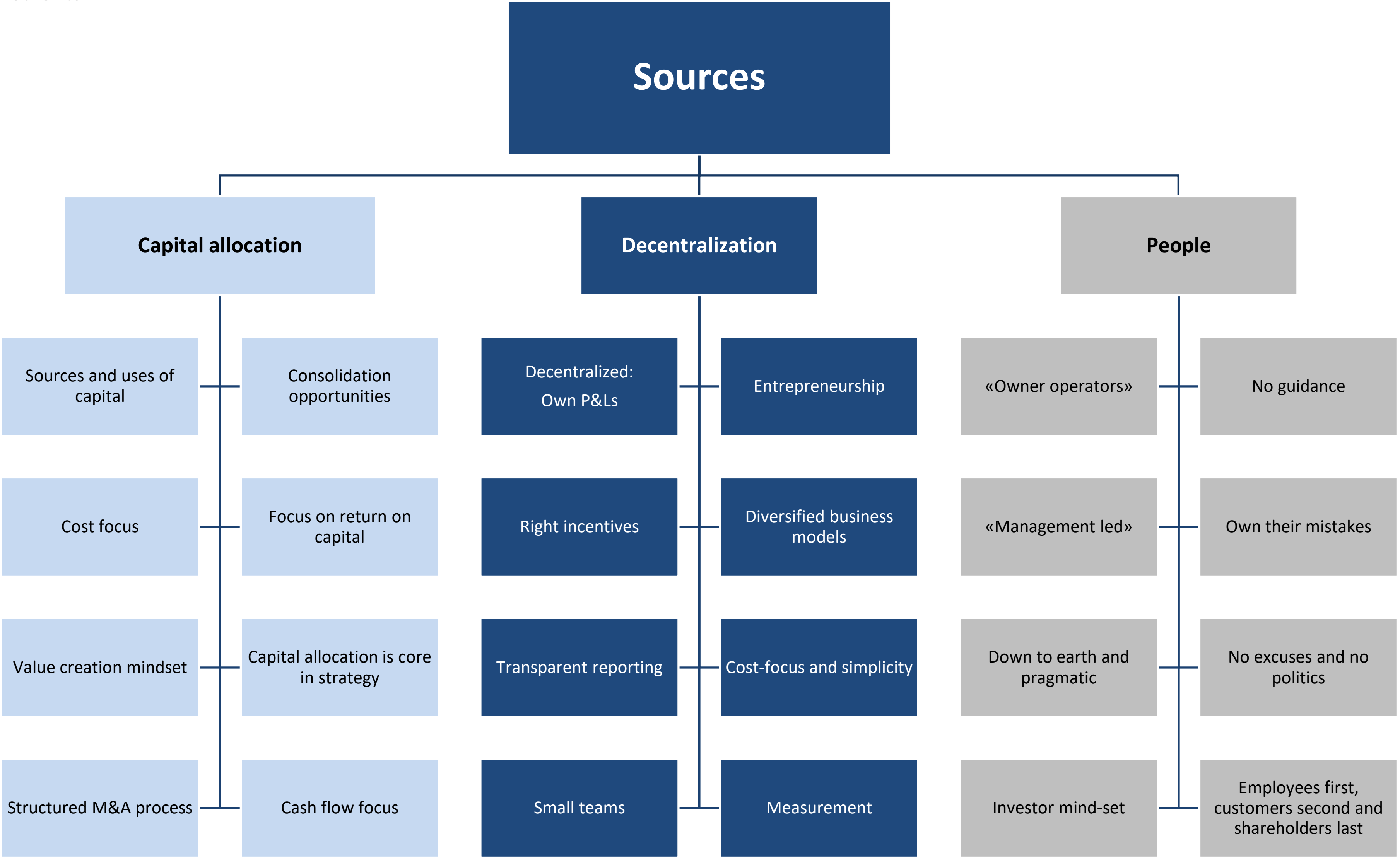
Sources of Extraordinary Performance

Three key ingredients

Introduction to REQ Capital and Investment Strategy



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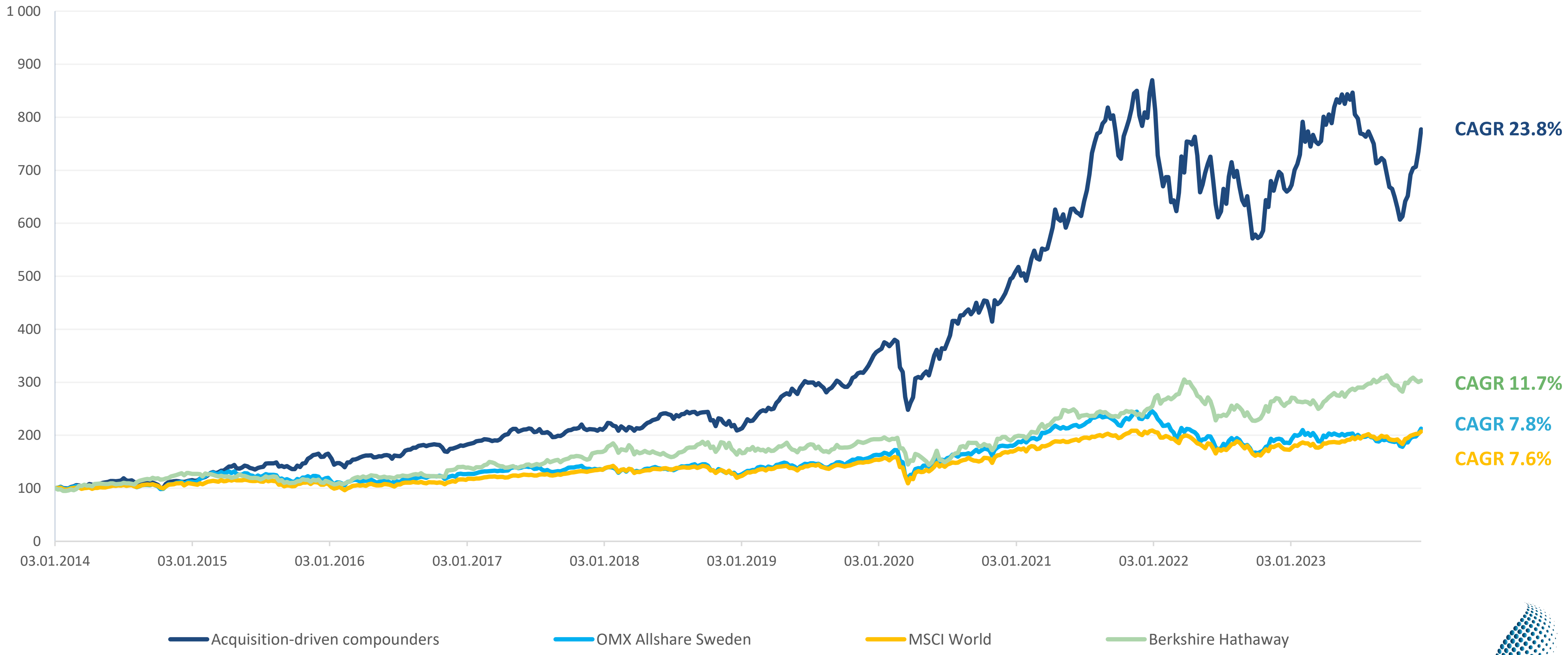
Superior Long-Term Share Price Performance – Nordic 10Y

10-year indexed share price performance
Nordic acquisition-driven compounders up 8x



Source: Factset as of 2014-01-01 to 2023-12-15
Note: Average for companies by REQ identified as acquisition-driven compounders listed during the full period. We have not adjusted for spin-offs of Addlife, Momentum Group and Epiroc, which would increase the overall performance.
Assa Abloy, Addtech, Beijer Ref, Lagerecrantz, Addnode, Bergman&Beving, Ependion, Indutrade, OEM, Xano, Beijer Alma, Hexagon, Atlas Copco, Nibe, AQ Group, Vitec

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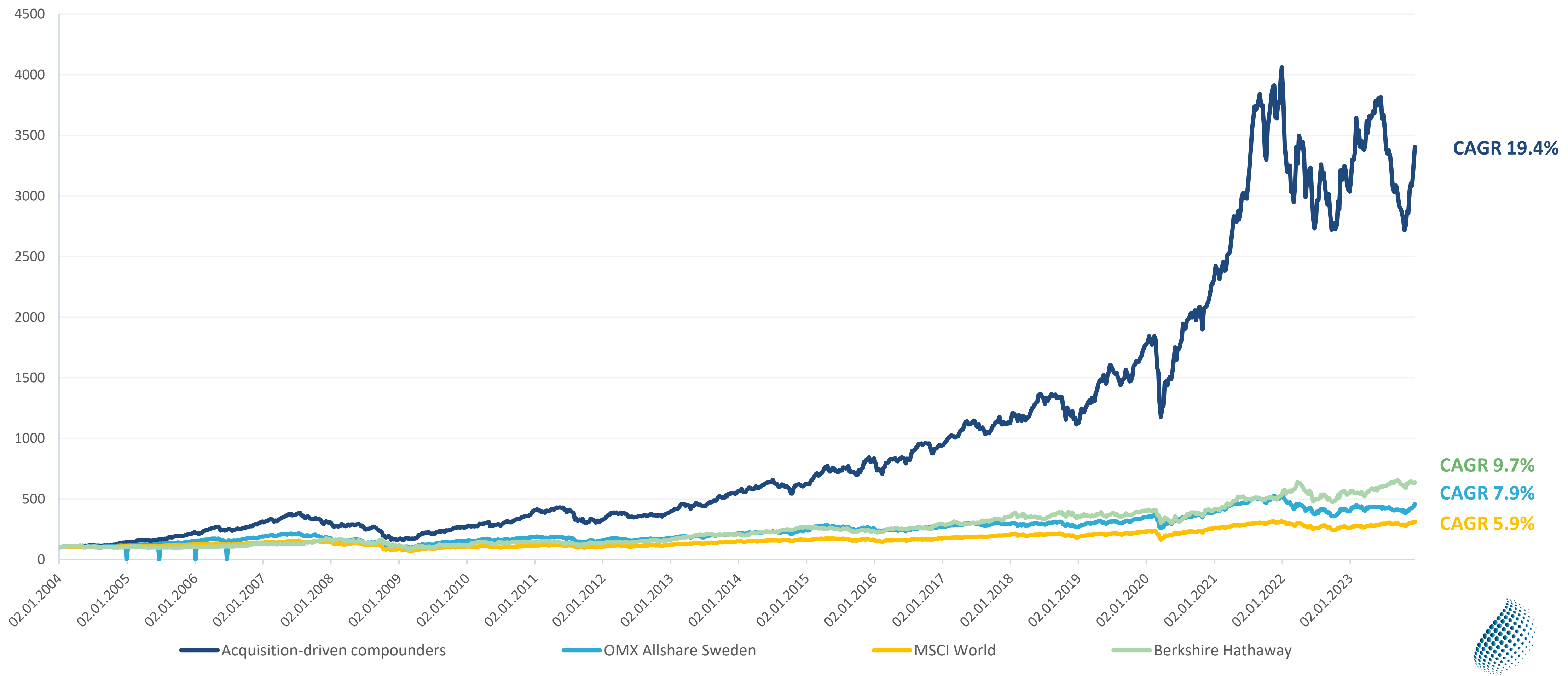
Superior Long-Term Share Price Performance – Nordic 20Y

20-year indexed share price performance
Nordic acquisition-driven compounders up 34x, Berkshire Hathaway up 6.4x

Introduction to REQ Capital and Investment Strategy



Source: Factset as of 2004-01-01 to 2023-12-15
Note: Average for companies by REQ identified as acquisition-driven compounders listed during the full period. We have not adjusted for spin-offs of Hexpol, Addlife, Momentum Group and Epiroc, which would increase the overall performance.
Assa Abloy, Addtech, Beijer Ref, Lagerecrantz, Addnode, Bergman&Beving, Ependion, OEM, Xano, Beijer Alma, Hexagon, Atlas Copco, Nibe, AQ Group

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Superior Long-Term Share Price Performance – Global 10Y

10-year indexed share price performance
Global acquisition-driven compounders up 5x, Berkshire Hathaway up 3x

Source: Factset as of 2014-01-01 to 2023-12-15
Note: Average for companies by REQ identified as acquisition-driven compounders listed during the full period:
Heico, Diploma, Halma, Judges Scientific, Roper Technologies, Illinois Tool Works, Dassault Systems, Brown&Brown, DCC, Ametek, Nordson, Teledyne, Constellation Software

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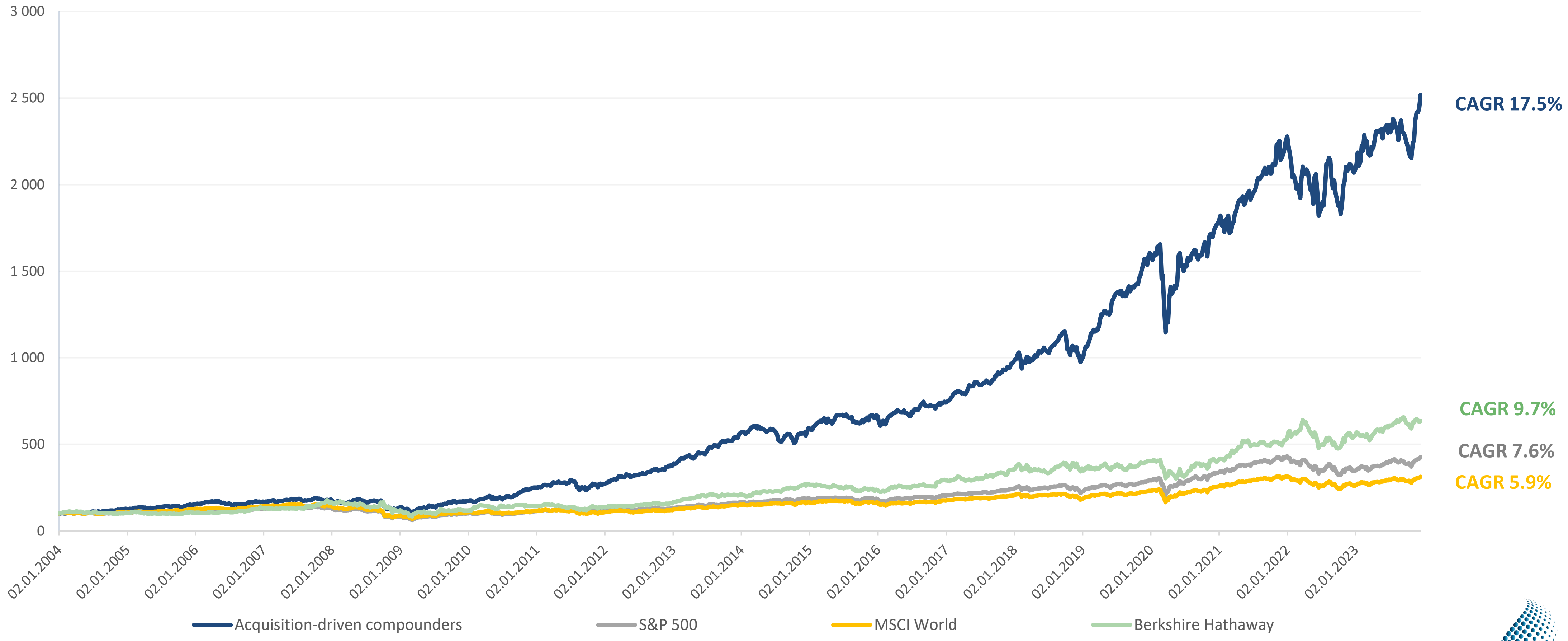
Superior Long-Term Share Price Performance – Global 20Y

Introduction to REQ Capital and Investment Strategy

20-year indexed share price performance
Global acquisition-driven compounders up 24x, Berkshire Hathaway up 6.4x



Source: Factset as of 2004-01-01 to 2023-12-15
Note: Average for companies by REQ identified as acquisition-driven compounders listed during the full period:
Heico, Diploma, Halma, Judges Scientific, Roper Technologies, Illinois Tool Works, Dassault Systems, Brown&Brown, DCC, Ametek, Nordson, Teledyne

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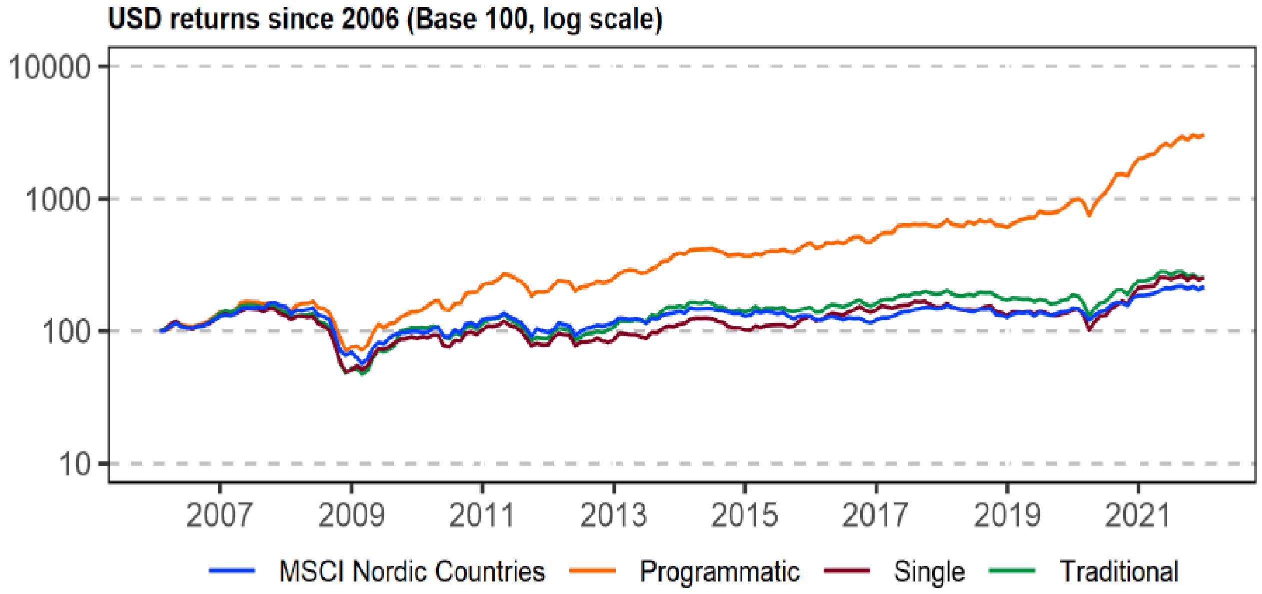
Programmatic Acquirers Outperform Other Acquirers*

A 2022 study on 993 acquirers show that programmatic acquirers outperform other acquirers



100 USD invested 01.01.2006	31.12.2021
MSCI Nordic Countries	217
Programmatic	3 037
Traditional	254
Single	252

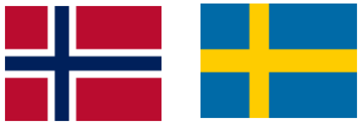
*The Performance of Acquiring Firms in the Nordic Market - Return Characteristics of Single, Traditional, and Programmatic Acquirers
Thomas Lie and Markus Martinsen, Norwegian School of Economics, 2022

REQ Group Structure

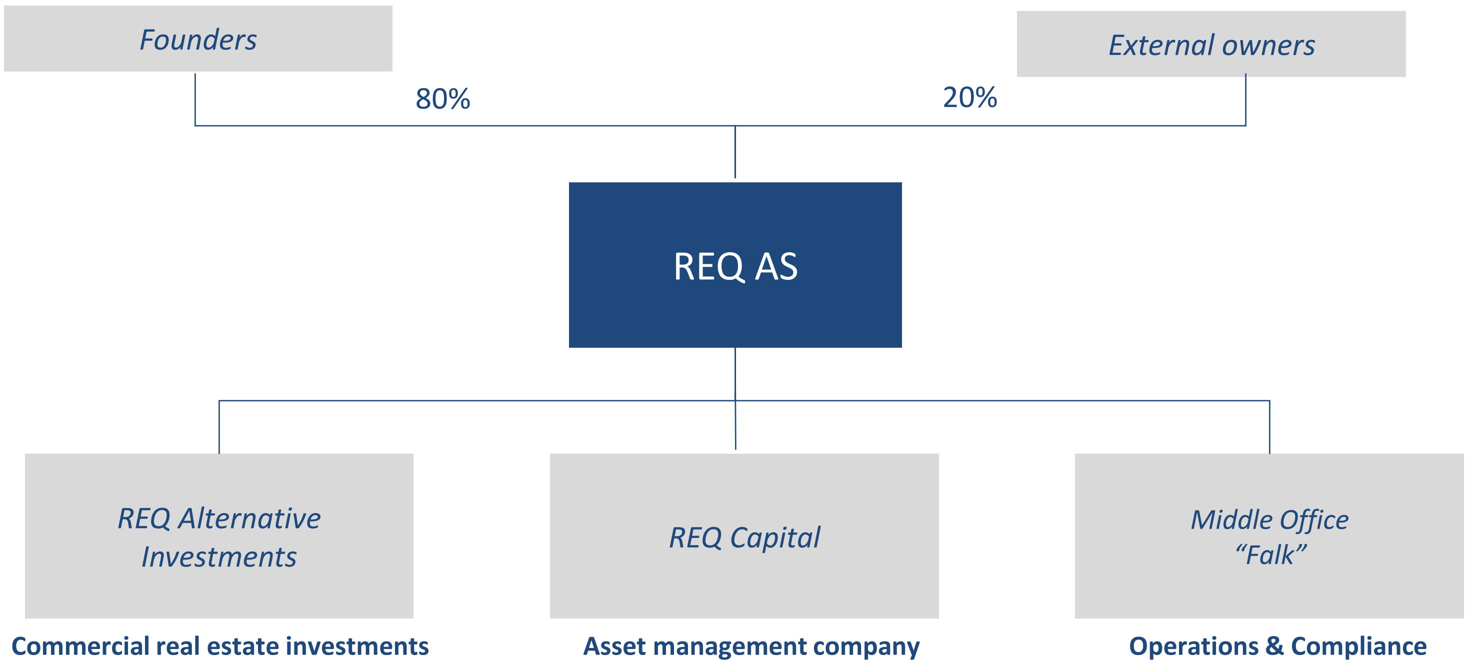
Company structure

Introduction to REQ Capital and Investment Strategy

- REQ Capital: Boutique asset management firm.
- Based in Oslo and Stockholm



- Structure: UCITS Long Only
- Single strategy: Listed Acquisition-driven Compounders
- Two funds, one strategy:
- REQ Global Compounders and REQ Nordic Compounders



Signatory of:

*Rest owned by employees

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The Team

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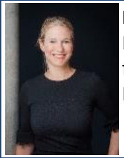
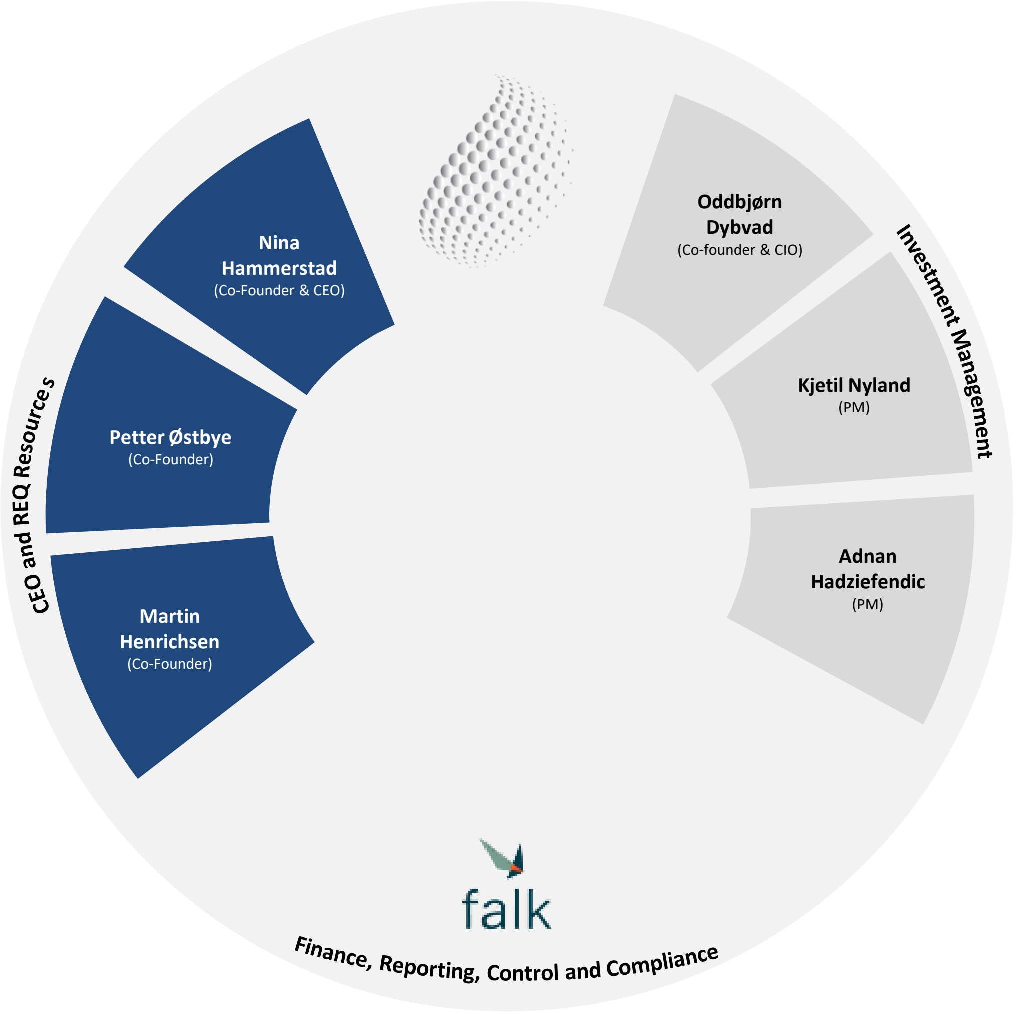


Nina Hammerstad
More than 20 years of experience from the financial and real estate industry, including Global Head of Real Estate Asset Management in NBIM

Petter Østbye
More than 10 years of experience from the financial industry and has extensive experience within capital raising and analysis.

Martin Henrichsen
More than 20 years of professional leadership experience in various roles from asset management and the financial industry.



Oddbjørn Dybvad
More than 13 years as portfolio manager - managing a global equity fund. Prior to becoming a portfolio manager, he worked as an equity analyst and a fund analyst.

Kjetil Nyland
More than 10 years of experience within the financial industry, both as an equity portfolio manager and as an equity and credit analyst on the buy-side. Previously managed the Borea Global Equities fund.

Adnan Hadziefendic
More than 10 years of experience within the financial industry as an analyst at Danske Bank and Swedbank. Author of Sweden's most extensive study on Acquisition-driven compounders, engaging with over 100 companies' Executives and Board of Directors.

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Introduction to Acquisition-driven Compounders

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Analyzing Business Models

-Free cash flow to fund acquisitions

-Strong incremental return on capital

-No synergies expected

-No guidance to the market

-Buys demonstrated track records

-Prefers to buy private companies

-Small, frequent tactical acquisitions

-Inhouse M&A team

-Founder operators or family owned

-Heavy use of equity to fund acquisitions

-Weak incremental return on capital

-Expects synergies

-Short term guidance

-Buys turnarounds

-Buys listed companies

-Few, large deals

-Use of M&A consultants

-Purely institutionally owned

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A Private Strategy for Public Markets

FEATURES	Acquisition-driven compounders	Private equity
Investment horizon	Permanent home	5-7 years
Continuity of culture	No change	?
Due diligence	Internal DD	Long process
Governance	Board member	Operational involvement
Post transaction	Autonomy & reporting	Change
Financing	Free cash flow	Use of debt

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Characteristics of an Acquisition-driven Compounder

Acquisition-driven compounders, often also called programmatic acquirers, are companies with private market acquisitions as an integrated part of their strategy for securing long-term growth and increased shareholder value.

Acquisition-driven compounders acquire small private niched businesses, frequently family-owned, with a solid financial record and organic growth, that often lack sufficient organic reinvestment opportunities to substantially absorb the cash flow they produce. Upon entering a permanent capital home, these small niched business continue to produce strong cash flow and acquisition-driven compounders can reinvest this pool of capital, generating higher returns on capital than their cost of capital for an extended period.

Many successful acquisition-driven compounders operate with a decentralized organizational setup and retain customer relationships and daily business decisions at the subsidiary level, letting acquired companies preserve their entrepreneurial independence.

Common for the best acquisition-driven compounders is that they have slim HQs, whose focus primarily is dedicated to capital allocation and close follow-up of financial performance.

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Source: REQ definition

Segmentation of Acquirers

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Segmentation of Acquisition-driven Compounders

Two types of strategies

Segmentation of Acquirers

Specialists

Niche players: Focusing on a single vertical

Investment analysis considerations:

Size of vertical?

Growth drivers?

Market penetration? Scalability?

Group structure? Integration?
Regulatory risk? Cyclicality?

Generalists

360 degree opportunity set for growth

Investment analysis considerations:

Internal M&A capacity?

Divisional CEOs? Spin offs? Group structure?

Market penetration less relevant

Less regulatory risk?

Specialists & Generalists

Perspectives on Acquisition-driven Compounders

Segmentation of Acquirers

Acquisition-driven compounders can be analytically confusing at first glance. From a 30,000-foot view, what you see might look like a mess. The logical conclusion may be to embark on integration efforts as these businesses seem ripe for serious cost and sales synergies. A closer look at the highest-performing companies in the universe reveals a collection of decentralized and autonomous business units, each protecting its entrepreneurial independence. Many of these businesses have distinct cultures, but they all thrive on ownership and autonomy enabled by decentralization. Therefore, finding the right balance between decentralization and integration represents an ongoing battle with temptations and difficult tradeoffs.

The book "Billion Dollar Lessons[1]" has a chapter on deflated rollups, companies rolling up a single vertical of companies. The author provides numerous case studies that resonate with our own experiences, documenting instances when these rollups faced failure. One lesson that characterized many failed rollup attempts stood out: "Buying a string of rock bands to form an orchestra." The architects of these rollups assumed they could benefit from both decentralization and integration. In his study, the author concluded that the rollups could choose either decentralization or integration but not both. Herein lies one of our takeaways from spending time in the field: forced synergies rarely unfold as modeled in Excel. The sacred multiplier in these organizations – a vibrant entrepreneurial culture – must be nurtured, regardless of the sacrifice.

Furthermore, the author also outlined three additional failures commonly associated with rollups that strongly resonated with our own observations:

- Rollups required an unsustainably fast rate of acquisitions.
- Rollups went for scale that wouldn't produce economies. Sometimes, rollups wound up with diseconomies of scale.
- Companies didn't allow for the tough times—and it seems every rollup runs into tough times at some point.

All businesses internally is a disaster . . . Almost every operator I know is just trying to go as hard as they can, and you're putting your finger in the leaks and working your tail off all day long . . . If you're putting your head down and you're a founder dominant organization with very little scale, with very little structure, how in the heck do you slam together two, three, four, five of these things and somehow standardize... I mean, it is like the most mindbogglingly difficult thing. You can produce a lot of EBITDA for a short period of time and then the wheels come off.

Brent Beshore, CEO of Permanent Equity, once shared a fascinating glimpse into the ups and downs of integrating small businesses. It speaks to the metaphor of buying a string of rock bands to form an orchestra. It might look good in Microsoft Excel; however, it's hard to model real-life interactions with human beings carrying different personalities in a complex system we call organizations.

In 2006, B&B Tools – a company with a 100-year heritage successfully executing the decentralization playbook – pursued the "One Company" approach, representing a decade-long centralization plan. The aim was to centralize everything, hoping to extract synergies from integrating product companies with wholesale and the many reseller companies in the group. The efficiency gains looked great on paper, but they never materialized. The company – now back to its original name, Bergman & Beving, after spinning off assets – has been on a cleanup mission ever since (continued).

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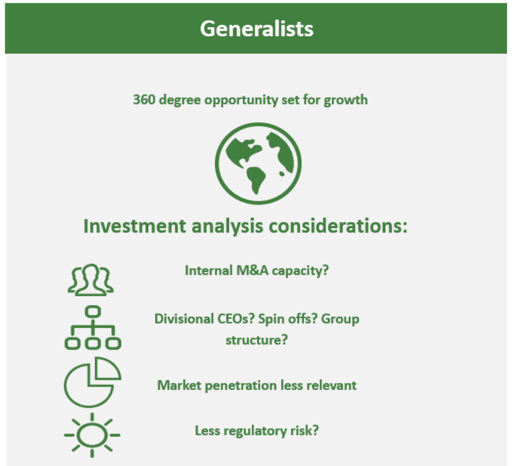
Specialists & Generalists

Segmentation of Acquirers

For classification purposes, plenty of excellent and detailed frameworks exist[2]. To keep it simple, we find it helpful to split acquisition-driven compounders into two broad buckets: specialists and generalists.

The Specialists

One frequently comes across centralized specialists exposed to narrow verticals in the specialist category. The failed rollups mentioned earlier are usually found within this group. These setups prioritize comprehensive operational integration, often pursuing cost synergies and economies of scale. Furthermore, there is a tendency to adopt a hasty approach to growth characterized by an unsustainably rapid pace of acquisitions, aggressive guidance, and high leverage. Our observations indicate that this rushed approach, often involving financial engineering, is a response to the inherent size constraints of the narrow verticals they target.



In the specialist category, we prefer global specialists with decentralized decision-making and a focus on customer intimacy, particularly those operating in large and fragmented markets. Synergies are welcomed but not forced. Moreover, we favor vehicles that embrace an industrial mindset and pursue a self-financed route to value creation. In our experience, these traits help mitigate some of the drawbacks commonly associated with centralized specialists exposed to narrow verticals.

> *It's really difficult for some people to understand what decentralization is because they've never experienced that, so they ask about synergies all the time. And it's very difficult to tell them we don't care about synergies. If they come, they come, but it's not why we invest in the company. We buy good businesses.*

Fredrik Karlsson, former CEO of Lifco (now CEO of Röko)

The Generalists

The generalist bucket allows for more flexibility. They often hone in on multiple verticals, either with recurring characteristics or unrelated themes. Multiple verticals expand the growth runway while allowing for domain expertise like a specialist. Among those we like best, synergies are often welcome but not forced. Viewed from the outside, they seem to focus on specific niches; in practice, however, they are often not limited by any particular sector. They learn as they move from one domain to a new one. To flesh this out a little bit more: a generalist acquirer like Lifco has three segments; one of them is called “System Solutions," with its subset of themes, where they put anything that does not belong in the other two boxes (Dental and Demolition & Tools). Similarly, with Lagercrantz and their “Niche" and “International" segment which serves the same purpose (continued).

Specialists & Generalists

In effect, the segment's name doesn't carry much significance internally as they are – first and foremost – investors hunting for great businesses at compelling forward returns.

Yearly gatherings and academies sharing best practices on pricing, working capital, and numerous other things help generate organic uplift – an essential contributor to overall growth. Simple profit goals related to cashflow conversion and predictability teach everyone that sales growth has to be calibrated 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, helped by the confidence boost you get when part of a larger unit. The aim is to maintain entrepreneurial drive while prioritizing cash flow and a self-funded cadence to growth; striking the correct balance is paramount and a key differentiator.

The level of decentralization among specialists and generalists varies. Some companies practice a decentralized model on the platform level while extracting synergies within the platform, adapting to the business dynamics of each particular platform. Moreover, cooperation within and between the various business units also occurs. However, the most successful practitioners let the decision originate from the individual level and not through a top-down approach.

We don't push synergies; if you ask me, the decentralized responsibility is more important than anything else. If we start taking too many decisions top down, then we will ruin the whole culture. So that will never happen as long as I'm here. But, of course, we urge for cooperation within the units since they are working on similar fields, like the battery group with 14 battery companies. They have similar suppliers, similar production needs, with similar R&D. Of course, they cooperate quite a lot. And, also between the companies….We gather once a year where all the MDs are meeting and…they sit down with gin and tonic or water, whatever, and you can really hear how they are discussing business opportunities and that is because they are driving their own business and are responsible for their own P&L.

Niklas Stenberg, CEO of Addtech[3]:

A Negative Flywheel of Incentives

A common thread among deflated rollups is a financial engineering mindset underlying a rushed approach to value creation, chasing "deals" not through the lens of great investments and often with aggressive guidance incorporating future acquired sales and synergies. The result is often added fragility throughout the ecosystem of stakeholders. Hence, we often observe a negative flywheel of incentives rooted in the structural size constraints of rolling up a narrow vertical.

The framework and labels presented here should come with a caveat, however. Companies are organisms in a dynamic environment. Some companies start with a single product niche and gradually expand into other verticals and, eventually, become more of a generalist as they go along. Case in point; in the 1990s, Diploma experienced that their traditional core businesses matured into cyclical, lower-margin companies. As a result, they launched a new acquisition program to diversify into new, more attractive sectors.

(continued)

Segmentation of Acquirers

There was no master plan from the start; it was all layers of iterations as they learned along the way. A similar story with Lagercrantz when Jörgen Wigh joined as CEO in 2006; he approached the situation with a fresh perspective and promptly addressed the competitive challenges and margin erosion within the distribution of electrical components and telecom. Armed with this insight, Lagercrantz expanded into more expansive product niches, diversifying across higher-margin companies with longer product life cycles, owning the IP outright.

Zooming out, despite our efforts in categorizing these types of companies, one realizes that the labels thrown at the best-performing ones are somewhat limited in portraying what happens behind the curtains. The focus tends to be fully anchored on the acquisition engine, while the second engine of growth – the organic growth unleashed by entrepreneurial energy – goes unnoticed by most observers. In effect, we don't fully acknowledge the reasons behind these companies' long-term fundamental track records. The business-building mentality – in addition to a successful acquisition engine – is something we find particularly interesting.

Underperforming companies are mostly worse than they look, and good companies are mostly better than they look. We don't have the management time to buy underperforming companies and are not superheroes to change them. We are not a PE turn around company. We are in the technical trade. We love people. We love customers. We like to build.

Ulf Lilius, CEO of Momentum Group

Structure, Cooperation, and Entrepreneurial Energy

What we bring to the table is really two things: it's a structure and its energy. You need to realize that it's usually in sort of a succession sort of phase that we come in as new owners. And we find that sometimes we find companies that have been sort of complacent a bit and they need new energy. There might be some discussions between the older generation and the younger generation and when we come in you loosen things up, you get new energy, you get some professionalism in, so we add energy, we add structure. We have a lot of things going on with the companies but it's not about finding new synergies between the companies, that should come from the companies themselves.

Jörgen Wigh, the CEO of Lagercrantz, once emphasized a perspective on synergies that we are particularly fond of, synergies in the form of injecting energy and structure.[4]

Organizational psychology has a term called "crowding out," which may explain why a singular focus on external rewards for completing an activity might lower the intrinsic desire to perform that task. The crowding out phenomenon underscores the importance of decentralization and a better understanding of incentive structures that work with carrots, not sticks. In the book "The Evolution of Cooperation," Robert Axelrod also shares many of the same lessons regarding human motivation that echo this sentiment: "*You provide freedom from the top and get rewarded from underlying companies that feel the freedom*." (continued).

Specialists & Generalists

Perspectives on Acquisition-driven Compounders

Segmentation of Acquirers

Summary

In the specialist category, we exercise caution when dealing with centralized rollups exposed to narrow verticals. Instead, our focus centers on global specialists with decentralized decision-making processes, operating in large and fragmented markets. In the generalist category, we favor decentralized generalists with domain expertise across specific themes or those adopting a more sector-agnostic approach. Furthermore, we favor vehicles with an industrial mindset and a self-funded path to value creation.

Moreover, capital allocation is typically centralized, while operations are fully decentralized, albeit with lead generation – and sometimes small bolt-on acquisitions – initiated from the business units. Synergies are welcomed but not forced.

In effect, this is the laissez-faire approach to efficiency gains where the entrepreneurial spirit is the forcing function; cost efficiencies are sacrificed in the belief that the cumulative impact of ownership, autonomy, and entrepreneurial spirit will offset them.

We believe the best generalists and specialists operate with the same ethos as great long-term investors. They provide click-and-buy public investors with intrinsically diversified operations across private markets and long runways for growth.

One, you have to believe it because you have to pass up at times apparent cost savings on the belief that the loss of entrepreneurial spirit and ownership will more than overcome what you might save by having a common account receivable department or something like that, or a common sales force. You just have to believe that. You'll do a lot better if you lived it for a while and had to deal in a corporate environment, where it just stifled people like that.

Nick Howley, CEO Transdigm, 50X Podcast July 2022

Sources and further reading:

1. Billion Dollar Lessons
2. Scott Management / Demesne Investments / Canuck Analysts / Redeye
3. Carnegie Trading Companies Seminar 2022
4. Acquisition-driven compounders Event March 8, 2023

Examples from the Nordic Universe

*Segmentation of Acquisition-driven Compounders**

Segmentation of Acquirers

Specialists

Bravida
Exsitec
Fasadgruppen
Green Landscaping
Instalco
ISS
Knowit
Lindab
Norconsult
Nordic Waterproofing
Norva 24
Rejlers
Wall to Wall Group

Addnode
Afry
Beijer Ref
Bufab
Hexatronic
Hexpol
Karnov Group
NCAB
Nibe
Omda
Schibstedt
Swedencare
Sweco
Systemair
Vimian

Generalists

AQ Group
Addvise
Atlas Copco
Beijer Alma
Boreo
Indutrade
Humble Group
Lagercrantz
Lifco
Storskogen
Vitec
Sdiptech

Addtech
Addlife
Bergman & Beving
Christian Berner
Idun Industrier
Seafire
Teqnion
Medcap
Momentum Group
Volati
Xano Industrier
OEM International

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The universe of acquisition-driven compounders comprises around 300 companies worldwide; however, not every company aligns with our preferred criteria for consideration.

Examples from the Global Universe

*Segmentation of Acquisition-driven Compounders**

Segmentation of Acquirers

Specialists

Brown & Brown
Kelly Partners
Boyd Group
Ferguson
Ashtead
Rollins
POOLCORP
Keywords Studios
CDW Corp
Thermo Fisher
Nemetschek
OneWater Marine
LVMH

Dassault Systemès
Eurofins Scientific
AutoNation
Berry Global
Dentalcorp
HireQuest
Waste Management
SiteOne Landscape Supply
Watsco
Novanta
Comfort Systems
Alimentation Couche-Tard
TopBuild

Generalists

Diploma
Halma
Ansys
Heico Corporation
Atkore
SDI Group
Constellation Software
DCC
Pluribus Technologies
Epsilon Net
Nordson
Software Circle
Tyler Technologies
TerraVest Industries
Perimeter Solutions
IDEX
Wolters Kluwer
Ametek

Fastenal
Interpump
Chapters Group
TransDigm
Judges Scientific
Roper Technologies
Converge Technology Solutions
IMCD
Zigexn
Topicus
CSW Industrials
Danaher
Sygnity
Amphenol
DisocverIE
SeSa
Reply
Bunzl
Lumine Group

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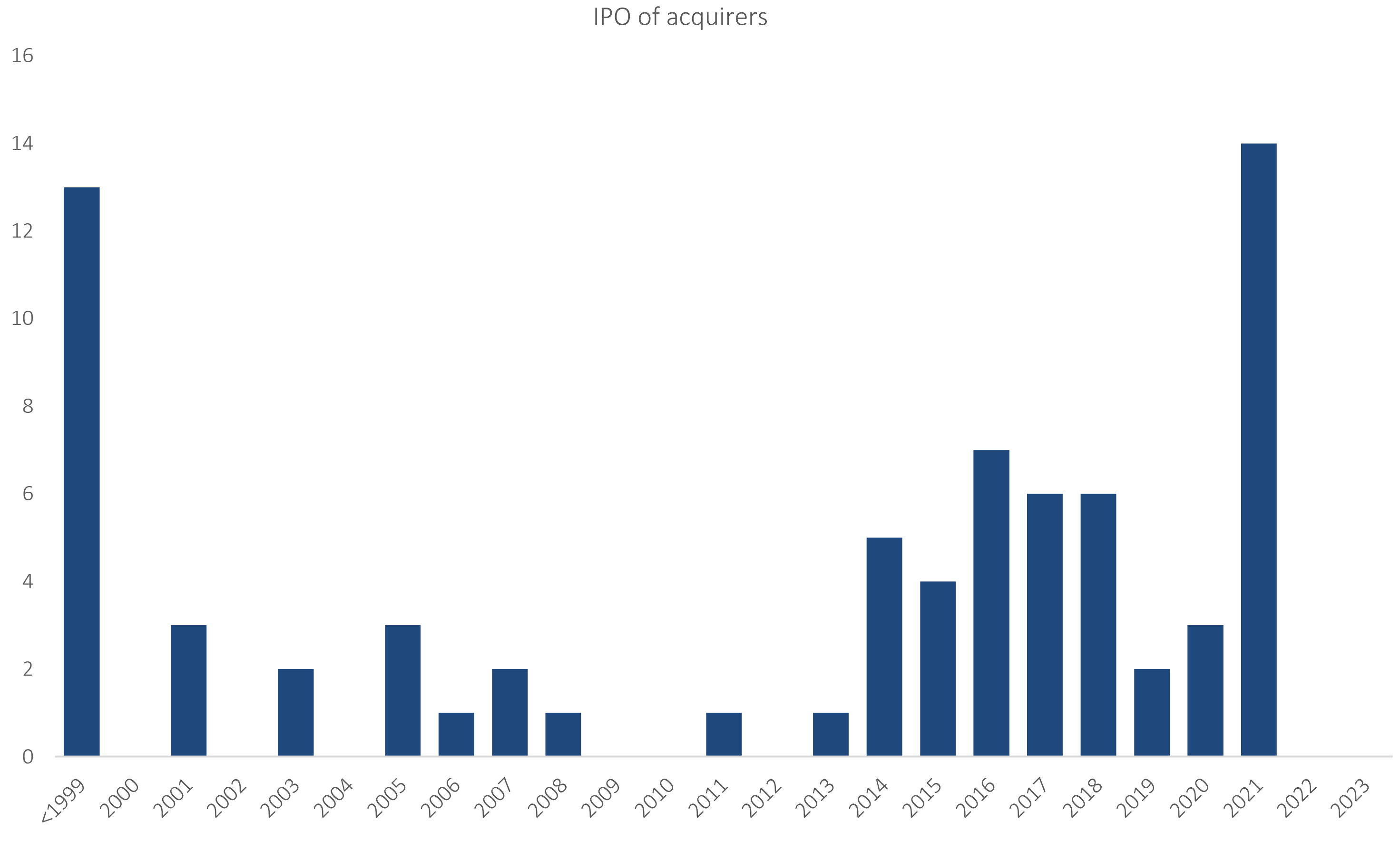
*The universe of acquisition-driven compounders comprises around 300 companies worldwide; however, not every company aligns with our preferred criteria for consideration.

IPO of “Acquisition-driven Compounders” in Sweden

Segmentation of Acquirers



We have in Sweden in recent years seen many acquisitive companies IPO.

The most recent IPO of an acquisitive company in Sweden was in December 2021 (Norva24). We have not counted the spin-offs/separation of Momentum Group and Alligo during 2022 as IPOs.

The companies that we own in the REQ Nordic Compounders portfolio have on average been listed for 18 years (median company has as well been listed for 18 years).

Source: Company websites/reports

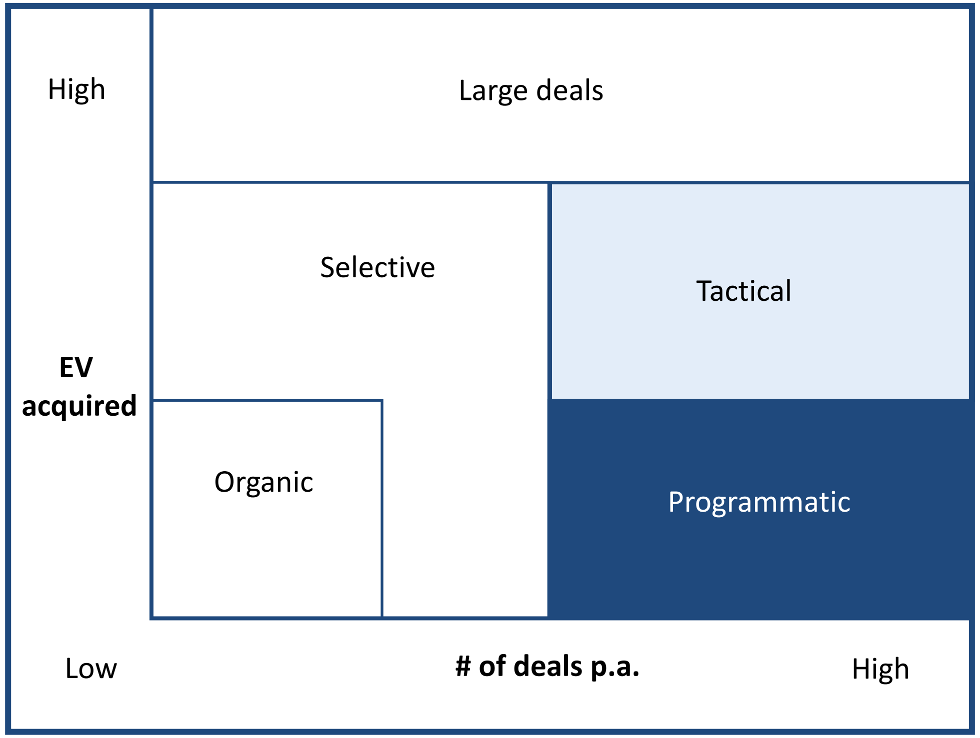
Characteristics of Programmatic Acquirers

Identifying Acquirer Characteristics*

Programmatic acquirers are often categorized as companies completing small deals with a frequency

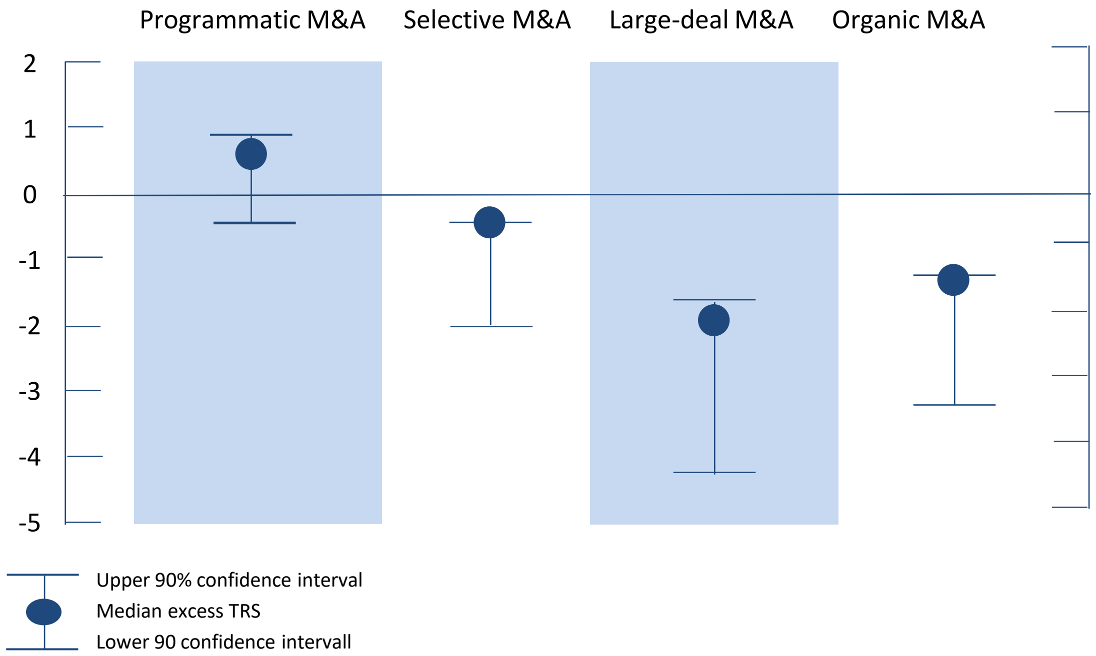
Characteristics of Programmatic Acquirers

Type of acquirers according to McKinsey



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 %



**McKinsey - How lots of small M&A deals add up to big value – Definition of programmatic is when a company makes two or more small or mid-sized deals p.a.*
*** McKinsey - How lots of small M&A deals add up to big value*

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

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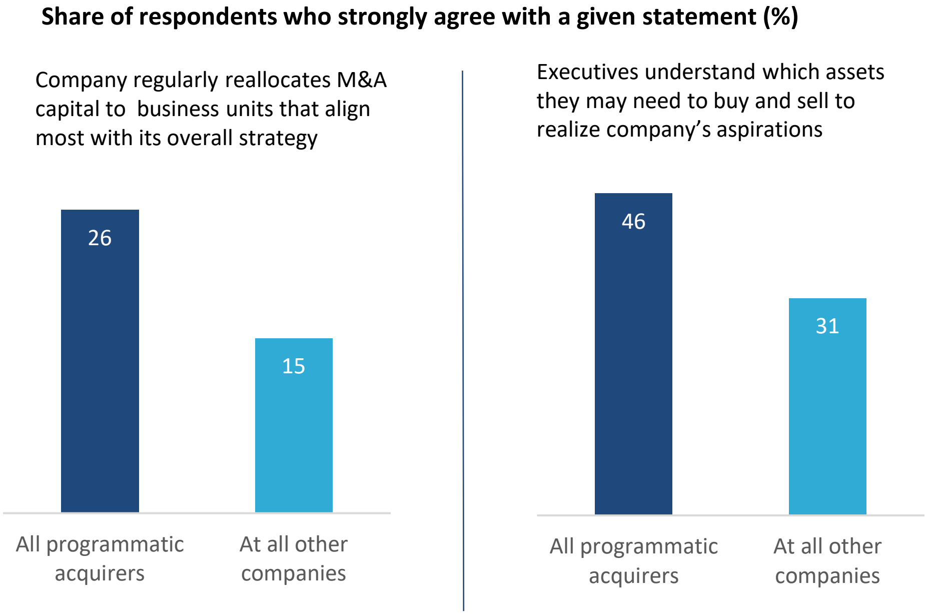
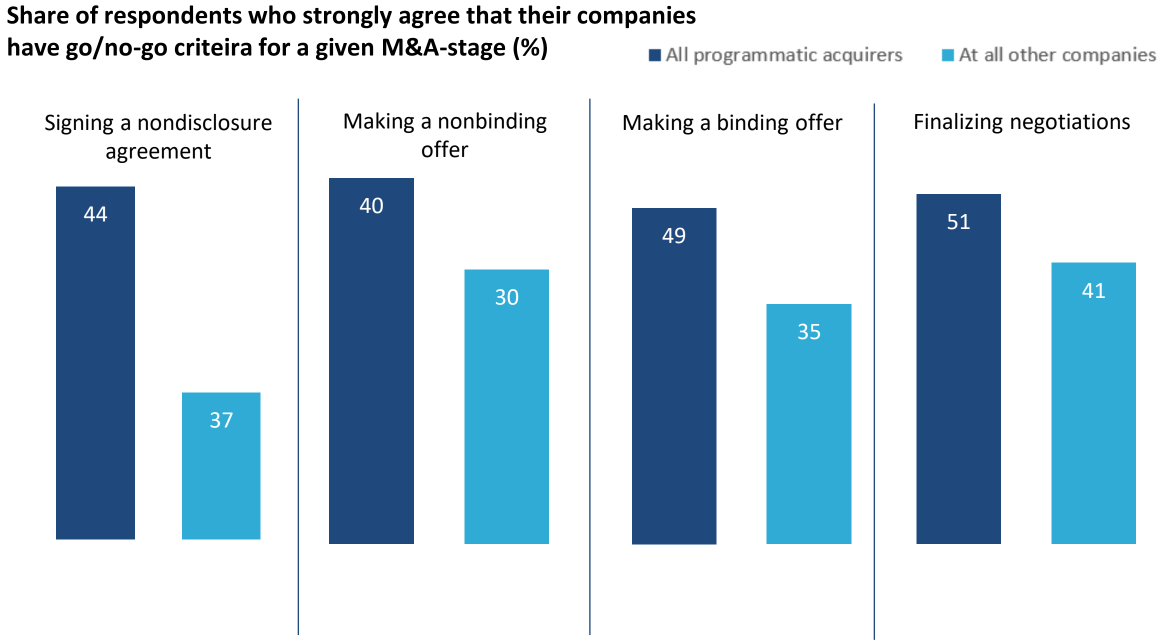
What Programmatic Acquirers Do Differently*

[Characteristics of Programmatic Acquirers]

In M&A strategy and sourcing, respondents at programmatic acquirers are more likely than others to strongly agree that their companies take measures to align M&A strategy with corporate strategy.



Companies with a programmatic approach to M&A set go/no-go criteria for each stage of a deal.



**McKinsey study - Practice makes perfect: What sets programmatic acquirers apart.*
Programmatic acquirers n = 321, For all other companies n = 961

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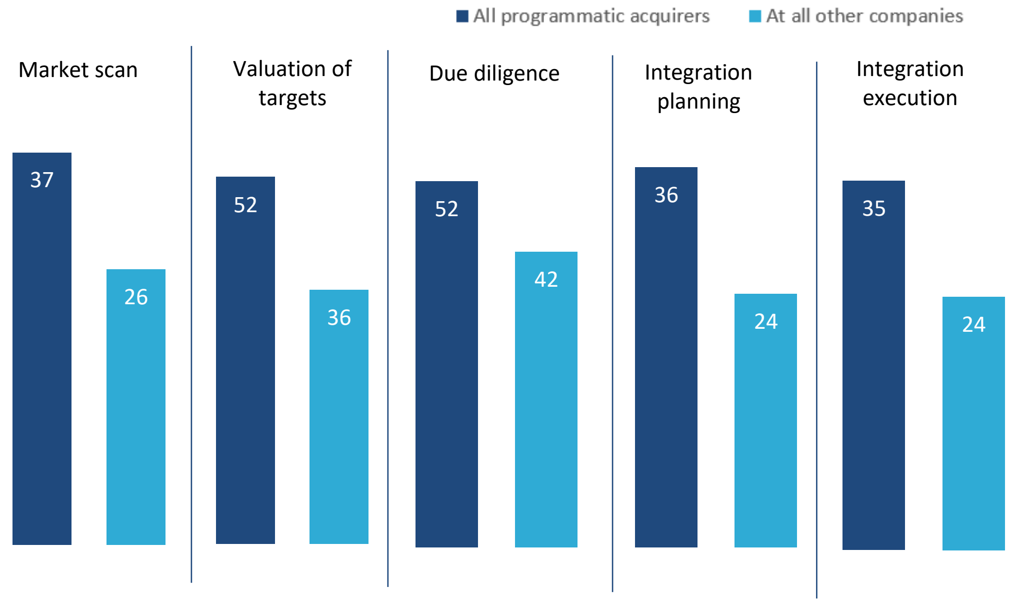
What Programmatic Acquirers Do Differently*

Characteristics of Programmatic Acquirers

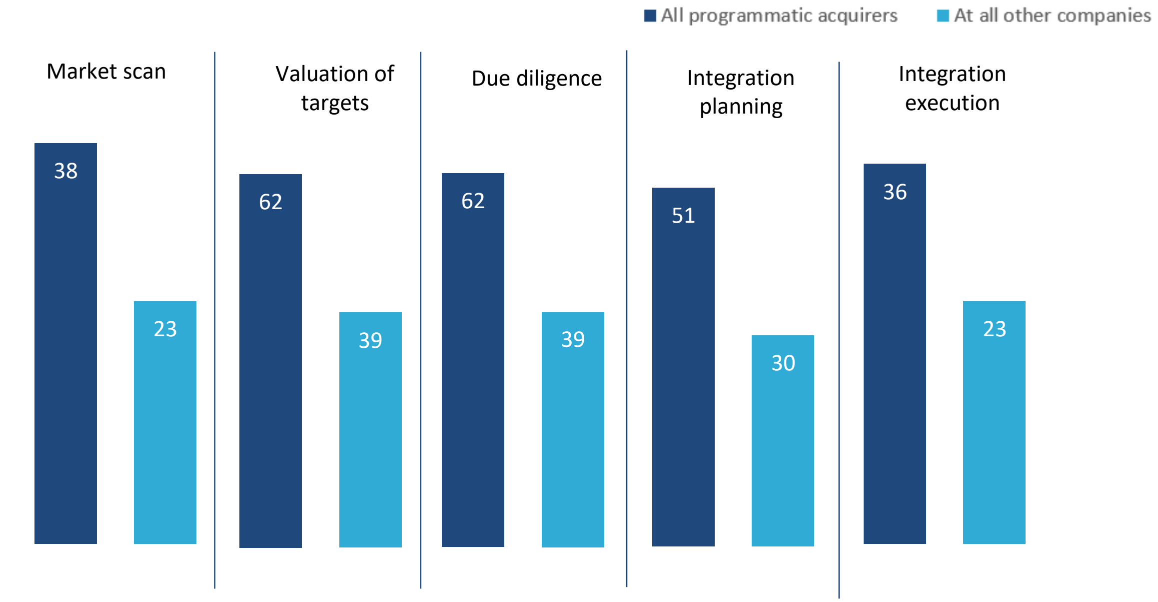
Programmatic acquirers are more likely than other companies to have clear owners for each phase of the M&A process.

Share of respondents who strongly agree that there is a clear owner for a given M&A phase (%)



In each phase of the M&A process, programmatic acquirers are likelier than other companies to use playbooks.

Share of respondents who say their companies have a playbook or how-to-guide for a given M&A-phase (%)



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**McKinsey study - Practice makes perfect: What sets programmatic acquirers apart.*
Programmatic acquirers n = 321, For all other companies n = 961

What Programmatic Acquirers Do Differently

[Characteristics of Programmatic Acquirers]

In order to achieve a high number of acquisition candidates and be able to process in a diligent manner, we have established an M&A process that is easy to follow and is sufficient. It starts with a growth screening where we identify companies based on the criteria, as mentioned before, but where we also have the parameters of transaction feasibility based on ownership structure and at least soft values. Do we think that the company and its entrepreneur will fit in our group and also add to the further development of us as a company.

We work our way through the process, through meetings and further analysis, which we summarize in a short form, which also must include a value creation plan. We run our acquisitions with our own personnel, a team comprises normally one commercially responsible and one to two process-oriented people. These are the same people that will follow and support the company also after an acquisition. As of today, we have 10 people being involved in the screening, execution and M&A support in the group, including group management, business area management and CFOs.

We seldom participate in structured processes and if we do, we must have some form of exclusivity down the road as we invest a lot of time and effort in these processes. We think it is important to have a clear communication and easy access throughout this process as these things always materialize. That needs to be solved. This also builds trust for the continued journey.

The acquisition process is just not a process for closing of the transaction. It is also a basis for getting to know the company we are acquiring and its people. That is one important reason why we staff these processes with our own people. This is established through a common view on key issues, culture, business acumen, organization, etcetera. Further, we developed a joint strategic plan linked to a model of increased value creation and often with joint ownership over a defined period through our option model.

***Niklas Enmark, CFO Momentum Group,** 2022 Q2 Conference Call*

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What Programmatic Acquirers Do Differently

Characteristics of Programmatic Acquirers

The academic literature on M&A consistently shows that acquisitions are an expensive growth path for buyers. Studies point to overreliance on synergies and management teams that engage in acquisitions to build empires rather than create shareholder value.

However, most of the literature on M&A focuses on large M&A deals in public markets. Acquisition-driven compounders, on the other hand, do small and often private deals. Acquisitions of small private companies tend to be priced more favorably than public companies.

Acquisition-driven compounders are a different breed of companies than companies that make large "transformative" deals. Instead, they differ in 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.

When it comes to great small businesses: Why not own a bunch of them through a holding company?

Mark Leonard, CEO Constellation Software

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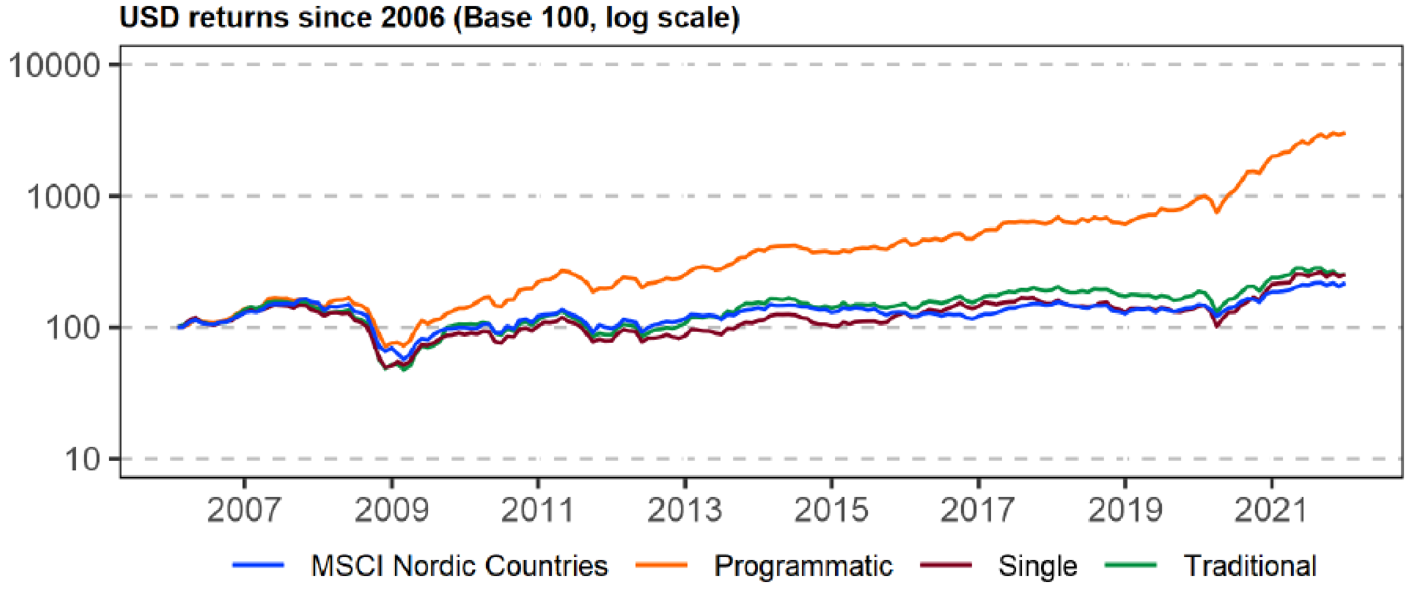
Programmatic Acquirers Outperform Other Acquirers* (1/2)

A 2022 study on 993 acquirers show that programmatic acquirers outperform other acquirers

Characteristics of Programmatic Acquirers



100 USD invested 01.01.2006	31.12.2021
MSCI Nordic Countries	217
Programmatic	3 037
Traditional	254
Single	252

Continued on the next slide

*The Performance of Acquiring Firms in the Nordic Market - Return Characteristics of Single, Traditional, and Programmatic Acquirers
Thomas Lie and Markus Martinsen, Norwegian School of Economics, 2022

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Programmatic Acquirers Outperform Other Acquirers* (2/2)

A 2022 study on 993 Nordic acquirers show that programmatic acquirers outperform other acquirers

Characteristics of Programmatic Acquirers

A study conducted in 2022 shows that, based on 993 acquirers and 5473 deals from 2006-2021, Programmatic acquirers display superior returns compared to Single and Traditional acquirers.

The authors state that current academic literature has made adverse findings regarding the long-term performance of acquiring firms relative to the market. They state that Programmatic M&A is not only a volume play but a strategy consisting of choreographed acquisition programs.

In their study of Nordic acquirers, they created equally weighted portfolios to investigate long-term performance. One portfolio was designed for each sub-sample: single, traditional, and programmatic acquirers. The portfolios were rebalanced monthly to include and exclude companies based on deal flow over the past 12 months. To determine whether any excess returns are generated, the portfolios were regressed based on CAPM, the Fama French three factor model, and the Carhart four factor model.

Overview of Revenue Growth, ROIC and Insider Ownership

	Programmatic			Traditional			Single		
	RG	ROIC	Insider	RG	ROIC	Insider	RG	ROIC	Insider
Mean	27.47%	9.45%	9.94%	17.99%	0.11%	5.14%	17.55%	-0.60%	5.05%
Median	18.01%	9.88%	2.39%	12.46%	5.04%	0.07%	13.35%	4.49%	0.10%

They concluded from the study that the portfolio containing programmatic acquirers outperforms the market by 0.88 to 1.32 percentage points monthly, depending on the model. In contrast, the portfolios containing single and traditional acquirers show insignificant excess returns. The results are in line with the findings of some practitioners approach that M&A does create excess returns for the acquiring firms' shareholders.

Following the evidence of the programmatic acquirers' performance, they found quantitative differences among the acquirer types. By analyzing data on all 997 firms in the sample, the study found that the programmatic acquirers have a significantly higher average revenue growth and ROIC than other acquiring firms. The table on the bottom left show that their yearly revenue growth is about 9.5 percentage points higher than their peers. Similarly, their median ROIC is almost 10%, twice as high as the other acquirers.

Further, high insider ownership typically signals confidence in a company's prospects. Therefore, they wanted to determine whether programmatic acquirers have a higher degree of insider ownership and found that insiders own 9.94% of programmatic acquirers' stocks. For single and traditional acquirers, the ownership % is 5.05% and 5.14%.

*The Performance of Acquiring Firms in the Nordic Market - Return Characteristics of Single, Traditional, and Programmatic Acquirers
Thomas Lie and Markus Martinsen, Norwegian School of Economics, 2022

The Story of Financial Targets

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Financial Targets

	Sales target	Sales growth	Profit target	Profit growth	Margins	Return on WC	Equity ratio	RoE	ROCE	NIBD/EBITDA	NIBD/Equity	Cash flow	Dividend
Addlife				EBITA >15% p.a.		>45%							30-50% (net profit)
Addnode		>10%			>10% EBITA								> 50% (net profit)
Addtech				15% p.a.		>45%							>30% (net profit)
Addvise	SEK 1.7 bn (2023)	>30% org + acq	EBITA 500m (2023)		EBITDA >28%					<3.0x			25% (EBIT excl EO)
Alcadon	2.6bn (2025)	>20%	EBITA 280m (2025)		>10% EBITA					2-3x			
Alligo		>5% organic			>10% EBITA					<3.0x			30-50% (net profit)
AQ Group				EBT >8%			>40%						
Atlas Copco		8%							Sustained				50% (net profit)
Beijer Alma													
Beijer Electronics		>10%*			EBIT >15%								
Beijer Ref		10-15%			EBITA 10-12%		>30%		>12%*	<3.0x			>30% (net profit)
Bergman & Beving				15% p.a.		>45%							
BHG Group	Sales SEK 20bn				Adj EBIT >7%					1.5-2.5x			
Bravida		>5%			EBITA >7%					<2.5x		Cash Conversion >100%	50% (net profit)
Bufab		>10%		>15% p.a.*	EBITA >14%					2 - 3x			30-60% (net profit)
Byggfakta		>10% org + 5-15% acq			EBITDA >40%					<3.0x			
Cary Group		>15% (half org.)			Adj EBITDA >20%					<2.5x			20% (net profit)
Christian Berner		>10%			EBITA >9%		>35%	>25%					30-50% (net profit)
Embracer													
Fasadgruppen		>15%			EBITA >10%					<2.5x		Cash Conversion >100%	30% (net profit)
Green Landscaping		>10%			EBITA >8%					<2.5x			40% (net profit)
Hexatronic		>20% p.a.			EBITA >15-17%								
Humble Group	Sales SEK 16bn*		EBITA SEK 1.9bn*							<2.5x			
Idun Industrier				EBITA >15% p.a.*						<3.5x			<10%*
Indutrade		>10%			EBITA >12%				>20% *		<1.0x		30-50% (net profit)
Infrea		>20%			EBITA >8%			12-15%					30% (net profit)
Instalco		>10%			EBITA >8%					<2.5x		Cash Conversion >100%	30% (net profit)
Inwido	Sales SEK 20bn								>15%	<2.5x			50% (net profit)
Karnov Group		Org. Growth 3-5%			Increase margins					<3.0x			30-50% (net profit)
Lagercrantz				15% p.a.		>45% (internally)		>25%					30-50% (net profit)
Lifco				EBITDA >GDP g.					>50%*	2-3x			30-50% (net profit)
Lindab		10%			10%					<3.0x			
MedCap	Sales SEK 1.5bn*			EBITDA >15%						<3.0x			
Momentum Group				EBITA 15% p.a.		>45%							30% (net profit)
NCAB	SEK 8bn		EBITA SEK 1bn							<2.0x			50% (net profit)
Netel		10%			EBITA >7%					<2,5x			
Nordic Waterproofing		> Market growth							>13%	<3.0x			>50% (net profit)
Norva24	NOK 4.5bn*				EBITDA 14-15%					<2.5x			
OEM		>10%			EBITDA >10%		>35%	>20%					
Proact Group		>10%			EBITA >8%				>25%	<2.0x			25-35% (net profit)
Sdiptech			Acq. EBITA SEK 120-150m p	EBITA 5-10% p.a.*					>15%	<2.5x			
Seafire													
Soltech*	Sales SEK 4.7bn				EBIT 8-10%								
Stillfront	Sales SEK 10bn*				adj EBIT >35%					<1.5x			
Stockwik		> Market growth							>25%				
Storskogen				EBITA + >1-2% real GDP-g*	EBITA >10%					<3-3.5x		Cash Conversion >70%	
Swedencare	Sales SEK 4bn*				EBITDA 30%								
TCECUR		>10%*			EBITDA >10%					<2.5x			
Teqnion				Grow EPS 100% every 5y	EBITA >9%		>20%			<2.5x			
Thinc Jetty Collective	SEK 600m	>50% SaaS growth			EBITDA >10%								
Vestum				EBITA/share >15% p.a.	EBITA >12%					<2.5x			
Vimian		>30% (organic 15%)	EBITA EUR 200m		EBITA >35%					<3.0x			
Vitec					EBIT >20%								>33% (net profit)
Volati				EBITA/share >15% p.a.				>20%*		2-3x (max 3.5x)			
Vo2 Cap	Sales > SEK1bn				>8% EBITDA		>40%						
Xano Industrier		Org growth>market			EBT >11%		>30%						

The Story of Financial Targets

Source: Company websites/reports

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Financial Targets

The Story of Financial Targets

We deliberately chose to develop a group which would be completely self-financing but which would also be able to sustain a growth in EPS in the range of 20%-30% compound per annum or, as we later defined it, 15% plus inflation. This latter target was our overriding corporate objective.

We determined that in order to achieve this in that very inflationary climate, we needed to be achieving an average Return on Capital Employed of 40%. Was it a good idea at the time? Without doubt the establishment of these very demanding targets was a key driver in achieving the results we did.

I can tell you that once you have created and find yourself running a group with such a high rate return on capital, it is a position you will relinquish only with extreme reluctance!

If the targets are too complex, then this quick mental reference can be very difficult to achieve. The salient points arising from it must be simple and easily understood. There is a virtue in having relatively simple, relatively understandable key targets.

The route we adopted at Halma as long-term operators was to focus on mix. In broad terms, simply doing less of anything that gave returns below the target level and doing more of what gave returns above this level. It sounds simplistic but given time, the cumulative effect of chis can be massive, even in a large group.

David Barber, former CEO and Chairman of the Board Halma, October 1997 Strategy Speech

Risk-taking requires good profitability. We have previously stated that minimum good profitability can be defined as a return on capital employed that exceeds the inflation factor by 5 percent.

Tom Wachtmeister, former CEO Atlas Copco, *Annual Report 1980*

Financial Targets

The Story of Financial Targets

Our findings from studying financial targets

- No correlation between how companies use financial targets.
- Companies with a longer track record on the stock market include dividends in their financial targets.
- Leverage is predominately communicated as a financial target.
- Only two companies in our sample measure sales and profit growth in terms of "per share" – Volati & Vestum.
- Companies like Addtech, Lagercrantz, Lifco, Indutrade and Bergman&Beving do not communicate financial targets as "per share", but they do not issue any shares.
- Very few companies have (at least externally communicated) financial goals on capital or equity return targets.
- We see that relatively newly listed roll-ups apply financial targets in absolute numbers; Addvise, Norva 24, BHG Group, Humble Group, Soltech, Stillfront, Sdiptech, Swedencare and Vo2 Cap etc.
- Bergman & Beving's spin-offs Addtech & Lagercrantz and Addlife (spin-off from Addtech), Momentum Group measures return on working capital - measured from top management down to lower business levels.

How to think about financial targets?

- We believe that one of the main responsibilities for CEO's is to articulate financial goals as a tangible focus for its business mission and strategy.
- Financial targets should be aligned with companies' capital allocation priorities.
- It should also reflect the companies' overall equity story.
- Financial targets should also be understandable and applicable within the organization (Bergman & Beving-sphere examples with P/NWC pushed down in the organization).
- We believe it is also essential to have financial targets and goals that can be used through business cycles and in changing business environments. Simultaneously, financial targets should also be dynamic and reflect the current state.
- Financial targets should also be realistically set. Companies that do not achieve their targets will most likely be punished by the market.
- Financial targets can also create internal dissatisfaction and undermine management and its' goals and strategies if they are perceived not achievable.
- Generally, companies should not only target sales/profits in absolute numbers if coupled with dilution or too high operational and financial risk.

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Financial Targets

Nibe's financial targets from 1999 serve as a compelling example on shareholder-friendly financial targets that are further clarified by clear strategic targets

[The Story of Financial Targets]

From Nibe 1999 Annual Report

Nibe Industrier's main objective is to combine powerful and sustainable growth with healthy profitability, so creating value for shareholders, providing an interesting and stimulating workplace for employees, and attracting satisfied long-term customers who value the peace of mind that the NIBE Group can offer. The Group also has four overall financial targets:

- to achieve average year-on-year growth of 20%, half of which is to be organic
- to report average annual operating profit for each of the three business areas of at least 10% of turnover over a business cycle
- to achieve an average annual return on equity over a business cycle of at least 20% after standard deductions for tax
- to ensure that the equity/assets ratio does not fall below 30%.

Strategies

Growth

will be based on:

- a greater market share in priority markets
- a focus on new markets and segments, preferably with the help of unique products
- strategic acquisitions in selected markets, preferably with strong brands and complementary products.

Competitiveness

will be improved through:

- the continual development of leading-edge products in close cooperation with the market and customers
- constant rationalisation of the production process through mechanisation and automation, supported by the optimum utilisation of working time through a flexible wage system
- standardisation, the coordination of components and modularisation
- economies of scale thanks to large volumes in purchasing and production
- the use of IT support for product development, purchasing, production, sales, marketing and finance
- modern designs that reflect the quality and performance of our products.

Profitability

will be maintained through:

- faster growth than competitors
- optimising costs, minimising the amount of tied-up capital and consistently strengthening competitiveness
- high levels of value-added
- brand-building
- activity in a variety of different markets and segments, so reducing sensitivity to fluctuations in demand
- benchmarking, both internally and externally
- the integration of newly acquired units in line with the three-phase model: analysis-improvement-growth.

Corporate culture

will be further strengthened through:

- training and development of individual employees and the organisation as a whole
- the retention of existing and recruitment of new key employees
- employee share schemes.

Customer satisfaction

will be further improved through:

- a broad range of products that ensures that each and every customer benefits from optimal solutions
- the best service and customer support
- high quality
- competitive prices.

Environmental considerations

will play a key role in product development, from the choice of materials, through production and use to recycling.

Sincerity and an ethical approach

will characterise the company and its employees in terms of both internal relations and dealings with shareholders, customers, suppliers, the authorities and society in general.

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Scaling M&A and Long-term Opportunities

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How Big Can an Acquisition-Driven Compounder Become? «7-7-7 structure»

An interview with Kristina Willgård, ex CFO of Addtech / ex CEO of Addlife.

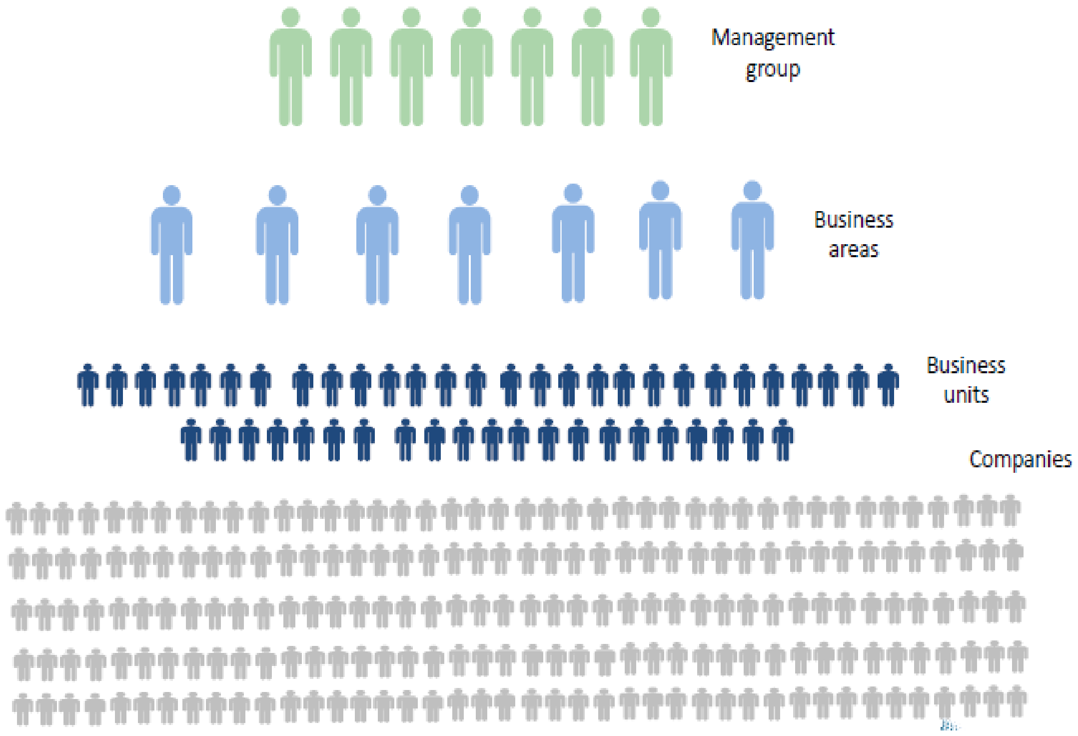
Kristina Willgård, former Addlife CEO in Affärsvärlden article, 2021-05-30:

"The group now consists of more than 70 companies. How many could it be in the future?
Johan Sjö and I, the then CEO of Addtech, did a calculation a few years ago. We asked ourselves how big Addtech could really become and how many companies we could manage. We arrived at 343.

What were you thinking?
"We were both economists, so we thought purely mathematically like this: A management team of seven people is enough. There are seven business areas that you can keep. Each business area can then have seven business units. It will be quite reasonable because then they can have their management teams, and each unit can have seven companies. This makes a total of 343.

I don't know if that reasoning works in reality. But it's the best answer I have. When you buy companies on an ongoing basis, as we do, it's incredibly important to have the capacity to take care of everyone. You can't just buy companies and let them go. That's not the idea. Instead, you have to work closely and develop together. It is important to have both human and financial capacity.

Many people think that 70 companies is a lot. But when I started at Addtech in 2010, we had 70 companies with a turnover of around 3.5 billion. When we spun off AddLife in 2016, Addtech had twice as many companies – 160 or so. And it was really built with this 7-7-7 structure. Although at the time, we were five at the top and seven below."



Lifco: Scaling M&A

Scaling M&A and Long-term Opportunities

We are slowly developing and gradually developing our acquisition capacity, which has led to this effect that we are now able to do a little bit more acquisitions that we were maybe able to do 4 or 5 years ago. And this is a continuous development of organically developing our own resources and being active in finding companies, but also being able to take care of new acquisitions.

That is equally important that we make sure we set the foundation to continue organic development of these acquired entities. And we take a big emphasis on having the right people involved in steering that development from a Lifco perspective.

Per Waldemarsson, CEO Lifco*, 2021 Q4 Conference Call*

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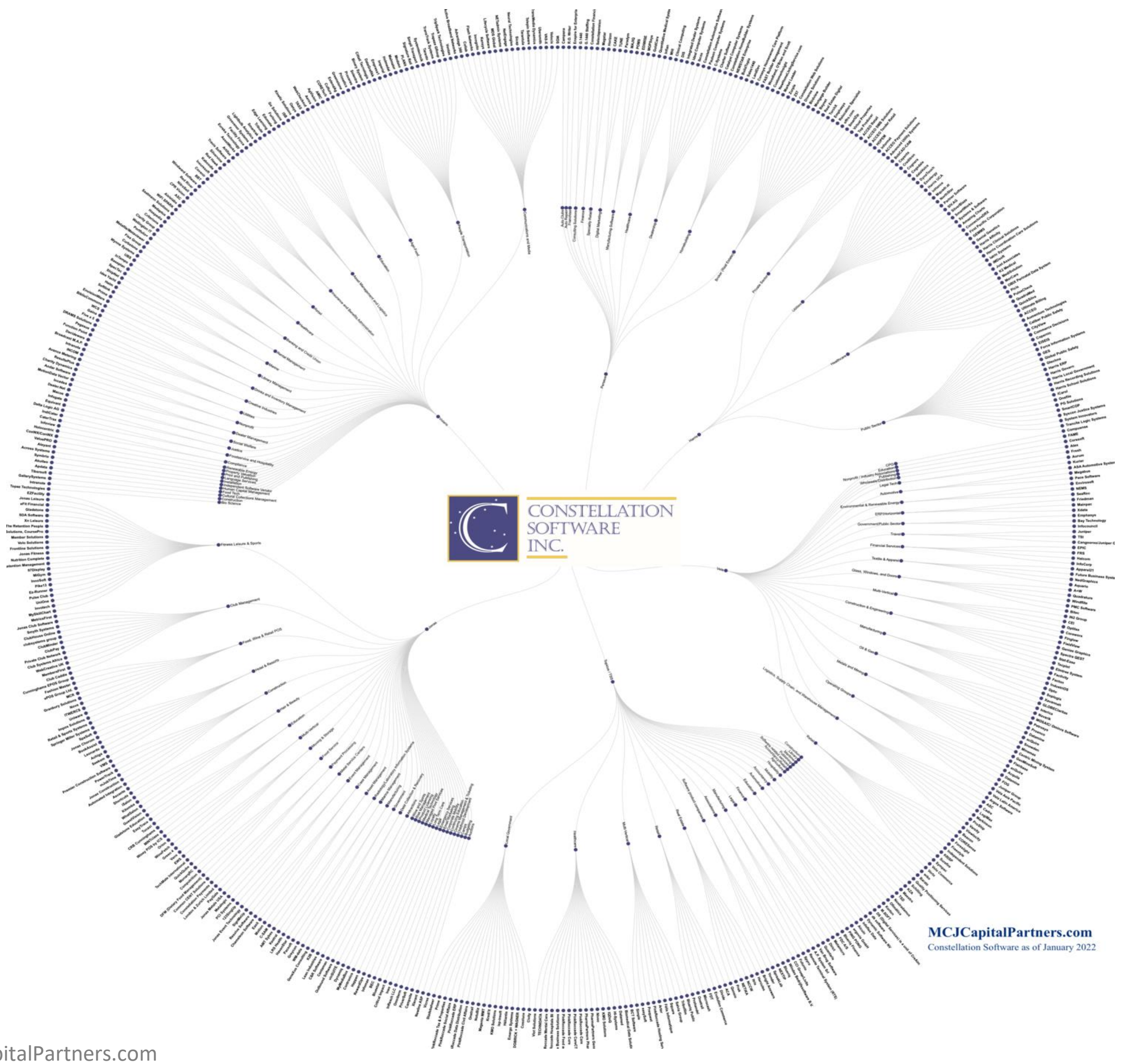
Source: Lifco annual report

How Big Can an Acquisition-Driven Compounder Become?

A snapshot of Constellation Software businesses in 2022

[Scaling M&A and Long-term Opportunities]



The picture represents Constellation Software organizational chart with different levels, illustrating how an Acquisition-driven compounder can organize itself as it becomes larger.

Source: MCJCCapitalPartners.com

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How Big Can an Acquisition-Driven Compounder Become?

A snapshot of Constellation Software businesses in 2022

One of the issues that the CSI Board, in particular, worries about as CSI gets larger, is the complexity created by our continued growth. We totted up the numbers this quarter, and we had approximately 125 business units which were competing in approximately 50 verticals. We tend to add 10-15 business units and 3-5 verticals each year. The Board rightly asks how they (and CSI management) can expect to understand and manage an ever larger number of business units and verticals.

In response to the Board's concern, I've asked each of our Operating Group General Managers to lead the board through an analysis of how their Operating Group has evolved during the last decade: how they are structured now, what has changed over time, where the business unit, divisional and Operating Group managers have come from, how big the business units are and how big they are likely to become, from whom they were acquired, what their subsequent performance has been, etc.

One early observation is that our business units rarely get large. The biggest is 307 employees, and the average business unit currently has 44 employees. Two thirds of our employees are working in business units with less than 100 employees. When we did a linear regression analysis of performance against business unit size for Q1 2013, we found less than a .001R2. This suggests that the size and performance of our business units are almost totally unrelated. I believe that these business units are small for a reason…that the advantages of being agile and tight far outweigh economies of scale. I'm not a proponent of handling our "complexity problem" by creating a bunch of 400 employee business units to replace our 40 employee units. I'm looking for ways of achieving scale elsewhere.

I'm not sure if there's an optimal structure and size for an Operating Group. At the one extreme, I do worry about the Operating Group managers becoming overwhelmed because of constrained resources at the Group level. At the other extreme, I'm concerned that they may hire too many staff at the Group level and take on too much of the business units' activities. This is one of those debates where there are likely no easy answers, but it helps to have a regular dialog and some crisp data.

Mark Leonard, CEO Constellation Software, 2012 President Letter

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When Are They Running Out of Companies to Buy?

Some thoughts on European market opportunities

“When are they running out of companies to buy?“

We often receive a common question regarding the length of the growth runway for acquisition-driven compounders and the number of companies they can find and acquire.

Generally speaking, when studying acquirers with a sector-agnostic/generalist approach, their strength lies in the decentralized model where the acquired companies continue to operate according to their way of doing business, complemented by best practices and intelligent incentive structures.

Having that sector-agnostic approach means that these companies have a large pool of companies within many different industries to fish from. Still, questions arise about how many companies there are to buy and how to scale M&A properly to other geographies. We believe that the "duration" aspect of many of these companies is underestimated by the market because the pool of future acquisitions is large. So, what does the "pool of companies” look like?

On the next slide we show the larger Swedish generalist acquisition-driven compounders Lifco, Indutrade, Addtech and Lagercrantz, which together for the last ten years have made around 175 acquisitions outside the Nordics, more or less a drop in the ocean compared to the total potential acquisition targets. While Lagercrantz is the smallest among these companies and is going through similar phases as the larger ones, it has more recently placed more emphasis on scaling M&A outside the Nordics.

Establishing a stable foundation in their core market (the Nordics) has allowed these companies to gradually expand geographically while maintaining their disciplined approach and applying their best practices to M&A.

Moreover, companies already successful in M&A within their home markets can reduce risks and increase optionality compared to companies in the early phases of geographic expansion. However, it's crucial to note that this trial-and-error approach needs to be monitored more closely by shareholders.

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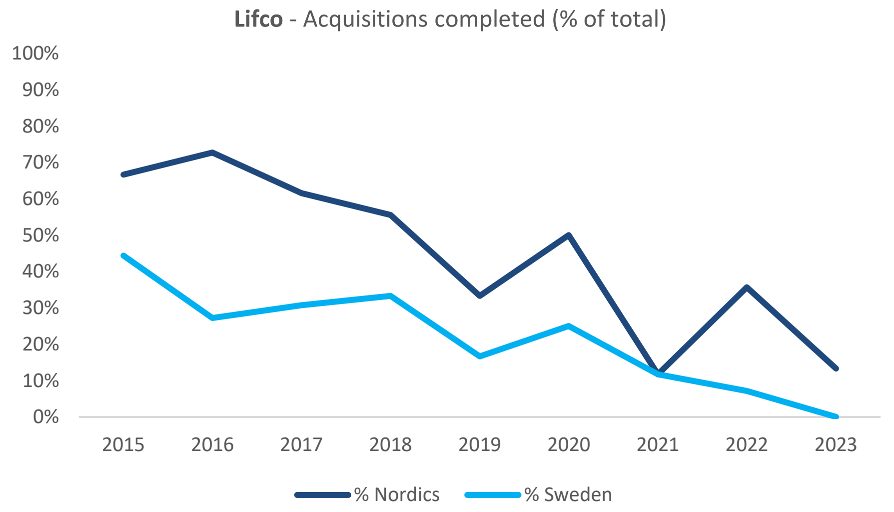
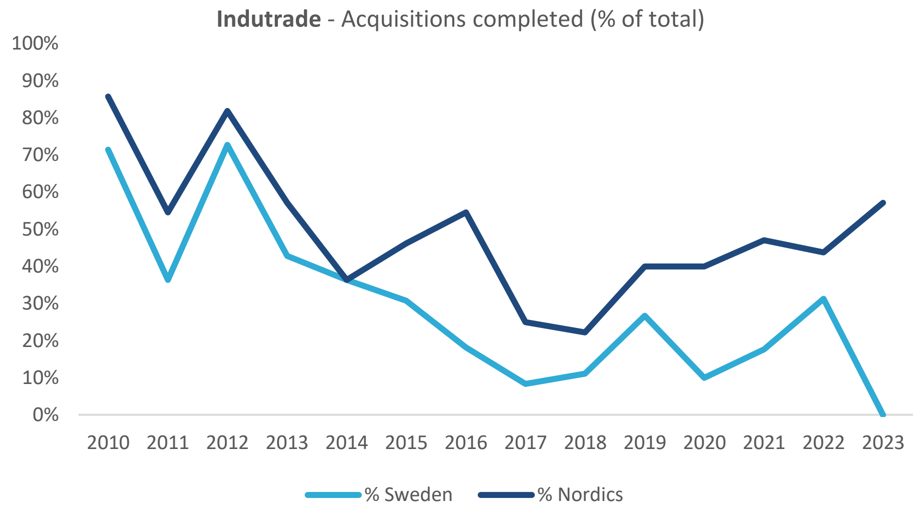
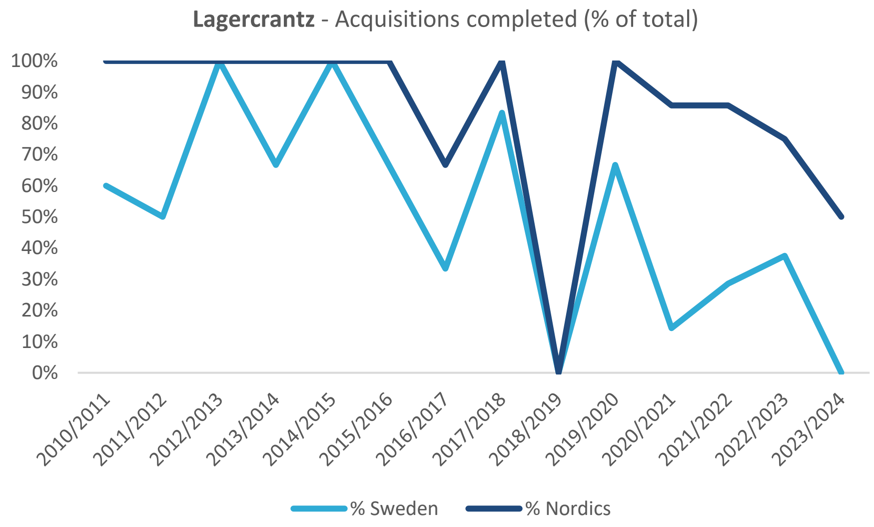
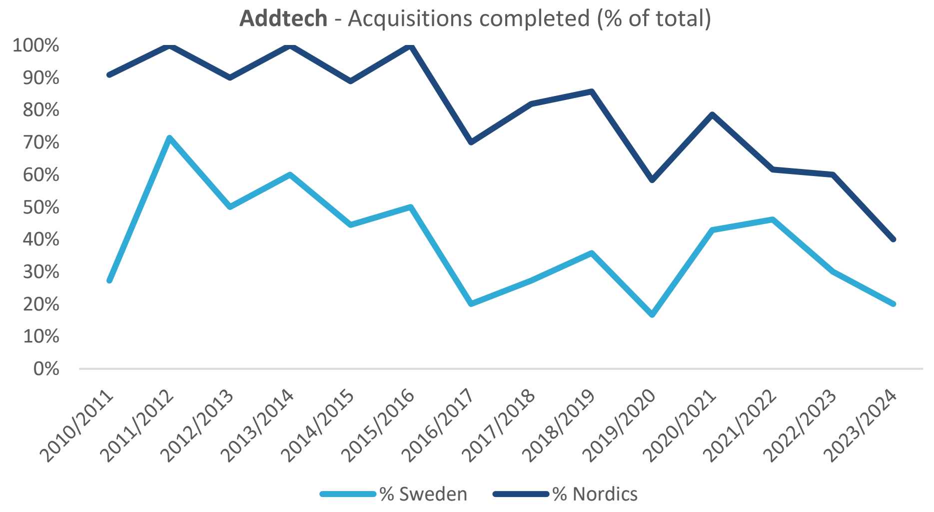
When Are They Running Out of Companies to Buy?

Scaling M&A and Long-term Opportunities









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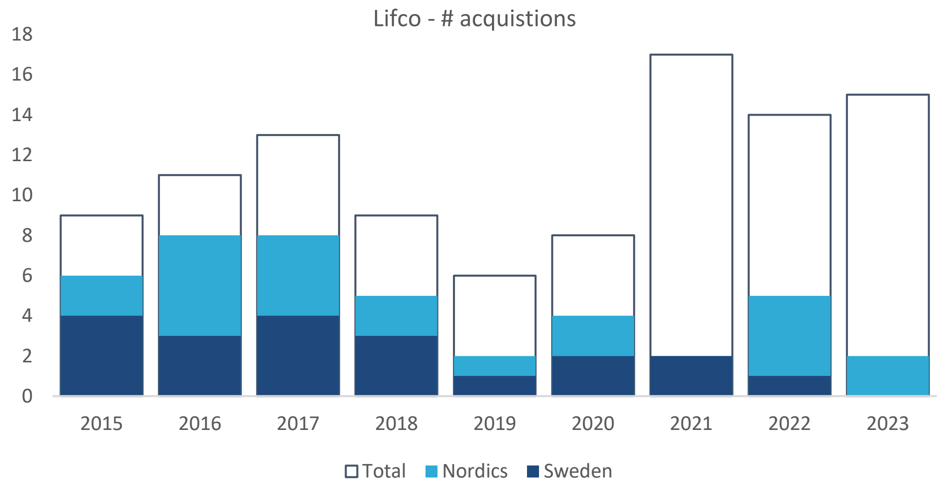
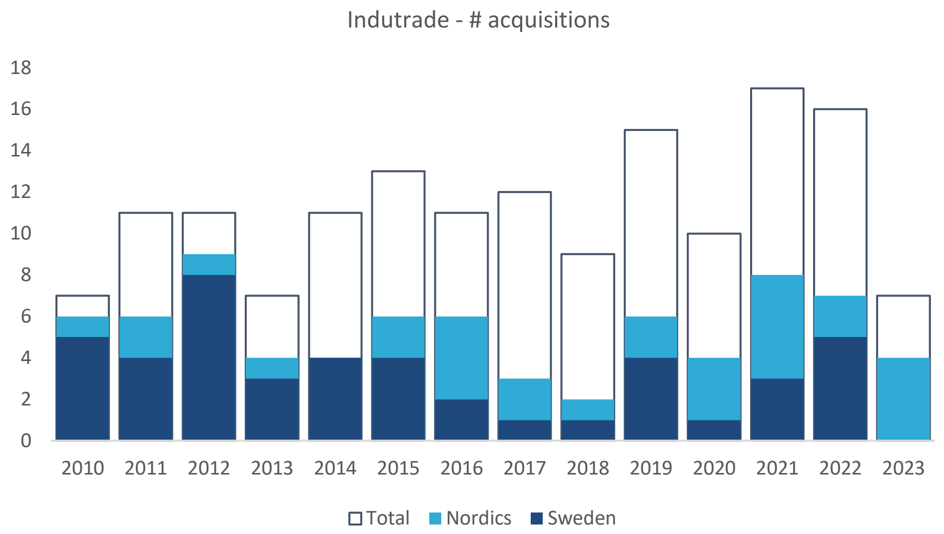
Source: Company reports

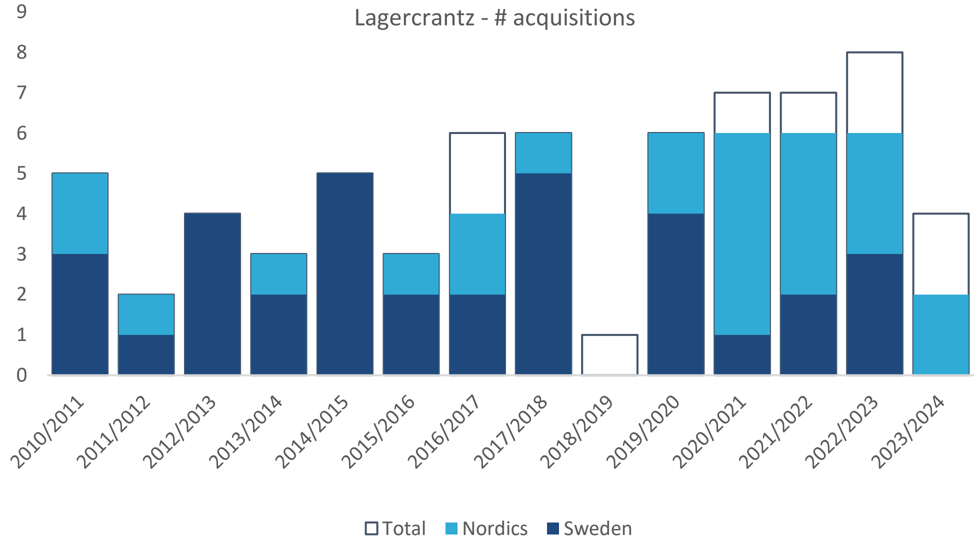
When Are They Running Out of Companies to Buy?

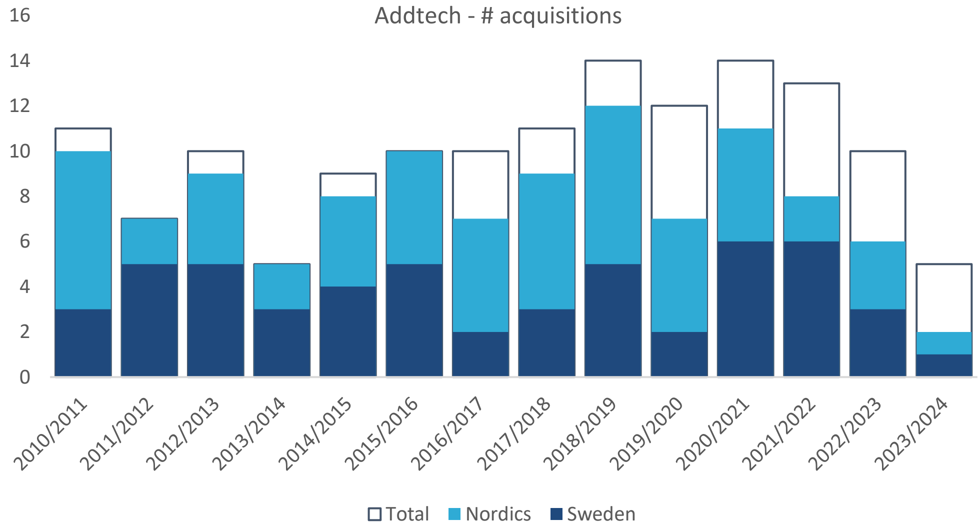
 # acquisitions completed in the Nordics vs. total

Scaling M&A and Long-term Opportunities









Source: Company reports

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European Market Opportunities

Some thoughts on European market opportunities

Our investment philosophy is to own companies with a persistently high return on capital against a long growth runway.

Many publicly listed acquisition-driven compounders share these characteristics. We believe the market underestimates our investments' "duration" aspect because the opportunity set of future acquisition targets is so large. We believe the best acquisition-driven compounders are attractive investments as they reinvest a high proportion of their free cash flow in a disciplined manner (high ROCE acquisitions) over time and repeatedly acquire new companies.

The publicly traded acquisition-driven compounders we invest in benefit from several advantageous features of the private SME market (Small and Medium-sized Enterprises). When looking for new acquisitions, these companies are not constrained by the size of an end market, particular sector, or geography. For most of our companies, the global SME market is their target.

The backbone of the economy

Small private businesses are the backbone of the economy. In Europe, 99.8% of all companies[1] 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 15,000 companies are sold each year[2]. Some are acquired by large corporations or strategic buyers, some by private equity firms, and some by acquisition-driven compounders. The country distribution of SMEs in Europe is as follows (in millions of companies):

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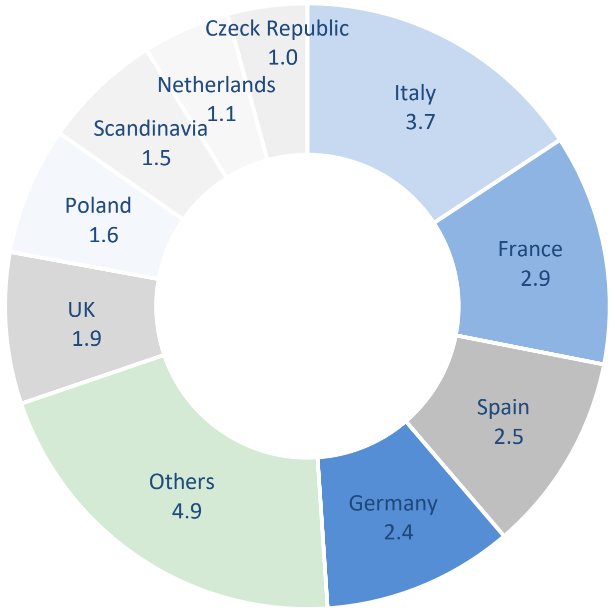
Distribution of European small private companies (in millions)



European Market Opportunities

Some thoughts on European market opportunities

Scaling M&A and Long-term Opportunities

Italy

Italy is one of the largest manufacturing countries in Europe. Many family businesses were established in the 1950s and 1960s[4] when Italy experienced a significant economic boom. Many of Italy's regulations favor small businesses. Transitioning from one generation of entrepreneurs to the next brings challenges and opportunities. Family goals may differ from business rationale and threaten a company's competitiveness, which can lead to a transaction. Given the cultural importance of close personal business relationships, acquirers must have a local presence in Italy. Given the size of the private business landscape in Italy, it is unsurprising that one of our portfolio companies, Lifco of Sweden, made five of its 20 acquisitions in Italy in 2021. In May of this year, the most recent was Trevi Benne S.p.A. - a manufacturer of excavator tools and attachments for demolition, scrap handling, earthmoving, and forestry. Founded in 1992, Trevi Benne employs 105 people and has chosen Lifco as its permanent home.

Germany

There are 2.4 million small and medium-sized enterprises in Germany. There is a strong family influence for larger listed companies and SMEs. A study by the "Institut für Mittelstandsforschung"[5] shows that around 95% of all companies in Germany are family-owned. The shareholder structure is often more broadly distributed among family members than in other countries, such as the United Kingdom. This characteristic represents both a challenge and an opportunity for potential acquisition-driven compounders. Since January 1st of this year, our portfolio companies have acquired eight German companies. On March 31st, Addtech acquired 90% of Fey Elektronik GmbH, a German battery manufacturer. Fey has 160 employees, and the CEO remains a minority shareholder with 10% of the shares.

UK

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. Despite economic and political challenges, the UK mergers and acquisitions market remains exceptionally active. The smaller company segment, defined as transactions of up to £10 million, grew by 21%[6] last year. We are seeing increasing private acquisitions by our businesses in the UK. In June alone, four transactions were completed by our companies in the UK. The Canadian company Constellation Software was particularly active, acquiring two software companies, including Alemba, with 109 employees. On July 25th, Swedish Lagercrantz acquired Door and Joinery, a UK supplier of customized fire doors with sales of GBP 4.5 million.

Summary

Acquisition-driven compounders take advantage of the highly attractive features of the SME market. With local representatives in each market, our companies find, negotiate, and close attractive acquisitions.

In summary, investing in companies with long-term growth opportunities and high returns on capital is necessary to achieve high long-term stock returns. 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.

Sources:

"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)
Thomson Reuters, based on the three-year average for 2019-2021
"Made in Italy" How culture and history have shaped the modern Italian business environment, political landscape, and professional organizations. (Susan Global and Kayla Gibson)
"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/

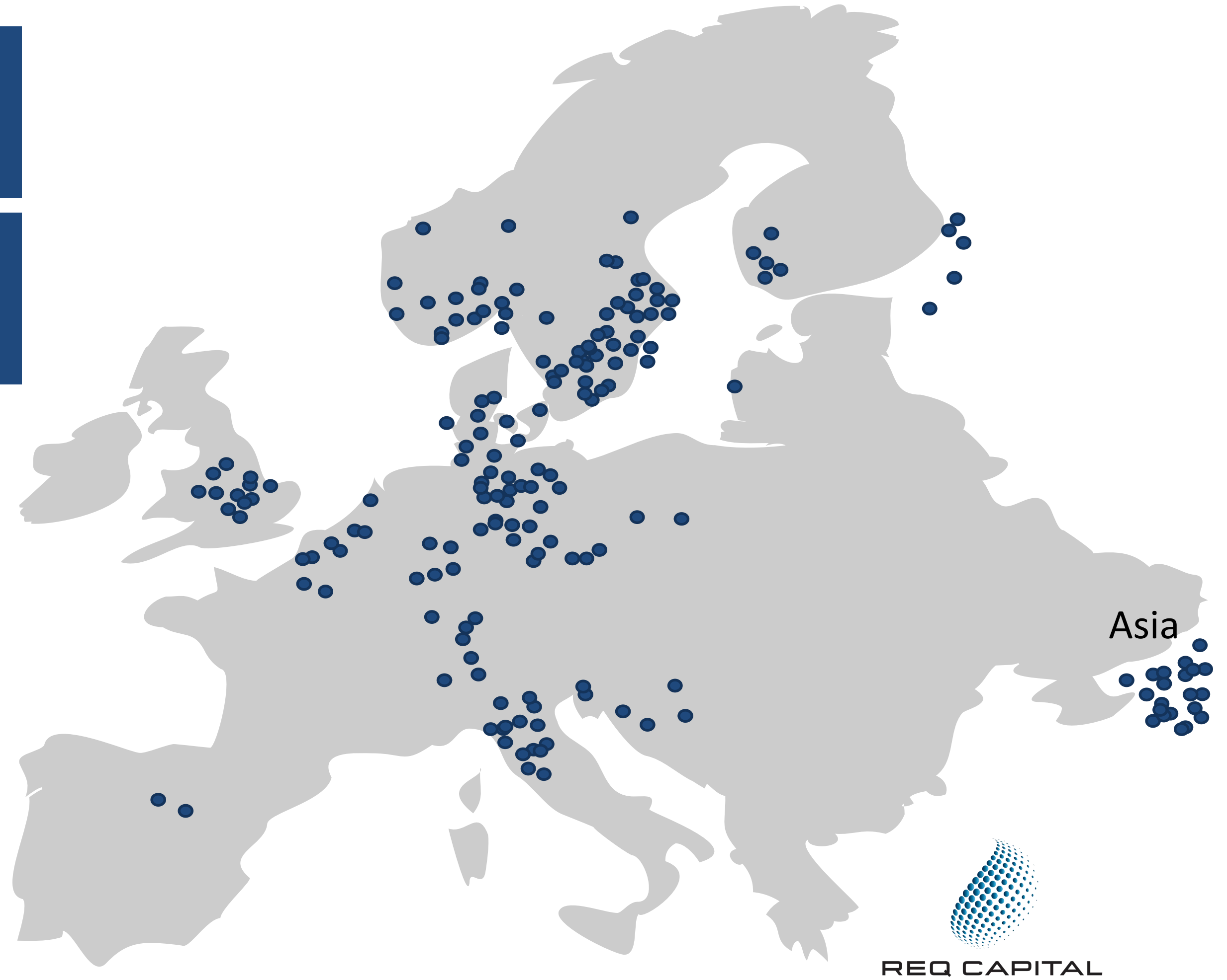
Lifco: Ownership of Private Companies Globally

Scaling M&A and Long-term Opportunities

Company	Country	Co...	
Lifco Dental International AB	**Sweden**	**556730-...**	
Dental Direct AS	Norway	991,315,847	
Swallow Dental Supplies Ltd	United Kingdom	03652780	
Lifco Dental AB	Sweden	556061-7747	
Elman Produkter AB	Sweden	556217-2394	
Almaso för tandvården AB	Sweden	556484-4115	
Preventum Partner AB	Sweden	556613-2790	
DentalEye AB	Sweden	556611-7338	Sto...
Anidem Computers AB	Sweden	556537-1001	Stock...
Hammasväline OY	Finland	0881266-0	Helsinki
Nordenta AB	Sweden	[illegible]	Enköping
DAB Dental AB	Sweden	[illegible]	Upplands Vä...
Directa AB	Sweden	556013-8827	Upplands Väsby
Directa, Inc.	USA	47-1788231	Newtown, CT
Parkell, Inc.	USA	11-2522127	Edgewood, NY
Parkell Europe AB	Sweden	[illegible]315-5772	Upplands Väsby
Topdental (Products) Ltd	United Kingdom	04261332	Silsden
J.H. Orsing AB	Sweden	[illegible]	Helsingborg
Rønvig Dental Manufacturing A/S	Denmark	10078563	Daugård
Plum Safety ApS	Denmark	41057653	Assens
Plum Deutschland GmbH	Germany	Germany 201580	Cuxhaven
DAB Eesti OÜ	Estonia	11149461	Tallinn
DAB Dental Latvia SIA	Latvia	40003744465	Riga
DAB Dental UAB	[illegible]	300115774	Vilnius
LIC Scadenta AS	[illegible]	[illegible]	Sandvika
Technomedics Norge AS	[illegible]	[illegible]	Asker
Jacobsen Dental AS	Norway	918,882,014	Alnabru
Dansk Nordenta A/S	Denmark	10416698	Hørning
AI dente Software A/S	Denmark	27961363	Hørning
3D Dental ApS	Denmark	28159439	Hedensted
Rhein'83 S.r.l.	Italy	02418300378	Bologna
EDP European Dental Partners Holding GmbH	Germany	Germany 7331	Lübeck
M+W Dental Müller & Weygandt GmbH	Germany	Germany 3753	Büdingen
M+W Dental Handels GmbH	Austria	FN 256862 p	Wien
M+W Dental Swiss AG	Switzerland	CH-020.3.029.916-4	Brau
M+W Dental Magyarország Kft	Hungary	01-09-889071	Budapest
DentalTiger GmbH	Germany	Germany 9340	Büdingen
Praxismed Service GmbH	Germany	Germany 78293	Hamburg
Computer Konkret AG	Germany	Germany 16107	Falkenst...
CONSYS Gesellschaft für Softwaretechnologie und Systementwicklung mbH	Germany	Germany 72249	Münch...
Kaniedenta Dentalmedizinische Erzeugnisse GmbH & Co. KG	Germany	Germany 5025 / Germany 5951	H...
Kentzler-Kaschner Dental GmbH	Germany	Germany 510028	
Dentamed (ČR) spol. s r.o.	Czech Republic	CZ25083163	
Dent Unit, s.r.o.	Czech Republic	CZ45538263	
MEDEMA, s.r.o.	Czech Republic	CZ15547256	
Prodent International d.o.o.	Slovenia	12577900	
Dental Grupa d.o.o.	Croatia	02597888	
MDH AG Mamisch Dental Health	Germany	Germ...	

> 200 businesses

30 countries

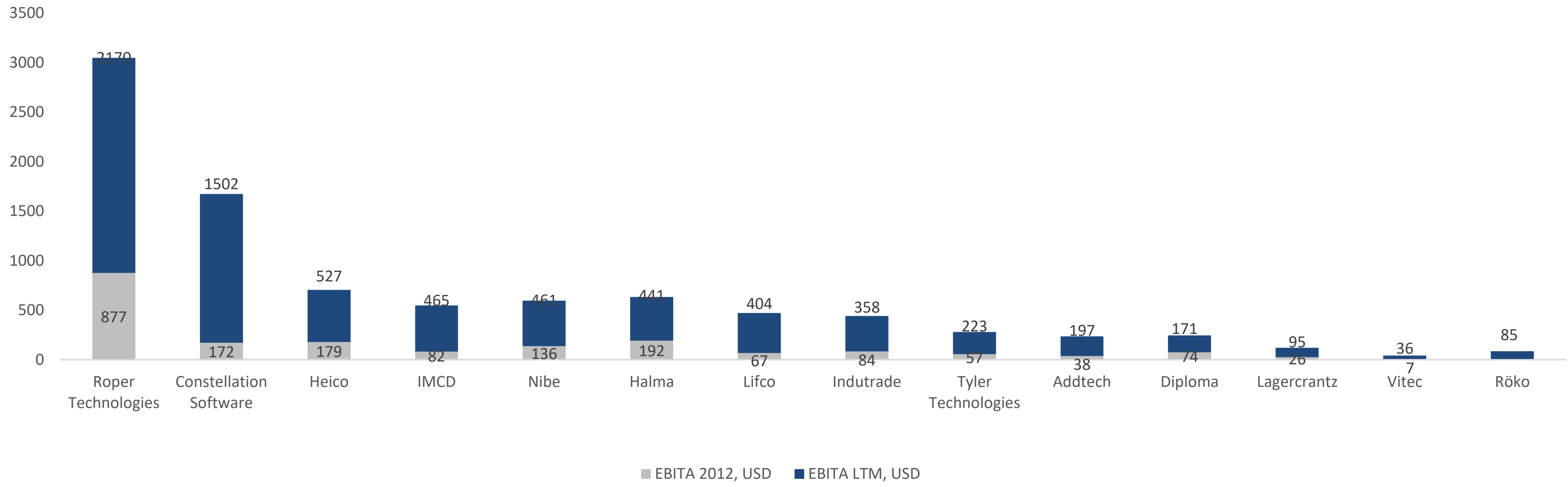


Source: Lifco annual report

Selected Acquisition-Driven Compounders – EBITA LTM

EBITA (USD) vs . LTM vs. EBITA (USD) 10 years ago

Scaling M&A and Long-term Opportunities



10-year EBITA growth	**2,5x**	**8,7x**	**2,9x**	**5,7x**	**3,4x**	**2,3x**	**6,1x**	**4,3x**	**3,9x**	**5,1x**	**2,3x**	**3,7x**	**5,1x**
ROE last financial year	9%	29%	14%	15%	17%	19%	25%	22%	8%	30%	13%	28%	15%

Based on current exchange rates. EBIT for IMCD, Diploma, Nibe, Vitec, Beijer Ref and Halma:

Risk Reduction Through Expanding Root Systems

Some thoughts on risk and return

In the plant world, the roots of the African rock tree, Ficus abutilifolia, can split huge open rocks and penetrate up to 60 meters deep in search of water. Plant roots perform several important tasks: They resist the effects of wind, water, and dirt, among other things[1]. In addition, some trees can stand upright for hundreds of years because their roots grow deep and wide into the ground, surviving even when large sections are cut off[2]. Therefore, a robust root system is a prerequisite for a tree to grow for decades because all growth becomes fragile without it.

Photo credits: tampa-tree.com

Most people focus on what's visible and measurable: a growing tree with its corresponding branches and leaves in full glory. Or, in a corporate context, a company experiencing high growth and seemingly firing on all cylinders. But a closer look may reveal a growth profile based on a concentrated product line sold to a single customer in a narrow end-market with favorable macroeconomic tailwinds. Each of these risks may look low-risk, but it's bound to happen if you keep running the clock on a low-probability event. After all, compounding works both ways. Hence, we stay away from companies that are too dependent on any one of those factors because we know that any one of these risks will eventually play out in the fullness of time.

Avoiding blowups

Most investors' fascination with acquisition-driven compounders often stems from a return perspective. This group of companies can systematically deploy large amounts of capital at high returns over a long time. To return to the analogy between a plant and a tree: the tree's growth with all its branches and leaves represents reinvestment opportunities harvested in due course.

To reach the "second half of the chessboard[3]", i.e., where an exponentially growing factor gets going, one mustn't aim for the highest reward but avoid blowups at all costs. That's why we shun single-exposure risk. Most other outcomes are good if we don't make big losses at the fundamental level. For this reason, we don't try to find rockets but to avoid meltdowns.

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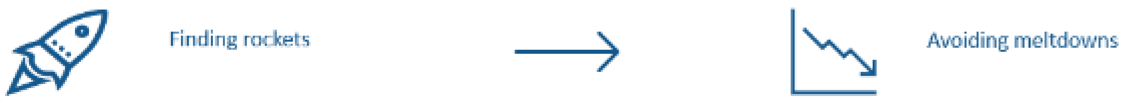
Risk Reduction Through Expanding Root Systems

Some thoughts on risk and return



Therefore, we approach these compounders from two different angles, which are ultimately joined at the hip in the context of compounding:

Fundamental downside protection: internal diversification that ultimately reduces the risk of a blowup. We like deep and expansive root systems. From a return perspective, the ability to deploy capital with high returns through multiple small acquisitions of private companies – a growing tree with corresponding branches and leaves in full glory.

Teledyne

Teledyne's Henry Singleton, an early pioneer of the decentralized model and widely celebrated for his capital allocation skills over nearly three decades, may have shared a similar interest in plants and trees. In a 1978 Forbes interview, he said he saw diversification as insurance against disaster:

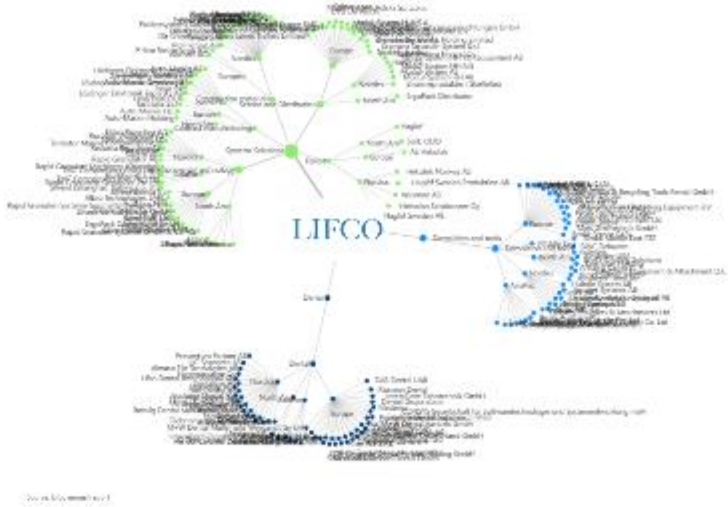
Teledyne is like a living plant, with our companies the different branches and each putting out new branches and growing so that no one business is too significant.

Henry Singleton, former founder & CEO of Teledyne

Indeed, Teledyne designed a decentralized system of autonomy and ownership that collectively smoothed out peaks and troughs as well as any individual single exposure risk lurking around. It's fascinating to see how many lessons from Singleton and Teledyne shared across high-performing conglomerates. Those investors who invested in Teledyne stock in 1966 earned an annualized return of 17.9% over 25 years, or 53 times the invested capital, versus 6.7 times for the S&P500[4]. We share more about Teledyne in a below chapter.

The following organizational chart illustrates the extensive root system of Lifco, one of many acquisition-driven compounders from Sweden, with more than 200 companies across multiple niches and geographies:

We, therefore, prefer growing trees with ever-expanding root systems. These structures should be celebrated for their compounding superpowers, but equally important is their ability to reduce idiosyncratic risk at a fundamental level.

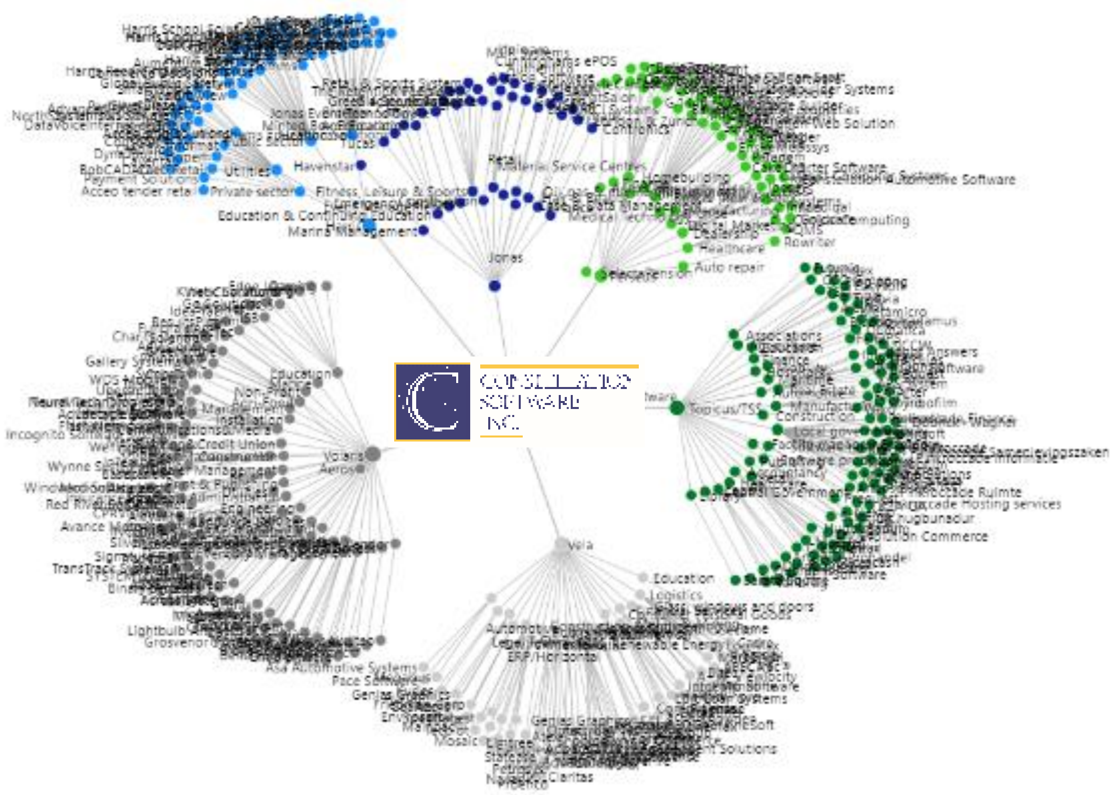


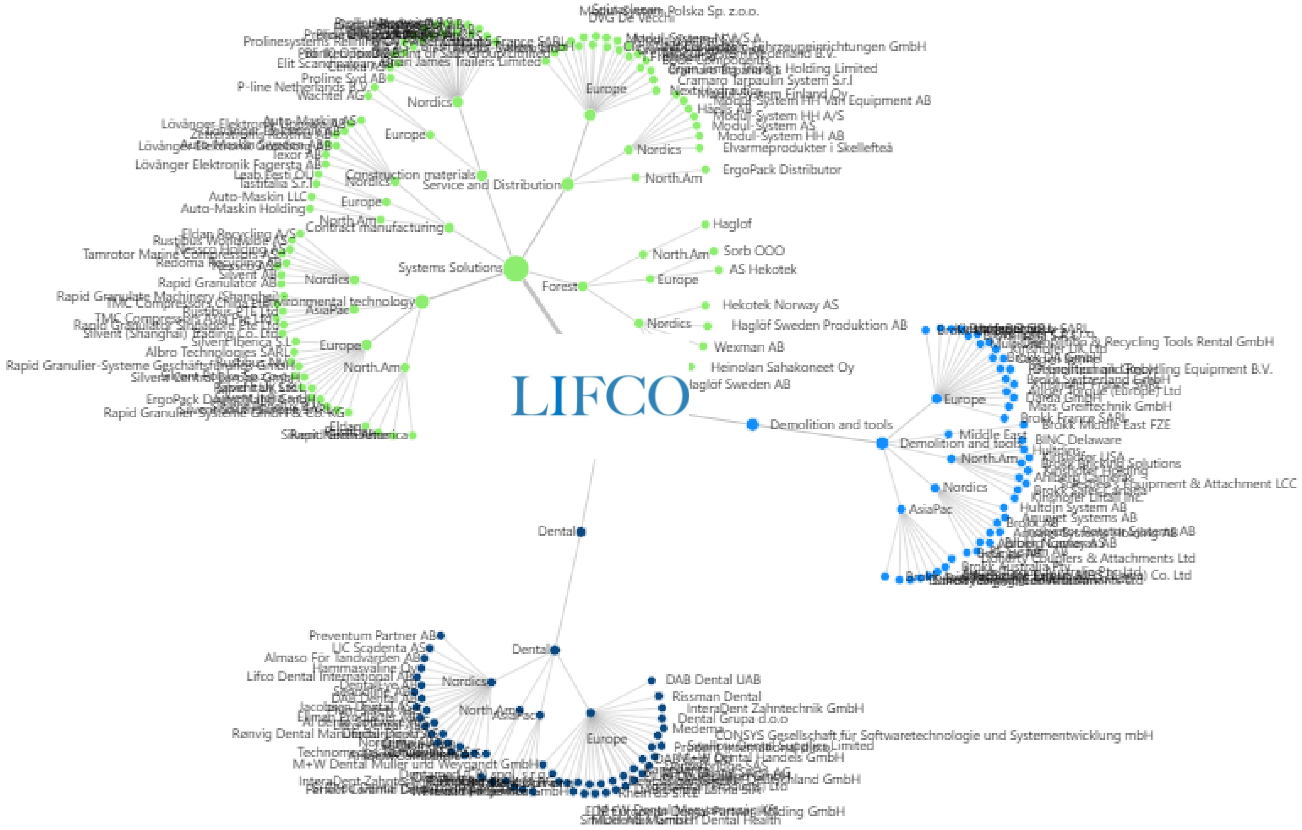
Sources:
1. Myths and Misconceptions About Tree Roots Explained (treehugger.com)
2. The metaphor of root systems was inspired by a blog post (LibertyRPF) related to portfolio construction
3. A concept laid out by Ray Kurzweil
4. Distant Force: A Memoir of the Teledyne Corporation and the Man Who Created It (by George A. Roberts)

Great Risk-Mitigating Characteristics

Constellation Software and Lifco

Scaling M&A and Long-term Opportunities





Source: Constellation Software & Lifco Annual reports

Decentralization

Trust-Based Business Models

Reflections on Decentralization

Decentralization

The cornerstones of our investment philosophy are "capital allocation", "decentralization" and "people". Finding outstanding capital allocators who decentralize their business and act like true owners is critical to achieving exceptional long-term returns as investors.

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 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.

Being a successful investor is all about picking the right guy or gal. Because as an outsider you can't even know enough to really make an informed decision. You are almost entirely dependent on the abilities of the people you invested behind.

Barry McCarthy *reproduced by Sidecar Capital @sidecarcap*

A complex undertaking

In our experience as investors, some unique business models are based on an extraordinary level of trust. Decentralization is at the core of these businesses. These decentralized businesses, where management is willing and able to provide significant autonomy to the underlying subsidiaries, create solid returns for shareholders over decades. We invest in many of these decentralized businesses because we firmly believe that these companies have an entrepreneurial energy from which we, as shareholders, benefit significantly from.

To practice simplicity in business is a very complex task. Our investment philosophy is based on the belief that a decentralized - non-bureaucratic - and independent management model is the best way to promote entrepreneurship and performance. It is the belief that individuals can influence the company and should be entrusted with responsibility for decision-making. The decentralized businesses we invest in represent independence, accountability, and rapid decision-making. Entrepreneurship should be actively encouraged and protected to create extraordinary business performance.

It is easy to teach quantitative analysis and business valuation methods. Unfortunately, it is not so easy to teach qualitative methods. These can be taught, but learning from experience is often the best way.

Charlie Munger

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Trust-Based Business Models

Reflections on Decentralization

Decentralization

Does cooperation pay off?

We believe the simple answer is "yes!" In the book, "The Evolution of Cooperation" by Robert Axelrod, the author explores the long-term rational approach to solving situations where two parties' benefit from cooperation in the long run, but where the short-term rational approach is to maximize their own gain. We know this from business school as "The Prisoner's Dilemma."

The book's main conclusion is that a so-called "tit-for-tat" strategy is highly beneficial in all types of relationships. This is an optimistic view of cooperation. It is about starting with a friendly invitation and hoping the other party will respond kindly. What does this have to do with business and, ultimately, investments?

In a business context, "tit-for-tat" means that the head office offers a lot of autonomy and trust from the start, helping subsidiaries to develop. The subsidiaries, in turn, sense this freedom from above and respond by cooperating and ultimately making business decisions that benefit headquarters, themselves, and shareholders. When this long-term, two-way cooperation develops in these decentralized business models, all parties benefit – not least the shareholders.

One of the key things is that we do not control how our companies do business; we help and support them. Teqnion has board representation in all subsidiaries where we try to push positive energy onto the CEO.

If something out of the ordinary happens , someone from the Teqnion management can be landed in the company and help them sort things out. We encourage CEOs to become friends amongst themselves and exchange ideas and beers. We try to meet up a couple of times per year to build strong relationships, learn new things and inspire each other to greatness.

Johan Steene, CEO Teqnion, acquirers.com interview

To say that the concept of decentralization works well is an understatement when you look at the results of our portfolio companies. The headquarters does not micromanage the acquired companies. However, the acquired companies are offered support and assistance in their development and growth. Trusting cooperation with the headquarters is the hallmark of the decentralized business.

The powerful concept of decentralization is of great benefit to us as investors. It is an investment concept that stands the test of time. We have invested in many decentralized models that will continue to create high shareholder value in the future.

The pull integration has been really key to our sucess- We never say subsidiaries. We say sister companies. We never look at the cost synergies. We always look at the growth synergies. We never improve the top-down type of integration. We aim for the pull integration. New sisters use Bufab best practice where it helps the most, not just because they have to. As a result, this has given us borth opportunities to acquire and has given us a favourable pricing and a good development of the acquired companies. I also lowers the risk, I would say.

Urban Bulow, Group Director North America, Bufab, Capital Markets Day 2021

A Decentralized Collection of Niche Businesses

Decentralization

Hermann Simon's insightful book, "Hidden Champions of the Twenty-First Century," first published in 2007, highlights lesser-known niche companies that excel in specialized sectors. These businesses operate in the "hinterland" of the value chain, frequently engaging in business-to-business (B2B) transactions by supplying machinery, components, or processes integrated into the final product or service. As a result, they often go unnoticed by consumers.

These hidden champions, commonly family-owned, achieve market dominance by emphasizing focus, global reach, dedication to premium products, and robust customer relationships. To be classified as a hidden champion, a business must meet specific criteria, including market position, revenue generation, and limited public exposure. Examples from the book – some of which have since emerged from obscurity – include Rud, a leading player in industrial chains; Amorim from Portugal, a world leader in cork products and cork flooring; and Jungbunzlauer, a global leader that supplies citric acid for every Coca-Cola produced and sold.

Hidden Champions
Investing in private niche companies within a decentralized structure presents several advantages. Firstly, their essential offerings grant them resilience against economic fluctuations, allowing them to maintain pricing power and high gross margins. Focusing on a narrow niche can often create an oligopolistic structure that protects incumbents, preserves pricing power, and deters newcomers. These markets are typically too small to attract significant interest from potential competitors.

Secondly, niche companies often exhibit adaptability and responsiveness to market changes, fostering a dynamic entrepreneurial culture through decentralization.

The most successful acquisition-driven compounders collect these specialized companies, building a diverse portfolio that spans products, customers, suppliers, and regions. This combination of different earnings streams provides stability and resilience. Many of the companies targeted by our portfolio companies share several key traits with hidden champions, which include the following:

• Engaging primarily in business-to-business (B2B) transactions for their products and services.

• Providing mission-critical and often customized offerings at relatively low cost. This approach can generate a lock-in effect, leading to high customer retention and pricing power. To attain the latter, the best-performing organizations frequently employ value-based pricing strategies that underscore their offerings' unique value proposition to customers.

• Focusing on flow products, or consumables, linked to customers' operating expenses rather than capital expenditures. This connection enhances predictability and diminishes reliance on cyclical spending fluctuations.

• Benefiting from a favorable working capital mix and typically limited in-house production results in low capital requirements. This aspect is often further optimized following an acquisition.

(continued)

A Decentralized Collection of Niche Businesses

Decentralization

The culmination of these factors often results in recurring revenue streams with high gross margins and attractive cash conversion. The allure of these core characteristics is far from random. Maintaining a consistent acquisition pace necessitates both predictability and high cash flow conversion.

Additionally, steady revenue streams and strong cash conversion rates are vital for a self-financing acquisition strategy, allowing the organization to maintain financial stability without relying on external funding sources. Consequently, once the onboarding process concludes, cash flow and other return-on-capital metrics become the shared language among these companies.

Consider Heico Corp, a Florida-based enterprise founded in 1957. As a leading technology-driven aerospace, industrial, defense, and electronics firm, Heico is recognized as one of the world's largest independent providers of FAA-approved engine and component parts. These mission-critical parts are vital for their customers, primarily airlines, as they ensure their fleets' operational efficiency, safety, and reliability.

In one of our conversations, Larry Mendelson and his son Eric shared the essential factors contributing to Heico's success since they took over in 1990. Despite its size, which now boasts 6,400 team members and 88 acquisitions of niche businesses, Heico has maintained its agility and responsiveness. With his background as an accountant at Arthur Andersen, Larry Mendelson emphasized the importance of cash flow in Heico's success, which shaped his perspective. His former boss's mantra, "GAAP is crap" and "the key is cash flow”.

We are not merely an aerospace company, but rather a vehicle that generates strong cash flow through aerospace parts and technology.

Larry Mendelson, Heico CEO

Consequently, Heico's focus on cash flow and decentralization has produced remarkable results. Since 1990, when the Mendelsons took over the business, Heico stock has delivered 21% annual returns, amounting to a staggering total return of 67,900%.

The basic culture of Heico is one of a decentralized organization, where we give tremendous authority to the operating level. As you know, we have no mid-level vice presidents that filer everything that comes from the operating group up to the corporate and to myself, Eric, Victor and Carlos.

So, the first thing we do in acquisition, the most important is really scrutinize, analyze, get to know the person who is selling the company to us and how he manages. And if he treats his people well, this is very important.

As an example, if he goes through the factory and he sees somebody and he tells us “Oh, that’s a machine operator, that’s this and that’s that.” That is not very impressive. But some of those people go through the factory and they stop at a machine and say “Charlie here, this is Mendelson, ’How’s Anne?’, meaning his wife, ‘is the family okay?’. ‘Charlie, how long have you been working here for ,22 years?’

This means an awful lot. We understand the relationship between the owner of the company and his workforce, his team members. That goes a long way, and we understand how that all works. That’s the Heico culture.

Larry Mendelson, Heico CEO, 2022 Q4 Conference Call

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A Decentralized Collection of Niche Businesses

Decentralization and Customer Focus

Another essential lesson focuses on organizational structure, with decentralization being vital for two reasons. First, agile, entrepreneurial companies collaborate closely with customers to create tailored solutions.

Therefore, decentralization is essential for these businesses to continue thriving after being acquired as part of a larger structure. This structure encourages entrepreneurial flexibility, enabling companies to excel in their specialty and remain close to their customers.

Second, a decentralized system is critical for maintaining the acquisition engine's pace of multiple small private transactions. Without decentralization and autonomy within each business unit, the M&A engine falters.

It's nearly impossible to sustain an acquisition cadence of 5-10 new companies, if not 100, per year if integration efforts and micromanaging consume management resources. In the long run, this isn't feasible. Thus, the organizational design for these acquisitive companies is a feature, not a bug. We tend to grow skeptical if we observe overly optimistic growth targets with acquisitions factored in, but without a decentralized mindset, in place.

But decentralized responsibility is very easy to say. But how do we do it? Decentralization for me is very easy. It's like jeopardy. You ask the question, but they have the answers. That's how you lead. You lead by questions, not lead by, if I were you, maybe I would do like this. That's not decentralization. That's centralization.

Ulf Lililus, **CEO Momentum Group**, ABG Investor Day March 2023

(continued)

A Decentralized Collection of Niche Businesses

Decentralization

The Ideal Combination

While some niche businesses may not be as glamorous as some SaaS enterprises boasting high growth prospects, their true potential emerges when integrated into a decentralized structure. Limited growth prospects in niche markets can lead to these businesses being less sought after in auctions. However, acquisition-driven compounders remain undeterred, as they offer a reinvestment engine to redirect cash flow into other exceptional niche companies. Therefore, limited reinvestment opportunities and size thresholds that disqualify specific buyers don't hinder them. These factors can be advantageous, as they often deter other investors, reducing competition and, ultimately, prices paid for these businesses.

In Conclusion

The achievements of hidden champions, as discussed in Hermann Simon's book, emphasize the importance of focusing on niche markets, decentralization, and fostering close customer relationships. Investing in specific niche enterprises may entail risk; however, the portfolio strategy employed by acquisition-driven compounders offers diversification and an efficient reinvestment mechanism. With predictable cash flow streams, these vehicles can succeed without rapid growth, resulting in resilience, adaptability, and market dominance.

If you fill a room with our subsidiary CEOs, really soon when they look around and they get inspired by all their co-workers or colleagues in that group, they start to fantasize about how they should build a big company, not 25 small autonomous companies, because that's what people do. They tend to build a clan. They want to stick together. So, if you would ask that question to that group, they would say, yeah, we should ask you one on Teqnion and the head office on how we should build a good culture.

And then we should make a Teqnion culture with all these 24 companies, as we have today. And then I have to step in between and say, no, no, no. We demand from you that you create a good culture, your culture at your workplace.

It's not a Teqnion culture. It's your responsibility as a leader to make sure that people enjoy being with you. That's your culture. It's not a Teqnion formula.

Johan Steene, CEO Teqnion, Redeye Serial Acquirer Event March 2023

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The beauty of Small Niches: «Customer Intimacy»

And customer intimacy requires decentralized operations

Decentralization

We operate a portfolio of 27 companies. While the end markets are very different, the business models of each of the 27 are remarkably similar. They're all leaders in very small markets. We like small markets because they're protected from competition. We like them even more because the basis of competition is customer intimacy. So, we're the leaders in these small markets, and everything all of our 27 businesses do is deeply verticalized or application-specific. Because of this customer intimacy, we operate a highly decentralized operating structure—a high trust autonomy structure.

Neil Hunn, CEO of Roper Technologies, Goldman Sachs Conference September 2023

Swedish Legacy of Decentralization

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

There isn't a single answer but rather several factors that collectively weave a history explaining why Sweden has successfully fostered numerous companies, many of which have thrived on acquisitions spanning decades.

To begin with, Sweden boasts a rich industrial heritage dating back to the 19th century, with companies like Sandvik, Atlas, and Trelleborg being industrial pioneers. As a small and geographically isolated nation, Sweden promptly embraced 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) and Atlas Copco, backed by financially robust families (like the Wallenberg family in Atlas Copco), 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. This decentralized corporate governance model found widespread adoption, becoming deeply ingrained in Swedish business practices. Inspired by models such as Atlas Copco's & Bergman & Beving's, 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.

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.

Directors' Report To the Shareholders, Atlas Copco Annual Report 1976

Swedish Legacy of Decentralization

Moreover, Sweden consists of many small and medium-sized businesses, often family-owned, which makes fertile hunting grounds for acquirers or small private companies. Also, Sweden is known for its open societies and data accessibility, which contributes to high transparency.

Annual reports for all companies are open to the public in Sweden, adopting trust and reliability in the companies' financials and decreasing unpleasant surprises post-acquisition.

As these companies demonstrated the practical value of their models and maintained an entrepreneurial spirit within the acquired entities, trust between sellers and buyers 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, corruption perceptions, and human development.

Another crucial factor is that successful acquisition-driven with small private transactions at the heart of the strategy have established a simple, efficient and standardized way of conducting business, employing simplified, short, and concise deal making and deal documentation over time.

Source: European Social Survey Round 8 Data (2016)

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Becoming the Preferred Buyer

Decentralization

One of the most critical questions for a buyer is," How do I become the preferred choice to sell to?" Only paying a higher price than everyone else will sooner or later provide low returns on capital and hence be value-destructive.

For acquisition-driven compounders with a long track record, being the "Buyers' Choice" is one of the strongest moats on why sellers will choose to sell to them.

Over decades, they have built trust among potential sellers as a company that takes care of the companies acquired, providing a "home" for the selling entities, often family-owned niched companies.

They will offer selling entrepreneurs, frequently family-owned, a permanent home for their companies. The companies being acquired will continue to operate according to their way of doing business, keeping their core values, business acumen, and culture. The "Buyers of Choice" will not provide the most significant and juiciest offers. On the contrary, they are very disciplined with multiples paid and instead share a vision with the companies acquired, coupled with the right type of incentive structures based on carrots rather than sticks.

We have since the beginning in 2003 strived to become a preferred buyer. I think you can reach that position in many ways. Ultimately, it is about understanding the seller and the brokers needs. Some examples of sellers needs beyond price is: easy and smooth process, straight purchase setup, simplified agreements, the possibility to remain in the company, the acquired company's possibility to remain in its town, keep the name, future strategy and access to capital.

Patrik Wahlén, Chairman of Volati, Twitter post 2021-10-05

So, if they find themselves in a competitive process, they generally won't win, right? But unfortunately, a lot of the time, they can pick these off before getting into a competitive bidding process. And there was one instance at Constellation where I saw a company sell to Constellation , it was to Vela, despite coming in at a lower price, and it was purely because they like Constellation. They knew Constellation were the company that knew all about vertical market software, and they wanted their company to go into the kind of safe house.

Former Director at Constellation Software, Tegus interview 2022

Often, by being the buyer's choice, the highest price will not be the determinant factor when selling a life's work – it will be many supporting factors like keeping the employees and offering them a development plan. An important factor is providing the acquired companies with a financially stable home with a multi-decade view on growth and value creation.

Entrepreneurs selling their life's work will, in many cases, favor those with a long track record of acquiring family-owned businesses, often referenced by other sellers who have been through the selling process.

Becoming the Preferred Buyer

Decentralization

These acquisition-driven compounders with no exit horizon, offering a permanent "home," have a significant advantage compared to private equity buyers, who often seek to integrate and search cost synergies, which acquisition-driven compounders generally do not.

Also, acquisition-driven compounders already owning companies in similar industries or sectors will have an advantage over acquirers with no insights into the specific industry. However, if that acquirer seeks to cut costs or tries to change the business in other ways, it could mean that the advantage will play a less critical role.

Even though many acquisition-driven compounders with a long track record source many deals internally, which sometimes can take many years to complete, it is also essential to maintain relationships with corporate brokers to maintain a healthy pipeline. When entering new markets or geographies, using brokers is a quick way of getting to know the acquisition market, and for that reason, developing and maintaining a preferred buyer status among those is also essential.

Since I started, we put more effort around acquisitions, but it takes time to build and work through the pipeline. You can have a first contact two years ago when it's not for sale, then the situation can change two to four years later, and owners are suddenly interested in discussing a sale. It's about drinking coffee together and establishing a relationship so you can be the preferred buyer when the moment arises.

Magnus Söderlind, CEO Bergman&Beving, InPractise interview, 2022-12-14

I think, for us, is making sure that, I think – and everybody comes back to making sure that entrepreneurs see a future being part of Addnode Group. Meaning that we need to make sure that we are professional, we can provide opportunities, and it makes sense to work with us, because normally, we talk with entrepreneurs who are thinking they have been probably – they've been running their company for, like, 20 years.

And it's time to, sort of, decide, do you want to go another five year, is it time to do something else, and they, sort of, want to make sure that their baby is taken well care of. And then we want to make sure that we are that preferred home, and we can make that happen, because we do like to grow, but I come in – because they are probably made the first sale, sent the first invoice, hired the first guy.

So, they feel really for the company, and then we want to create that environment. And our best salespeople is actually the guys who we acquired before them because we can always say that, okay, you can listen to us and you can hear all of the sweet sales talk but, if you want to know how it is, please call these five guys, they were our five recent acquisitions, and they will tell you, hopefully, the same story.

Johan Andersson, CEO Addnode, Redeye Serial Acquirer event 2023-03-08

Becoming the Preferred Buyer

Decentralization

Halma had a good history and had done a great job in messaging Mr Owens about keeping the people intact within the business. They were a good decentralized holding company and Mr Owens wanted a business future for all his staff. He was very employee centric and spent a lot of money on his employees. He had developed a strong culture and wanted that to continue, and Halma had messaged it was their culture and they would support that even past the acquisition."

Some people can strip the business, show off the profits and look to sell it. Halma typically hold businesses longer term and invest in them. At that time, they were very decentralized which allowed the business to be successful and continue to flourish.

Fromer VP Global at Kirk Key, a Halma company, InPractise interview 2022

We feel that also the sellers, that they want someone that is very, very long term, that they know what they're selling their company to, and that we will be a long – that will be around for a very long time. And that's usually good arguments for us being, yeah, being in a favorable spot and a preferred buyer.

Jörgen Wigh, CEO Largercantz, 22/23 Q3 Conference Call

But it's a lot of relationship building. It's a lot of long-term thinking. I think the #1 pieces or value prop that resonates with a lot of the companies that engage with Constellation is the fact that it's a permanent home for a company that they have built. And then most entrepreneurs, for them, it's their baby. It's something to have nurtured for 30 years.

These companies are typically are interested in being acquired by Constellation because their owners are not just looking to get the biggest kind of like a greatest exit of all-time and just bounce or like I don't care anymore. It's more so they're emotionally invested and they want to see their company thrive.

The other value proposition that really works well with the target companies is the fact that the companies are run autonomously, which is massively important to those people, the founders of the company, because they've built a certain culture over the years. And they want to maintain that. They've built a certain brand over the years, and we want to maintain that. So instead of kind of getting lost in an SAP like company or Oracle or IBM like company. They maintain their characteristic, they maintain their brand, which is, believe it or not, is massively important.

Former Manager of Corporate Development at Constellation Software, Tegus interview 2022

It's All About Durable Growth

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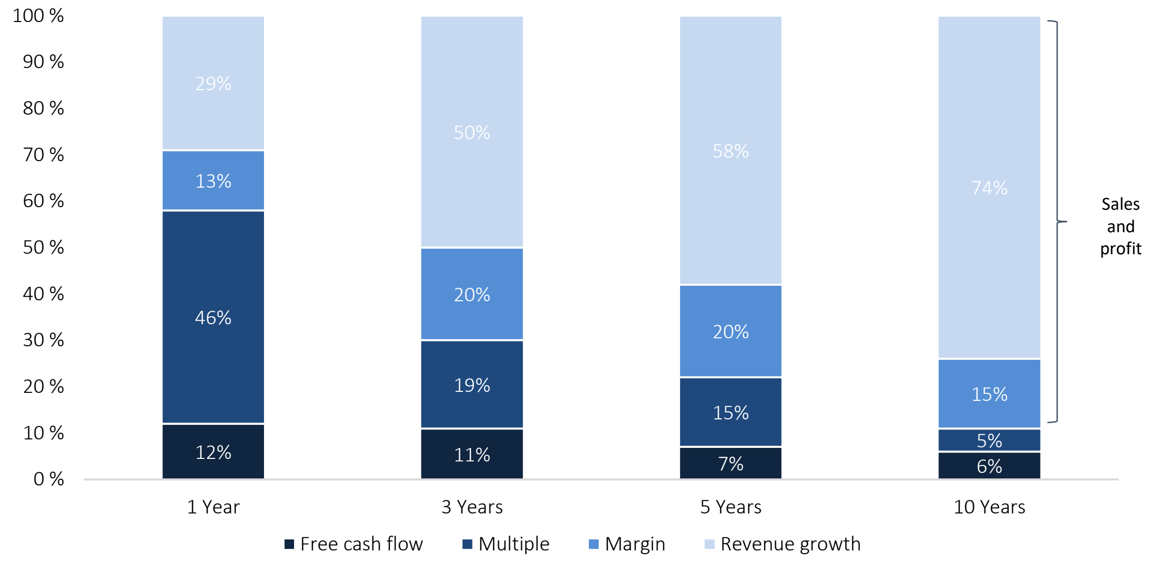
It's a Game of Durable (EPS) Growth

An empirical approach to long term growth

It's All About Durable Growth

Sales growth is the key driver EPS and long-term stock performance
Sources of total shareholder return for top-quartile performers
S&P 500 (1990-2009)



Source: BGC Analysis, Morgan Stanley Research

Boston Consulting Group and Morgan Stanley Research have researched what drives long-term stock performance for top-performing companies. The study was conducted on companies on S&P500 between 1990-2009.

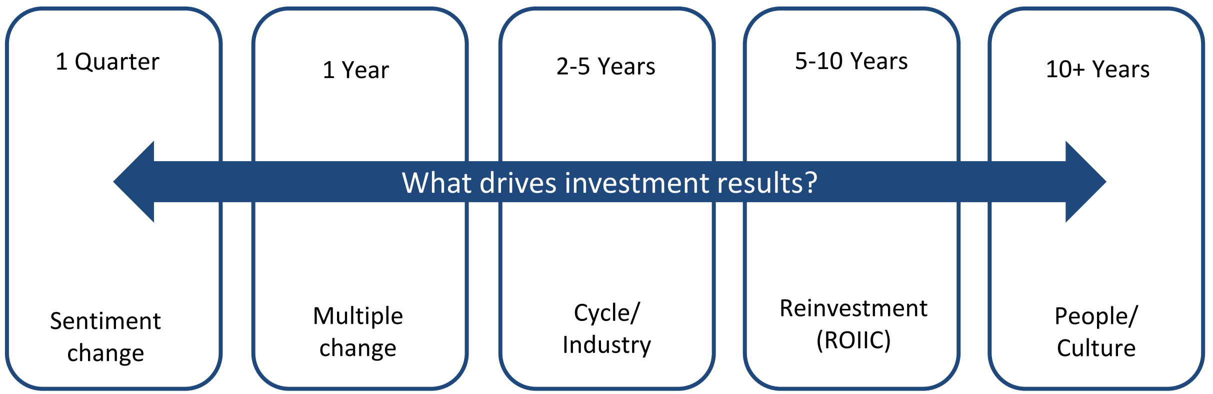
What it concludes is that in the short term (1 year), multiple expansion (46%) is the primary driver of stock performance, followed by sales development (29%). In the mid-term (3-5 years), sales and margin expansion are the primary shareholder return drivers, while multiple expansion decreases in importance.

In the long term (10 years), growth in sales is by far the most critical driver for EPS and hence stock performance. Together with margin expansion, it explains 90% of the stock performance.

* Total shareholder return = Total price return incl. reinvested dividends

What Drives Long-Term Investment Results?

[It's All About Durable Growth](#)



At REQ, we put much effort into understanding a company's long-term prospects by focusing on People, Decentralisation, and Capital allocation.

We believe we can generate superior long-term results by understanding these three pillars.

The chart to the left displays what drives investment results over different time horizons. From this, we can learn that long-term performance is heavily influenced by the people and cultures within these companies.

Looking at the best Nordic Acquisition-driven Compounders like Addtech, Lagercrantz, Lifco, Indutrade, Addnode, and others, we can see that they have some things in common.

Firstly, they all have very long-term owners who do not change strategy often (or at all). When finding a durable strategy, they do not change it. Having long-term owners also provides management with a level of confidence and an entrepreneurial spirit.

Secondly, many of these companies have internal succession planning set in place. When CEOs leave, the owners ensure that the set strategies are not changed.

Examples of internal CEO successions:
- Per Waldemarson, Lifco
- Niklas Stenberg, Addtech
- Johan Andersson, Addnode
- Magnus Söderlind, Bergman&Beving (from Lagercrantz)
- Jörgen Wigh, Lagercrantz (returning to Lagercrantz from B&B).

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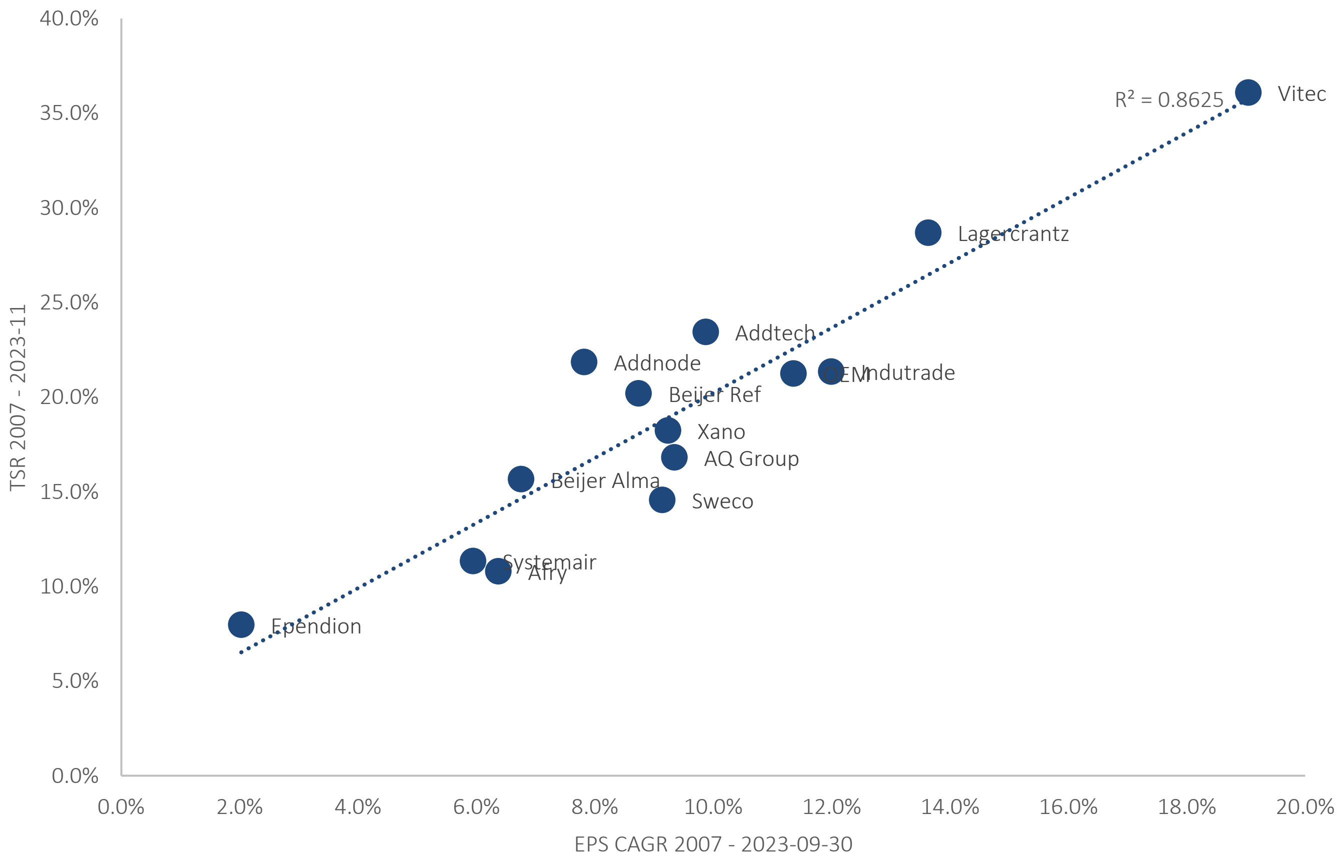
Source: IMC (International Management Corporation)

All About (EPS) Growth

It's All About Durable Growth



We find a strong correlation between Total shareholder return 2007-2023 November and EPS CAGR 2007-2023 Q3 YTD; profitable EPS growth over time will drive the share price.

Even though EPS is the primary driver of long-term share price performance, it is essential that EPS reflects FCF per share as much as possible.

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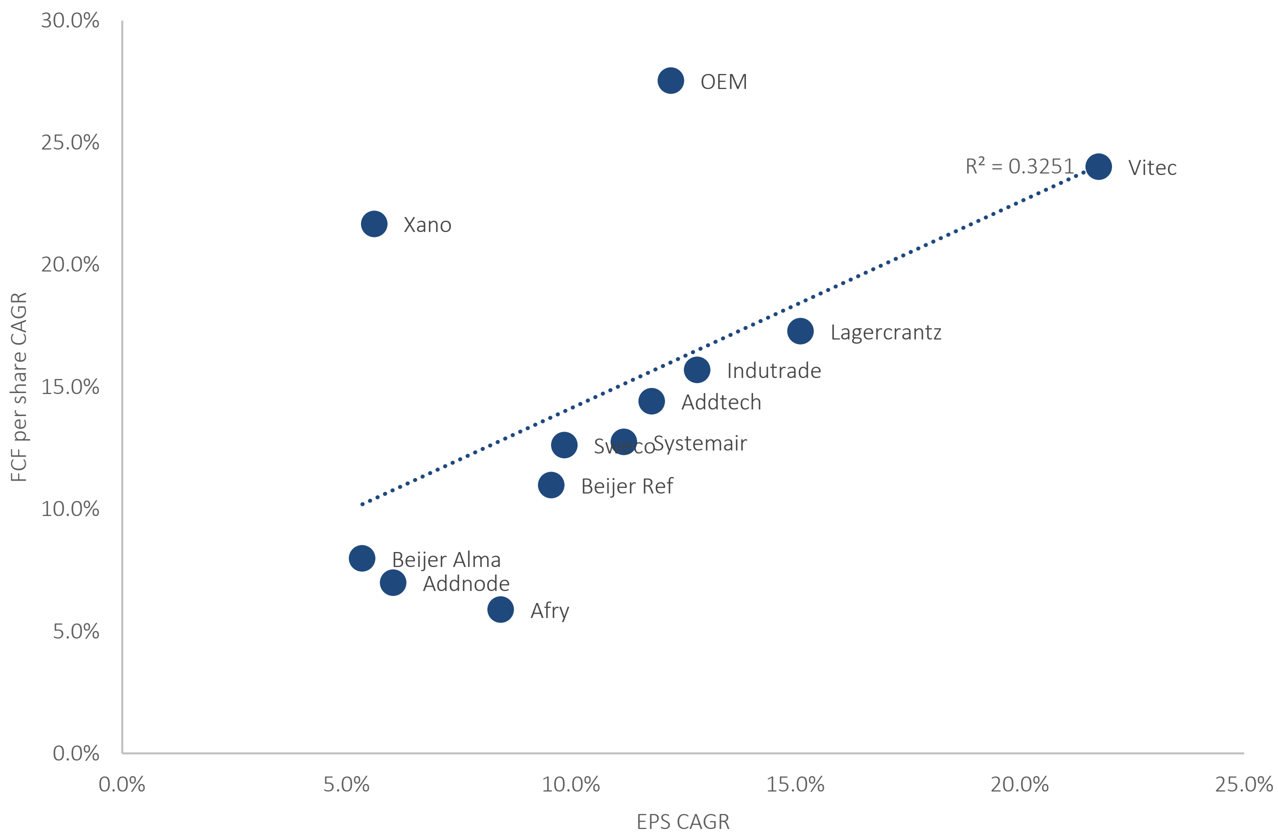
Source: Factset 2023-12-01

EPS and Free-Cash Flow Growth*

EPS vs FCF per share 2007-2023 Q3

It's All About Durable Growth



We find a strong correlation between EPS and FCF per share CAGR 2007-2023Q3 YTD; profitable EPS growth over time will drive the share price.

Even though EPS is the primary driver of long-term share price performance, it is essential that EPS reflects FCF per share as much as possible, which our data shows it does.

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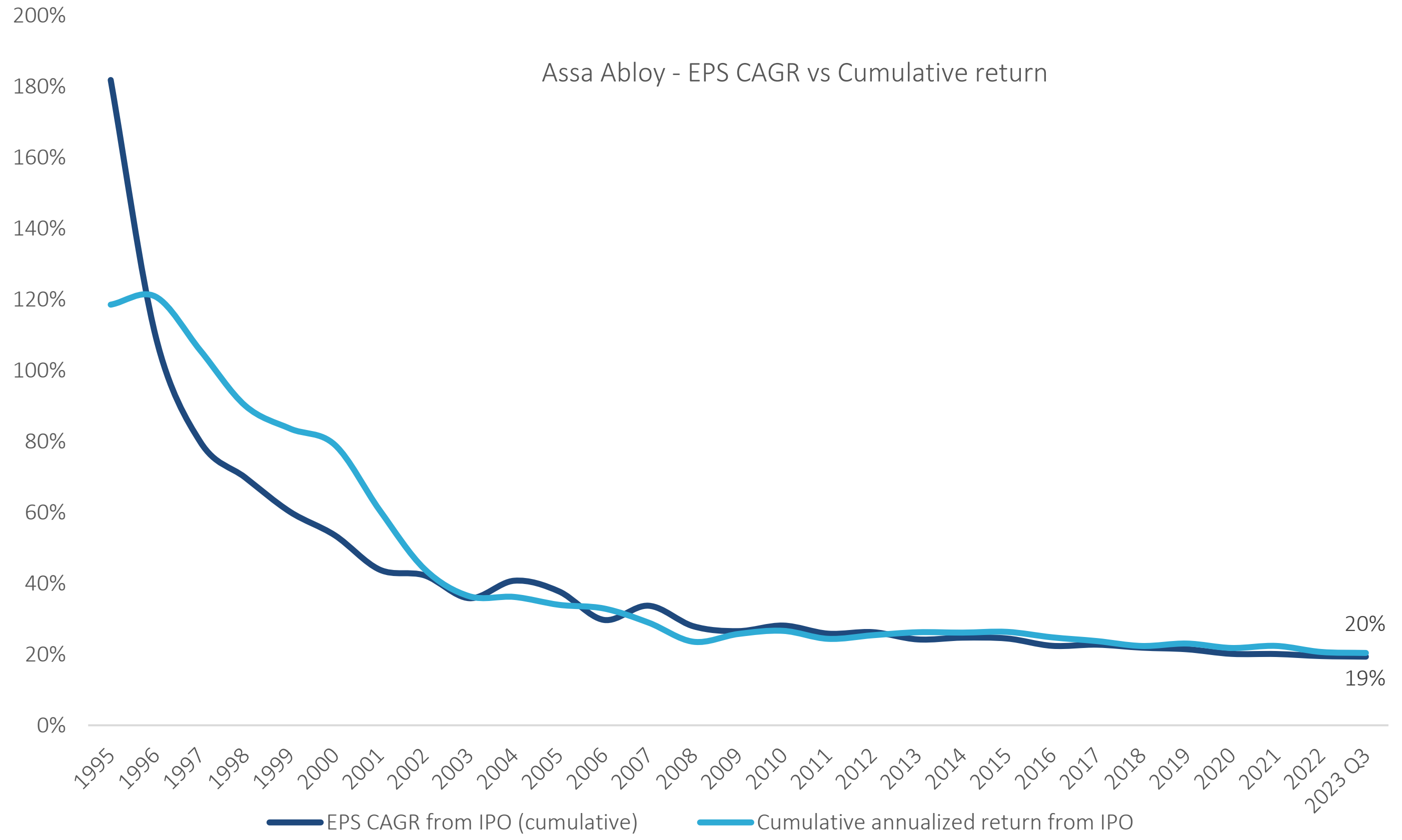
Source: Factset 2023-12-01

All About Durable Growth – Assa Abloy

EPS growth main driver of long-term shareholder creation

It's All About Durable Growth



This chart illustrates that in the short term there is no relationship between EPS growth and total return investors get, but in the long-term real return CAGR reflects the EPS CAGR.

For Assa Abloy, the EPS and TSR (total shareholder return) CAGR started to merge around 2003 (9 years after the IPO in 1994).

Using EPS as a measure of company performance has its critics. Certainly no single measure of this kind is perfect. But EPS is still a pretty good indicator, over a sufficiently long period of time, of a groups's performance in delivering shareholder value,

David Barber, former founder and CEO of Halma, 1997 speech

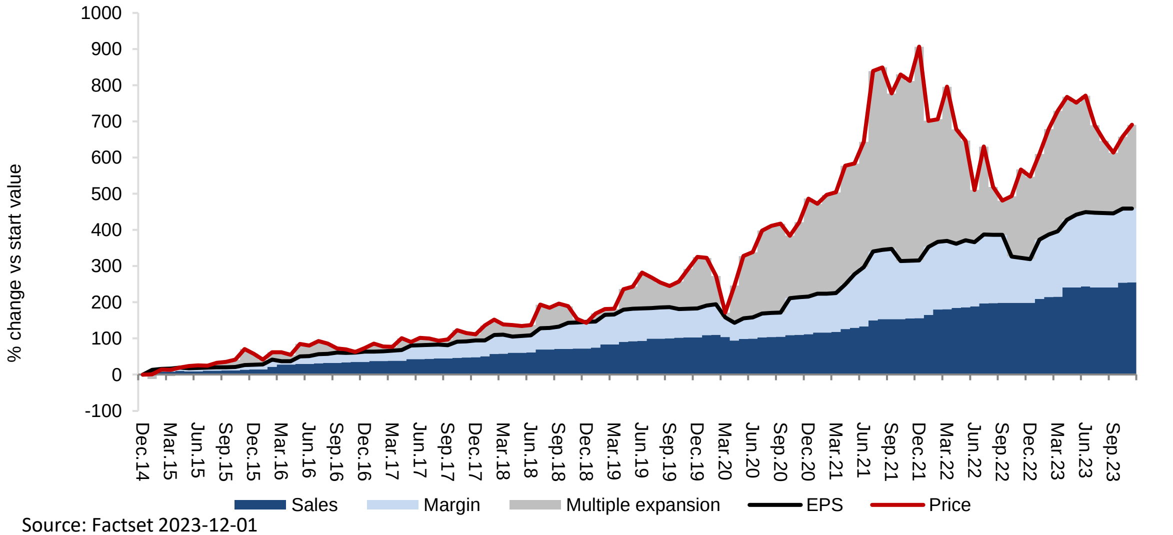
Source: Factset 2023-12-01

All About Durable Growth

Main drivers of long-term shareholder value creation

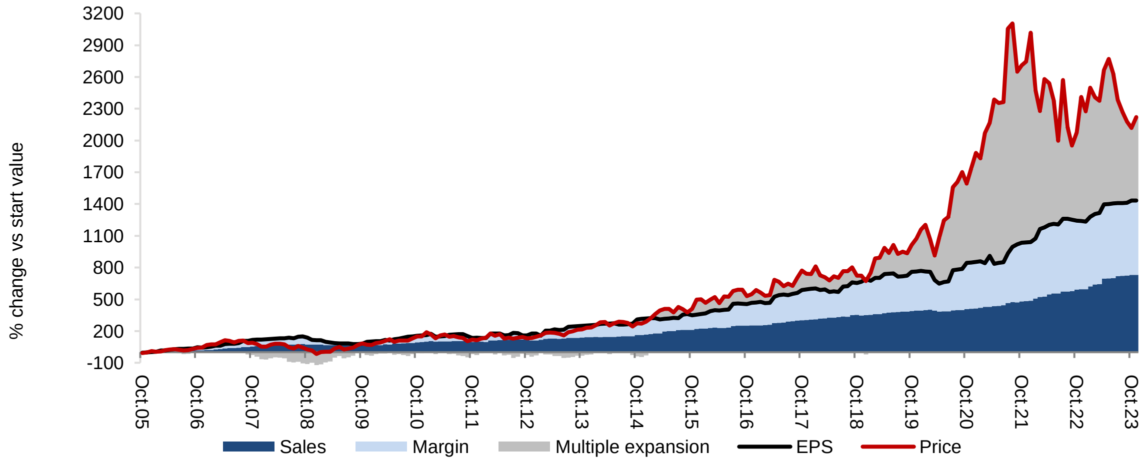
It's All About Durable Growth

Lifco



Source: Factset 2023-12-01

Indutrade



Source: Factset 2023-12-01

From the charts to the left, we can observe that EPS is the main long-term growth driver of shareholder return (in this case, share price).

Over time, the share price tends to follow the EPS growth but can, in shorter periods, deviate due to multiple expansions or contractions.

As we can see from the charts, these companies have experienced multiple expansions starting around 2018 – rewarded by the long ability to generate earnings growth with high returns on capital and a maintained sound financial position.

The charts show that sales growth is a significant driver of EPS growth, but margin expansion also plays a role.

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Main drivers of long-term shareholder value creation

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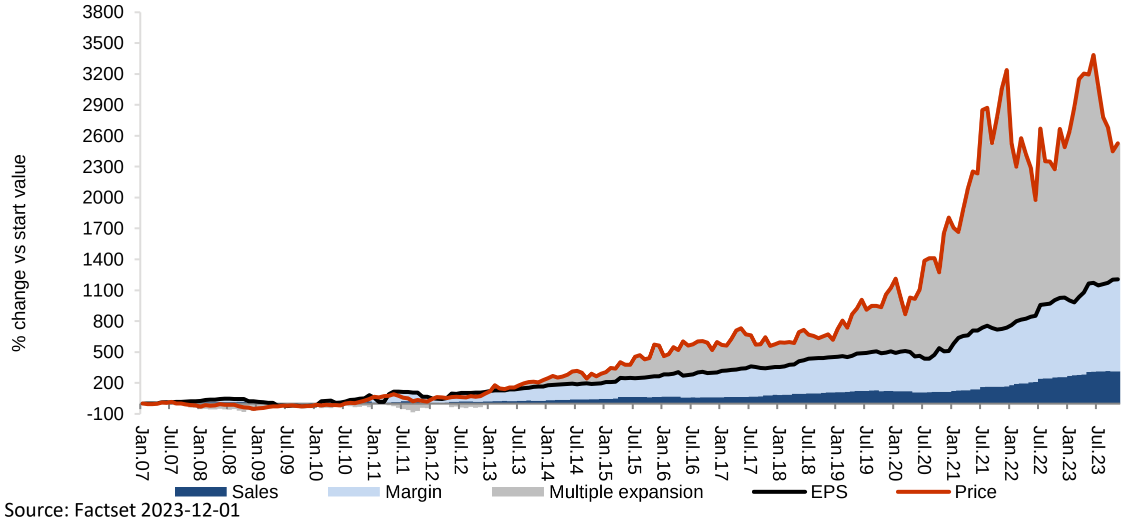
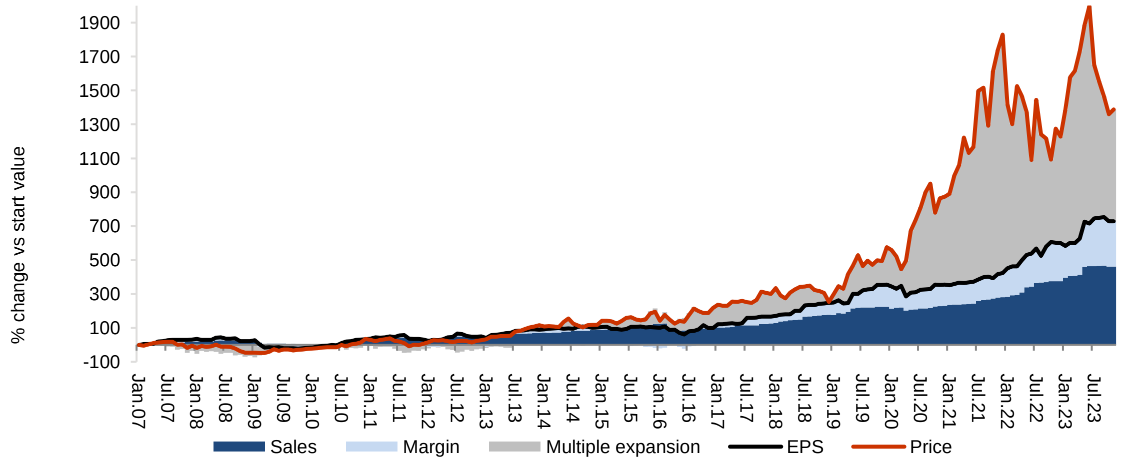
Lagercrantz



Source: Factset 2023-12-01

Addtech



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Main drivers of long-term shareholder value creation

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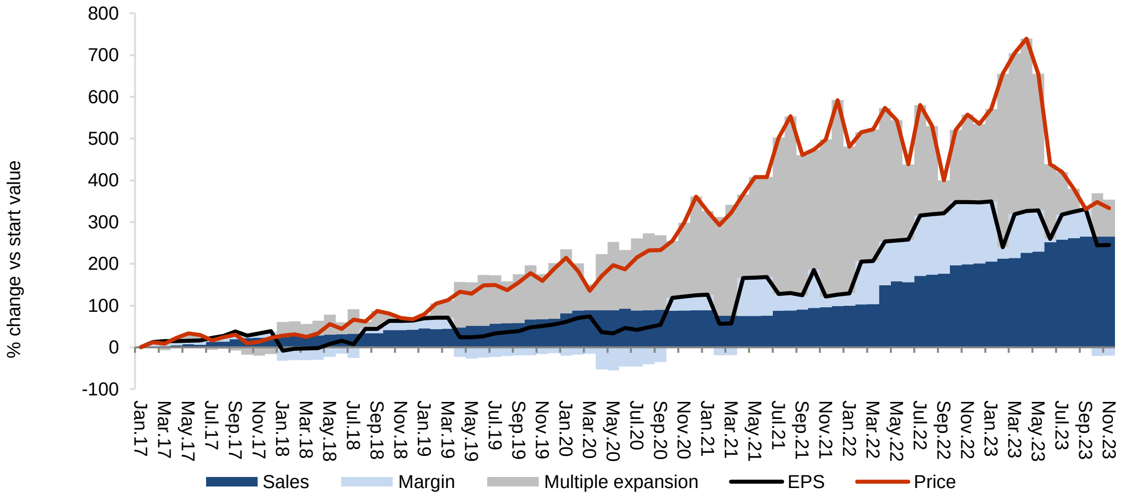
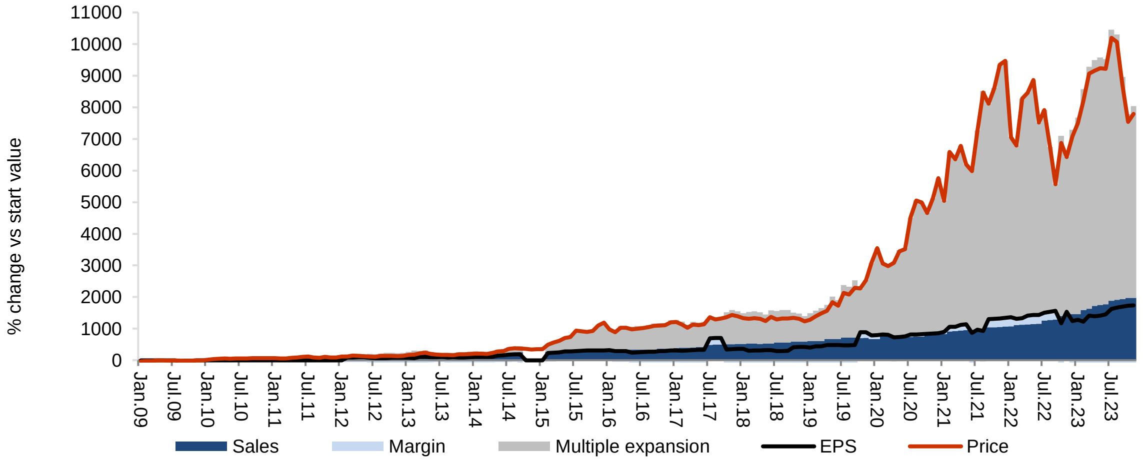
Addnode



Source: Factset 2023-12-01

Vitec



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Main drivers of long-term shareholder value creation

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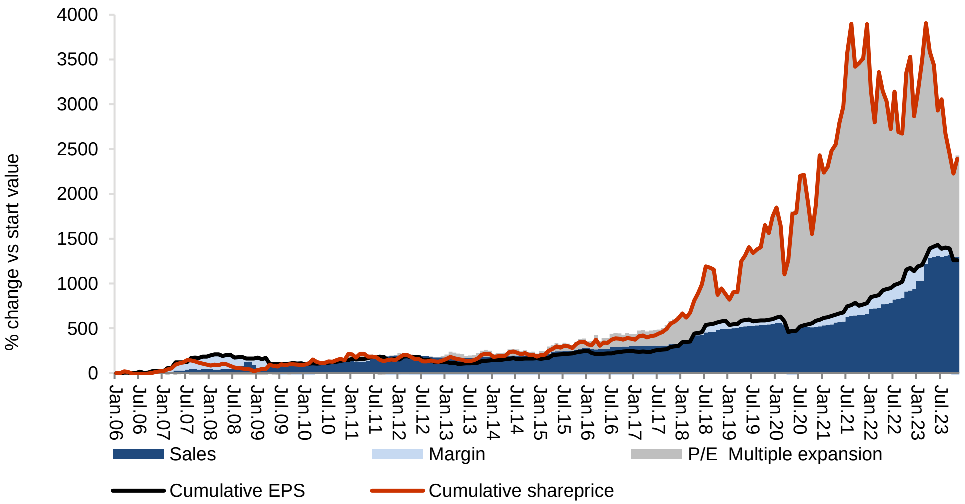
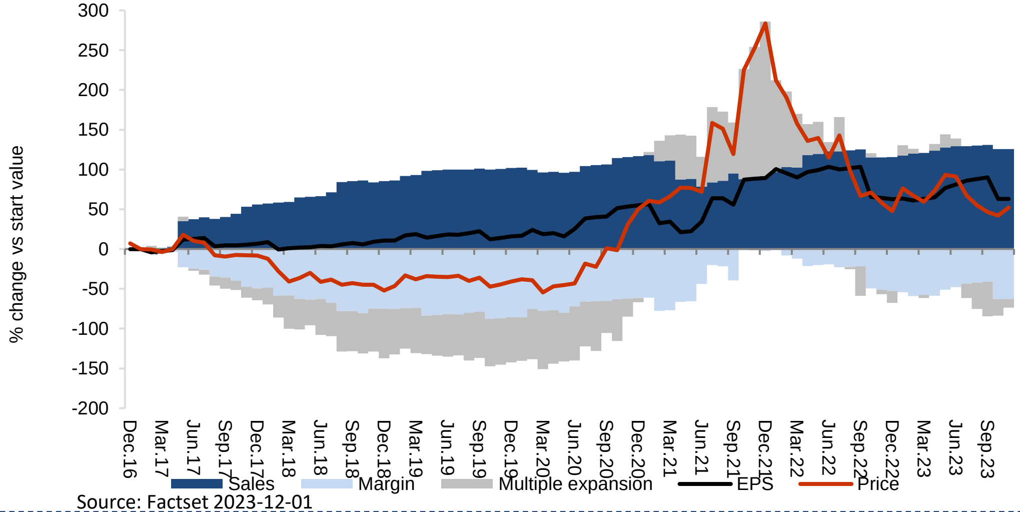
Beijer Ref



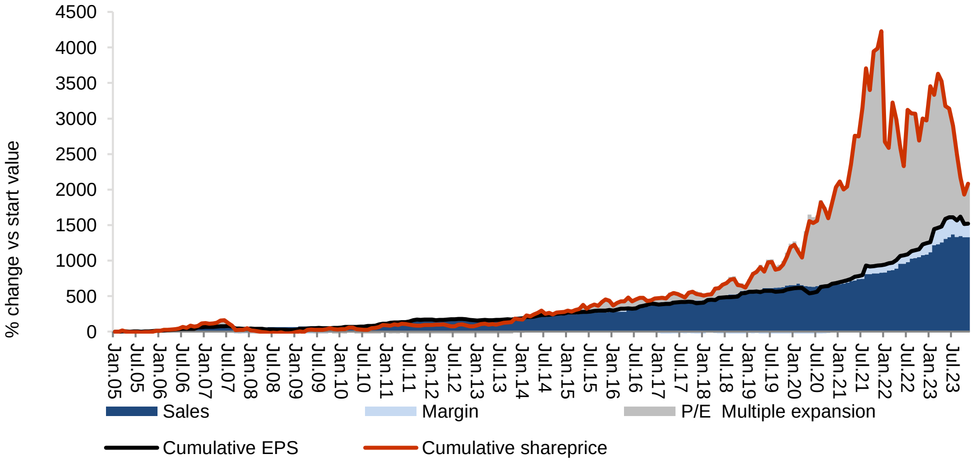
Source: Factset 2023-12-01

Volati



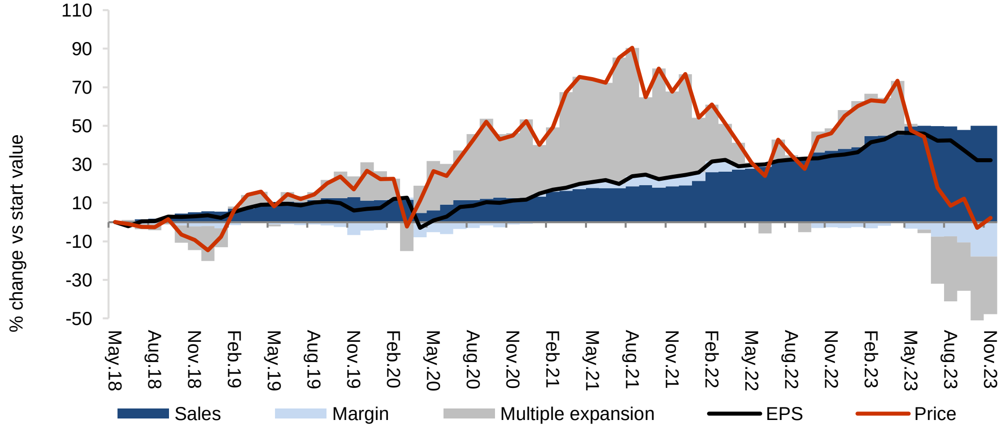
Source: Factset 2023-12-01

Nibe



Source: Factset 2023-12-01

Bravida



Source: Factset 2023-12-01

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Main drivers of long-term shareholder value creation

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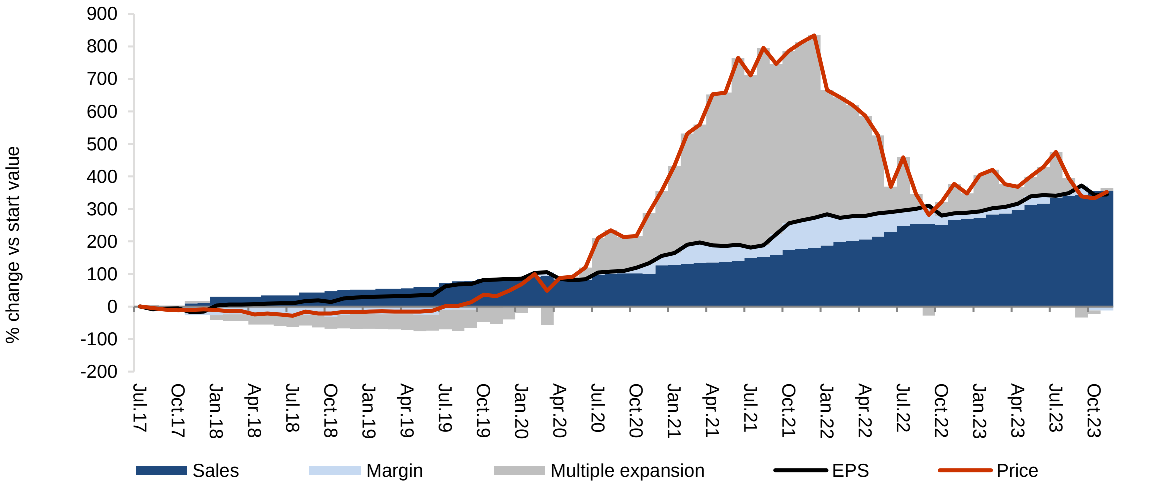
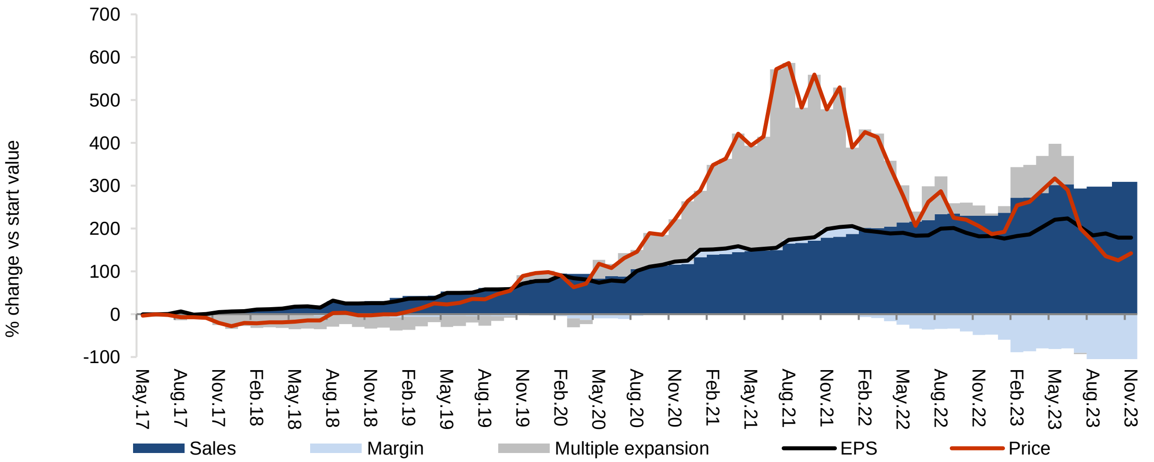
Sdiptech



Source: Factset 2023-12-01

Instalco



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As we can see from the charts, these companies have experienced multiple expansions starting around 2018 – rewarded by the long ability to generate earnings growth with high returns on capital and a maintained sound financial position.

We can also see from the charts that sales growth is a big driver of EPS growth, but margin expansion also plays a role.

In the stock market during 2020/2021, we have seen that companies with a short track record were also rewarded heavily with multiple expansions – but have now reversed in a much higher pace than for the companies with a long track record.

We can see that both Sdiptech and Instalco trades at or below the multiples at IPO.

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Main drivers of long-term shareholder value creation

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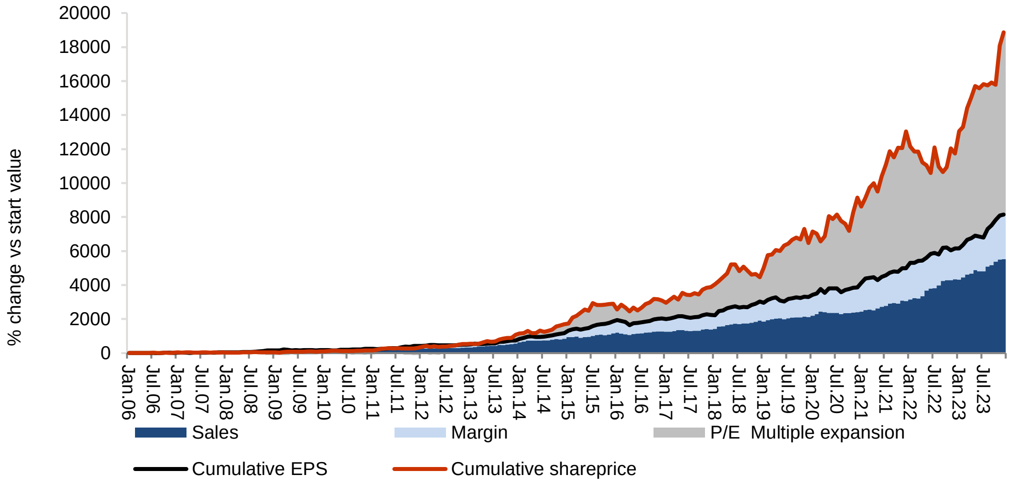
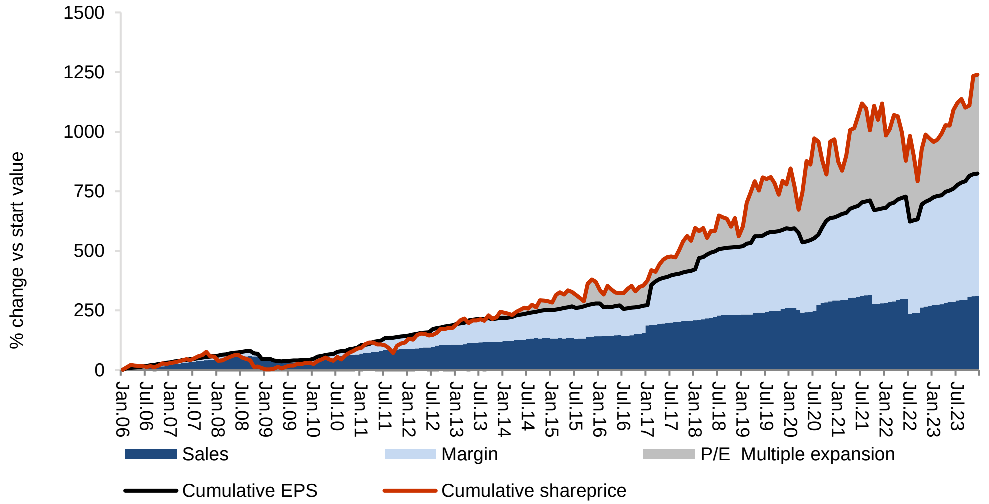
Constellation Software



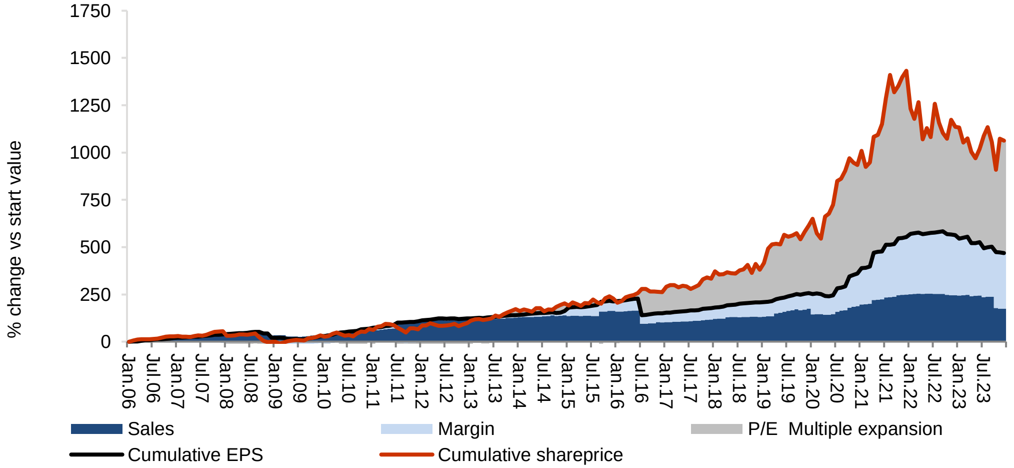
Source: Factset 2023-12-01

Roper Technologies



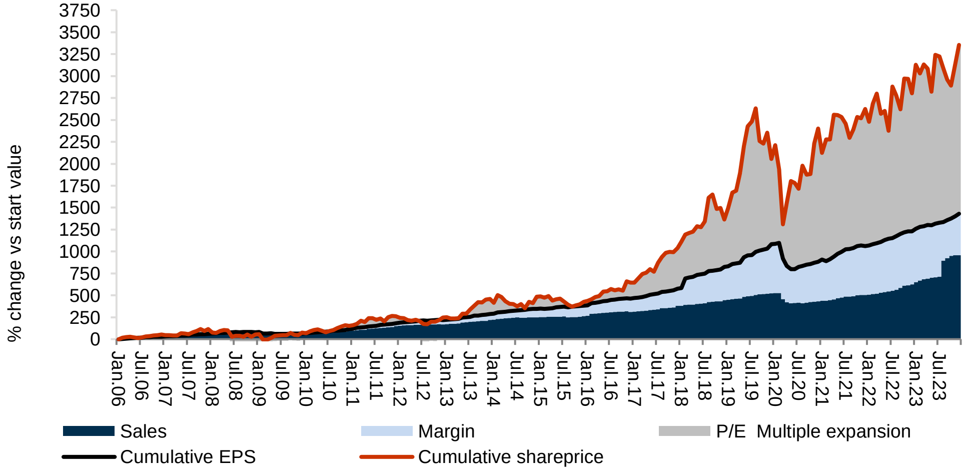
Source: Factset 2023-12-01

Danaher



Source: Factset 2023-12-01

Heico



Source: Factset 2023-12-01

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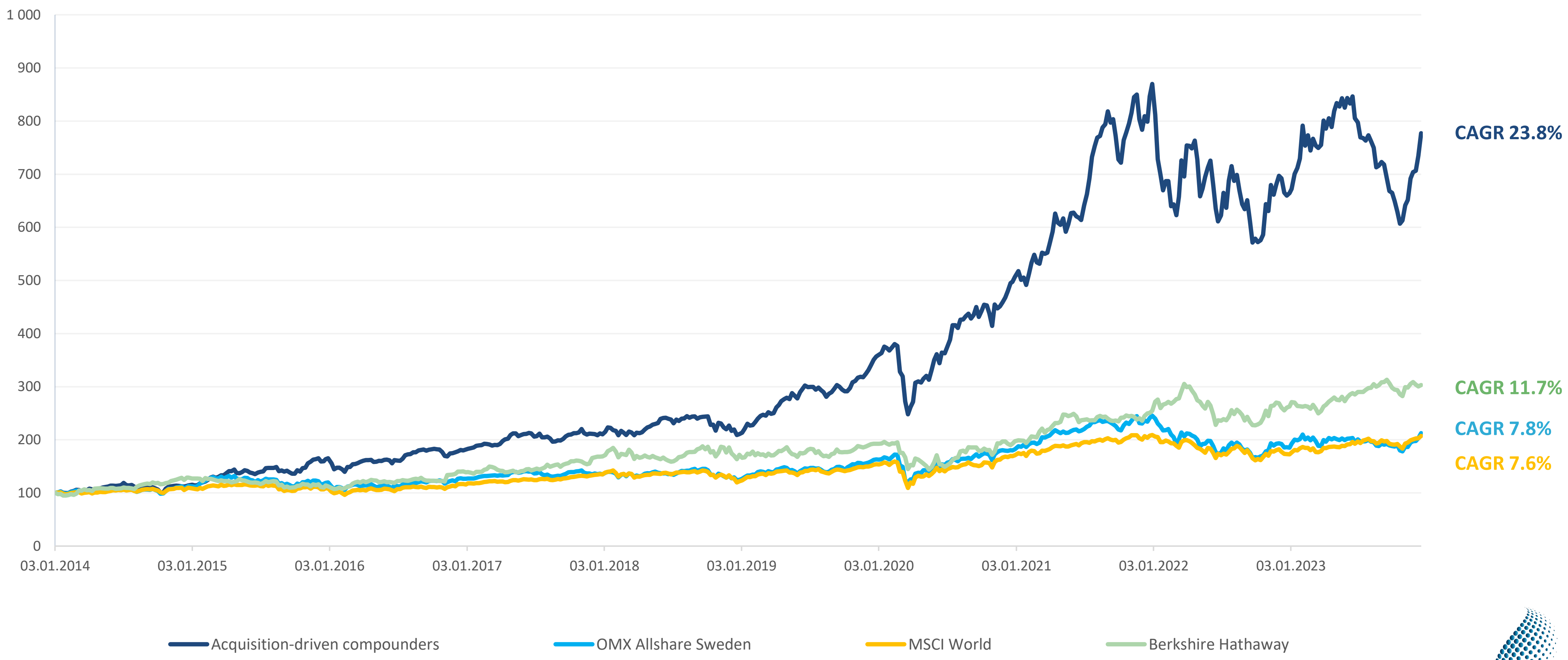
Superior Long-Term Share Price Performance – Nordic past 10 years

10-year indexed share price performance
Nordic acquisition-driven compounders up 8x

It's All About Durable Growth

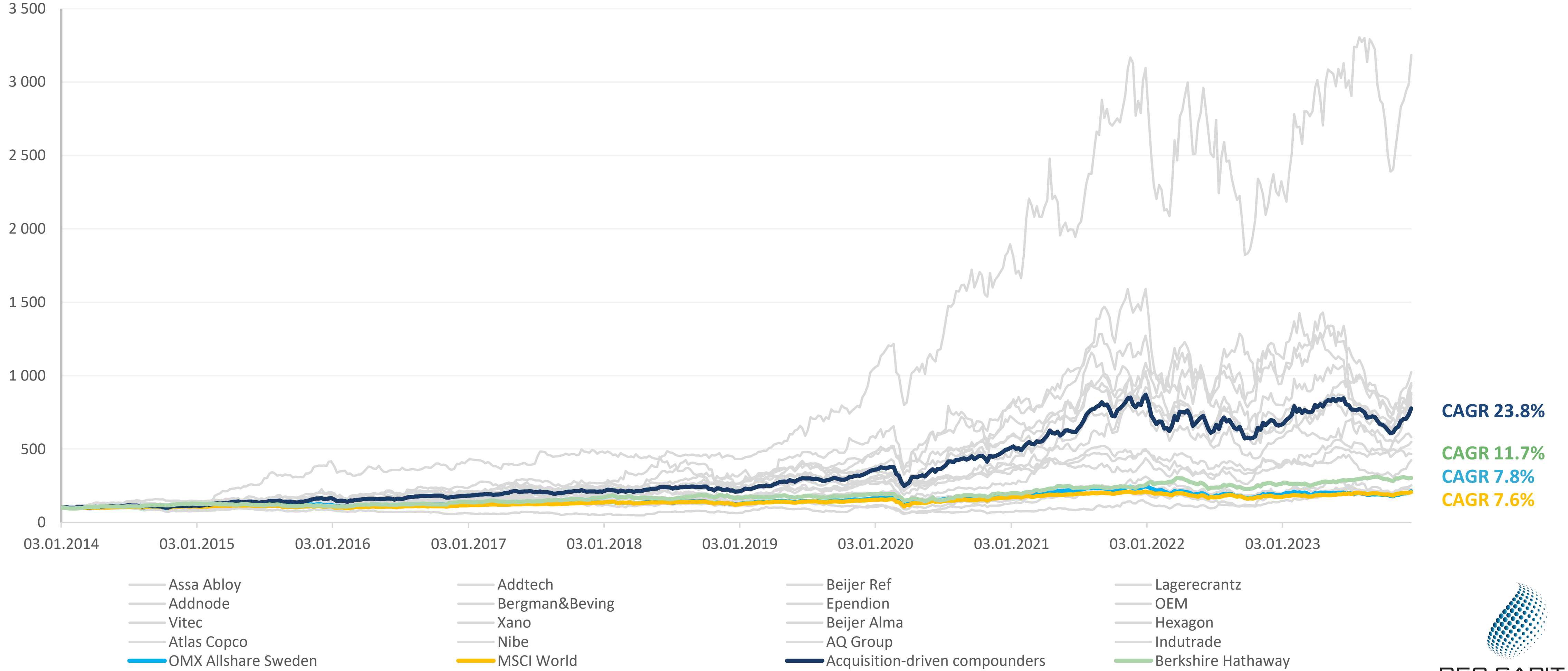


Source: Factset as of 2014-01-01 to 2023-12-15
Note: Average for companies by REQ identified as acquisition-driven compounders listed during the full period. We have not adjusted for spin-offs of Addlife, Momentum Group and Epiroc, which would increase the overall performance.
Assa Abloy, Addtech, Beijer Ref, Lagercrantz, Addnode, Bergman&Beving, Ependion, Indutrade, OEM, Xano, Beijer Alma, Hexagon, Atlas Copco, Nibe, AQ Group, Vitec

Superior Long-Term Share Price Performance – Nordic past 10 years

[It's All About Durable Growth](#)

10-year indexed share price performance
Nordic acquisition-driven compounders up 8x



Source: Factset as of 2014-01-01 to 2023-12-15
Note: Average for companies by REQ identified as acquisition-driven compounders listed during the full period. We have not adjusted for spin-offs of Addlife, Momentum Group and Epiroc, which would increase the overall performance.
Assa Abloy, Addtech, Beijer Ref, Lagerecrantz, Addnode, Bergman&Beving, Ependion, Indutrade, OEM, Xano, Beijer Alma, Hexagon, Atlas Copco, Nibe, AQ Group, Vitec

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Superior Long-Term Share Price Performance – Nordic past 20 years

20 yr indexed share price performance
Nordic acquisition-driven compounders up 34x, Berkshire Hathaway up 6.4x

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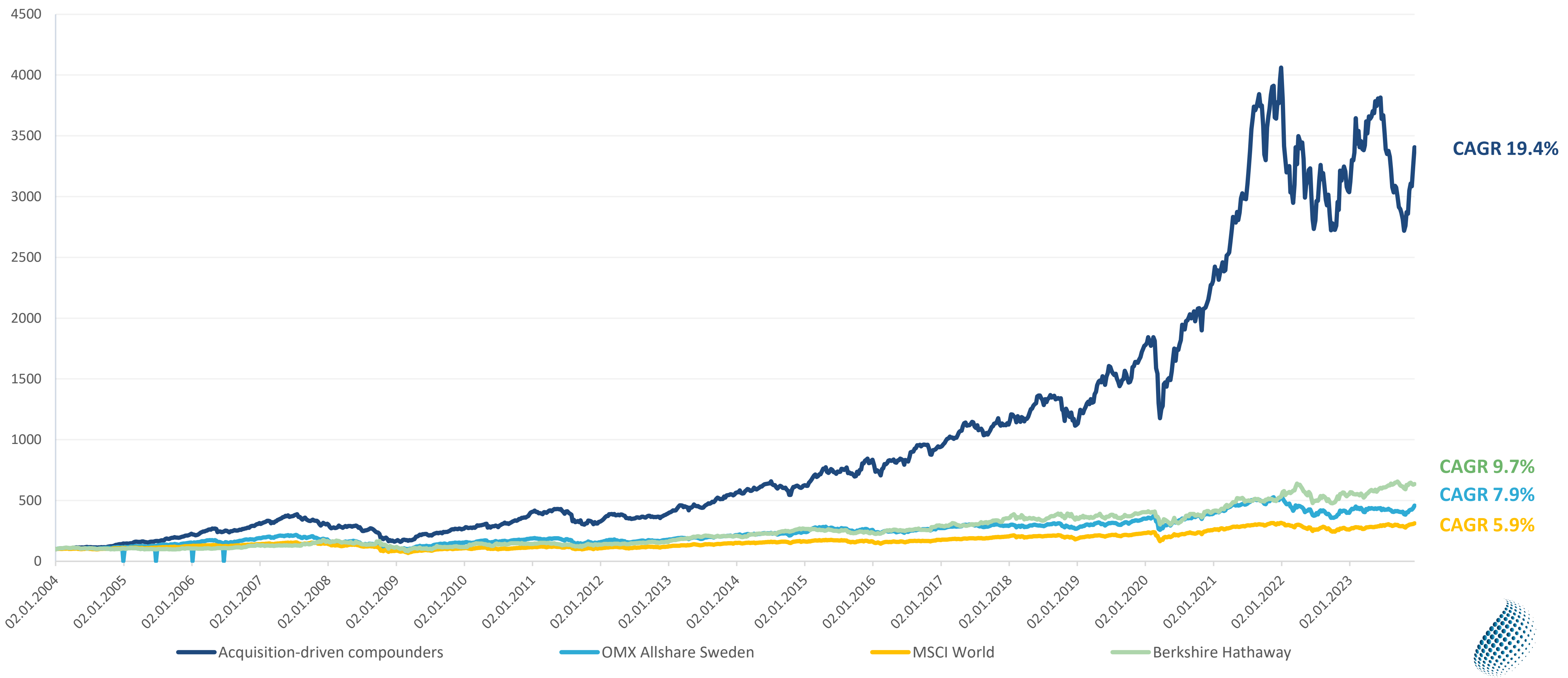

Source: Factset as of 2004-01-01 to 2023-12-15
Note: Average for companies by REQ identified as acquisition-driven compounders listed during the full period . We have not adjusted for spin-offs of Hexpol, Addlife, Momentum Group and Epiroc, which would increase the overall performance
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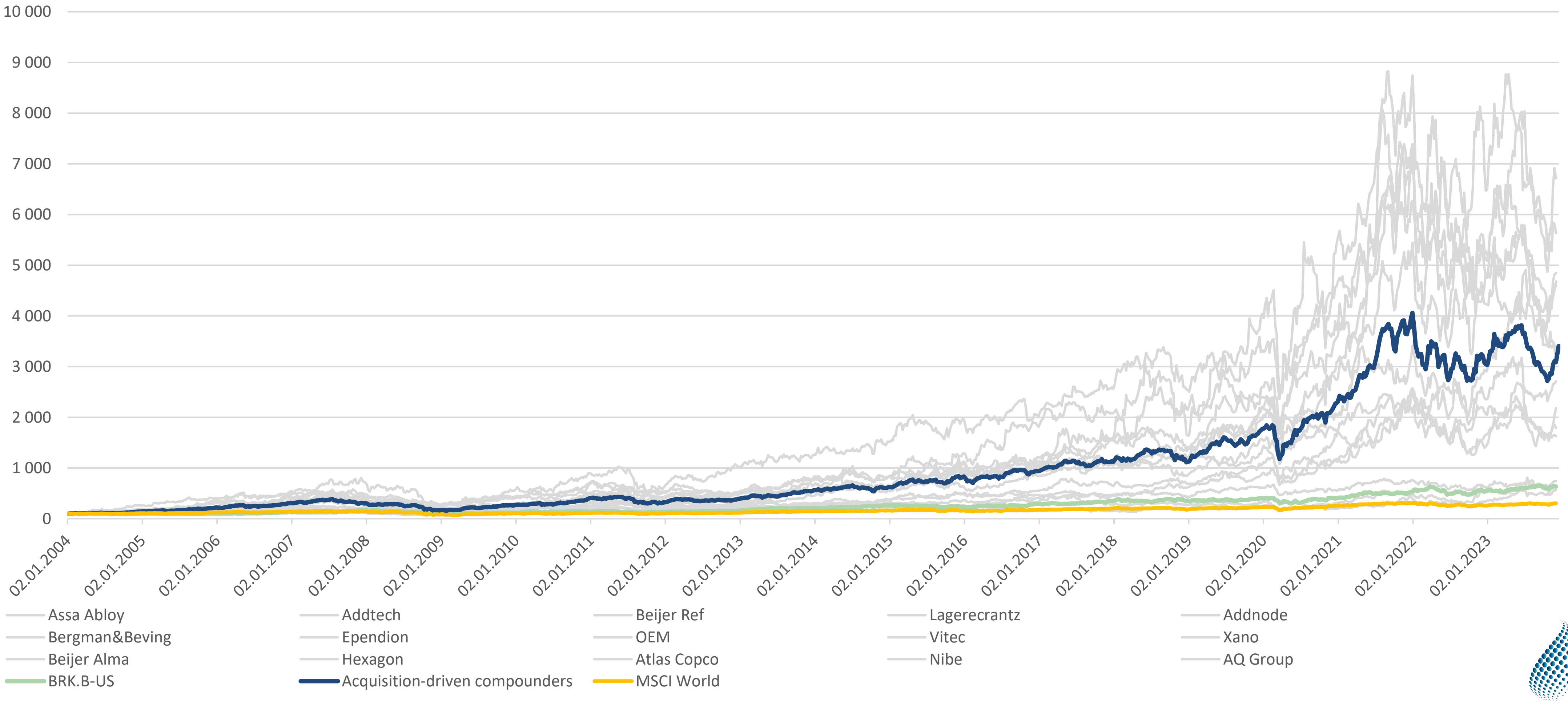
Superior Long-Term Share Price Performance – Nordic past 20 years

20 yr indexed share price performance – Nordic acquisition-driven compounders up 31x, Berkshire Hathaway up 6.4x

[It's All About Durable Growth]



Source: Factset as of 2004-01-01 to 2023-12-15
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Superior Long-Term Share Price Performance – Global past 10 years

[It's All About Durable Growth](#)

10-year indexed share price performance
Global acquisition-driven compounders up 24x, Berkshire Hathaway up 6.4x

Source: Factset as of 2014-01-01 to 2023-12-15
Note: Average for companies by REQ identified as acquisition-driven compounders listed during the full period:
Heico, Diploma, Halma, Judges Scientific, Roper Technologies, Illinois Tool Works, Dassault Systems, Brown&Brown, DCC, Ametek, Nordson, Teledyne, Constellation Software

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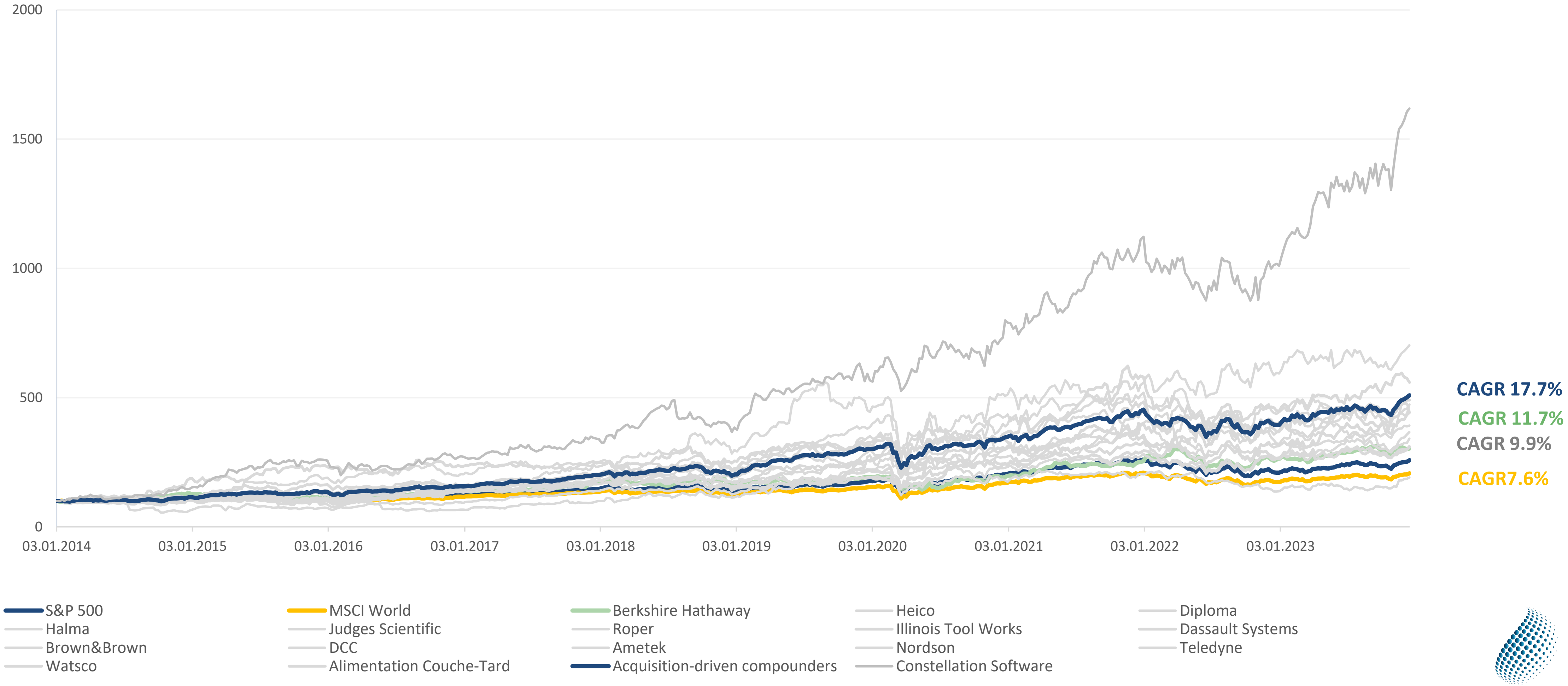
Superior Long-Term Share Price Performance – Global past 10 years

It's All About Durable Growth

10-year indexed share price performance
Global acquisition-driven compounders up 24x, Berkshire Hathaway up 6.4x



Source: Factset as of 2014-01-01 to 2023-12-15
Note: Average for companies by REQ identified as acquisition-driven compounders listed during the full period:
Heico, Diploma, Halma, Judges Scientific, Roper Technologies, Illinois Tool Works, Dassault Systems, Brown&Brown, DCC, Ametek, Nordson, Teledyne, Constellation Software

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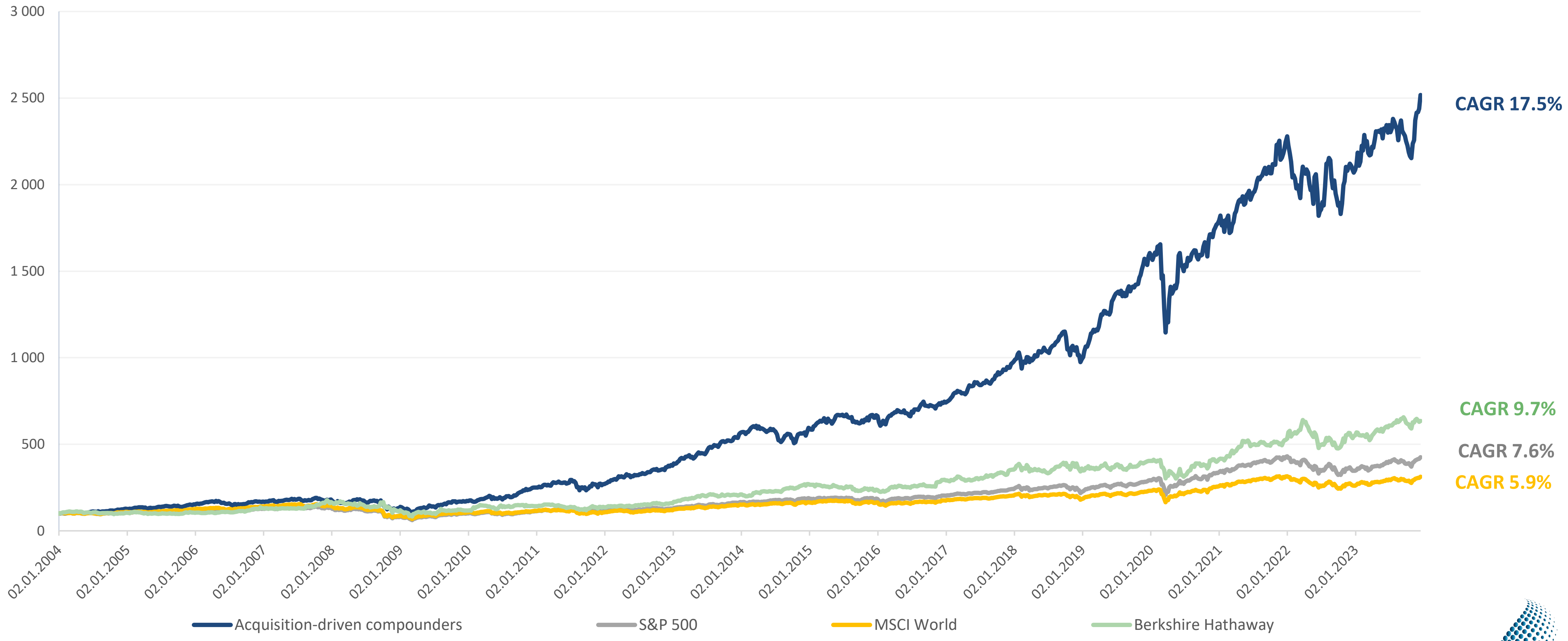
Superior Long-Term Share Price Performance – Global past 20 years

[It's All About Durable Growth]

20 yr indexed share price performance
Global acquisition-driven compounders up 24x, Berkshire Hathaway up 6.4x



Source: Factset as of 2004-01-01 to 2023-12-15
Note: Average for companies by REQ identified as acquisition-driven compounders listed during the full period:
Heico, Diploma, Halma, Judges Scientific, Roper Technologies, Illinois Tool Works, Dassault Systems, Brown&Brown, DCC, Ametek, Nordson, Teledyne

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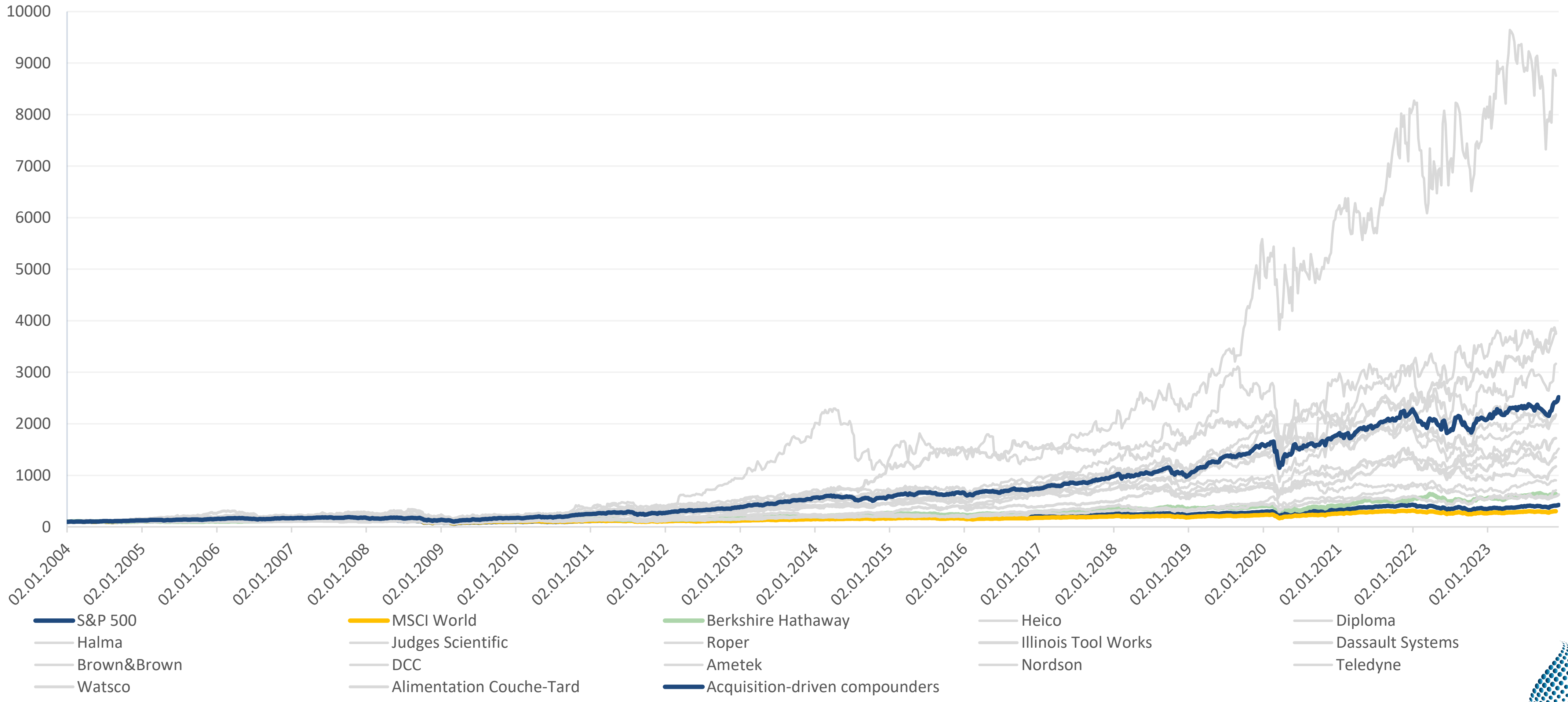
Superior Long-Term Share Price Performance – Global past 20 years

20 yr indexed share price performance – acquisition-driven compounders up 24x, Berkshire Hathaway up 6.4x

It's All About Durable Growth



Source: Factset as of 2004-01-01 to 2023-12-15
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Ownership Structures and Succession Planning

The Value of Succession Planning

Some thoughts around succession planning

Ownership structures and succession planning

An important part of our investment philosophy is "people" – the analysis of a company's management team and corporate culture. The CEO role is crucial in every company. The CEO is the "Cultural Executive Officer". We want to invest in companies led by "outsider CEOs" who dare to deviate from traditional ways of allocating capital, organizing and creating cultures. We like to invest in companies that have systematic CEO succession planning. When analyzing our portfolio companies, we see three common roadmaps in succession planning.

We invest in companies where the CEO treats the company as their own. We prefer companies where the CEO has a long tenure with the company, either as a founder or with years of experience with the company before being appointed CEO. CEOs who share the company's beliefs and strategic DNA create more value for shareholders than CEOs who view the position as the next career move or a high-paying job.

The "Forever-CEO"

Some CEOs are the DNA of the company. These CEOs are often founders or co-founders of the company and have been with the company since the beginning. Think of Steve Jobs at Apple or Warren Buffett at Berkshire Hathaway. The board of these companies gives the CEO full autonomy, and the CEO runs the company the way he or she wants. These CEOs treat the company as their own, and often hold large ownership stakes. When investing in such companies, the CEO is an important part of the investment analysis. These CEOs often have a very distinctive leadership style. We own several companies with "forever-CEOs". Examples from our funds include Mark Leonard at Constellation Software and Gerteric Lindquist at Nibe.

The downside to investing in these companies is that much of the company's perceived value creation is tied to the CEO. If the CEO suddenly quits or otherwise leaves the company, it will be difficult to replace them immediately in many cases. It is essential to assess succession risk in these companies and whether the corporate culture might change under a new CEO.

The internal candidate

Some companies always recruit internally for the CEO position. The board of these companies has a detailed succession plan for the CEO position that includes several internal candidates. This recruitment strategy enables the board to recruit a CEO who understands a company's existing corporate culture, norms, and strategy. It de-risks the process of changing the CEO, and gives shareholders more of what has been.

Typically, these companies will not change their strategic direction or undergo significant changes in execution after the new CEO is in place. In these companies, the CEO is simply an excellent enforcer of the company's strategic DNA, which is set by the board and maintained over time. When a CEO in such a company decides to leave, the board has several excellent internal candidates to succeed them, and shareholders know what to expect. Most companies in our fund follow the internal candidate strategy. Examples from our funds are Niklas Stenberg at Addtech and Per Waldermarsson at Lifco. (continued)

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The Value of Succession Planning

Some thoughts around succession planning

Ownership structures and succession planning

External recruitments

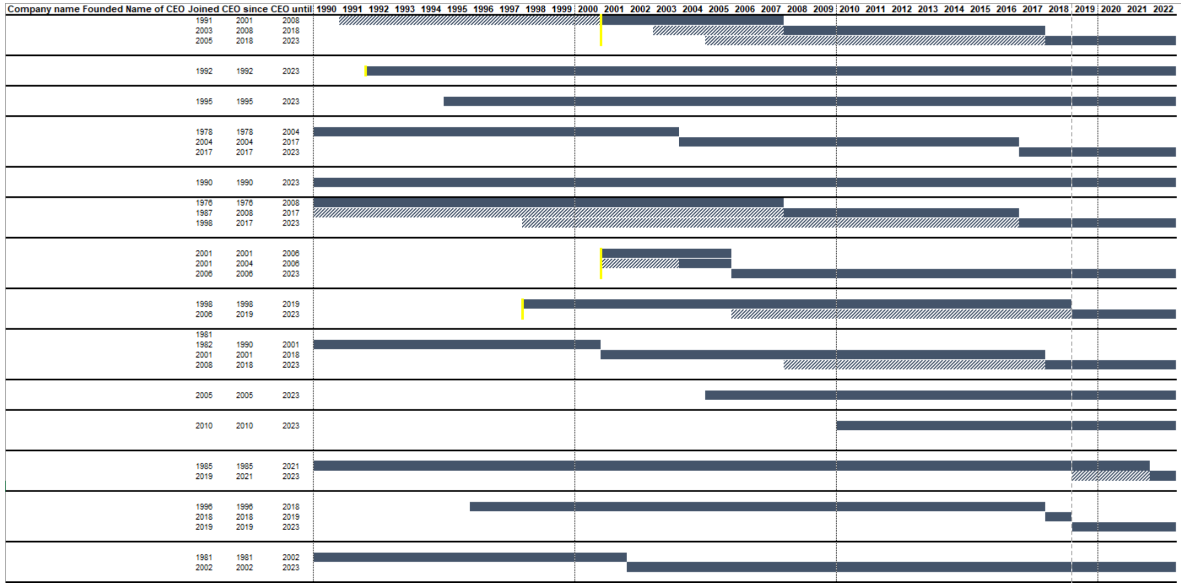
Some companies recruit externally when they hire a new CEO. An external candidate brings something new, as they have limited knowledge of the company's existing organizational culture and internal company DNA. An external candidate also has limited ownership of executing the company's strategy. In most cases, external CEOs will carve out a new strategic business direction when joining a new company, reflecting their leadership skills and strengths. External recruitment thus ensures that the company's strategy and business development are reviewed with new perspectives and constantly challenged over time.

The downside of such a strategy is that the company risks changing its strategic direction too often. We generally do not observe external recruitments for the CEO position in our portfolios.

If you take the time to study a company's CEO history, you will often see a distinct pattern in how the board does its succession planning. Very few companies tend to alternate between external recruitment, internal recruitment, or having multiple dominant "forever CEOs".

The companies in our funds have often been successful for decades by pursuing the "forever-CEO" and internal candidate recruitment strategies. These are CEOs who properly understand the corporate cultures and mindsets of the companies and create long-term value for shareholders.

Overview of CEO succession planning since 1990 (company names not disclosed)



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Owership Structures as a Competitive Advantage

We believe it is vital to consider the ownership structure of a company before making an investment decision. In most cases, companies with a high degree of insider ownership are better managed than purely institutionally owned companies. Insiders have a longer-term view of a company's performance and implement that long-term view through board representation, management composition, and strategic direction. We believe that the ownership structures of our companies provide a significant competitive advantage by enabling companies to act in the best interests of long-term shareholders.

We define insider ownership as shares owned by executives, board members, and large private owners (often families), as these are all stakeholders that can significantly impact a company's performance. In our portfolios, you will typically find ownership structures where the family behind the company controls the votes but not necessarily the capital. Examples of such companies are Vitec in Sweden and Heico in the US.

When management owns a significant stake in a company, they treat the company as their own. You treat your car differently than a rental car. Management with ownership tends to avoid poor decisions that increase short-term profitability goals at the expense of longer-term value creation. This requires that ownership stakes are not given away for free through warrants or options but through investment requirements or long-term incentive plans with appropriate vesting periods.

It is a paradox that, from a governance point of view, high institutional ownership is perceived by many to be better than one or a few large private owners. The argument is that institutional investors are often professional and have experience implementing appropriate governance measures. However, institutional investors often have a short-term view of their investments, trusting that management will maximize shareholder value. This gives management much freedom without, in many cases, properly aligned incentives. In addition, institutional investors rarely take seats on the board, as this limits their ability to trade shares. On the other hand, a private owner often has a generational perspective on his or her ownership stake and wants to take a seat on the board. This ensures a long-term perspective in the board room, which we prefer.

Some will argue that insider ownership does not matter in a well-governed company as control mechanisms will ensure that the company is well-managed. We believe that stock ownership incentives work better than formal control mechanisms. Management and directors rarely implement a long-term perspective if incentive structures are not correctly aligned. We favor both management and directors owning a significant amount of stock, increasing accountability and forcing them to have a longer-term perspective. The total value of the stock ownership should significantly exceed annual compensation.

There are instances when insider ownership can be a significant negative factor for companies. This is especially the case in conjunction with poor governance, where insiders act irrationally to maximize their value at the expense of other stakeholders.

(continued)

Owership Structures as a Competitive Advantage

One such example may be when a company is heavily indebted and enters a downturn. Instead of raising equity to repair the balance sheet, a majority owner who holds most of their personal wealth in the company may postpone a capital increase to avoid dilution. This is suboptimal for the company because management may spend more time worrying about the capital structure than focusing on operations during a difficult downturn.

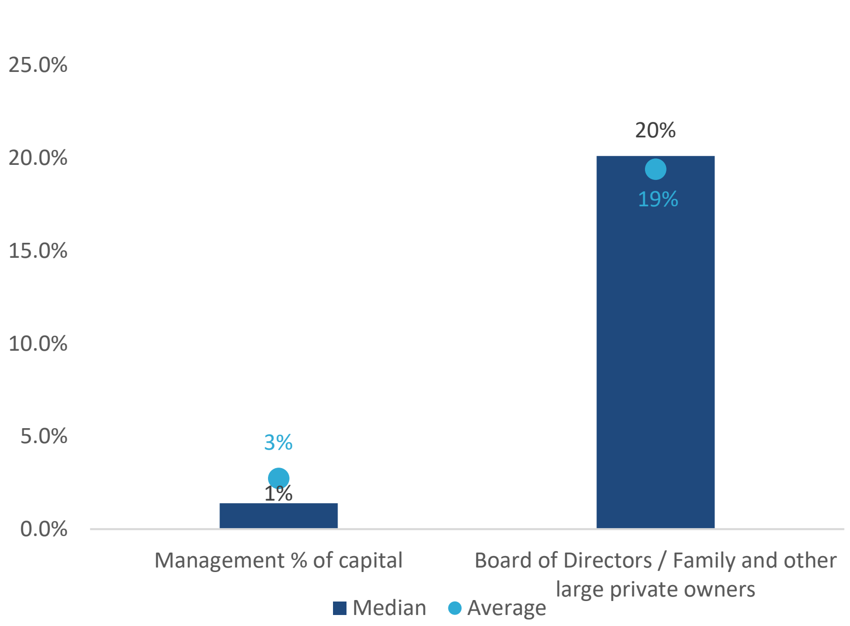
Therefore, it is important to consider whether a company has the right governance mechanisms when investing in companies with high insider ownership. Much of the risk of insider ownership can be mitigated by examining a company's governance mechanisms, in addition to its business model, organizational structure, and management profile.

We believe that high insider ownership creates long-term value because insiders often have a long-term view of the company and want to maximize long-term shareholder value. This means that management does not focus on empire-building or make suboptimal short-term strategic or financial decisions. We have high insider ownership in our portfolio holdings and believe this is a crucial investment criterion to ensure long-term value creation.

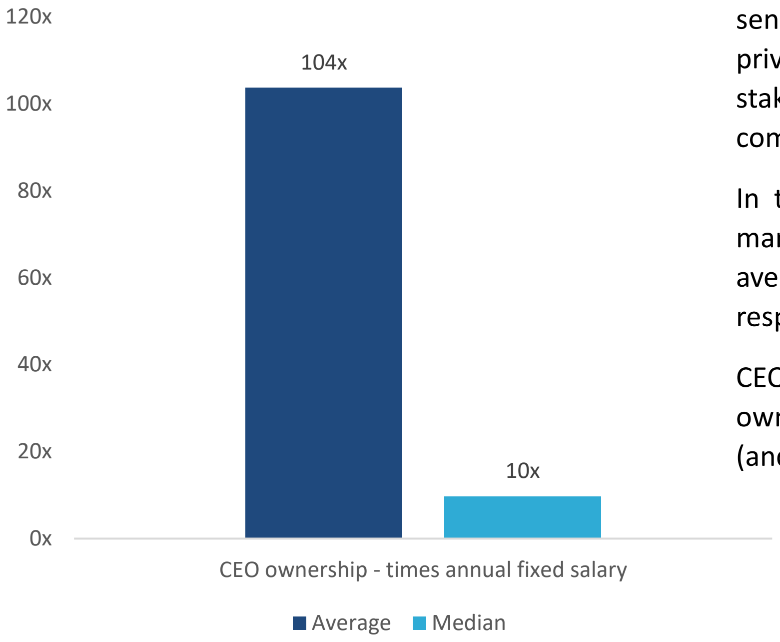
Insider Ownership – REQ Nordic Compounders

Ownership structures and succession planning

Insider ownership (% of capital)



CEO insider ownership (% of capital)



We define insider ownership as shares held by senior management, board members, and large private owners (often families) since these are all stakeholders that can significantly impact a company's long-term performance.

In the companies we own in the Nordic fund, management and Board of Directors hold, on average, 3% and 20% of the share of capital, respectively.

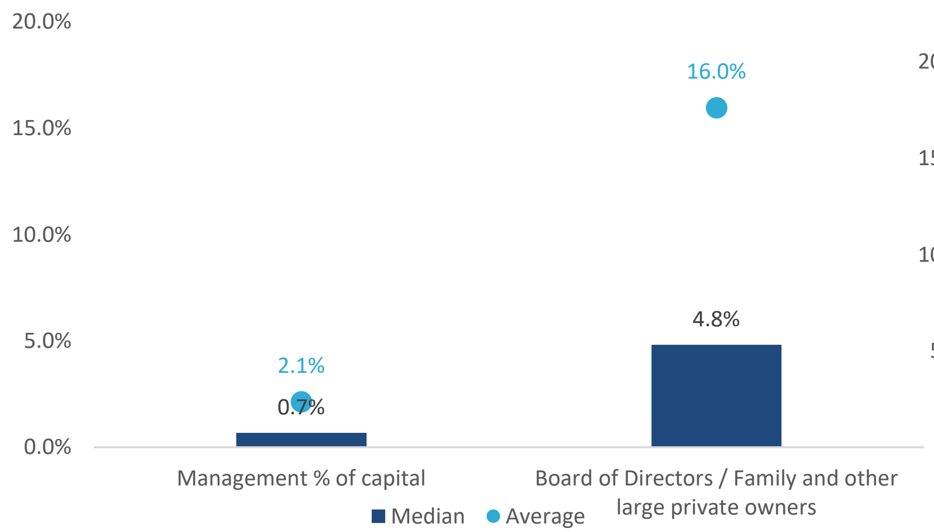
CEOs of our holdings, on average, have insider ownership 104 times their annual base salary (and 10x on median).

Source: Company websites, company reports, Factset

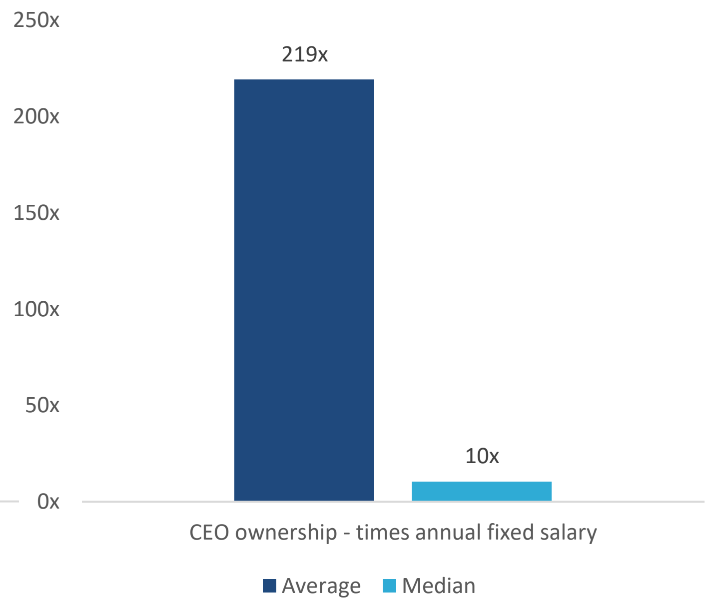
Insider Ownership – REQ Global Compounders

Ownership structures and succession planning

Insider ownership (% of capital)



CEO insider ownership (% of capital)



We define insider ownership as shares held by senior management, board members, and large private owners (often families) since these are all stakeholders that can significantly impact a company's long-term performance.

In the companies we own in the Global fund, management and Board of Directors hold, on average, 2% and 16% of the share of capital, respectively.

CEOs of our holdings, on average, have insider ownership 219 times their annual base salary (and 10x on median).

Source: Company websites, company reports, Factset

Does Organic Growth Matter?

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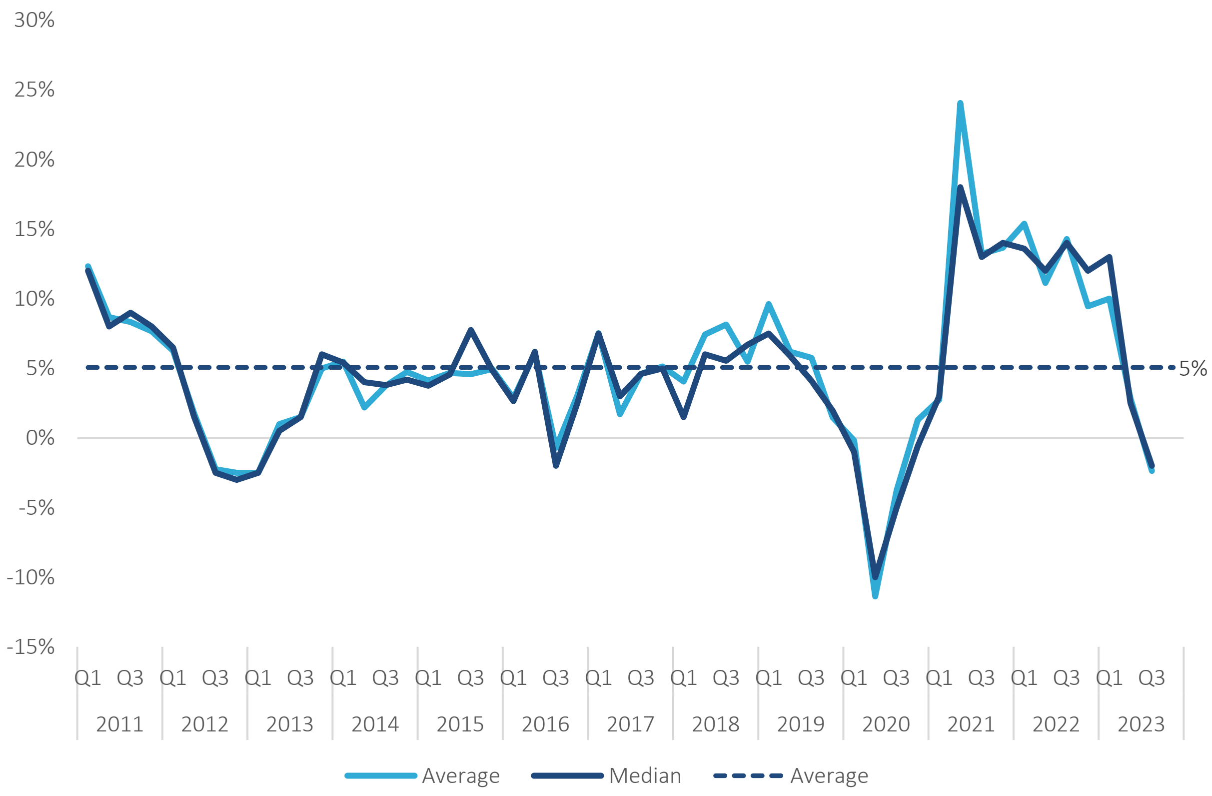
Does Organic Growth Matter?

Organic growth – selected companies*



** Addtech, Addnode, Beijer Alma, Beijer Ref, Indutrade, Lagercrantz, Lifco, OEM, Xano*

Why is organic growth important for an Acquisition-driven Compounder?

Maintaining organic growth over time is crucial as it demonstrates Acquisition-driven Compounders' ability to develop acquired companies.

For Acquisition-driven Compounders it is essential as it shows that the acquired companies continue to develop positively under the new ownership. A strength in a decentralized organization is pushing down the responsibility close to the customers, enriching an empowering environment that leads to continuous growth in the acquired companies.

We believe that overall success is dependent on total growth over the long term. However, organic growth is essential as it demonstrates the strength of many of these companies' decentralized business models, leading to a valuation premium.

Looking at our historical development, the thing that I am most proud of is that we have succeeded in generating organic growth. Doing acquisitions is something that many can do, but achieving organic growth is a proof that you do something that develops companies. Over time I think this is an important way to evaluate if the model is successful.

Niklas Stenberg, Addtech CEO
Stora Aktiedagen Stockholm 29th November 2021

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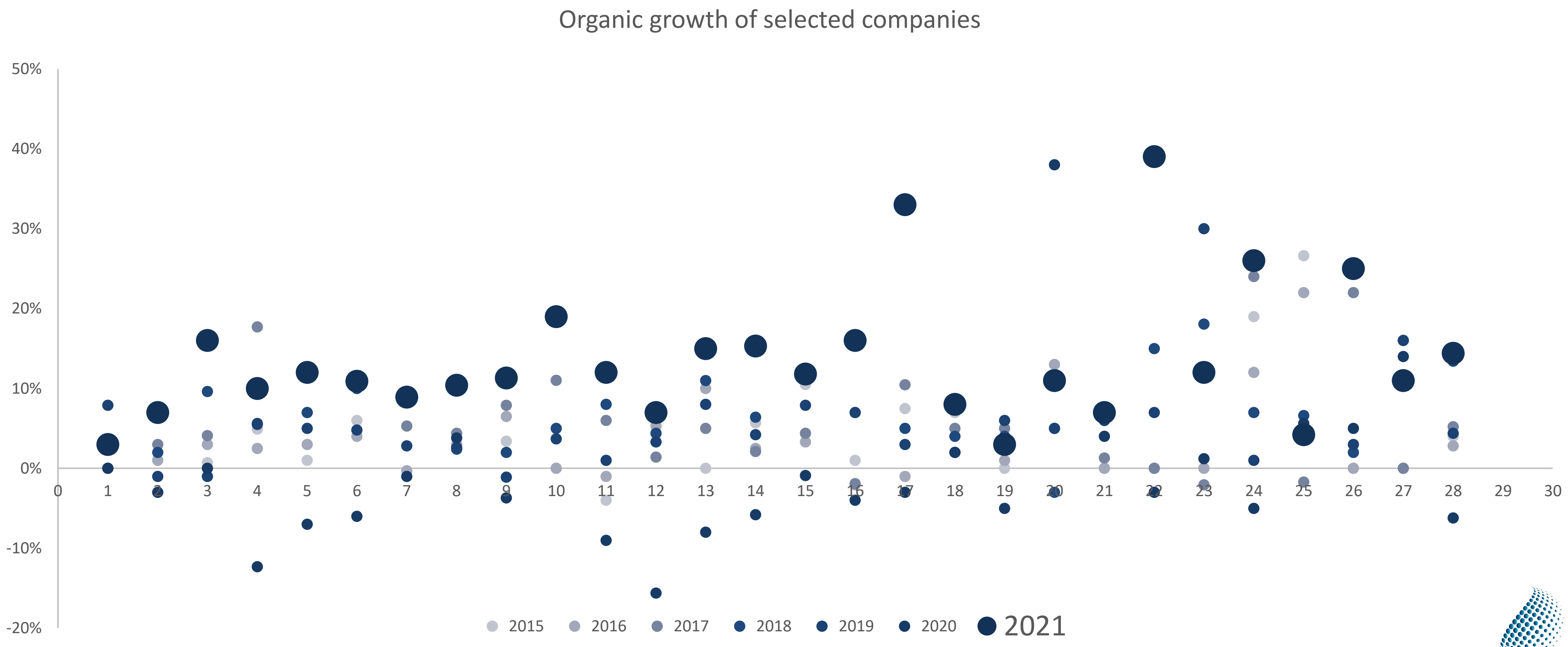
Source: Company reports

Does Organic Growth Matter?

Overall strong level of organic growth

Does Organic Growth Matter?



Source: XANO Industri, Vitec Software, Teqnion, AddLife, Addtech, Atlas Copco, Beijer Ref, Constellation Software, Diploma, Indutrade, Brown and Brown Inc, IMCD, Heico, Halma, Idex Corporation, Lagercrantz, Lifco, Lime Technologies, Sdiptech, AddNode, Boyd Group Services, HMS Networks, Judges Scientific, , NCAB, NIBE Industrier, Roper

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Does Organic Growth Matter?

Does Organic Growth Matter?

An interesting perspective on the importance of organic growth

So why is organic growth important for Indutrade? We have been quite successful in the last years in terms of acquisition growth. Well, as an individual company, I think organic growth is a receipt in terms of that you are credible and you're competitive and you actually deliver value to your customer…

..,and if you don't grow, there is a risk that you stagnate as a company and you're on the same level year after year. And if you don't grow, you can't really recruit new talent and mix your sort of employee group with older experienced and younger energetic persons with different sort of talent so you might become a little bit stale and stagnant. So, I think the growth aspect makes us more attractive also in talent management perspective.

It's obviously accretive in terms of profit and value to provide organic growth. If you continue just to buy companies with low organic growth, it becomes quite a lot of acquisitions you have to do. And I think the organic growth part is also de-risking the strategic perspective of Indutrade as a group. Not being so reliant on the acquisition side, but actually having a professional growth based on innovation and being competitive and balancing that, I think it's making a lot of sense for us to invest time and resource in becoming better and better in terms of organic growth.

Bo Annvik, Indutrade CEO – Indutrade Capital Markets Day November 2022

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All About (Organic) Growth

Does organic growth matter?

Does Organic Growth Matter?

An interesting perspective on the importance of organic growth

From previous CMDs, previous discussions that we said we had the ambition to accelerate our organic growth. We said we grow 3% and how can we now grow 4%? If we have a vertical where we grow 7%, how can we grow 8%, because we said 1% more organic growth in a sustainable way. It's the difference between a good company and a great company. /…/

We believe or we are convinced that continued profitable growth starts with understanding our customers. Product leadership to innovation, where we see innovation as an enabler for everything we do, and also the most important driver for our organic growth"

We focus on organic growth because it creates more value.

Nico Delvaux, CEO Assa Abloy
Capital Markets Day, November 2022

Remuneration and Targets of Organic Growth

Examples of CEOs remunerated on organic growth

Does Organic Growth Matter?

Lagercrantz

"Bonus is based 80% on earnings targets and 20% on return on equity target (P/WC). During the year, the outcome was 81% (78%).

*Also includes **organic growth** bonus up to 10% of other bonus"*

Lagercrantz Annual Report 2022

Assa Abloy

"The variable cash remuneration shall be linked to predetermined and measurable financial targets, such as earnings per share (EPS), earnings before interest and taxes (EBIT),
*cash flow and **organic growth** and can also be linked to strategical and/or functional targets individually adjusted on the basis of responsibility and function. "*

Assa Abloy Annual Report 2022

Lifco

*"The Group and all subsidiaries' goal is to ensure that **organic EBITA growth** exceeds GDP growth in the relevant geographic markets over the course of a business cycle. Additional growth should be achieved through acquisitions"*

Lifco Annual Report 2022

Topicus

*"We believe shareholder value is created by managing two financial components over long term: profitability and growth. As such, our corporate bonus plan, which compensates employees at all levels of our organization, is based upon ROIC and net revenue growth (in the case of Daan Dijkhuizen, **organic revenue growth**)*

Topicus Annual Report 2021

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Case Study: Organic Growth & Capital Allocation

Case study of Lagercrantz & OEM

Does Organic Growth Matter?

2002 figures	Lagercrantz	OEM
Sales	1463	1534
EBIT	27	40
Margin	2%	3%
ND/EBITDA	-0.4x	0.6x
Market Cap (year-end)	620	510

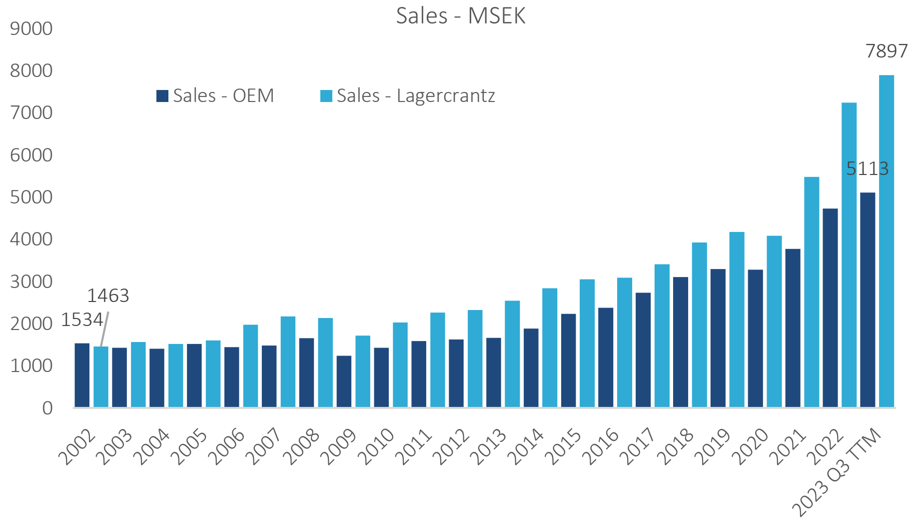
As we have stated, organic growth is important for an acquisition-driven compounder, but how important is organic growth to acquired/total growth?

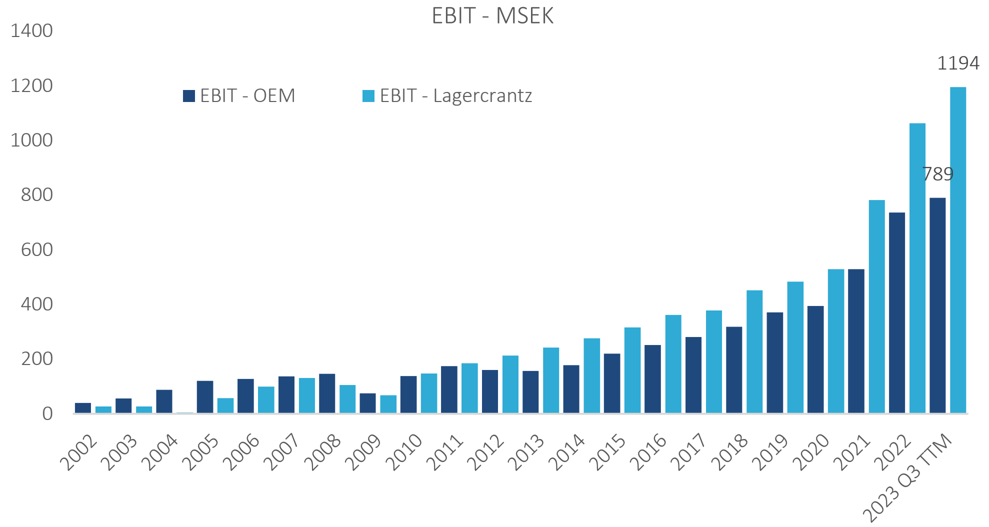
We will on the coming slides compare two companies with the same starting point (in terms of sales/EBIT) in 2022; Lagercrantz & OEM International.

In this case study we will look at some of the success factors behind both companies.

Looking at 2002 financials, we can see that both Lagercrantz and OEM were similar in both size and market cap.

Since 2002, Lagercrantz has grown sales with a CAGR of 8.6% and EBIT with 20.3%. The same for OEM is sales CAGR of 6.0% and EBIT CAGR of 15.7%.





Source: company reports

Case Study: Organic Growth & Capital Allocation

Case study of Lagercrantz & OEM

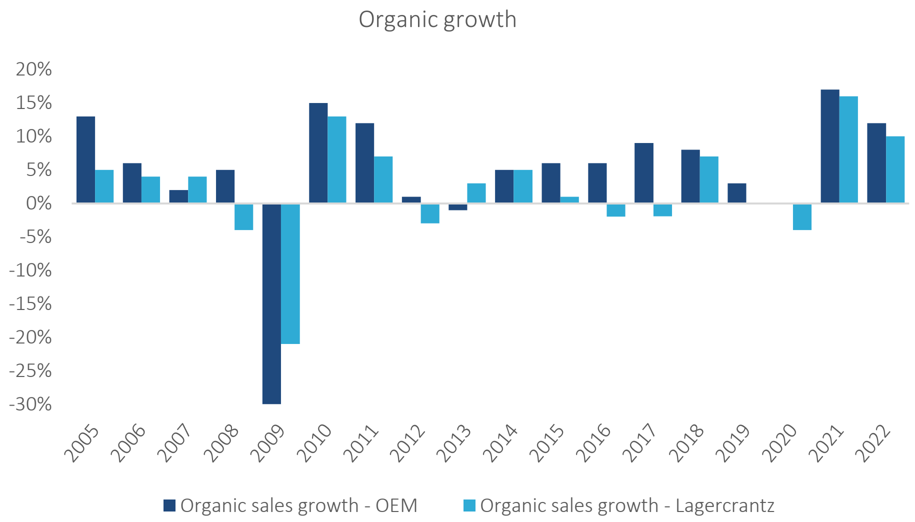
Does Organic Growth Matter?

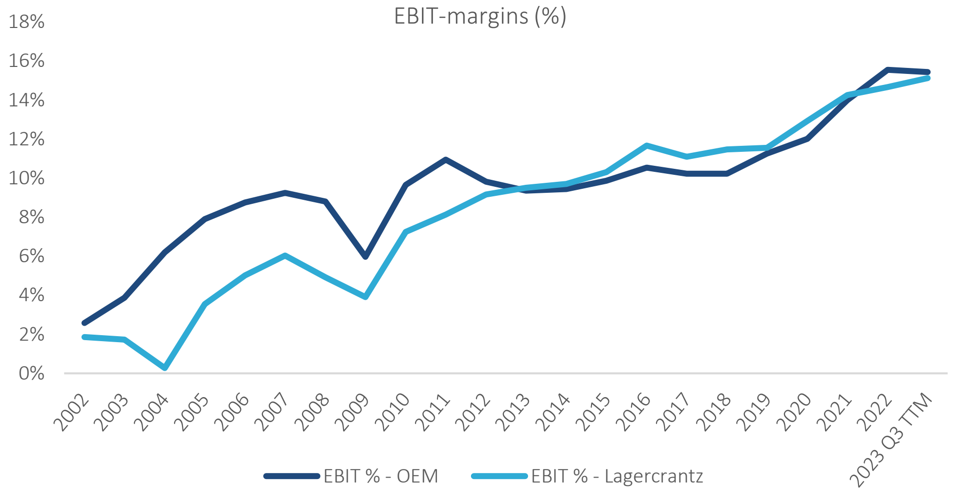
If we look at the margin development of Lagercrantz and OEM, we can see that margins have developed in a similar way from 2002 – 2023 Q3 (trailing twelve months).

However, underneath the surface lies two somewhat different strategies for growth and increasing margins.

While OEM has had a larger focus on organic growth, Lagercrantz has historically put emphasize on inorganic growth. As of 2017, we have however noticed a larger focus from Lagercrantz on organic growth as well. The conviction in driving organic growth is visible through the CEO's and business areas managers' compensation scheme as they are compensated on organic growth.

OEM's and Lagercrantz's organic growth on average since 2005 is 5% and 2%, respectively. We estimate that c. 60% of OEM's growth during this period is organic, compared to 25% for Lagercrantz.





Source: company reports

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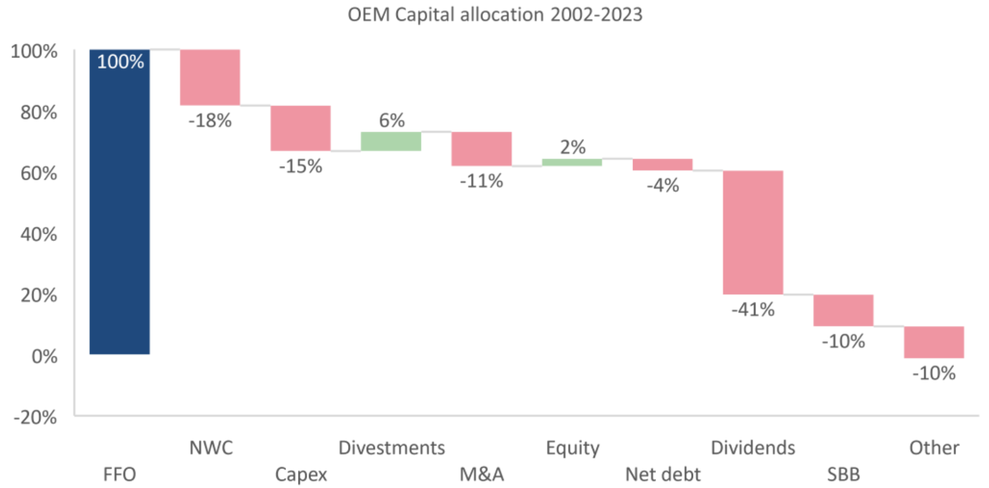
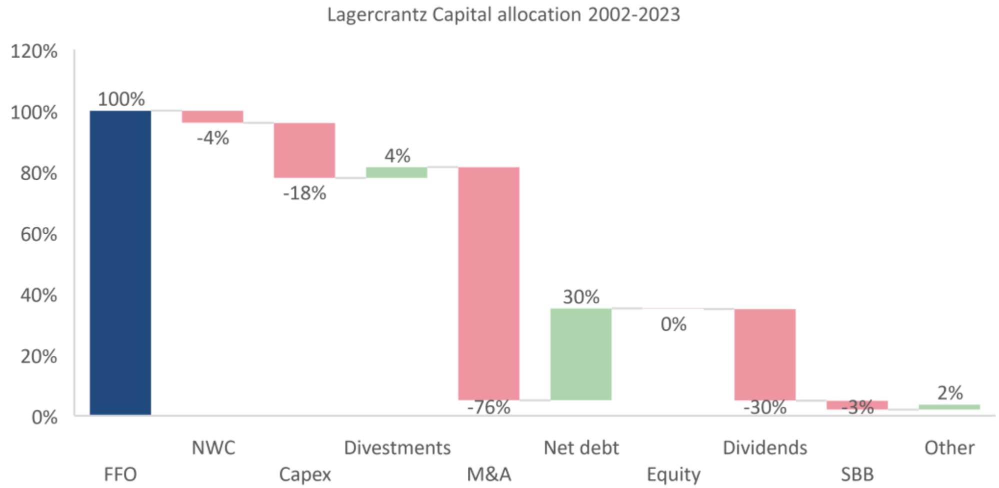
Case Study: Organic Growth & Capital Allocation

Case study of Lagercrantz & OEM

Does Organic Growth Matter?





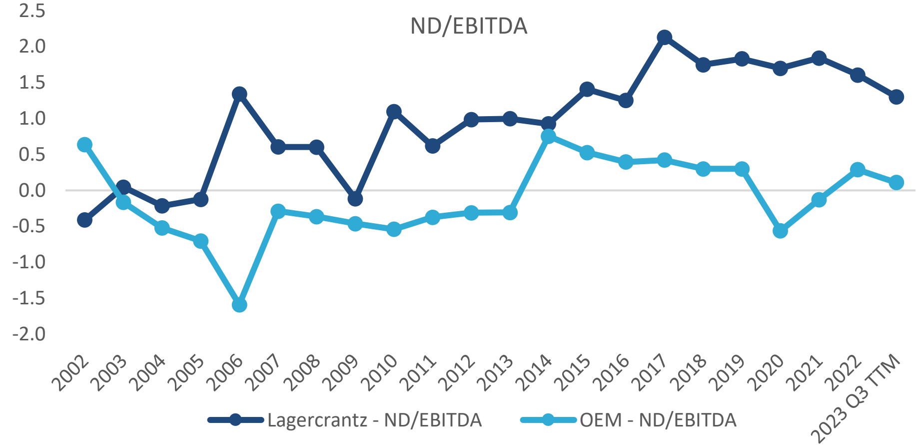
The difference in focus on organic and acquisitive growth is also visible through their capital allocation strategies during this time.

Comparing the capital allocation of OEM and Lagercrantz from 2002 – 2023, we can see that Lagercrantz has spent around 76% of FFO (funds from operations) on acquisitions, while OEM only has spent 11%.

However, OEM has spent 18% of its operating cash flow on NWC, compared to 4% for Lagercrantz, emphasizing the difference in growth priorities.

We also see differences in how capital to shareholders is distributed; OEM has through dividends and share buy-backs distributed c. 50% of its operating cash flow to shareholders while Lagercrantz has distributed c. 33%.

Even though Lagercrantz spent 76% of its cash flow on acquisitions and distributed 30% to shareholders, the leverage is still within levels we deem sound. OEM has mostly operated with very low leverage / net cash position.

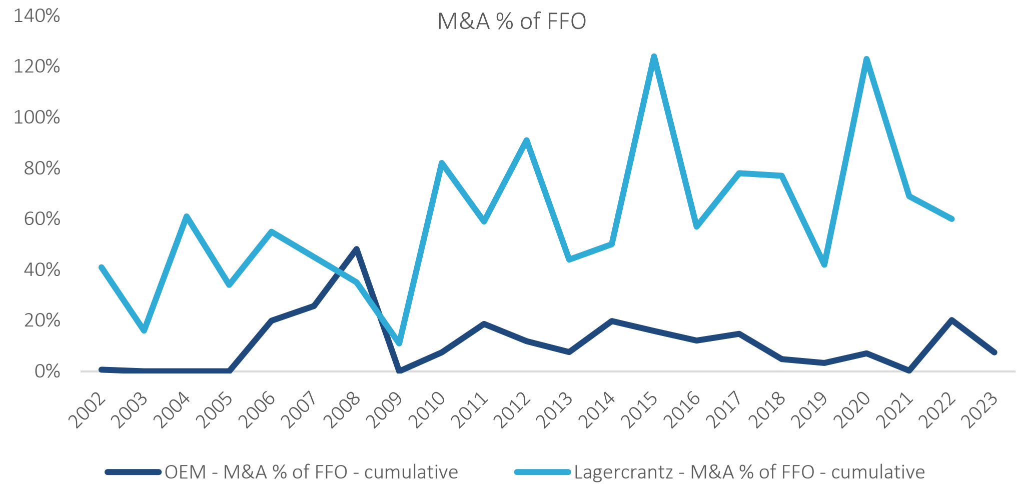


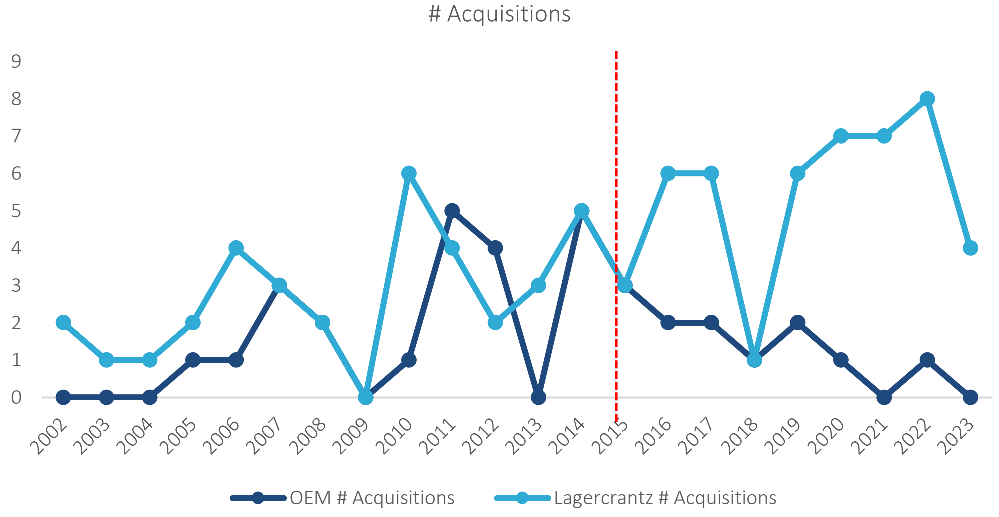
Source: company reports

Case Study: Organic Growth & Capital Allocation

Case study of Lagercrantz & OEM

[Does Organic Growth Matter?](#)





As we displayed on the previous slide, Lagercrantz has spent more on acquisitions than OEM, which is also visible on an annual basis.

Charts to the left show annual spend on acquisition in percent of operating cash flow as well as annual no. of acquisitions completed.

Up until 2015, Lagercrantz and OEM completed the same no. of acquisitions. We estimate the average deal size to be around SEK 10-20m for OEM and SEK 50m for Lagercrantz, hence Lagercrantz conducting somewhat larger (still small) acquisitions compared to OEM.

As from 2016, the different strategies became more apparent as Lagercrantz continued to acquire companies (and increased the pace somewhat) while OEM decreased focus on acquisitions.

So, why does this matter?

Source: company reports

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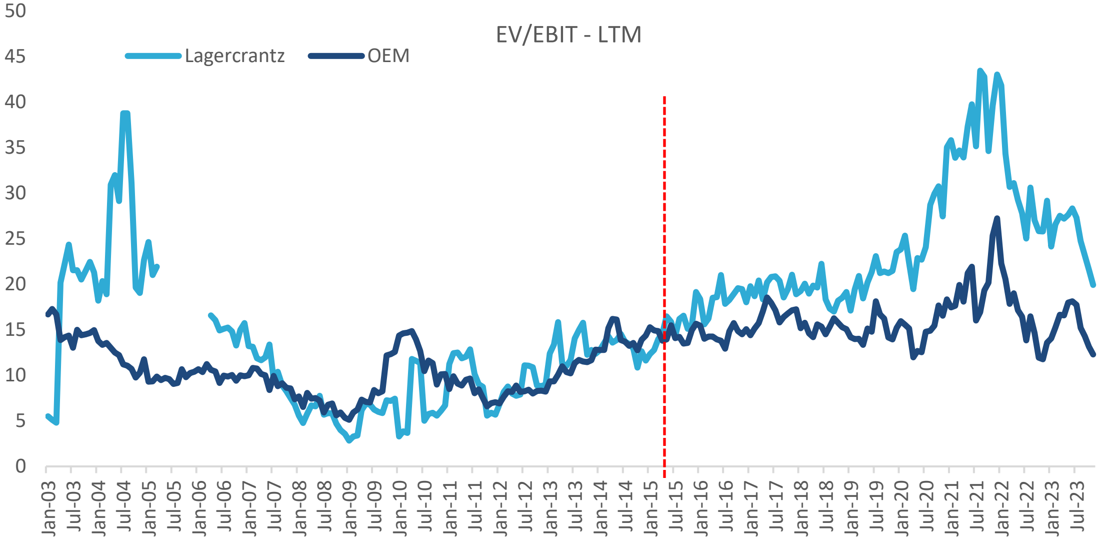
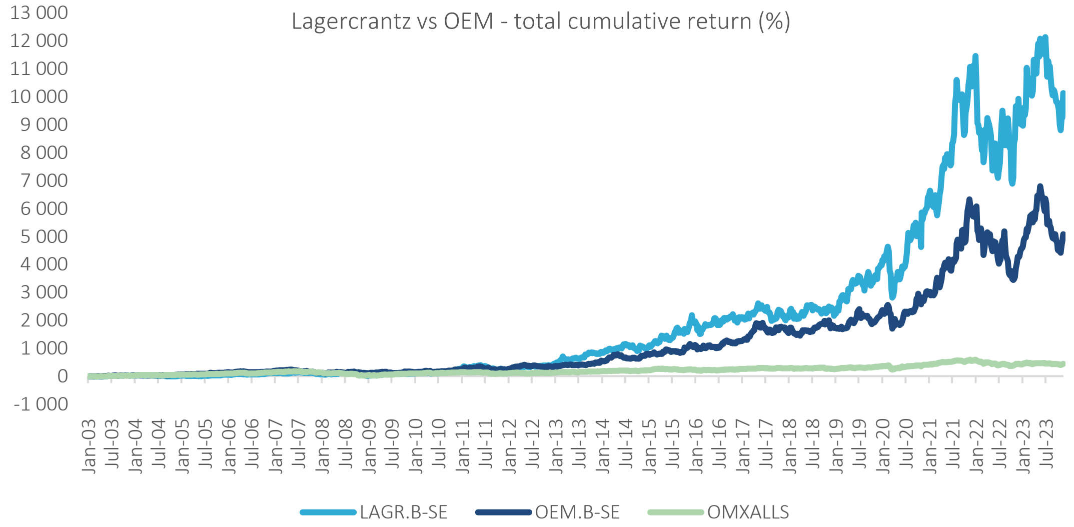
Case Study: Organic Growth & Capital Allocation

Case study of Lagercrantz & OEM

Does Organic Growth Matter?





It matters because the market started to change the perception of Lagercrantz in 2015 compared to OEM.

The chart displays EV/EBIT for these two companies over 20 years - and Lagercrantz was valued on par with OEM up until 2015.

This has led to a total TSR-outperformance (reinvested) from Lagercrantz compared to OEM. and it mainly started as from 2014/2015.

From the end of 2002 up until yesterday - Lagercrantz has produced a TSR of 10,000%, compared to 5,000% for OEM, if all dividends were reinvested.

OMXSALLS (OMX Stockholm Allshare, not reinvested) has during the same period produced a return of 400%, which means that both companies have far outperformed the broad stock market.

Source: company reports & Factset

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Case Study: Organic Growth & Capital Allocation

Case study of Lagercrantz & OEM

Does Organic Growth Matter?

What conclusions to draw from this case study?

As previously emphasized, organic is important for the overall equity story. OEM serves as a compelling illustration, demonstrating its organic tool kit being powerful for delivering shareholder returns when coupled with the expansion of profit margins while maintaining a prudent approach to risk.

However, achieving superior returns as an acquisition-driven compounder necessitates a sustained focus on acquisitions. The combined impact of these dual growth engines can be powerful, given that the execution is thoughtful and has a balanced view on risk.

In the preceding slides, we presented the margin expansion, noting their similar development – some through acquisitions and others through organic growth. Reflecting on this, it becomes apparent that market perceptions of margins may not always differentiate between organic and acquired.

Nevertheless, suppose a company displays zero or negative organic growth while its peers can drive organic growth. In that case, the market may question the organization's internal dynamics, potentially leading to distinct differences in valuation.

In conclusion, organic growth is essential, especially when compared to peers. However, to excel as a successful acquirer, maintaining a consistently effective M&A engine and a prudent approach to capital allocation and risk management is essential.

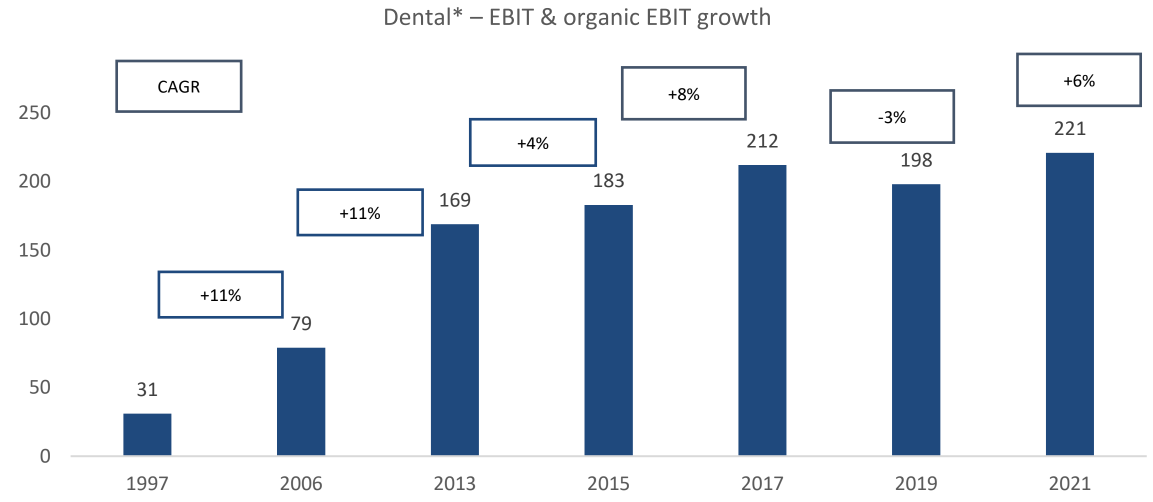
It is crucial to clarify that a prudent view of risk does not imply avoiding leverage altogether; at times, the opposite may be true to maximize returns. Examining the practices of successful acquisition-driven compounders reveals a consistent adherence to leverage levels, typically ranging between 1-2x and never exceeding 2.5x EBITDA.

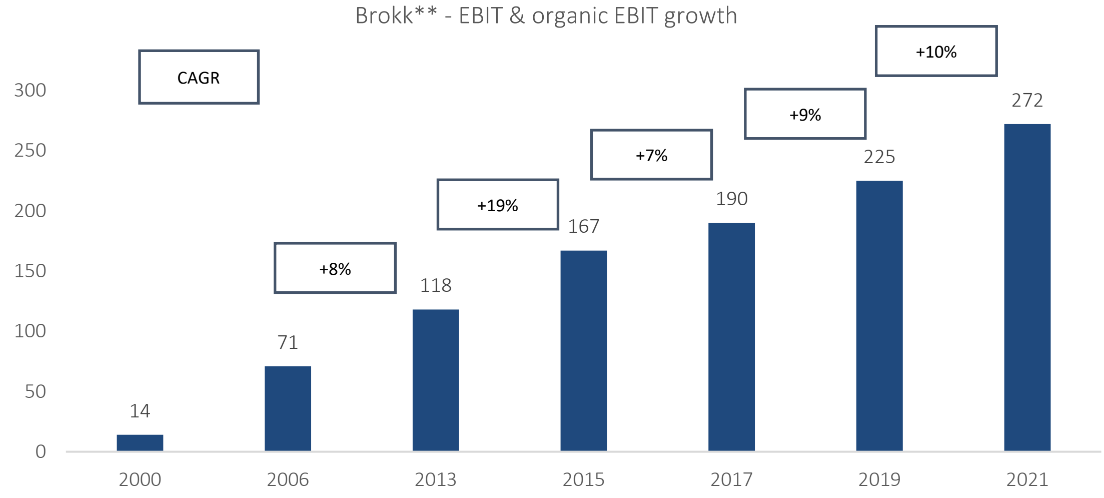
A company aligning with these criteria stands to be rewarded over time with higher multiples, mirroring the success of Lagercrantz and other similar companies, leading to outstanding shareholder returns in the long term.

All About (Organic) Growth - A Snapshot of Lifco

Organic EBIT-growth for companies acquired 1998 / 2000

Does Organic Growth Matter?





- The charts to the left display the organic EBIT growth for acquired companies in 1997 (Dental companies) and 2000 (Brokk AB). By displaying this Lifco want to show how they have grown some of the portfolio organically with a long-term focus on improvements in acquired companies.

- Following from Lifco's 2021 Q4 Conference call: Dental: "…we had very strong development through the first 15 years up until 2013. Basically, doing a lot of operational improvements in the subsets of the portfolio.."

- Brokk: "Here you can also see that this is one example of very long-term focus on gradually developing business from organic improvements, both improving margins and sales…".

- Despite its strongly decentralized organization Lifco still focuses on improving the acquired companies over time. On this matter they say that "We try to follow these examples from very, very long time perspective…"

Source: Lifco 2021 Q4 deck

* Companies included: Nordenta, DAB Dental, Dansk Nordenta, LIC Scadenta and Directa. Directa's sales have been adjusted for the effect of asset and liabilities acquisitions.
** Refers to Brokk AB.

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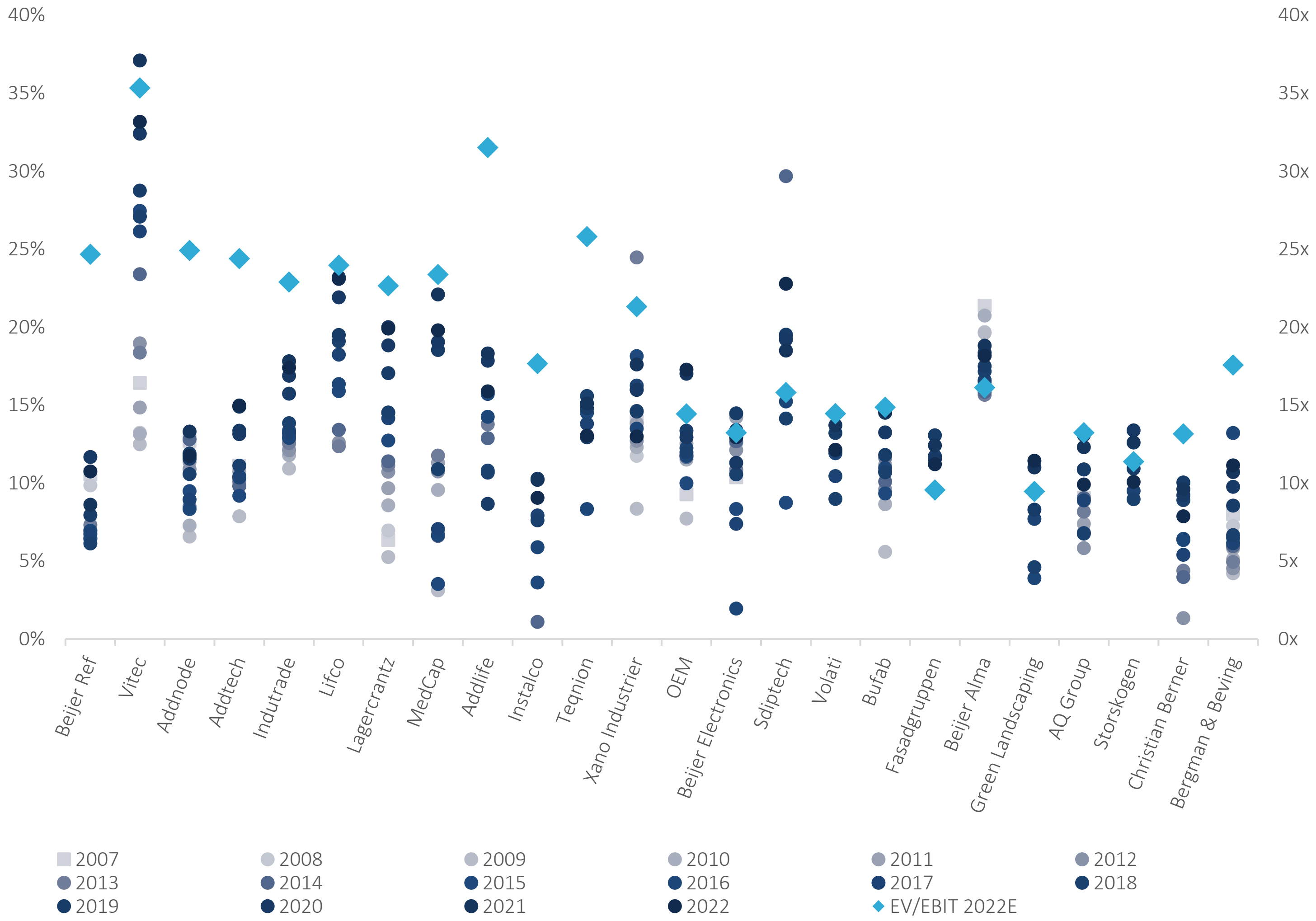
Stable and Increasing Margins Rewarded by the Market

Does Organic Growth Matter?



- Companies with stable or increasing margins have on a general level higher valuation (EV/EBIT) than companies with more volatile margin profiles.
- Margins as such do not play a role in terms of valuation between companies (as long as they are not too low), but rather the stability provides valuation resistance.
- Our experience is that it does not always matter if the margin delta is acquired or organic, what matters is that it is stable/increasing.
- We also see that the stock market rewards sustainable margins.

Source: Company reports & Factset 2023-12-01

Business Systems

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The Superinvestors of Bergman & Bevingsville

"The Superinvestors of Graham-and-Doddsville" originated as an article by Warren Buffett in the fall 1984 issue of Hermes, Columbia Business School magazine*. In this piece, Buffett highlighted a group of investors whose guiding principles were deeply embedded in the traditions of Graham and Dodd. Despite pursuing diverse paths and selecting different stocks, all these investors adhered to the fundamental principles of value investing. The outcome was a series of investing track records that defied randomness.

In drawing a comparison, the ecosystem associated with the Bergman & Beving sphere in Sweden, encompassing its various spun-out companies, adheres to a common set of principles crucial for their success as independent entities. Much like the investors in Buffett's narrative, these companies operate with a shared ethos, marked by two notable characteristics: a dedication to decentralization and a dedication to self-financed growth through simple profit goals, allowing each individual within the system to make a meaningful impact. Numerous successful acquisition-driven compounders find inspiration in the notable influence of the Superinvestors of Bergman & Bevingsville.

Founded in 1906 by Arvid Bergman and Fritz Beving, Bergman & Beving prioritized decentralization and simplicity. Initially operating as a technical trading company in Sweden, the company implemented a decentralized structure, distributing responsibilities among the original shareholders. The acquisition journey began in 1967 with Lagercrantz, leading to nearly 200 acquisitions by the year 2000, primarily in the 1980s and 1990s.

Copyright: Momentum Group AB

According to Ronald Fagerfjäll, the author of a book chronicling the Börjesson family**, the Bergman & Beving story starts with Arvid Bergman, a Swedish student from Norrköping who studied electrical engineering in Germany. There, he crossed paths with his German peer, Fritz Beving, in the 1890s. Their collaboration strengthened during pre-World War I European trade, shaped by the industrially expansive German Empire. In October of 1906, after engagements at Brown Boveri, a Swiss group of electrical engineering companies, they moved back to Sweden and founded a trading company. This marked the inception of Bergman & Beving, a trading company focusing on importing technological products for the industrial sector in Sweden. The company thrived despite war challenges and the founders' demise in the 1950s.

In the 1960s, amid family business pessimism where many small and medium-sized businesses were for sale at attractive prices, Bergman & Beving pursued acquisitions. Notably, the first subsidiary and the first foothold in the electronics technology field was Johan Lagercrantz in 1967. The trading firm established by Johan Lagercrantz in 1938 was dedicated to dealing with components and equipment right from its inception. The company was a trading firm with notable brands like General Radio and Du Mont, which were renowned for their oscilloscopes during that era.

Moreover, in the early 1940s, Bergman & Beving also took a significant step into the life science sector by signing an agreement with Radiometer, which laid the foundation for many more companies to come within the Lab and Diagnostics market areas, and ultimately Meditech, which was formed in 1997 as one of four divisions within Bergman & Beving. In 2005, Addtech acquired parts of the MediTech business area from B&B Tools (formerly Bergman & Beving) and formed the life science business area. In June 2015, Medtech was acquired, and in connection with this, the AddLife Group was formed and subsequently listed in 2016.

At the time of the public listing in 1976, Bergman & Beving only had sales of 167 million SEK and a pre-tax margin of 5%. During the 1980s, the group had distribution rights for over 300 companies and had over 50 subsidiaries. By the year 2000, the group had done nearly 200 acquisitions, primarily in the 1980s and 1990s. Many of these acquisitions involved family-owned trading companies that continued to operate under their existing names. However, intensified competition emerged with the expansion of the European Union, which allowed for parallel imports. The evolution of the market landscape, coupled with the growing commoditization of some distributed products, significantly impacted trading companies like Bergman & Beving. The ensuing challenges prompted a shift towards niche-oriented companies and emphasizing value-add beyond mere distribution.

Significant changes took place in the 1980s and 1990s when Tom Hedelius, the CEO of Svenska Handelsbanken, became chairman in 1982. In 1990, Anders Börjesson from Tisenhult-gruppen became the first external CEO. Börjesson, who had been part of the management team since 1979, had a deep understanding of the organization. This move marked a shift in Bergman & Beving's management strategy since the company had only had four CEOs over the past 84 years, all of whom had been significant shareholders. Börjesson together with Torsten Fardell launched the profit over working capital metric (P/WC), became CEO in 1990 and stayed with the company until 2001. Metrics like P/WC has stood the test of time for over 40 years. It continues to serve as a foundational guiding tool within the entire ecosystem of spun-out companies, influencing all aspects of business operations and acquisitions.

According to an interview with Pär Stenberg, the CEO preceding Anders Börjesson, internal academies and tools like P/WC, played a significant role in “transforming engineers and individuals from non-sales backgrounds into proficient sales professionals”, ultimately shaping a company to become the “Bergman Ideal”**.

In 2001, Anders Börjesson and Tom Hedelius divided Bergman & Beving into three separate companies. The aim was to highlight the company's underlying values and enable each entity to focus on growth as individual units. (Continued)

The Industry business area was formed into a new entity called Addtech, while the Electronics business area formed the Lagercrantz Group. The remaining companies evolved into the legacy Bergman & Beving. Since 2001 to today, both Lagercrantz and Addtech has generated more than 20% TSR CAGR. Subsequently, Bergman & Beving adopts the name B&B Tools, refocusing its operations to specialize in the sale of industrial consumables, including tools, machinery, protective and safety equipment, as well as various industrial components such as ball bearings, seals, transmissions, and automation.

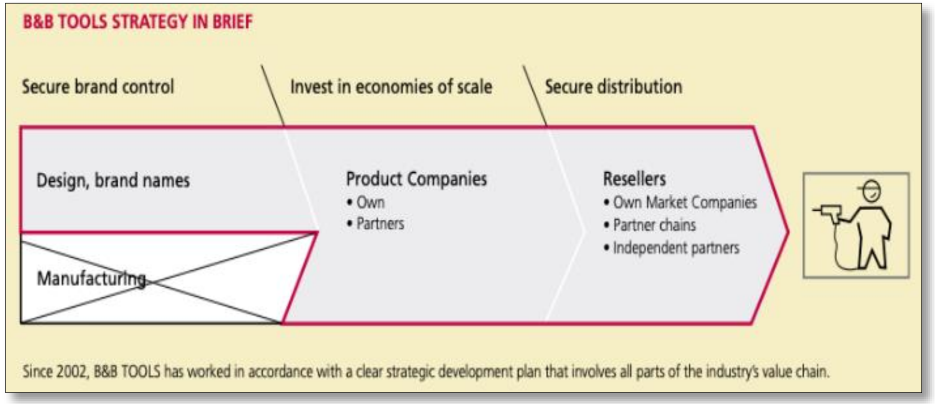
The Centralization Experiment

After spinning off Lagercrantz and Addtech in 2001, B&B Tools deviated from its established DNA of decentralization. In pursuit of efficiency gains and economies of scale, the company aimed to transition into one company, despite a century-long track record of successfully implementing decentralization. This marked the beginning of a decade-long experiment with centralization, hoping to extract synergies by integrating product companies with wholesale and the many reseller entities they bought and integrated.

While the anticipated efficiency gains appeared promising on paper, they failed to materialize in practice. In 2017, B&B Tools underwent a significant restructuring, resulting in the spin-off of Momentum Group. Consequently, B&B Tools reverted to its original name, Bergman & Beving.

This restructuring involved separating the value chain, with B&B Tools retaining wholesale operations and product companies, while Momentum Group took charge of the technical trade businesses (serving machines) as well as industrial supplies, tools, and workwear (serving humans).

In 2021, Alligo emerged as the "old" Momentum Group, offering products and services in tools, supplies, workwear, personal protective equipment, workplace equipment, and product media. Subsequently, in 2022, a new spin-off occurred, establishing the "new" Momentum Group, representing the former Components & Services business areas (primarily through Momentum Industrial AB). An alternative perspective on these changes is that the initial spin-off from B&B Tools involved the restructuring of the value chain, while the subsequent spin-off in 2022 focused on dimensions within the product portfolio.



Source: B&B Tools 2002 Annual report

*https://www8.gsb.columbia.edu/sites/valueinvesting/files/files/Buffett1984.pdf
**Tisenhult – Grundaren, familjen och foretagen (Ronald Fagerfjäll)

Profit Over Working Capital

Even in its nascent stages, the Bergman & Beving Group had a distinct focus on profitability. The organization pursued ambitious growth targets while adopting a profitability benchmark, which involved maintaining profits divided by working capital (P/WC) at levels exceeding 45%. Put simply, every dollar allocated to net working capital must produce a return surpassing 45%, akin to the mindset behind Buffett's $1 Test, if you will. As we will illustrate, this target has not only generated a self-sustaining business model but has also provided steadfast resilience to navigate the vicissitudes of the business landscape since it was introduced.

The Money's-Not-Free-Approach to Value Creation

The Profit/WC metric was introduced in 1981 when Anders Börjesson joined the management team of Bergman & Beving. Börjesson's exploration of business strategies and industry trends influenced the concept of an asset-light focus, which serves as the foundation for the return on working capital metric. During his studies, Börjesson discovered the benefits of an asset-light approach commonly used by successful entrepreneurs. This approach became particularly relevant for privately held firms facing a wealth tax on their net assets. Börjesson drew inspiration from entrepreneurs like Ingvar Kamprad (founder of IKEA) and Erling Persson (founder of H&M), who had successfully navigated similar challenges by adopting an asset-light strategy*. Motivated by their experiences, Börjesson together with Torsten Fardell, further explored and implemented the asset-light focus, leading to the development and utilization of the P/WC ratio.

Addtech, along with Lagercrantz, was spun out from Bergman & Beving in 2001. They have their own internal book called "The Mind and the Soul" (translated as "Tanken och själen" in Swedish), which outlines the company's fundamental business principles. This book is distributed to all employees and is relatively short, consisting of approximately 80 pages. Its purpose is to explain the company's culture, strategy, and how value creation is implemented at Addtech. The book is written in a way that every employee can understand, providing practical examples to illustrate the fundamental principles. One key focus is the P/WC metric, which demonstrates how every Addtech employee can contribute to returns.

Similarly, Momentum Group has its own book called "Entrepreneurship to Achieve Increased Profitability - Objectives and Tools to Achieve P/WC > 45%" (translated from Swedish to English). This book is an easy read of 45 pages.

According to the Superinvestors of Bergman & Bevingsville, a business is considered self-financing when the return on working capital (EBITA/WC) is higher than 45%. By achieving an EBITA/WC > 45%, the business can generate the necessary cash to cover taxes and make required investments in its existing business through capital expenditures, growth, and dividends. The goal of being self-financed means that growth, whether organic or through acquisitions, will not dilute current shareholders through equity raises or rely heavily on debt financing. This highlights the importance of capital efficiency in generating cash. (Continued)

Profit Over Working Capital

Case Study

Originally, the goal of exceeding the 45% target was set during a period when tax rates were higher. It was meant to cover one third tax, one third dividends, and one third growth (15% yearly growth measured over a business cycle, split between organic growth and acquisitions).

To analyze whether aiming for a target of 45% or more results in a self-sustaining business model, let's consider a scenario with no debt, a 20% tax rate, a payout ratio of 30%, and a 15% growth target. Half of the growth is acquisitive, requiring a 5x EBIT multiple paid, while the rest is organic. It is important to note that this analysis assumes no maintenance capex, only investments in working capital for growth. This exercise supports the idea that a 45% investment in working capital can indeed create a self-sustaining business.

Sales		100
Operating income		9
Net Working Capital		20
Profit/Net Working Capital		45 %
Tax		2
Dividends		3
Investment in acquisitions		3
Investment in organic growth		2
Free cash flow	-	0,4

Why use working capital instead of invested capital in the denominator? A trading or value-add distribution company, like those under B&B, primarily relies on working capital rather than fixed assets, which are often outsourced. This is why Profit over working capital serves as a suitable proxy for trading companies and an effective measure of overall capital return.

The P/WC ratio can be divided into 2 main parts, which can be further broken down into 6 distinct metrics: 3 metrics related to the profit (numerator) - sales, price, and cost base, and 3 metrics tied to the denominator (WC) - inventories, receivables, and payables. Profit can be calculated by dividing EBITA (Earnings Before Interest, Taxes, and Amortization) by Sales and then dividing that result by Net Working Capital. This simplification occurs because the "Sales" term cancels out when multiplying the two fractions together.

Profit is determined by the formula:
Profit = (EBITA / Sales) x (Sales / Net Working Capital)

This can be further broken down to:
Profit = (Sales x Margin) - Cost x Inventory + Receivables - Accounts payable

(Continued)

Profit Over Working Capital

Case Study

Let's apply this with another example. Suppose we have Company A generating 9% operating margins, which is typical for a trading business, offering value-added services to customers. Additionally, the business maintains a net working capital of 20, resulting in a P/WC ratio of 45%. To boost the profit ratio, there are six levers to consider. You can either increase sales, raise prices, or reduce costs. Each lever affects working capital differently, and the same applies to the working capital, which is the denominator in the P/WC KPI.

The easiest way to decrease working capital is by reducing inventory, speeding up customer payments, and extending supplier payment terms. These are aspects that every senior management team in large corporations focuses on. Employees in the group companies are encouraged to foster strong relationships with the right customers and suppliers and to have a solid grasp of inventory levels. Essentially, this framework both educates and heightens awareness about excelling in sales. It imparts valuable lessons on prioritizing customers, nurturing relationships following the 80/20 rule, adopting value-based pricing, and comprehending the consequences of providing discounts. These last two choices can result in significantly divergent cash flow outcomes.

Let`s focus on the working capital lever and more specifically receivables. Suppose a new company becomes part of the group, Company B, which historically hasn't been mindful of receivable days. After joining the group, they discover that similar companies in the group typically have receivable days of only 50, not 73. By reducing their receivable days, P/WC increases to 65%, resulting in a favorable impact on cashflow when growing and hence the ability to be self-funded**.

	Company A	Company B
Sales	100	100
Operating income	9	9
Margin	9 %	9 %
Inventory	10	10
Receivables	20	14
Accounts payable	10	10
Net Working capital	20	14
Receivable days	**73**	**50**
Profit/Net Working Capital	45 %	65 %

Small adjustments like these, continuously improved upon, create a positive feedback loop that enhances cash conversion, strengthens resilience, and increases the company's self-sufficiency for growth, ultimately leading to long-term value creation for shareholders. The best-in-class companies excel in sharing best practices across multiple levers simultaneously. They successfully boost cash flow and achieve substantial organic growth without resorting to coercive measures that could stifle the entrepreneurial spirit within their operating companies. This balance is a delicate equilibrium that can only be created through experience.

The Focus Model

Aiming for a P/WC ratio of 45% or higher is one aspect, and the companies emerging from Bergman & Beving, including Bergman & Beving itself, adhere to an internal benchmark known as the "Focus Model." This model essentially serves as a prioritization tool applied to all operating companies within the group, and their performance is evaluated accordingly. (Continued)

Profit Over Working Capital

Case Study

Business Systems

The Focus Model*** for Different EBITA/WC levels is as follows:

•Above 45%: Increase profits through revenue increases (organic and acquisitions)
•Below 25%: Increase margins!
•25-45%: Increase margins and working capital turnover for "proof of concept."

The P/WC ratio serves various purposes, such as assessing operating units, evaluating product performance, analyzing markets and customers, and even as a tool for assessing acquisitions, whether they are substantial or smaller bolt-on additions. Moreover, it is aggregated and measured at the group level. Ultimately, all employees receive incentives based on this profit ratio.

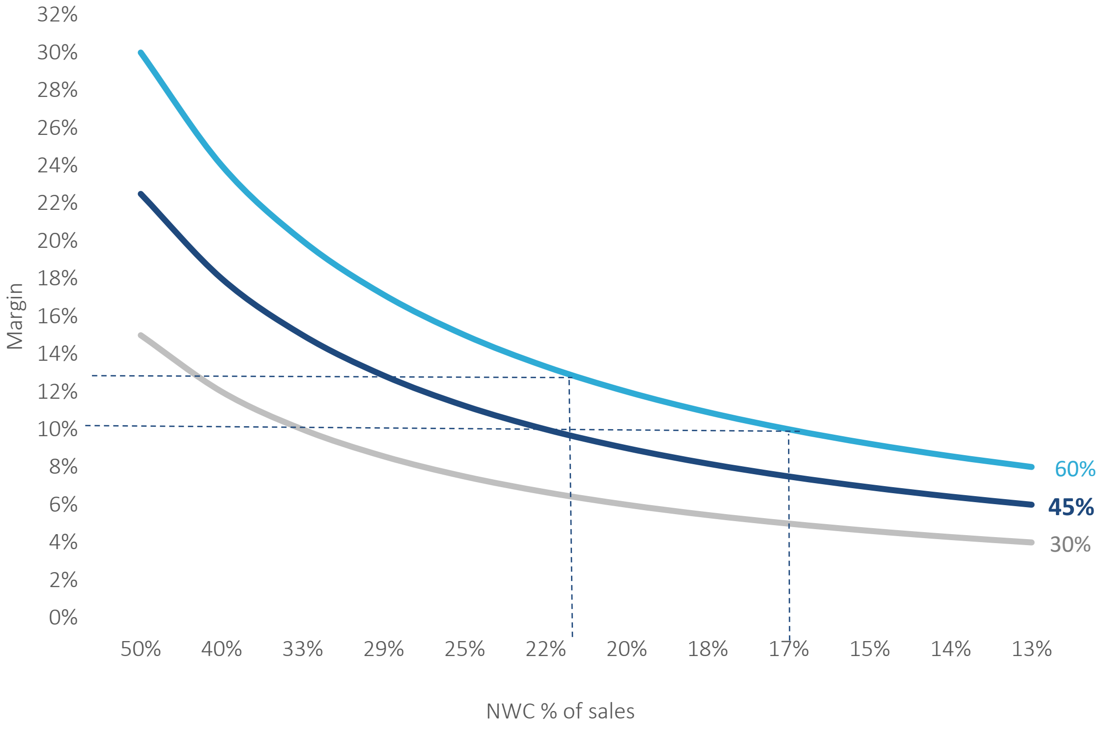
The overarching goal is for all employees to easily grasp and see the measurable impact on financial performance, which is quite different from aggregated accounting metrics that aren't as relatable. This theme is prevalent among the best-in-class companies, emphasizing straightforward profit objectives that genuinely make a difference, often tied to smart incentives. The recurring lesson from these top performers is to avoid unnecessary complexity. It's about establishing an internal language that resonates, especially with small business owners who may have engineering backgrounds and might not be well-versed in financial or sales terminology.

*Bergman & Beving to Addtech, a best-in-class serial acquirer and Tisenhult – Grundaren, familjen och foretagen (Ronald Fagerfjäll)
**It's worth noting that while both margins and turnover have a similar impact on the profit-to-net working capital ratio, increased margins have a more significant effect on cumulative cash flow compared to equivalent increases in capital turnover.
***From presentation material by Momentum Group AB

Profit Over Working Capital

Deconstructing the P/NWC business system

Business Systems



The left-hand chart illustrates different Profit/NWC indifference curves.

P/NWC >45% represents a self-financed model i.e. companies can finance both organic growth, acquisitions and dividends with internally generated cash flows.

The chart displays that different margins levels and capital turnover can provide the same cash returns.

The calculations also reveal that margin improvements contribute more to higher P/NWC than capital turnover.

Our example shows that for a company to increase P/WC from 45% to 60% - it can either raise margins by 3.0 percentage points, from 10% to 13%, or decrease NWC to sales with 4.5 percentage points, from 21.5% to 17%.

Acquisition-driven compounders, acquiring companies with potential to increase margins, will enjoy a substantial improvement in P/NWC, all else equal.

** All positions on a line give the same Profit/NWC.*

Source: REQ calculations for illustrative purposes

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Danaher Business System

The Kaizen Approach: Continuous Improvement

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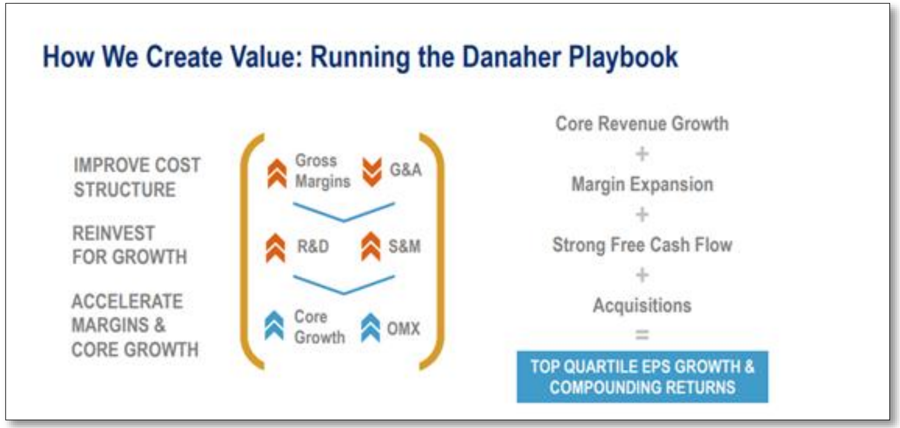


Every department, every OpCo, every site, every platform is running to around seven different key performance indicators and it is really broken down from the strategy to the policy deployment to the daily management. Everybody sticks to this, every single day. Certainly, one part of the DBS culture is also to make things transparent and to make things ugly. For example, we always said that red is the new green.

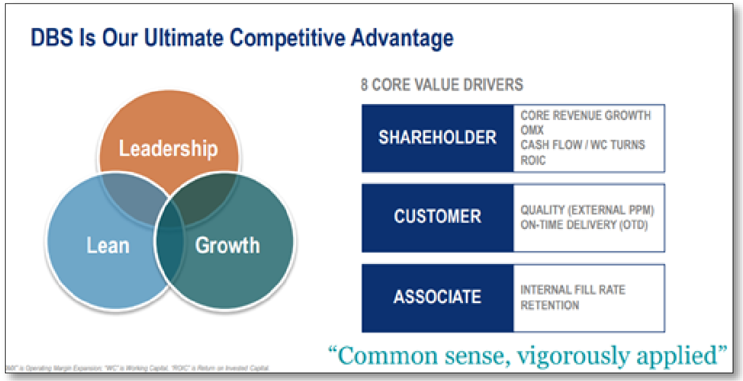
We put some targets out and if you have reached the targets and you become green in all of them, we skip the targets, go to the next level so that, more or less, everything is red again. This brings a lot of pressure to the people and a lot of folks can't really deal with this.But I don't think it's so bad because you have constant improvement. It is also very dependent on the site leader or OpCo leader as to how you really deal with these things. They need to explain to the people that red is nothing bad, but it is a chance, an opportunity. Therefore, they really have to embrace the culture because, as they were brought together, they bring in their old culture and, in the old culture, red was something negative

Bruno Meinhardt, Former Director at Danaher, InPractise interview 2020

Culp came to understand that DBS worked better with businesses with a high gross margin, especially those with a big spread between gross and operating margins. The wider the spread, the more opportunity for Danaher to take costs out with DBS. Culp had learned through operating experience that it was easier to improve the gross margin of a high-margin company versus a low-margin one.

Low margins usually meant that customers saw the product as low value. Culp's judgment ran against the consensus view, as M&A bankers and business schools often presented low-margin businesses as opportunities, particularly for those good at taking out costs.

Lessons from the Titans: What Companies in the New Economy Can Learn from the Great Industrial Giant



Roper: Cash Return on Investment

«CRI»

Business Systems

Zero-cost budgeting and smart profit goals rooted in cash flow

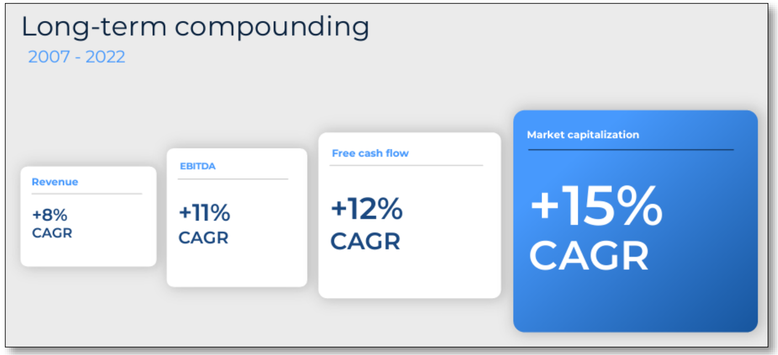
What's different under the Roper model versus prior to Roper, it's really that CRI model is very simple. Whenever you look at it from prior years, before 12 years ago, before part of the Roper company, we were working of annual budgets, annual forecasts. And as long as you were meeting that forecast, you were okay. We didn't look at it from a CRI model. We had a lot of investment in products. We would go chasing down rat holes that, at the end of the day were not -- didn't return the cash to us that we would like to see.

Tracy Marks, president of TransCore (a company divested by Roper in 2021)

You want to grow at a higher percentage than you did the year before. Now we're all incentivized around that. That's -- we -- again, we get up in the morning, we go to bed at night thinking about how can we grow better this year than we grew last year. So I think just the passion and the energy and looking at the business from 10 different ways also just really drives execution. We can have a great quarter, as we have had several great quarters over the last few years, we can have great years.

I can tell you, Brian will find a way to look at that business, to where it doesn't look so great. Every quarter, we think we have it nailed. We have records in every category, maybe except one, and we will spin that entire operating review talking about how we can get that one to be better

Tracy Marks, president of TransCore (a company divested by Roper in 2021)



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Capital Allocation and Cash flows

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What is capital allocation and how to think about it?

Great capital allocation is broadly speaking the use of cash that generate a return higher than its cost of capital. It stands as a fundamental responsibility for the management of a public company. The proper goal of capital allocation is to build long-term value per share and the emphasis is on building value and letting the stock market reflect that value. Being a great capital allocator can be compared to being a great investor; it is all about making the decisions that maximizes shareholder value.

Intelligent capital allocation means understanding the long-term value of the opportunities and spending money wisely and accordingly. It also includes knowing the value of a firm's individual assets.

Why is capital allocation so important? The first is that companies must compete and a company that is allocating its resources wisely will ultimately prevail over a competitor that is allocating its capital and resources poorly. The second is the opportunity cost; unless capital is going to its best and highest use, it will underperform relative to its opportunity cost.

In William Thorndike's book *The Outsiders,* he studied eight CEO's that were great capital allocators and on average outperformed S&P 500 by 20 times and their peers by seven times. One thing all the CEOs had in common was their *focus on cash flow generation*.

A proper capital allocation strategy allows CEOs to act opportunistically when the opportunity is given. But like managing a portfolio of stocks, managers should have low tolerance for business areas or subsidiaries with bad growth, hence being able to take decisions to divest such operations.

Academic research also shows that rapid asset growth is associated with poor total shareholder returns** . It is the focus on long-term value creation that matters and will increase ROIC levels and drive shareholder value over time.

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*Chart from the book "The Outsiders" by William Thorndike
** Capital allocation: Evidence, Analytical Methods, and assessment guidance; Michael J Mauboussin et al

Capital Allocation

The CEO as an investor

When deciding on how to spend capital, whether on M&A, organic growth, dividends or debt repayment, management should always focus on what creates the most long-term value per share.

Every situation is different and what is a good decision at one price may not be on another, thus capital allocation should be a dynamic process. For example; issuing equity for opportunistic reasons (like M&A) when stock is overvalued - or buying back shares when the company's stock is undervalued - is value creating. On the contrary, issuing new equity when the stock is undervalued or buying back shares when the stock is overvalued is value destroying.

We believe that managers (CEOs and CFOs) along with the board, ought to have a view on its company’s intrinsic value as well as its own structured capital allocation process, hence not imitating what others are doing but rather following their own framework. Some companies have predetermined levels when they assess their stock being undervalued and thus buy back shares (eg. a certain free cash flow yield).

Companies with excess cash flow can also effectively create value by buying back shares (e.g. Apple, Swedish Match), thus decreasing the share count and increasing the value per share.

We recommend reading Mark Leonard’s letters to shareholders as inspiration for capital allocation strategy, thinking and ideas.

Sources and uses of financial capital*

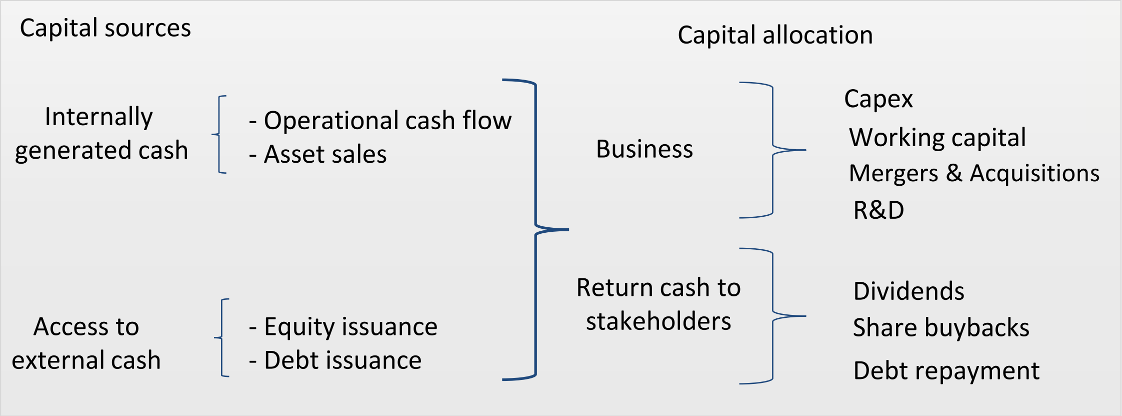

*Chart from the book “The Outsiders” by William Thorndike

** Capital allocation: Evidence, Analytical Methods, and assessment guidance; Michael J Mauboussin et al

Swedish Capital Allocation Examples

How do companies think about capital allocation and value creation?

Capital Allocation and Cash Flows

Addtech

"One central success factor is our focus on striving to attain strong cash flows in our companies. The money earned is invested in expansion of existing operations and in acquisitions of new complementary companies, which in turn contribute to future profit and cash flow and dividends to shareholders."
Addtech Annual Report 2014/2015

"Our strategy of acquiring cash flow is a successful one, made possible by our stable balance sheet and our focus on cash flow throughout the organization."
Addtech Annual Report 2020/2021

Lifco

"Lifco's business concept is to acquire and develop market-leading sustainable, niche businesses with the potential to deliver sustainable earnings growth and robust cash flows."

"A constant focus area for us is the Group's cash flow and changes in capital employed in our businesses."
Lifco Annual Report 2020

Indutrade

"Our strategy is based on generating profitable growth through acquisitions and development of stable and profitable companies in selected niches. Indutrade's strategy remains firm, and we have a solid foundation for continued long-term and competitive value creation"

"We have an opportunistic acquisition strategy that allows us to pick from the cream of the crop, and I feel that we have good prospects to continue acquiring the right companies at the right price."
Indutrade Annual Report 2019

Volati

"Volati creates long-term value by reinvesting the cash flows generated in the business units. We do this in two ways. First, we invest in existing business units to realize the potential for growth that exists in the companies. Second, we invest in the acquisition of new companies, which represents the largest part of our total reinvestments. Cash conversion from our activities gives us a sound and sustainable basis to conduct reinvestments
Volati Annual Report 2020

"Volati is growing fast but with a focus on long-term value creation. We have been able to maintain this high rate of growth without diluting existing shareholders or compromising our required rate of return. Our goal is sustained earnings growth per share, which means, for example, that we have never paid for acquisitions with our own shares and over the years we have only made one new issue, in connection with our IPO. We believe that growth is only value-creating if the return on equity is sufficiently high. A high return on adjusted equity is a prerequisite for sustainable self-financed growth.
Volati 2021 Q3 Report

Vitec

"Our acquisition work is governed by specific criteria… a criterion is that the acquisitions must directly contribute to an increase in the Group's earnings per share. Consequently, it is vital that the company demonstrates solid profitability and positive cash flows at the acquisition date.
Vitec Annual Report 2020

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Why is ROIC so Important?

A simplistic view on how ROIC impacts the value of a business

Value of 4 businesses - each with the same earnings but different ROIC

		Bad business	Average business	Great business	Excellent business
A	Earnings	100	100	100	100
B	Capital invested	1667	1250	500	250
	Return on capital (A/B)	6%	8%	20%	40%
C	Growth rate	5%	5%	5%	5%
D	Reinvested earnings to fund growth (BxC)	83	63	25	13
E	Earnings to Owners after growth investment (A-D)	17	38	75	88
F	Cost of capital	8%	8%	8%	8%
G	Value of the Business (E/(F-C))	555	1250	2500	2917
	Forward P/E ratio (G/A)	5.6x	12.5x	25.0x	29.2x

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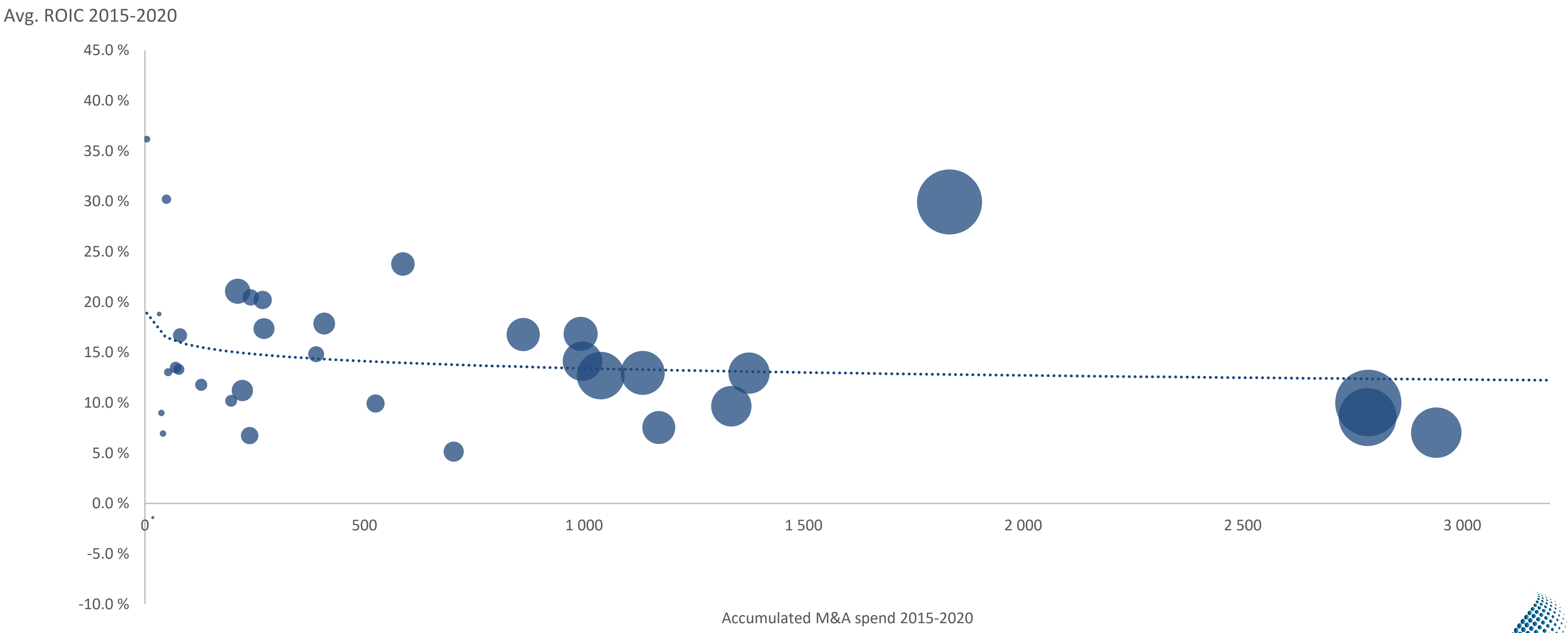
Source: internal calculations

The Larger You Get, the More Difficult it is Maintaining higH ROIC



Source: Data from own research database, inspired by: https://exploringcontext.substack.com/p/studying-serial-acquirers?s=r

The Value of Great Capital Allocation

Investing in a company requires trust in its management's ability to create value. Therefore, it is crucial to identify and invest in management teams that excel in capital allocation, effectively utilizing the company's resources to maximize returns on investment.

The significance of CEOs with strong capabilities in human and cultural aspects, combined with adept capital allocation skills, cannot be overstated. While many CEOs may ascend the corporate ladder based on their excellence in production, sales, or political acumen, the role of capital allocation becomes a critical responsibility when leading a company. It's essential to recognize that two companies, even if they have similar earnings but different approaches to capital allocation, can yield vastly different long-term results for shareholders.

Consider this scenario: imagine we have two companies, Company A and Company B, both generating hundred dollars of earnings. These earnings are converted fully into cash flow. Let's assume that the management team at Company A can reinvest their capital at a rate of 10%, which coincidentally matches their cost of capital. Moreover, they can reinvest 100% of their earnings every year over a 20-year period. In this case, a reasonable Price-to-Earnings (P/E) ratio to consider would be 10 (continued).

	Company A	Company B
Earnings	100	100
Invested capital	1 000	714
Return on capital (ROIIC)*	10 %	14 %
Reinvestment rate	100 %	100 %
Reinvestment period	20	20
Cost of capital (WACC)	10 %	10 %
Value of company**	1 000	1 971
Fair P/E ratio	10	20

*Return on incremental capital invested

**Growth = ROIC x Reinvestment rate

Future value = Earnings x ((1+Growth)^Years-1) | Company A: 100 x ((1+0.1)^20-1) = 611.6

Terminal value = Future value / WACC | Company A: 611.6 / 0.1 = 6116

Value of company = (FV+Terminal) / (1+WACC)^Years | Company A: (611.6+6116) / (1+0.1)^20 = 1 000

Fair P/E ratio = Value of business / Earnings | Company A: 1000 / 100 = 10

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The Value of Great Capital Allocation

However, now put yourself in the shoes of an investor tasked with evaluating the management team at Company B. This team not only excels in day-to-day operations but also possesses good investment skills. They manage to reinvest 100% of their capital at returns of 14% over a span of 20 years.

Given these circumstances, you could justify paying a price-to-earnings (P/E) ratio of 20 and still achieve a return comparable to the market over the entire holding period. Thanks to their shrewd capital allocation abilities, Company B's value surges by 100% compared to company A, all attributable to the astute investment acumen of its management team.

Now, let's shift our focus and analyze two other companies, still generating 100 dollars of earnings, that achieve identical incremental returns on their capital investments. However, they diverge significantly in terms of their reinvestment opportunities.

Company A can generate an impressive incremental return of 20% on invested capital. However, it operates within a niche market, selling a single product with restricted distribution potential. Another scenario is that it could be a company that already commands a substantial market share in a market characterized by slow growth. Consequently, it can only reinvest 35% of its capital at this attractive 20% rate. The remaining 65% is distributed to its shareholders, who must diligently seek comparable returns in the broader public markets. Because there is a "leak" of 65%, a fair P/E ratio to pay for Company A is 15.*

In contrast, Company B operates across diverse end-markets globally and consistently acquires small private companies of which there are many. The company has a long runway of growth opportunities. This strategy enables them to reinvest a substantial 75% of their cash flow each year at the same incremental return of 20% as Company A. Company B not only maintains an extensive list of potential acquisition targets but also benefits from the illiquidity of private markets, the relatively small size of transactions, and limited competition for these targets. This favorable landscape allows them to secure acquisitions at highly advantageous multiples. If Company B can sustain this compounding rate for 20 years, you might find it justifiable to pay a multiple of 30 times earnings and still achieve a market return throughout the entire holding period.

Despite both companies achieving a similar incremental return on capital of 20%, Company B experiences minimal leakage compared to Company A. Consequently, the reinvestment trajectory for Company B, in comparison to Company A, is worth double as much. To put it differently, public shareholders of Company B can effectively leverage the exceptional capital allocation expertise in the private market. As long as they remain invested, they can enjoy compounded returns** that are typically elusive for most fund managers when investing in publicly traded equities over extended multi-decade periods.

(continued)

*Computed through a 20-year discounted cash flow (DCF) analysis, where the terminal value is determined using the Gordon growth model without assuming constant growth. Subsequently, the Price-to-Earnings (P/E) ratio is derived by dividing the DCF value by the earnings of $100.

**Assuming the market values the company based on a theoretical DCF framework.

What About Dividends?

A frequently asked question centers around why acquisition-driven compounders opt to distribute dividends instead of fully reinvesting their cash flow.

In a broader context, our preference lies with companies capable of sustaining a high reinvestment rate over an extended period, coupled with superior returns on capital. This sets the stage for decades of profitable growth. One argument is that these companies, by acquiring privately owned companies at mid-single digit multiples, easier can find ways to reinvest their cash flow, achieving attractive returns beyond what investors can expect.

A common characteristic among many Acquisition-driven Compounders with a solid track records of creating shareholder value is that they have owners with a long-term perspective on value creation, company development, and ownership. Given many of these companies' capital-light nature and a cautious approach to risk and capital allocation, their owners can, by receiving dividends realize a pay-off on their investments without selling shares. Owners with a multi-decade mindset prefer gradually building companies while maintaining a strong financial position, creating the ability to pay dividends from a position of strength. A modestly increasing dividend payout as the company expands is seen as a testament to strong cash flow generation.

Our general belief is that boards should adopt a flexible stance on dividends and investments. When highly attractive investment opportunities with high returns on capital are available, and the financial and operational risk is manageable, boards should permit CEOs to pursue such opportunities.

This is not a sprint. It's a marathon to develop a company like Lifco.

Per Waldemarsson, CEO Lifco, 2021 Q4 Conference Call

We think it is important with dividends. Many of our owners have been invested in us for a long time and many has it as a private placement and they want a small dividend so we have always been persistent on keeping it.

Jörgen Wigh, CEO Lagercrantz*, Penserpodden 2023-09-07*

Additionally, paying dividends to shareholders introduces scarcity of capital, requiring managements to be selective in their investment choices. This limitation prompts managers to invest where the returns on capital are highest, acknowledging the concept of opportunity costs. Having access to a more limited pool of cash can prevent pressure on managers to deploy capital at lower incremental returns, potentially resulting in overall lower hurdle rates.

A critical consideration as the investable pool of cash grows is the need for companies to scale their operational capabilities in M&A. As Acquisition-driven Compounders grow, scaling M&A can become challenging, requiring companies to do more or larger acquisitions. Successful M&A scaling involves not just deploying a larger capital pool but also developing the organizational capabilities to do so.

While the theoretical preference is for companies to maximize reinvestment rates, the best Acquisition-driven Compounders have demonstrated in practice the possibility of achieving multi-decade profitable growth at 15-20% annually while distributing dividends. Also, companies that reinvest 100% of profits are more vulnerable if not delivering on growth expectations.

Distributing about 20-25% maximum of our income. It hasn't really interfered or consumed our deal equity to an extent it has prevented us from growing.

David Cicurel, CEO Judges Scientific*, Tu Dinero e n Accion podcast, 2023-12-01*

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Teledyne: A Great Study in Capital Allocation

Some thoughts around Capital allocation, Decentralization and People at Teledyne

It is very interesting to study lesser known but highly successful companies whose success is based on proven principles rather than a single product, customer or market. Investing is about recognizing patterns. If we can decode certain principles and lessons behind past successes, we can apply those same insights in our search for investments.

Teledyne is one such example. An investor who invested in Teledyne in 1966 achieved an annual return of 17.9%, or 53 times invested capital, over 25 years, compared to 6.7 times for the S&P500. Henry Singleton was co-founder and CEO over that same period. Teledyne was an industrial conglomerate with exposure to areas such as specialty metals, aerospace electronics and insurance. According to Warren Buffett, Henry Singleton at Teledyne had "the best operating and capital deployment record in American business." What were the key ingredients behind this success and how can we apply these lessons as investors?

Capital allocation

Henry Singleton was not only a strong business operator but also a unique allocator of capital, actively using Teledyne stock as a source of funds. In the 1960s and 1970s, he made 130 acquisitions that were financed by both equity and strong free cash flow. In the 1970s, Teledyne used a significantly undervalued stock to buy back and retire 85% of its shares outstanding at prices far below what Singleton believed was the intrinsic value of the company. These were not regular share repurchases. On several occasions, Teledyne made tender offers to buy five percent of its stock, which instantly increased per-share value for the remaining shareholders.

In addition to acquisitions, Singleton had a firm grip on the organic engine of the business. In the 1970s, organic net income grew 19% annually, compared to 12% for the S&P500. Return on equity was over 25% during this period. The secret behind the strong organic growth was a business model based on decentralization.

Decentralization

Diversification was an insurance against catastrophe, according to Singleton. At its peak, Teledyne consisted of more than 130 individual profit centers that were managed in a highly decentralized manner.

According to Teledyne:
"We had no intention of managing these businesses from the corporate level. We did, however, establish our own unique financial and operations reporting system which enabled us to monitor their performance closely, on a monthly basis, and see any trouble spots before they became serious."*

There was no intention of micro-managing these companies remotely because the managers of these companies knew much more than head office about their products, markets, competition, and so forth. The corporate-wide financial reporting system ensured that all companies spoke the same language. The fiscal month always ended on a Friday, and by the following Tuesday morning, reports from all 130 reporting units were collected at headquarters. That was in the 1960s, and even today, that would be an accomplishment.

(continued)

Teledyne: A Great Study in Capital Allocation

Some thoughts around Capital allocation, Decentralization and People at Teledyne

Capital Allocation and Cash Flows

Because the company was always aware of each company's performance, "we were able to establish an incentive system for honoring those companies that performed exceptionally well.*" The company called it "The Triple Crown Awards" and honored companies that set all-time records in three categories: Sales, Net Income and Cash Flow. The group wide overview and awards were sent monthly to executives at all companies. The top-performing managers were rewarded accordingly. The policy of keeping operating units small, each responsible for its own success, was followed throughout the company.

According to Singleton, "We depend on them. We have to trust them. Our success or failure depends on what they do.*" People are the most important factor in a company. "Why bother them if they are doing their job" was Singleton's mantra.

People

Henry Singleton was the company's largest shareholder with a 7.8% stake. Promoting the right people was on the top of the agenda. The result was a high-performance culture. According to Singleton: “we work our heads off to increase our own capability at collecting and promoting the right people. We increase our bets on the men who seem to be performers.*" Similarly, the company tried to avoid having people compete within Teledyne but looked outward to its real competitors. "Our objective is to increase our rate of earnings faster than they do. It is a lot of fun. As a result, we visualize it as a competitive game.*" In 1989, Henry Singleton retires after 29 years of brilliant leadership and outstanding value creation.

Summing up

Our investment philosophy is based on three fundamental principles that we believe stand the test of time: Capital allocation, decentralization, and people. We want to invest in management teams that are excellent investors, who understand the power of decentralization and entrepreneurship, and own part of the business themselves. Teledyne is a good example of the extraordinary long-term results that come from combining these principles. We believe we have found and invested in a special group of companies that have the right ingredients to become the "Teledynes of tomorrow."

*Distant Foce: A Memoir of the Teledyne Corporation and the Man Who Created It (2007)

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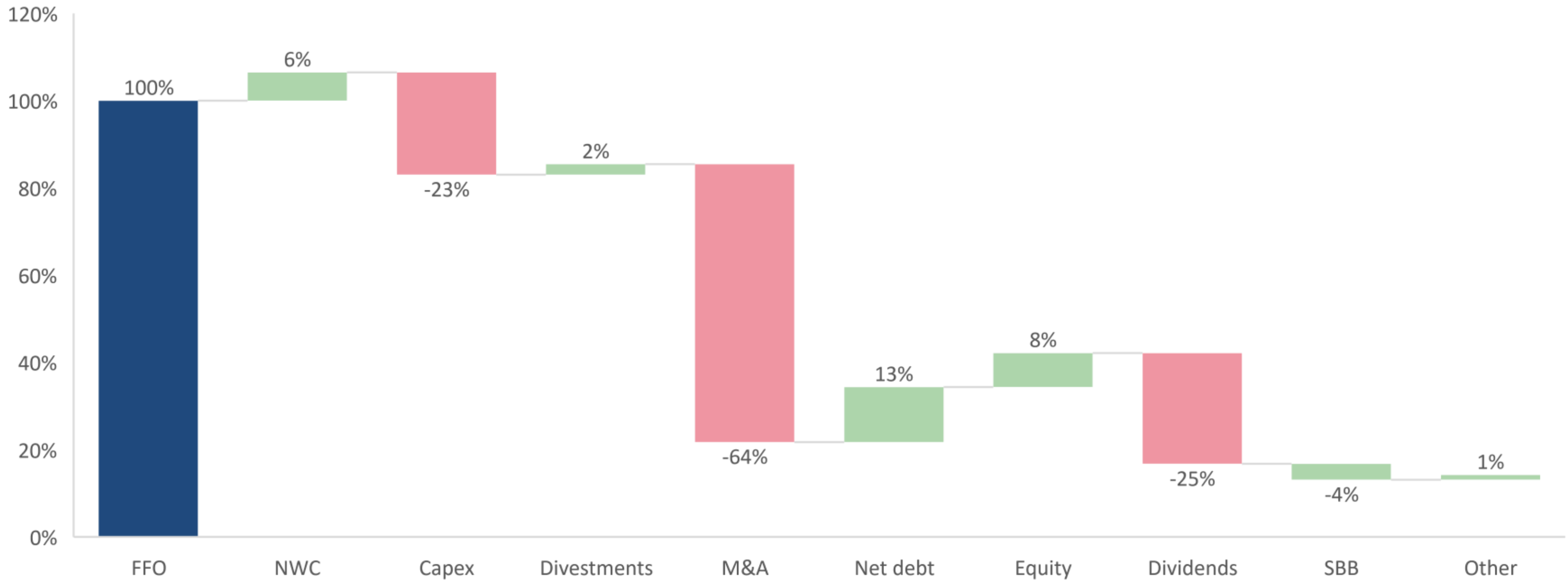
Capital Allocation Snapshots - Addnode

Addnode capital allocation 2008-2022

Capital Allocation and Cash Flows



Cash flow	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
FFO	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%
NWC	-9%	44%	0%	13%	-20%	5%	3%	-9%	-8%	-26%	17%	18%	40%	-2%	5%
Capex	-13%	-13%	-16%	-26%	-22%	-27%	-34%	-39%	-40%	-33%	-29%	-23%	-26%	-23%	-10%
Divestments	35%	11%	4%	18%	1%	2%	-3%	-1%	0%	1%	0%	2%	0%	-1%	0%
M&A	-68%	-56%	-62%	-10%	-30%	-87%	-38%	-34%	-40%	-189%	-40%	-71%	-65%	-65%	-62%
Net debt	-15%	-4%	-4%	-2%	0%	50%	-14%	46%	29%	212%	-39%	-34%	47%	-35%	8%
Equity	0%	0%	0%	6%	0%	0%	0%	0%	0%	0%	106%	0%	0%	0%	0%
Dividends	-23%	-78%	-51%	-33%	-43%	-57%	-45%	-42%	-40%	-34%	-28%	-24%	0%	-19%	-15%
SBB	-15%	0%	-4%	-6%	0%	0%	0%	0%	0%	0%	0%	0%	0%	-16%	-3%
Other	1%	2%	-4%	0%	-1%	-4%	1%	-3%	3%	1%	0%	5%	-11%	8%	5%

Source: Company reports

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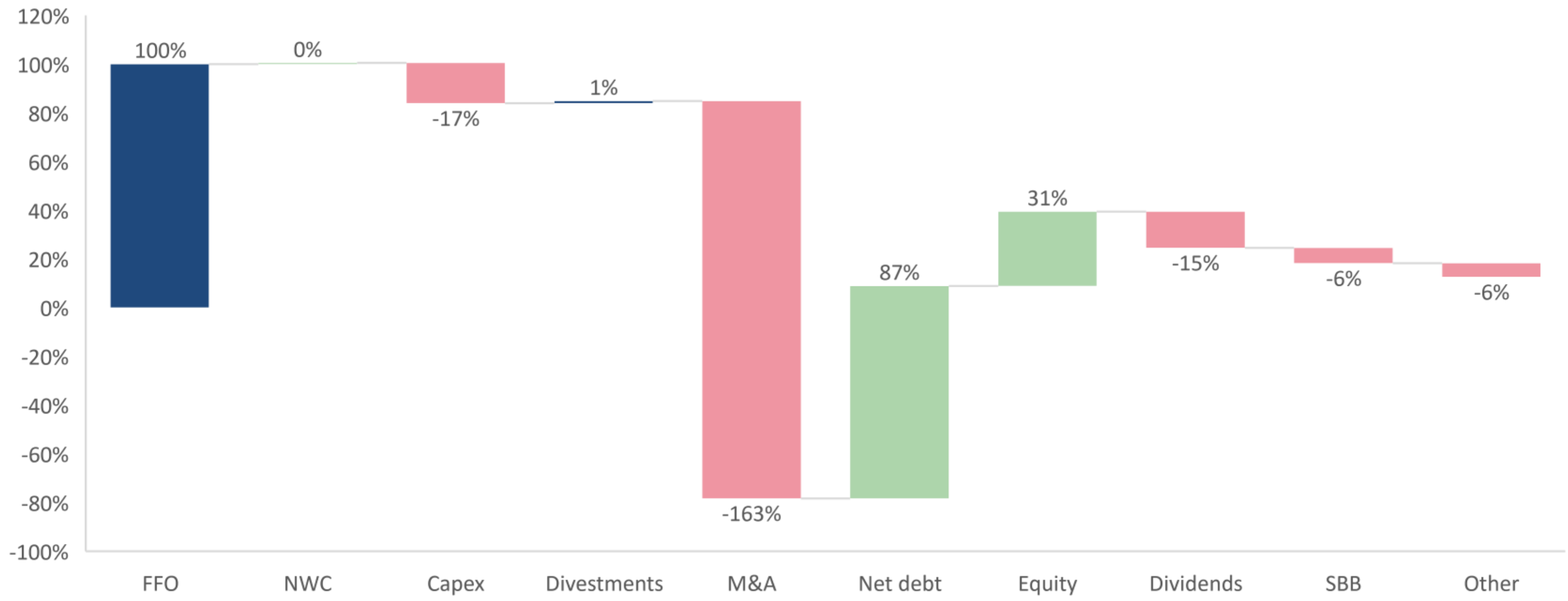
Capital Allocation Snapshots - Addlife

Addlife capital allocation 2016-2022

Capital Allocation and Cash Flows



Cash flow	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Operating cash flow					100%	100%	100%	100%	100%	100%	200%
NWC					-15%	7%	-3%	8%	15%	-11%	-14%
Capex					-15%	-22%	-27%	-23%	-12%	-14%	-32%
Divestments					1%	1%	1%	1%	1%	1%	2%
M&A					-108%	-153%	-182%	-88%	-46%	-283%	-93%
Net debt					-158%	102%	170%	-69%	-34%	250%	82%
Equity					216%	2%	0%	136%	0%	0%	4%
Dividends					0%	-19%	-29%	-17%	-8%	-18%	-28%
SBB					-24%	-19%	-19%	-12%	-3%	0%	-7%
Other					4%	0%	16%	-25%	3%	-11%	-18%

Source: Company reports

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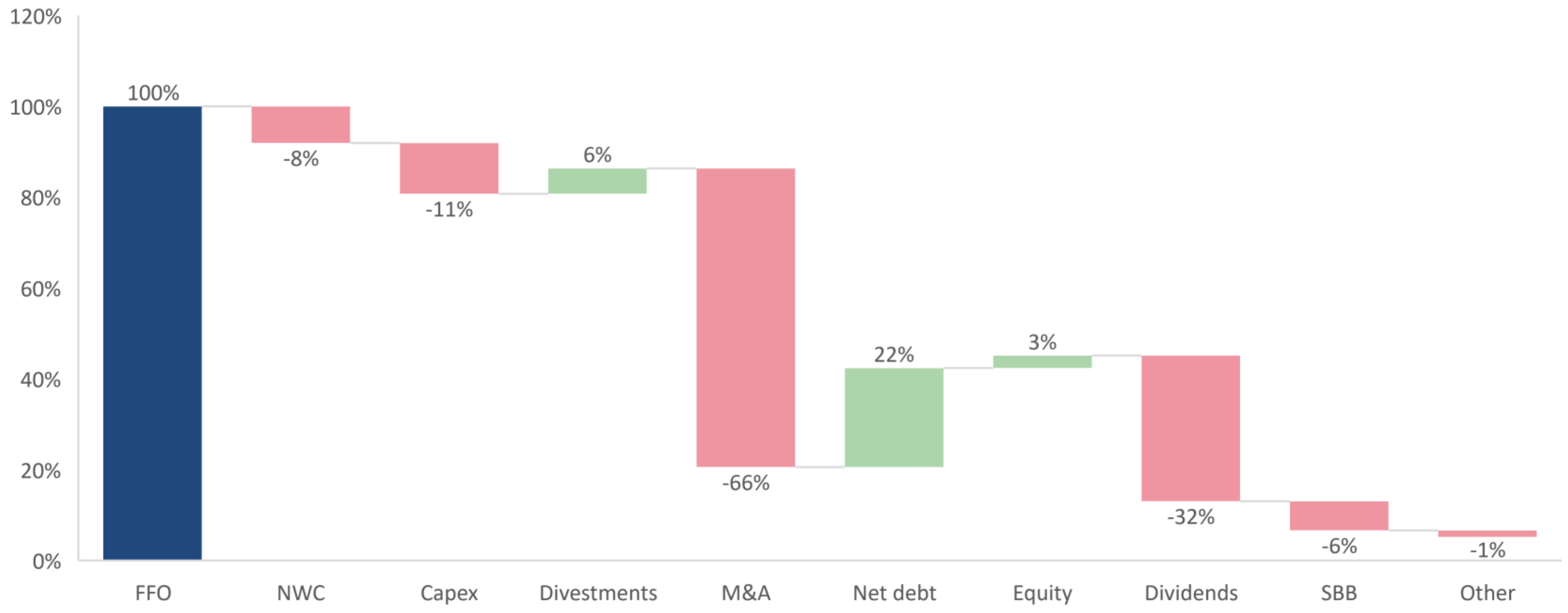
Capital Allocation Snapshots - Addtech

Addtech capital allocation 2001-2022

Capital Allocation and Cash Flows



Cash flow	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
FFO	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%
NWC	21%	67%	27%	17%	3%	-28%	-12%	3%	49%	-10%	-5%	-1%	3%	3%	-7%	-7%	-18%	-39%	-6%	34%	-35%	-16%
Capex	-62%	-30%	-15%	-15%	-14%	-14%	-12%	-20%	-15%	-12%	-9%	-12%	-13%	-11%	-15%	-12%	-8%	-11%	-9%	-9%	-9%	-10%
Divestments	74%	30%	6%	2%	0%	6%	5%	27%	4%	4%	0%	1%	1%	1%	69%	2%	6%	3%	0%	-1%	2%	1%
M&A	-38%	-41%	-16%	-61%	-34%	-55%	-45%	-35%	-11%	-82%	-59%	-91%	-44%	-50%	-124%	-57%	-78%	-77%	-36%	-123%	-70%	-60%
Net debt	-24%	-71%	-12%	10%	6%	34%	12%	-11%	-88%	35%	26%	58%	-13%	-6%	33%	22%	36%	68%	-11%	31%	48%	23%
Equity	0%	0%	0%	2%	1%	1%	1%	2%	8%	0%	0%	6%	6%	7%	11%	2%	5%	3%	3%	4%	1%	0%
Dividends	0%	-32%	-31%	-29%	-26%	-32%	-36%	-52%	-57%	-33%	-36%	-51%	-38%	-37%	-43%	-37%	-36%	-31%	-28%	-28%	-24%	-26%
SBB	-135%	-21%	-38%	-5%	-55%	-26%	-10%	-11%	-7%	-1%	-16%	0%	-3%	-6%	-9%	-7%	-5%	-4%	-4%	0%	0%	-2%
Other	-106%	2%	-1%	2%	0%	0%	0%	-1%	-1%	0%	-1%	-4%	0%	2%	-6%	-1%	-1%	-1%	-3%	-3%	0%	-1%

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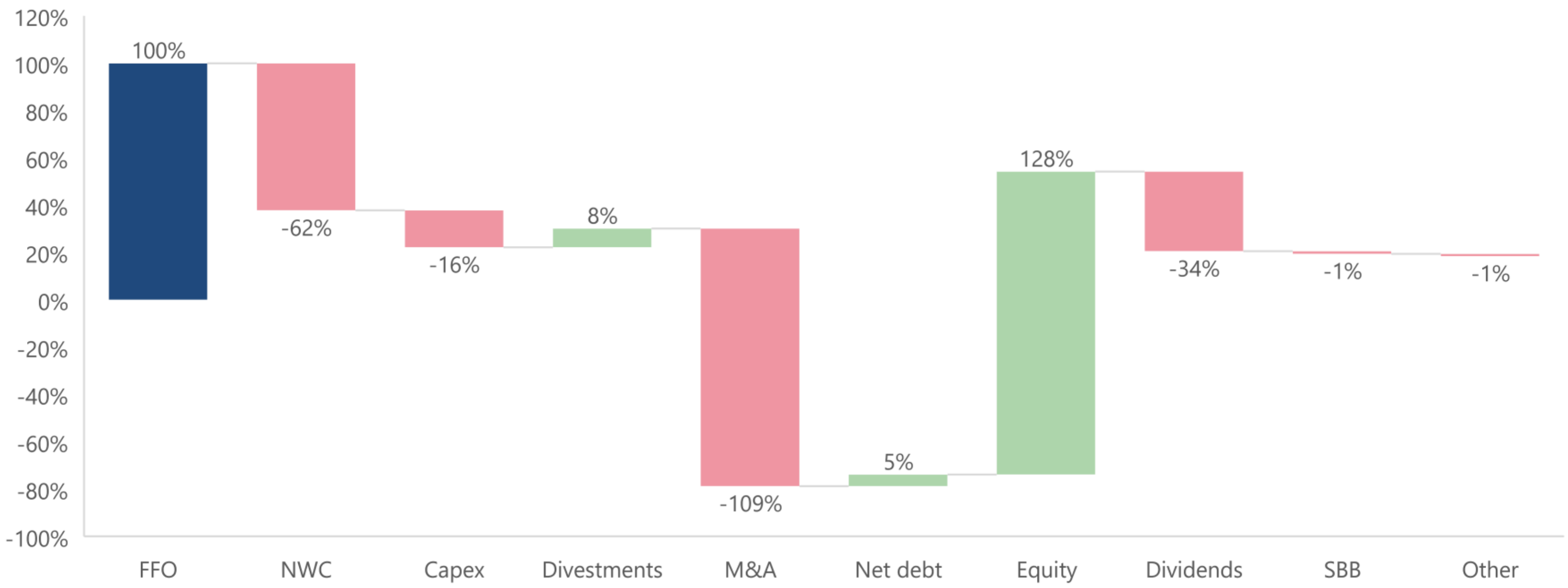
Source: Company reports

Capital Allocation Snapshots – Beijer Ref

Beijer Ref capital allocation 2008-2023

Capital Allocation and Cash Flows



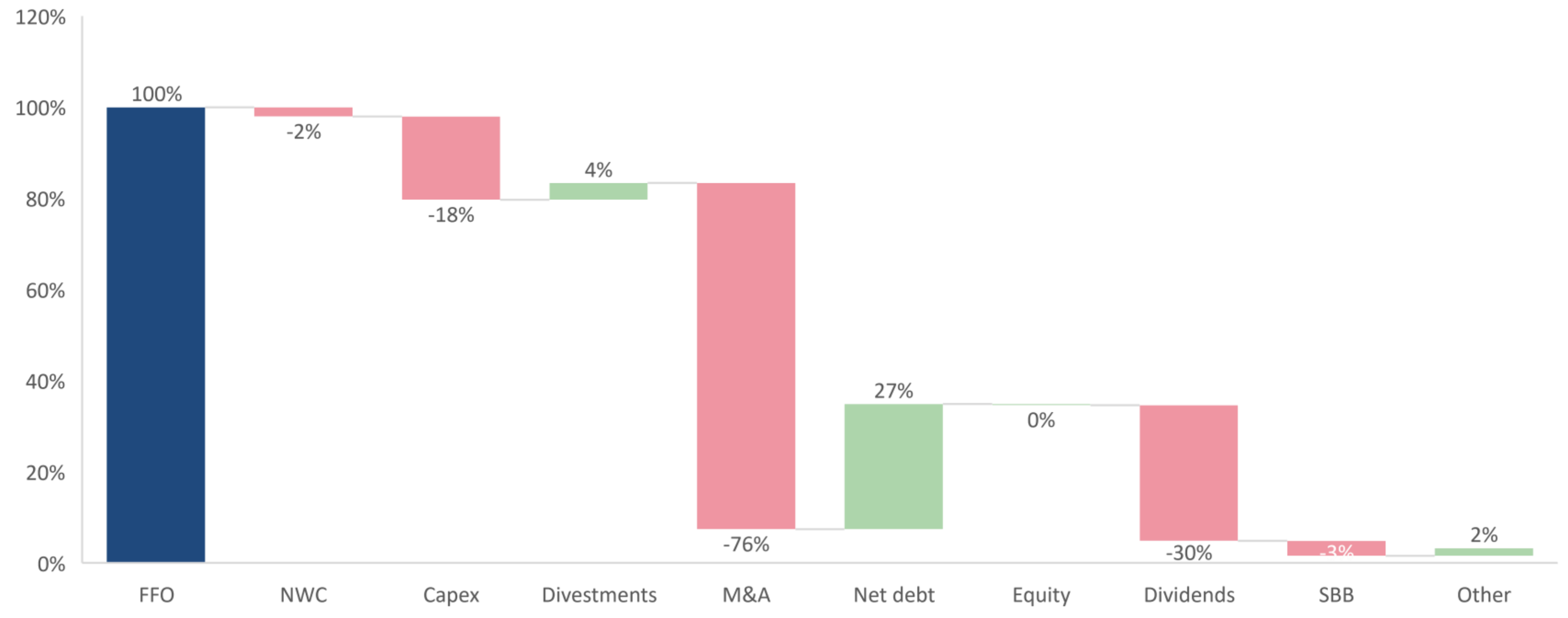
Cash flow	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Operating cash flow	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%
NWC	-66%	78%	-44%	-69%	-58%	16%	-38%	1%	-86%	-22%	-27%	-2%	20%	-122%	-118%	-225%
Capex	-29%	-25%	-13%	-21%	-18%	-19%	-15%	-12%	-20%	-14%	-17%	-13%	-17%	-18%	-13%	-11%
Divestments	45%	5%	15%	97%	18%	3%	2%	-1%	5%	-1%	15%	3%	1%	3%	2%	0%
M&A	-20%	-5%	-1%	-238%	-4%	-3%	-8%	-35%	-2%	-1%	-112%	0%	-16%	-51%	-69%	-811%
Net debt	15%	-22%	-61%	190%	8%	-19%	44%	18%	45%	7%	111%	-67%	-30%	111%	152%	-451%
Equity	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	1%	0%	0%	4%	0%	1477%
Dividends	-38%	-31%	-53%	-44%	-57%	-78%	-52%	-43%	-47%	-36%	-26%	-30%	-20%	-33%	-26%	-27%
SBB	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	-10%	0%	0%	0%	-1%	0%
Other	5%	-2%	-5%	1%	-4%	-2%	-19%	-5%	4%	0%	1%	0%	-6%	-8%	4%	6%

Source: Company reports

Capital Allocation Snapshots - Lagercrantz

Lagercrantz capital allocation 2001-2022

Capital Allocation and Cash Flows



Cash flow	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Operating cash flow	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%
NWC	316%	204%	106%	414%	65%	-18%	18%	44%	55%	-20%	-5%	1%	7%	3%	-11%	2%	-13%	5%	-19%	24%	-38%	-6%
Capex	-45%	-78%	-23%	-129%	-35%	-37%	-25%	-24%	-30%	-13%	-11%	-17%	-22%	-15%	-25%	-15%	-19%	-18%	-19%	-16%	-16%	-18%
Divestments	13%	13%	23%	257%	2%	26%	68%	1%	2%	0%	1%	1%	1%	0%	13%	2%	4%	2%	1%	0%	1%	1%
M&A	0%	-39%	-94%	-214%	-54%	-172%	-26%	-60%	-4%	-188%	-26%	-114%	-60%	-49%	-111%	-56%	-161%	-32%	-51%	-58%	-84%	-85%
Net debt	-392%	-183%	106%	-957%	-71%	170%	-82%	-34%	-118%	155%	-40%	58%	15%	13%	71%	16%	143%	-24%	21%	-17%	77%	36%
Equity	0%	0%	0%	0%	0%	0%	0%	0%	0%	7%	4%	6%	2%	2%	0%	0%	1%	0%	1%	2%	-8%	-1%
Dividends	0%	-104%	-66%	-314%	-35%	-26%	-29%	-36%	-59%	-22%	-27%	-35%	-34%	-35%	-35%	-32%	-42%	-31%	-33%	-24%	-28%	-29%
SBB	-55%	-148%	-66%	0%	-19%	0%	-36%	-12%	0%	0%	-6%	0%	-5%	0%	-3%	0%	-10%	0%	0%	0%	0%	0%
Other	0%	-35%	-6%	-14%	2%	-1%	-1%	-2%	-2%	0%	1%	0%	-3%	-3%	-2%	-2%	-1%	-1%	-6%	-4%	2%	17%

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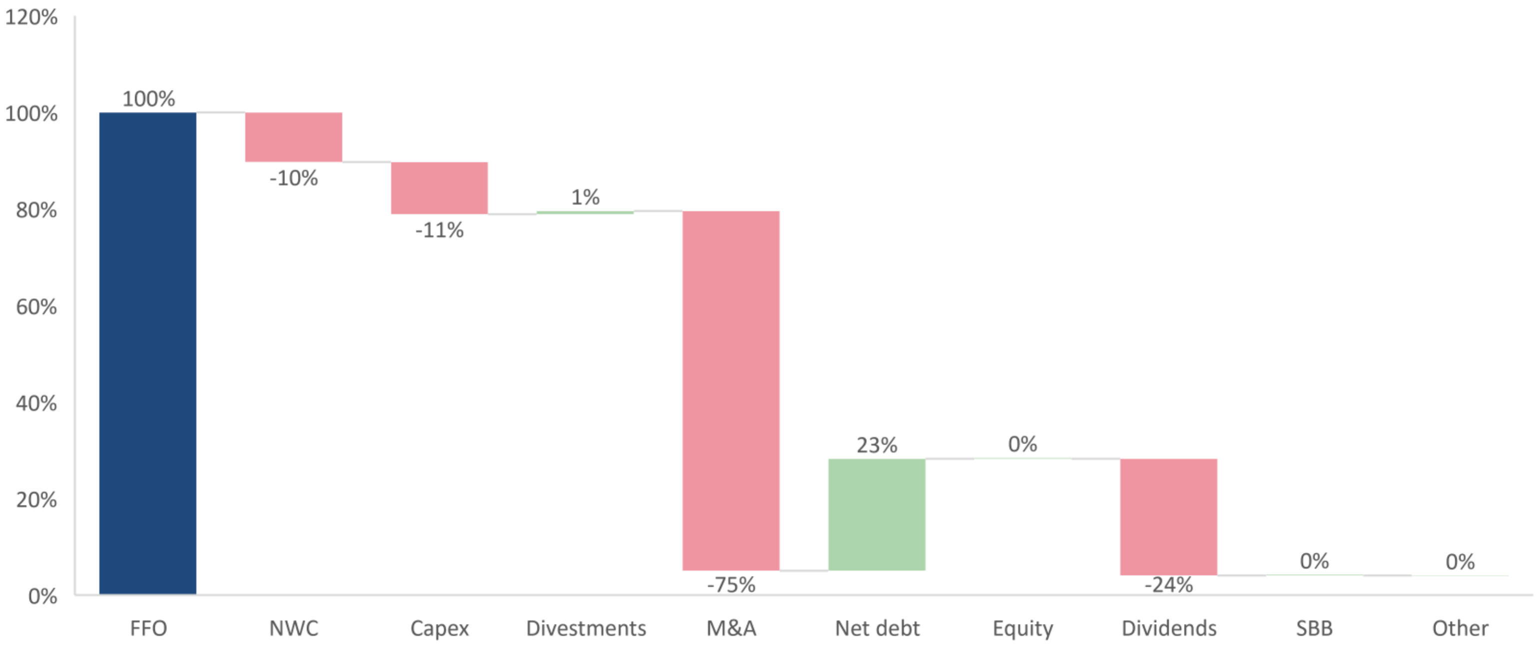
Source: Company reports

Capital Allocation Snapshots - Lifco

Lifco capital allocation 2015 - 2023

Capital Allocation and Cash Flows



Cash flow	2015	2016	2017	2018	2019	2020	2021	2022	2023
FFO	100%	100%	100%	100%	100%	100%	100%	100%	100%
NWC	-5%	-4%	-7%	-14%	-7%	20%	-13%	-27%	-14%
Capex	-11%	-11%	-11%	-10%	-16%	-12%	-10%	-9%	-10%
Divestments	2%	1%	0%	1%	1%	1%	0%	1%	0%
M&A	-57%	-142%	-97%	-28%	-93%	-49%	-97%	-64%	-69%
Net debt	-9%	64%	39%	-23%	56%	-9%	48%	22%	16%
Equity	0%	0%	0%	0%	0%	0%	0%	0%	0%
Dividends	-25%	-25%	-24%	-22%	-26%	-24%	-21%	-22%	-30%
SBB	0%	0%	0%	0%	0%	0%	0%	0%	0%
Other	-2%	2%	-1%	1%	2%	-6%	1%	1%	0%

Source: Company reports

REQ CAPITAL
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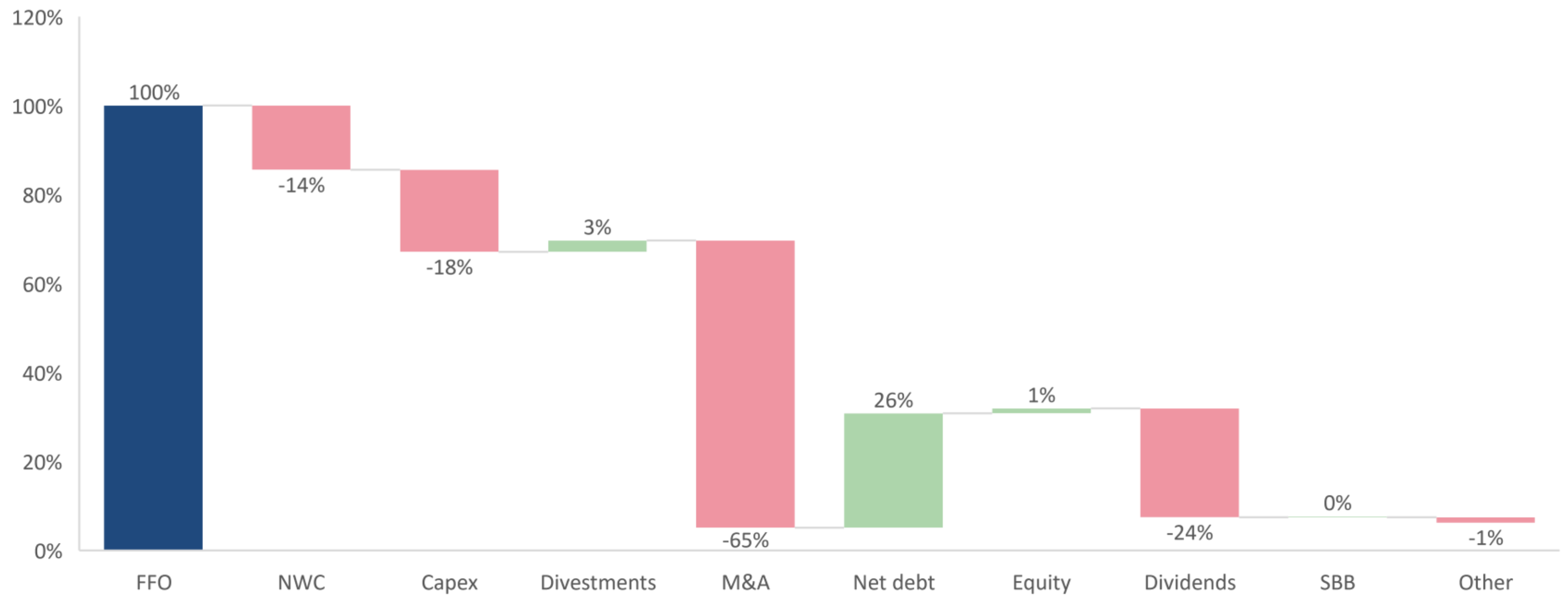
Capital Allocation Snapshots - Indutrade

Indutrade capital allocation 2005-2022

Capital Allocation and Cash Flows



Cash flow	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
FFO	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%
NWC	6%	-28%	-24%	-21%	27%	6%	-7%	-28%	9%	-7%	-18%	-8%	3%	-25%	-18%	9%	-12%	-44%
Capex	-18%	-19%	-16%	-24%	-24%	-21%	-21%	-20%	-29%	-15%	-18%	-25%	-17%	-18%	-22%	-19%	-12%	-16%
Divestments	2%	4%	3%	3%	3%	3%	5%	5%	6%	2%	1%	2%	1%	5%	3%	4%	1%	2%
M&A	-49%	-42%	-58%	-45%	-43%	-111%	-61%	-82%	-59%	-60%	-67%	-88%	-67%	-36%	-78%	-46%	-58%	-80%
Net debt	63%	18%	39%	21%	-3%	52%	18%	61%	11%	17%	23%	47%	8%	12%	46%	-47%	27%	63%
Equity	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	6%	0%	0%	4%	2%	0%
Dividends	-17%	-30%	-29%	-34%	-58%	-28%	-27%	-38%	-36%	-29%	-24%	-27%	-25%	-25%	-28%	0%	-23%	-24%
SBB	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%
Other	-83%	0%	1%	2%	-1%	-3%	0%	-1%	0%	2%	1%	0%	0%	-1%	-1%	-2%	2%	0%

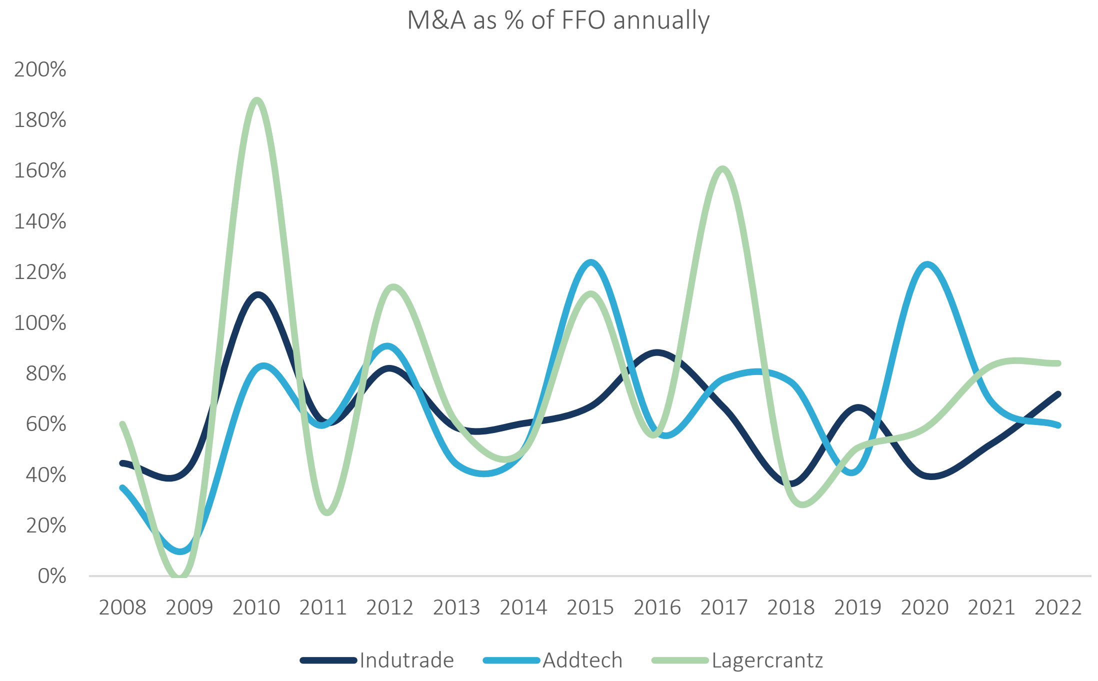
REQ CAPITAL
INVESTING WITH INSIGHT

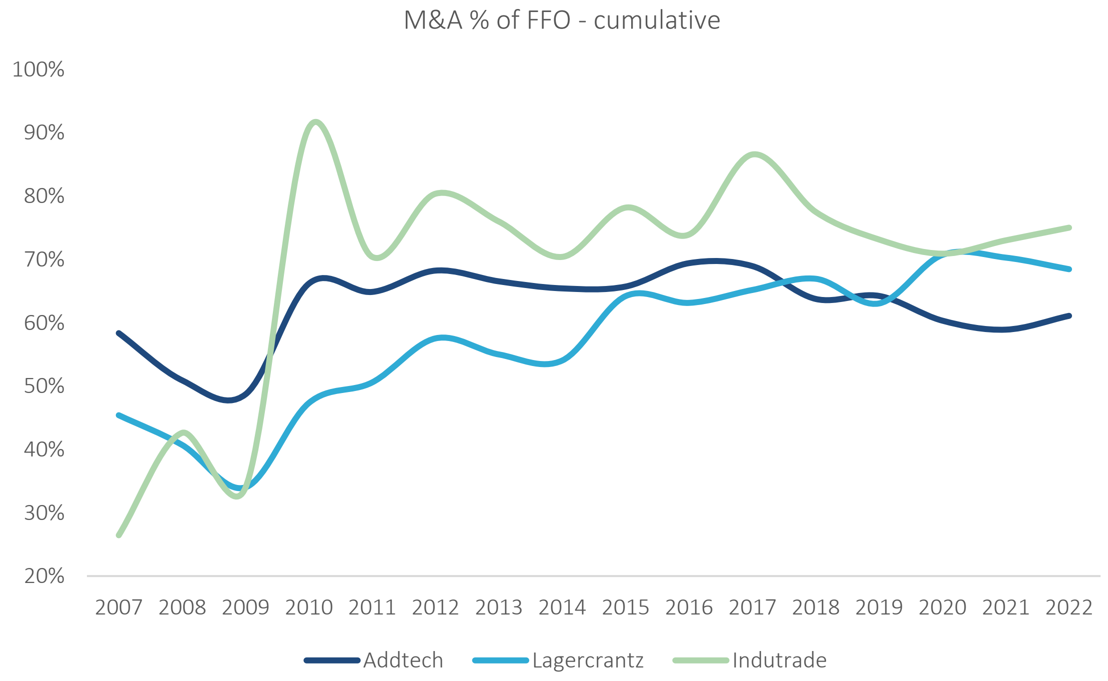
Source: Company reports

Capital Allocation – M&A Focus

Capital Allocation and Cash Flows

Similarities between Addtech, Lagercrantz & Indutrade in terms of continiously high reinvestment rates



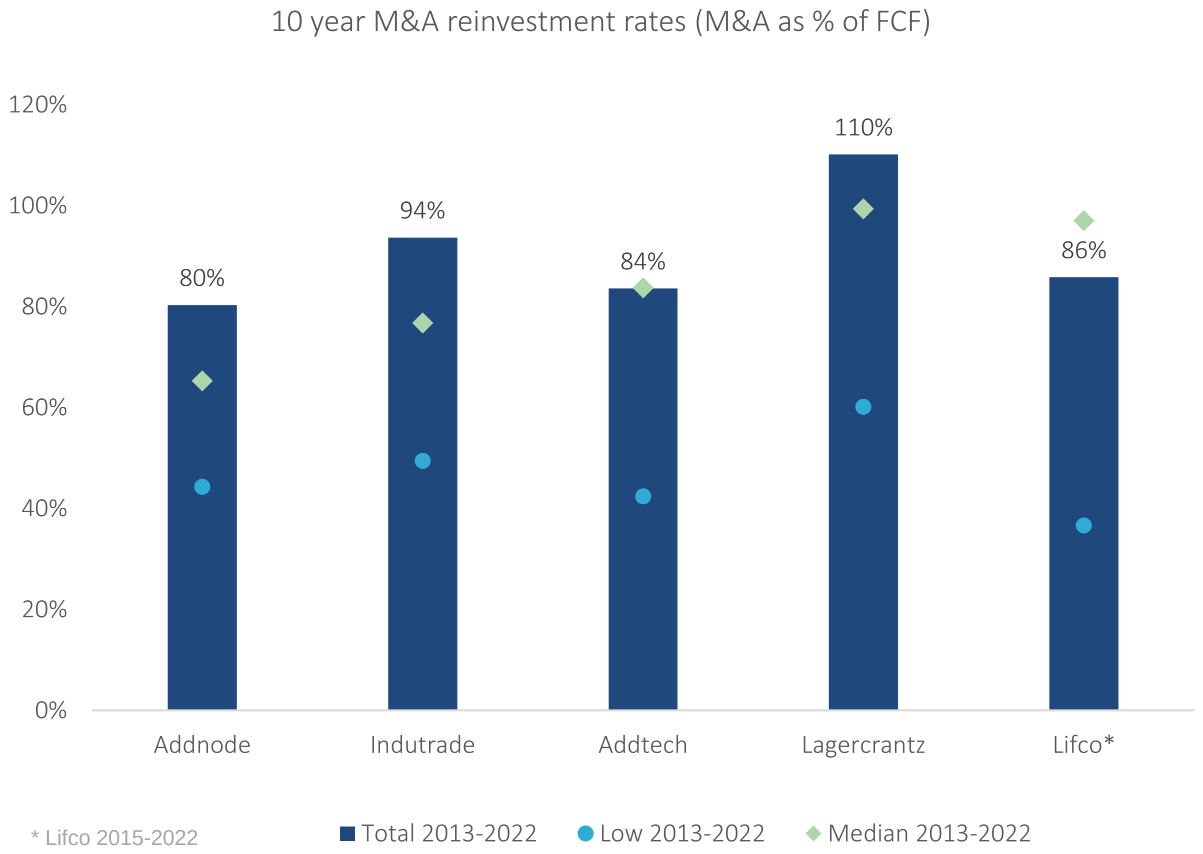


Source: Company reports

Capital Allocation – M&A Focus

[Capital Allocation and Cash Flows](#)

Similarities between Addtech, Lagercrantz & Indutrade in terms of continiously high reinvestment rates

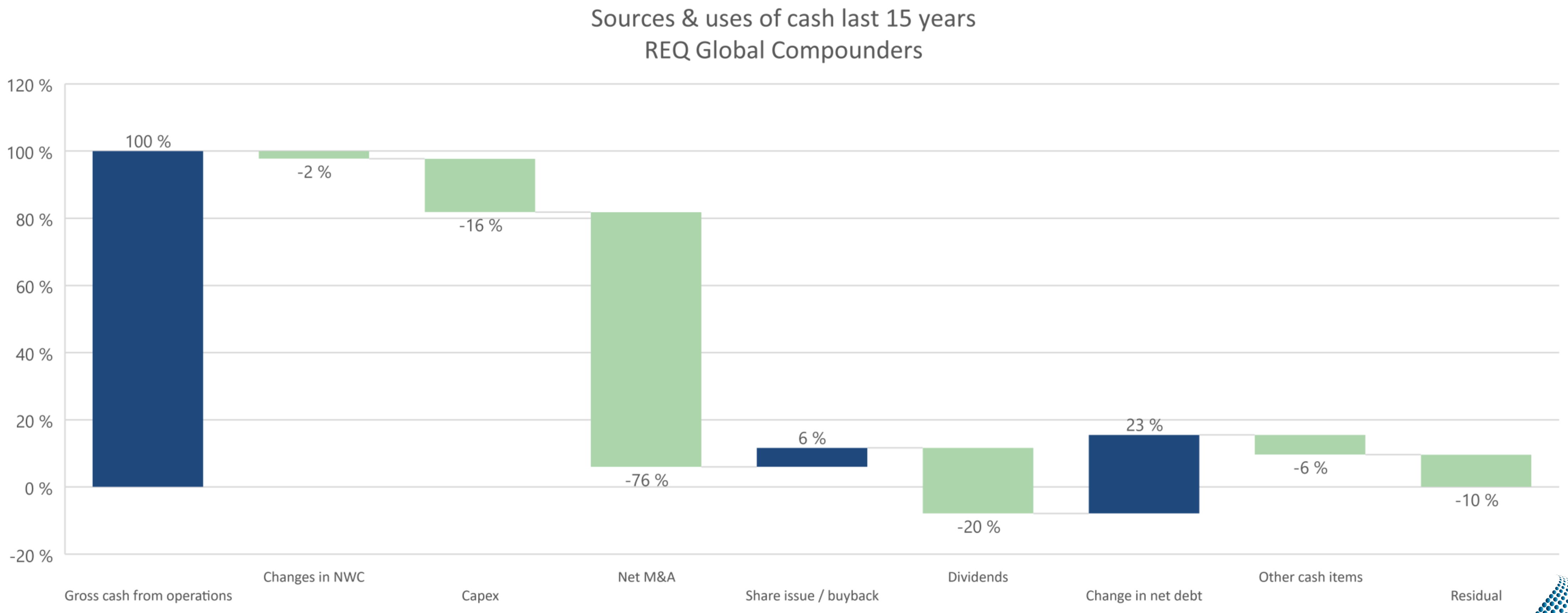


- This chart illustrates the 10-year reinvestment rates as % of FCF (lease-adjusted operating cash flow less capex).
- As lowest, these companies have spent a minimum of 40% of their FCF on acquisition, favourably supported by strong balance sheets and prudent approach to risk and capital allocation, enabling themselves to pursue M&A opportunities even when economic conditions are less favourable.
- Illustrated by the chart, we can see that these companies with a longer track record embrace the durability of growth (always able to do M&A) instead of speed of growth, where they do not spend more on M&A than they produce in FCF (Lagercrantz outlier due to NWC-build up in 2021/2022 that lowers the FCF).

Source: Company reports

Cash Flow Bridge: REQ Global Compounders

M&A reinvestment: Predominantly self-financed; dividends excluded.

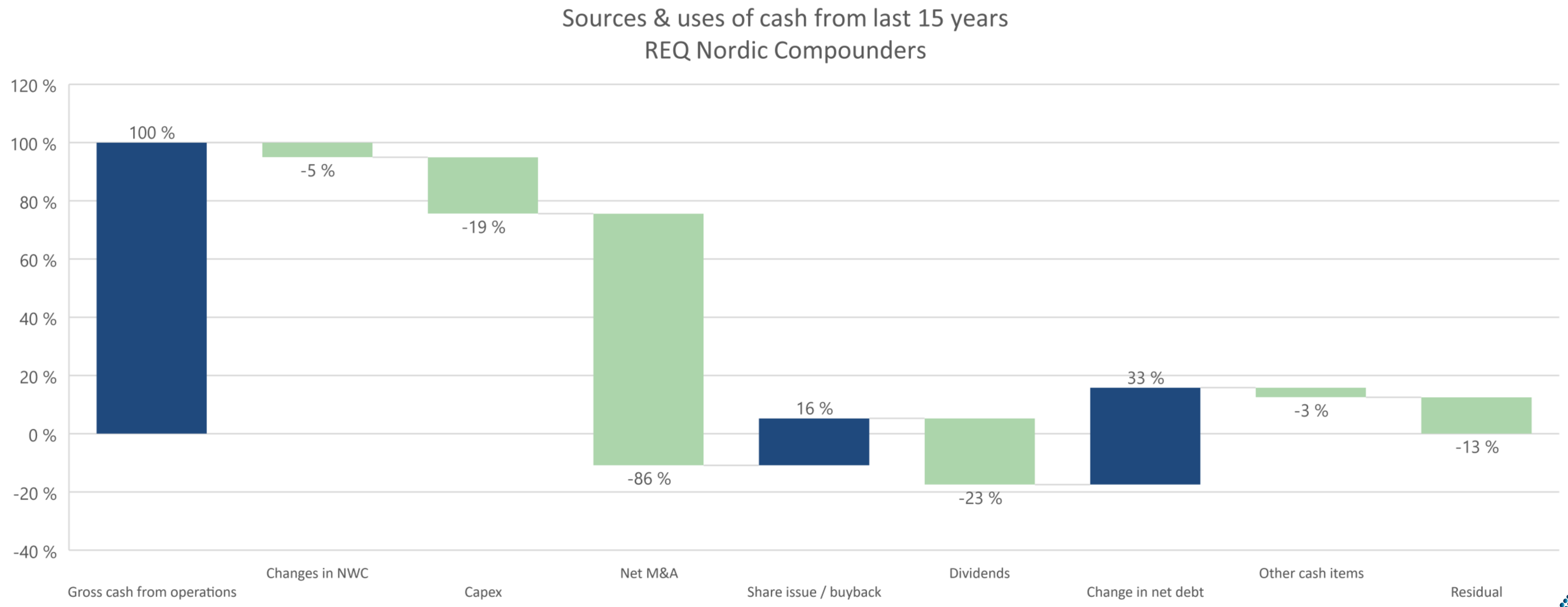


Source: Company reports

Cash Flow Bridge: REQ Nordic Compounders

M&A reinvestment: Predominantly self-financed; dividends excluded.

Capital Allocation and Cash Flows



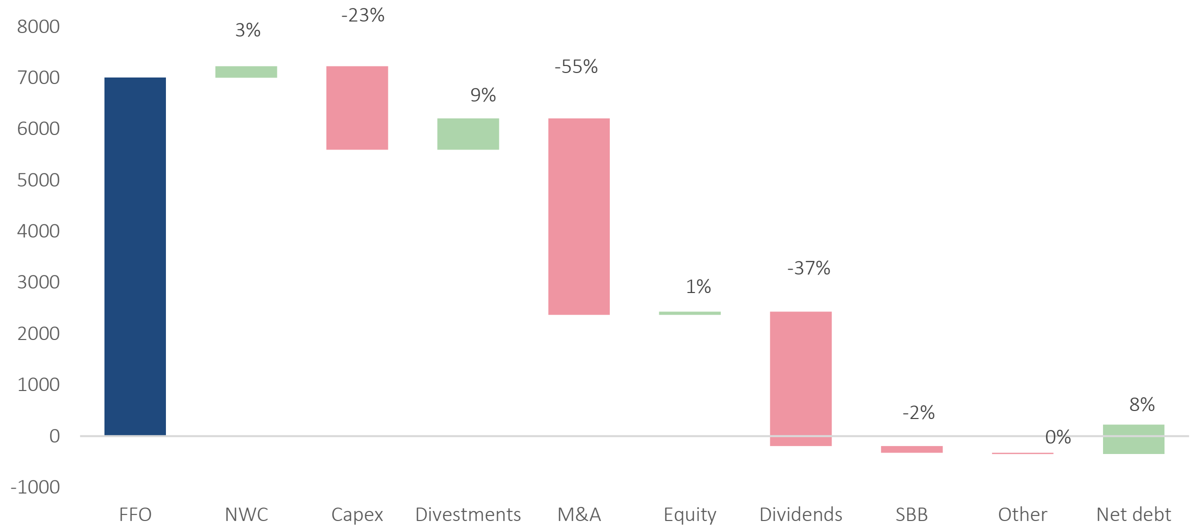
Source: Company reports

Capital Allocation Through GFC

How do companies allocate their capital in different economic cycles?

Capital Allocation and Cash Flows

How was capital deployed during the GFC (2008-2010)?



- During the Great Financial Crisis (2008-2010) we can see that companies allocated 55% of their operating cash flow to M&A (measured as operating cash flow before change in NWC) and 37% to dividends.
- What is interesting is that quite many companies in the economic downturn had a net working capital release when sales fell, improving their cash flow and enabling to continue its dividend or M&A story.
- We believe that maintaining dividends in economic downturns can have strong signalling effects, hence companies do not want to withdraw or decrease dividends and indicate a "crisis mode".

2008-2010	Addnode	Addtech	AQ Group	Beijer Alma	Beijer Electronics	Beijer Ref	Bergman & Beving	Indutrade	Lagercrantz	OEM	Vitec	Xano Industrier
Operating cash flow	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%
NWC	3%	7%	-5%	-12%	17%	-9%	9%	2%	14%	18%	47%	11%
Capex	-14%	-16%	-43%	-21%	-35%	-21%	-16%	-23%	-20%	-37%	-58%	-37%
Divestments	22%	12%	5%	2%	3%	20%	9%	3%	1%	16%	-8%	24%
M&A	-64%	-34%	-15%	-10%	-127%	-8%	-113%	-69%	-113%	-23%	-76%	-14%
Equity	0%	3%	0%	0%	1%	0%	2%	0%	3%	0%	15%	1%
Dividends	-41%	-46%	-18%	-46%	-24%	-41%	-32%	-38%	-33%	-58%	-15%	-14%
SBB	-9%	-9%	0%	0%	0%	0%	-2%	0%	-4%	0%	0%	0%
Other	0%	0%	-2%	2%	-2%	-1%	1%	-1%	-1%	0%	-5%	-3%
Net debt	-10%	-19%	-30%	-7%	77%	-26%	46%	26%	44%	-2%	29%	-66%

Companies included;
Addtech, Addnode, AQ Group, Beijer Alma, Beijer Electronic, Beijer Ref, Bergman & Beving, Bufab, Indutrade, Lagercrantz, OEM, Vitec, Xano

Source: Company reports

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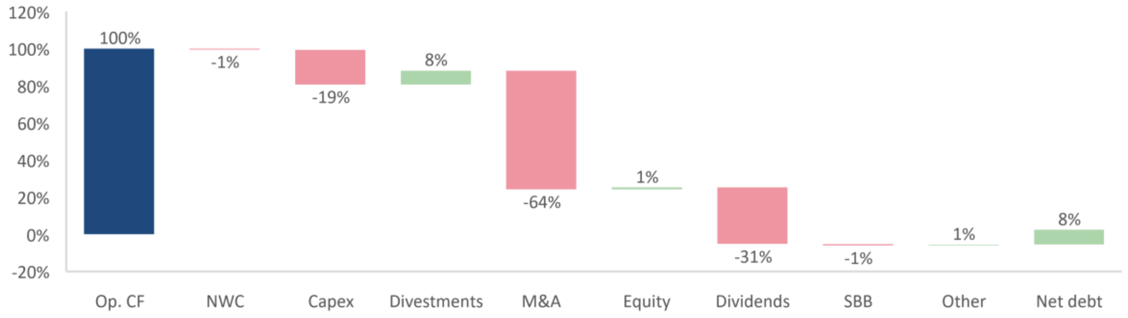
Capital Allocation Through GFC

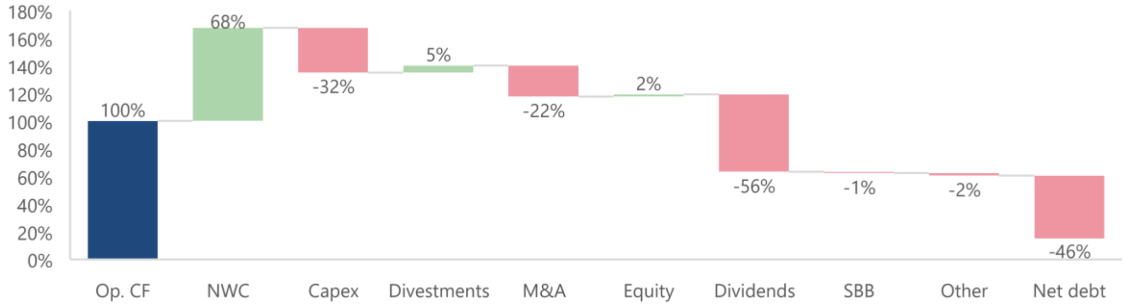
How was capital deployed during the GFC (2008-2010)?

Capital Allocation and Cash Flows

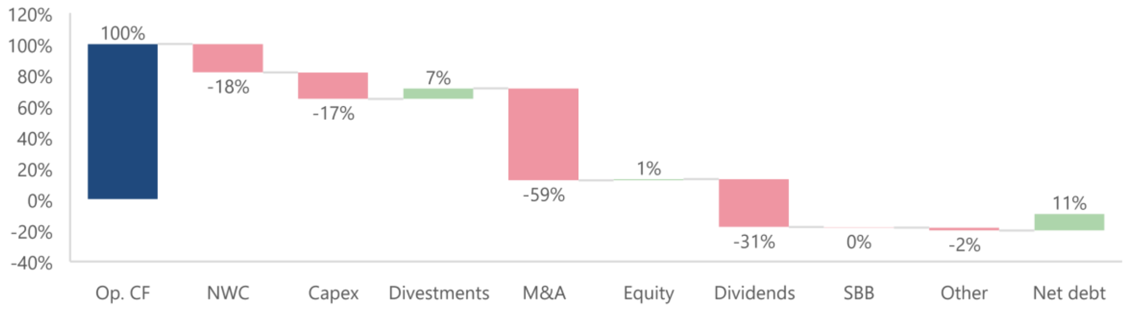
2008



2009



2010



- We observe differences both between companies, but also between the years.
- During 2008, our selection of companies spent 64% of their operating cash flow on M&A, compared to just 22% 2009 and 59% in 2010.
- In 2009 many companies had a large net working capital release (68% for our selection of companies).
- In economic downturns the companies are focused maintaining dividends and reducing their debt levels.
- We believe that a company should find the right balance and trade-off between accelerating growth through more debt and keeping sound over-the-cycle leverage levels.

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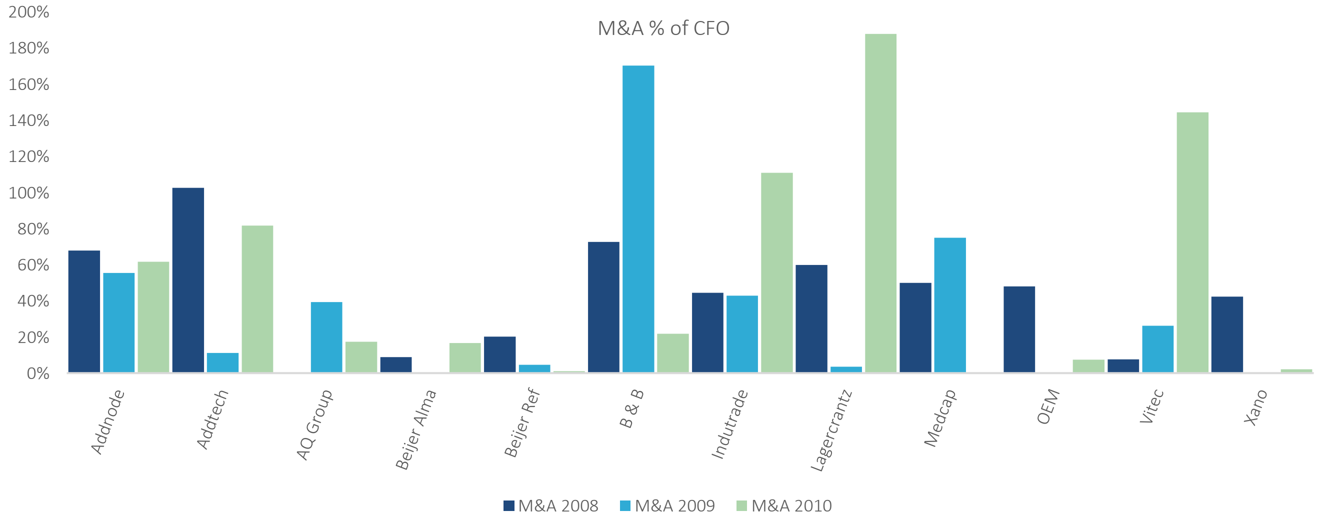
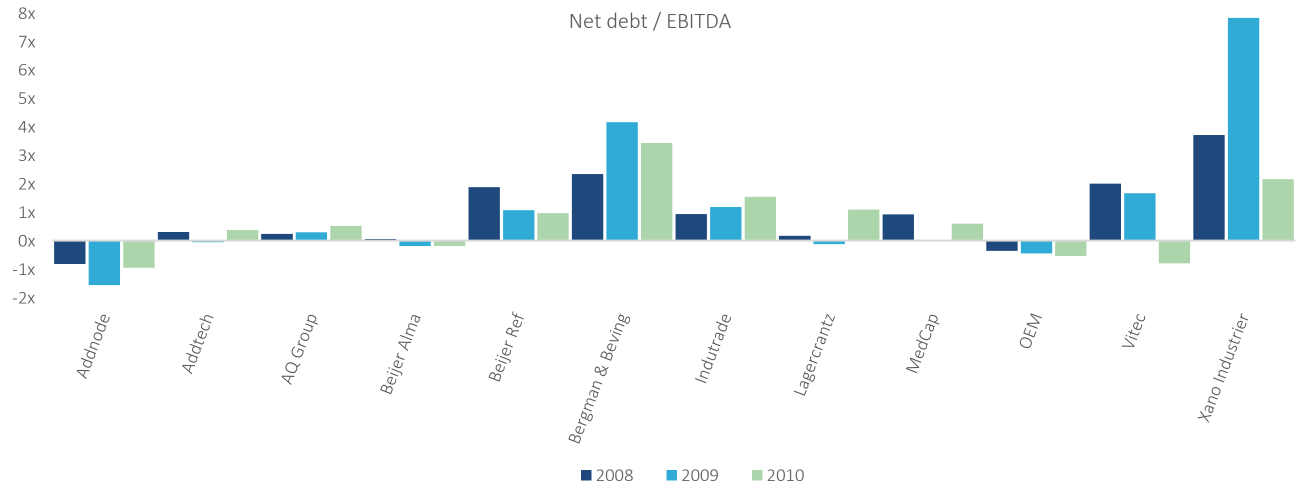
Source: Company reports

Capital Allocation Through GFC

How much was spent on M&A during GFC (in % of operating cash flow)?

Capital Allocation and Cash Flows



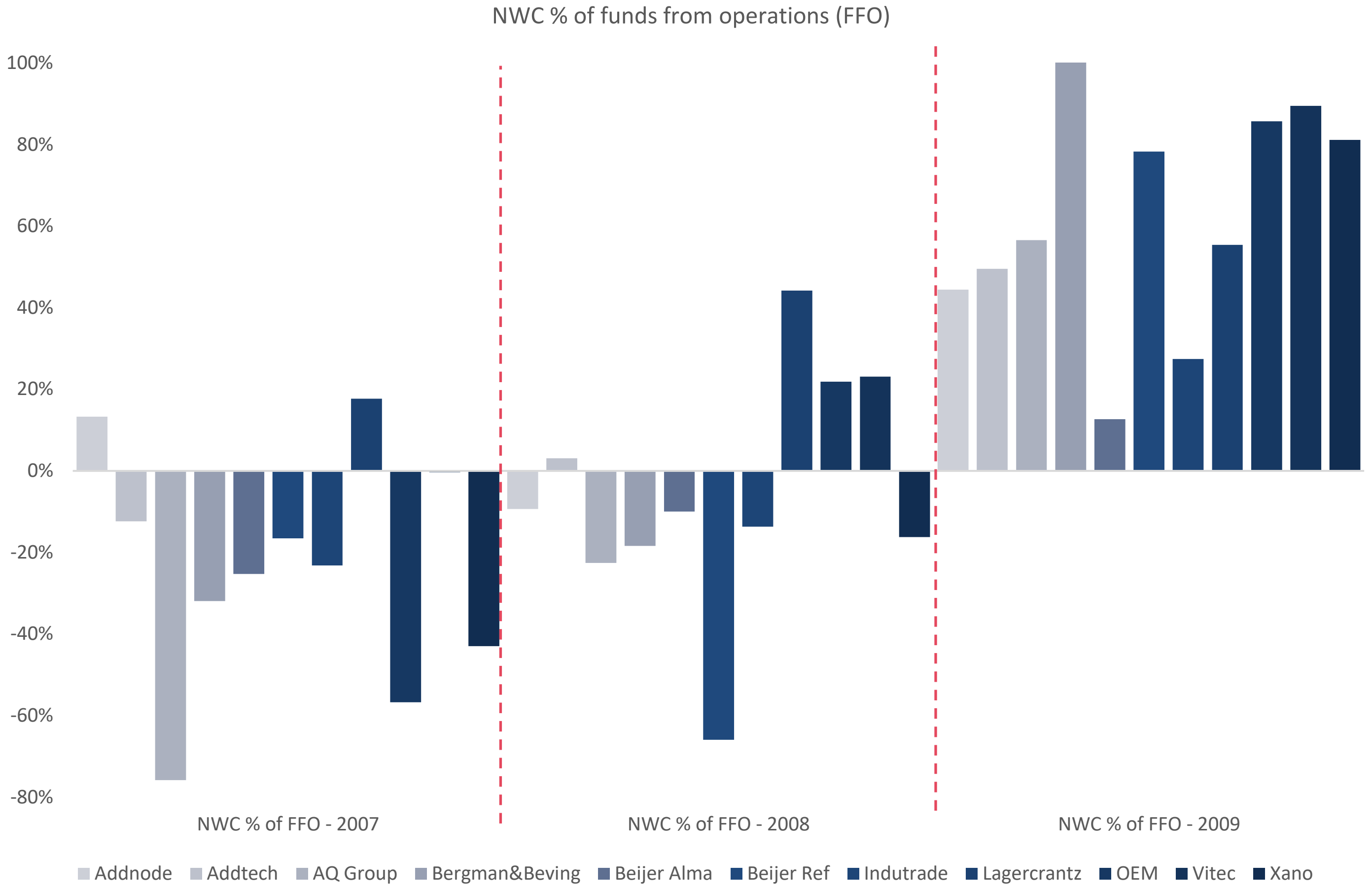


- This slide also displays the difference between the companies and years during the GFC in terms of M&A spending and net debt.
- We see that companies that entered the GCF with low leverage levels spent more on M&A (in relative terms) than those with higher leverage.
- Bergman & Beving is an outlier with high M&A spending as % of CFO, but their cash flow was boosted with a large net working capital release.

Source: Company reports

Cash Flow in a Downturn Scenario

Lessons from the Great Financial Crisis in 2008/2009



The left-side chart illustrates the Net Working Capital (NWC) movements as a percentage of Funds From Operations (FFO) for the years 2007, 2008, and 2009.

Studying the chart reveals that during 2007 and 2008, most of our selected companies experienced predominantly negative NWC movements.

However, in 2009, all companies demonstrated positive NWC movements, providing essential support to overall operating cash flows at a time when profits, and consequently FFO, declined amid the economic downturn.

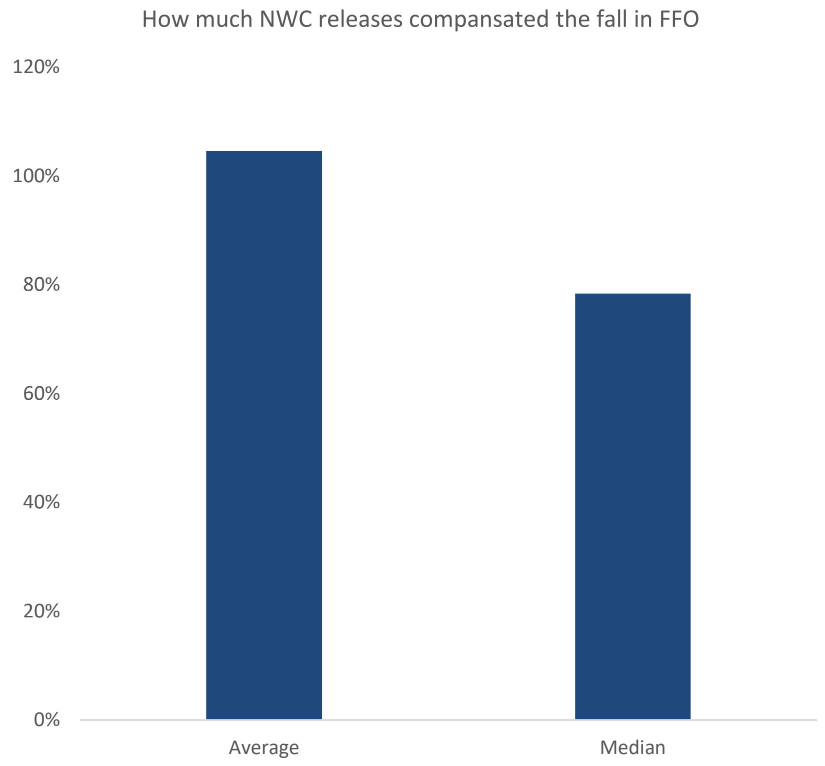
During periods of slowed growth or negative growth driven by unfavorable economic conditions, businesses tend to tie up less capital and, in many cases, release capital as a consequence.

For our portfolio of companies, where acquisitions are central to the strategy, this becomes particularly significant. Strong cash flows during downturns, facilitated 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.

Source: Company reports

In 2009, NWC Release Held up Overall Cash Flow

On average, NWC releases compensated for 78% of the fall in FFO



The chart on the left illustrates the extent to which Net Working Capital (NWC) movements in 2009 compensated for the decline in operating cash flow before NWC (FFO).

The interpretation of the chart is as follows:

If the figure is 100%, the NWC release fully offset the decrease in FFO.
If >100%, NWC contributed to a higher operating cash flow in 2009 compared to 2008.

As evident from the chart, companies on a general were able to maintain robust cash flows in 2009, providing the means to sustain M&A activities.

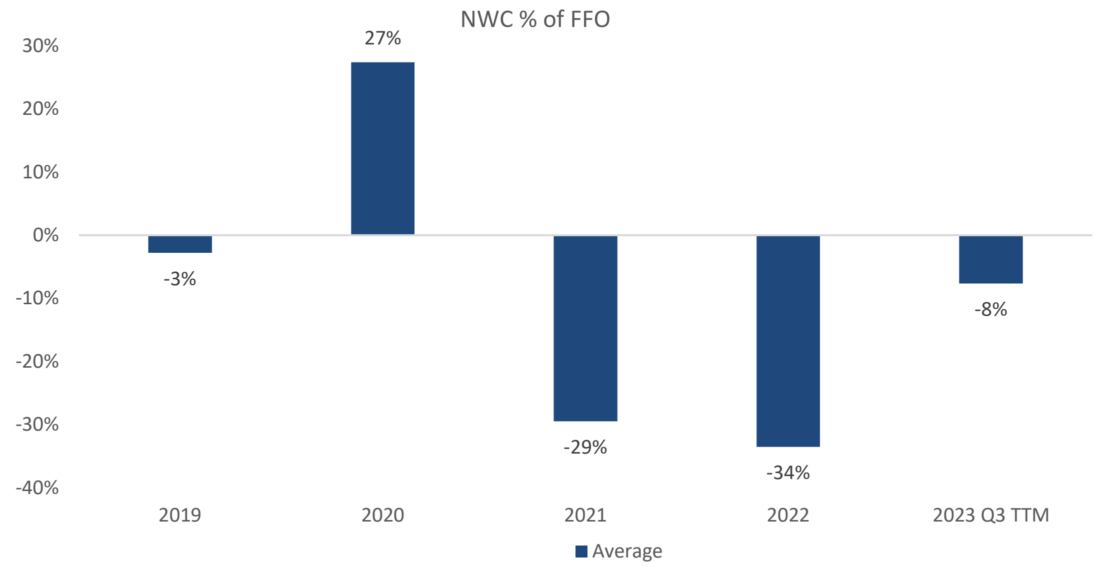
In periods of slowed or negative organic growth, operating cash flow reductions are typically mitigated through NWC reductions. This allows them to continue their M&A initiatives, capitalizing on the strengths of having dual growth engines, even in economic downturns.

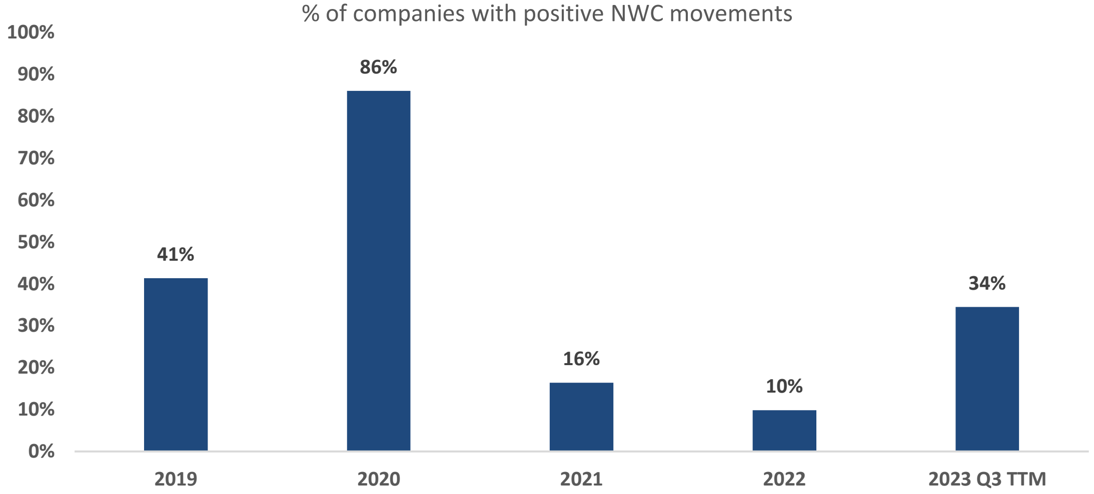
By adopting a prudent risk approach alongside a strong balance sheet and high cash flow generation, these companies not only endure challenging economic conditions but also thrive, propelled by the possibilities offered by their dual growth engines that keep up the overall growth.

Source: Company reports

Potential NWC Release in a Slower Growth Environment

If history from GFC repeats, we could expect NWC relase when growth slows





Source: Company reports

Conducting an analysis of the cash flows of 60 Nordic acquisition-driven compounders, the upper chart reveals that the average NWC tie-up as a percentage of FFO.

In essence, over the last twelve months, companies, on average, have experienced a negative NWC movement of 8%, a significant improvement from the negative 34% observed in 2022.

Throughout 2021 and 2022, many companies struggled with component shortages, supply chain issues, and extended lead times, resulting in capital being tied up in both inventory and receivables.

The bottom chart indicates a trend where an increasing number of companies are now releasing capital. In 2022, only 10% of companies achieved NWC release, primarily observed among software companies.

Analyzing the cash flow for the last twelve months, it is evident that the proportion of companies demonstrating positive net working capital movements has risen to 34%. This signifies a positive shift in operating cash flow, which will reduce debt levels and provide further room for inorganic growth initiatives.

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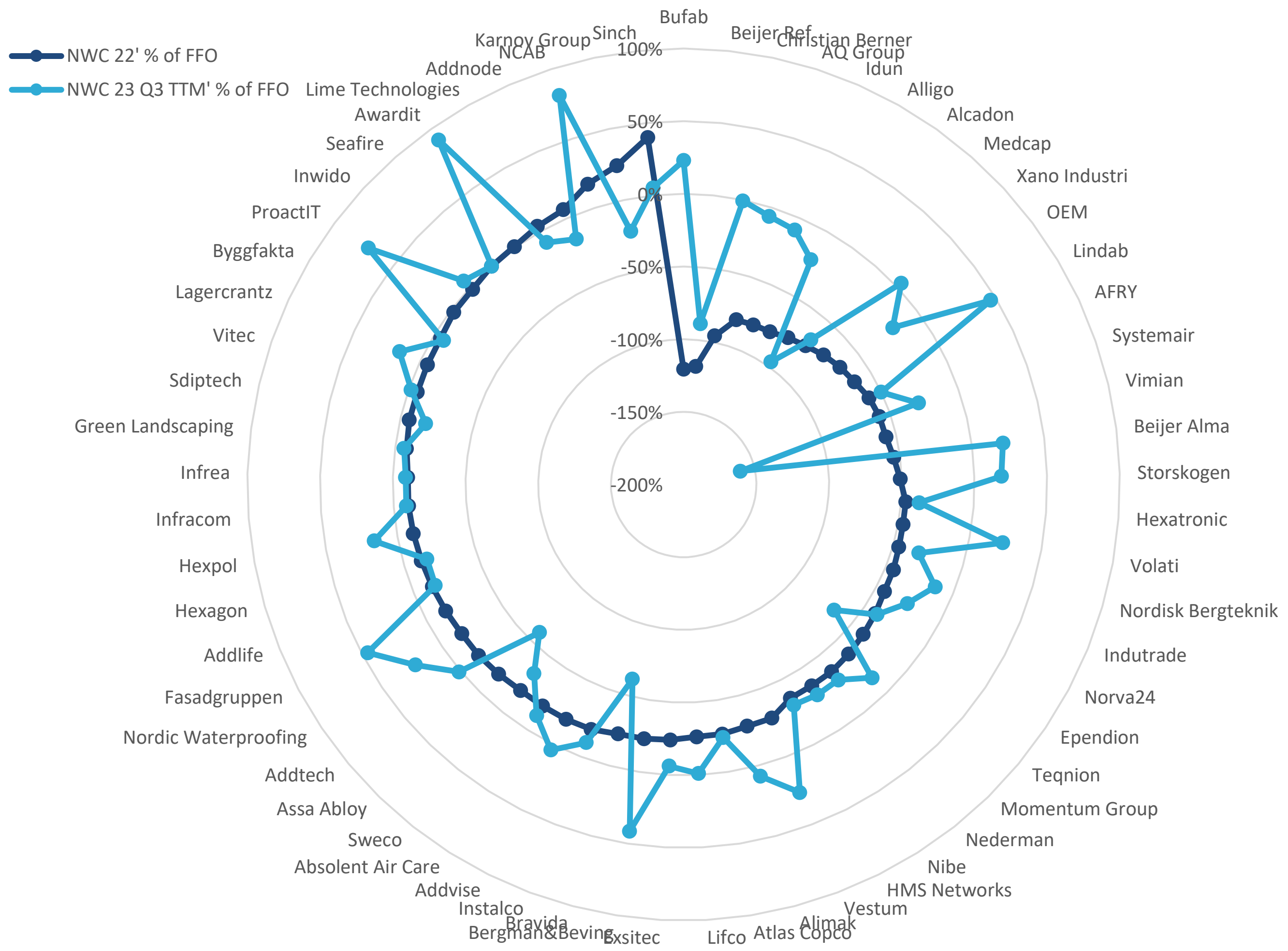
Potentail NWC Release in a Slower Growth Environment

Current state on a company-specific level



This chart illustrates the NWC as a percentage of FFO for the year 2022 and the trailing twelve months (as of 2023 Q3).

It is evident that more companies are currently

1) releasing NWC and
2) tying up less capital than observed in 2022.

If historical patterns, such as those seen during the GFC in 2009 and the COVID-19 pandemic in 2020, repeat themselves, we are likely to witness a further release of net working capital in the upcoming year/s. This trend would help maintain cash flow levels and reduce debt, all else being equal.

For many companies, this anticipated decrease in NWC could expand M&A headroom, presenting favorable opportunities for inorganic growth.

> *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.*

***Jörgen Wigh, CEO of Lagercrantz**, Redeye 2023 Q3 interview*

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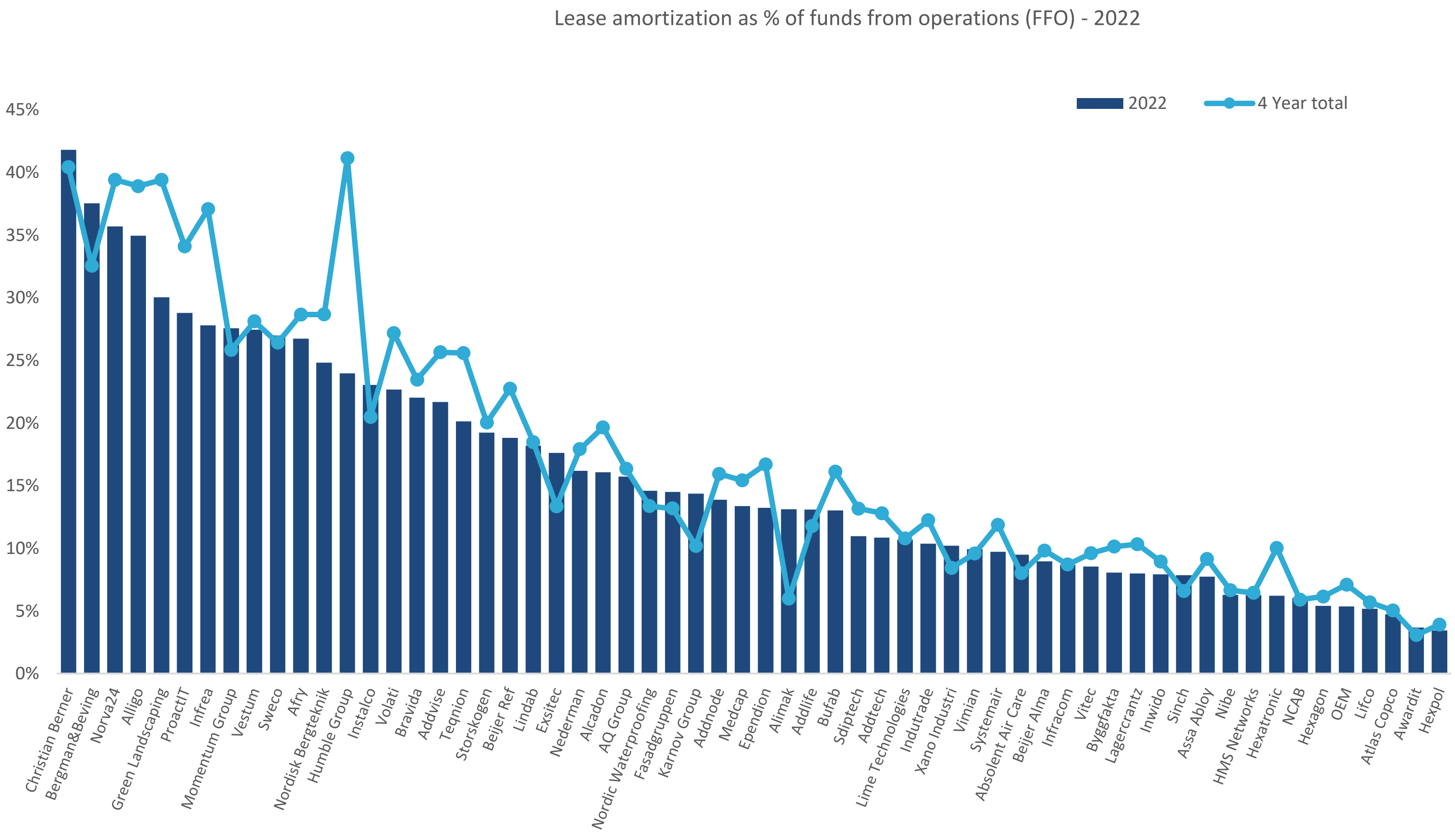
Source: Company reports

Capital Efficiency

Lease payments in cash flow as % of FFO

Capital Allocation and Cash Flows



- One important part of our analysis is to look at the capital efficiency of the group of acquisition-driven compounders. We like our holdings to generate as much cash flow as possible.
- On the char to the left, we show how capital efficient a large group of Swedish acquisitive companies are.
- When measuring capital efficiency, we look at how representative operating cash flow is to FCF and how capital light the companies are in terms of capex-spending.
- Starting by looking at lease payments (under financing activities according to new IFRS16 rules), we can see that operating cash flow is in various degrees close to the operating cash flow reported pre-IFRS 16.
- Hexpool, Awardit, Lifco, OEM, Hexagon and NCAB have under the new accounting standards operating cash flows that represents a “true” picture compared to previous standards.

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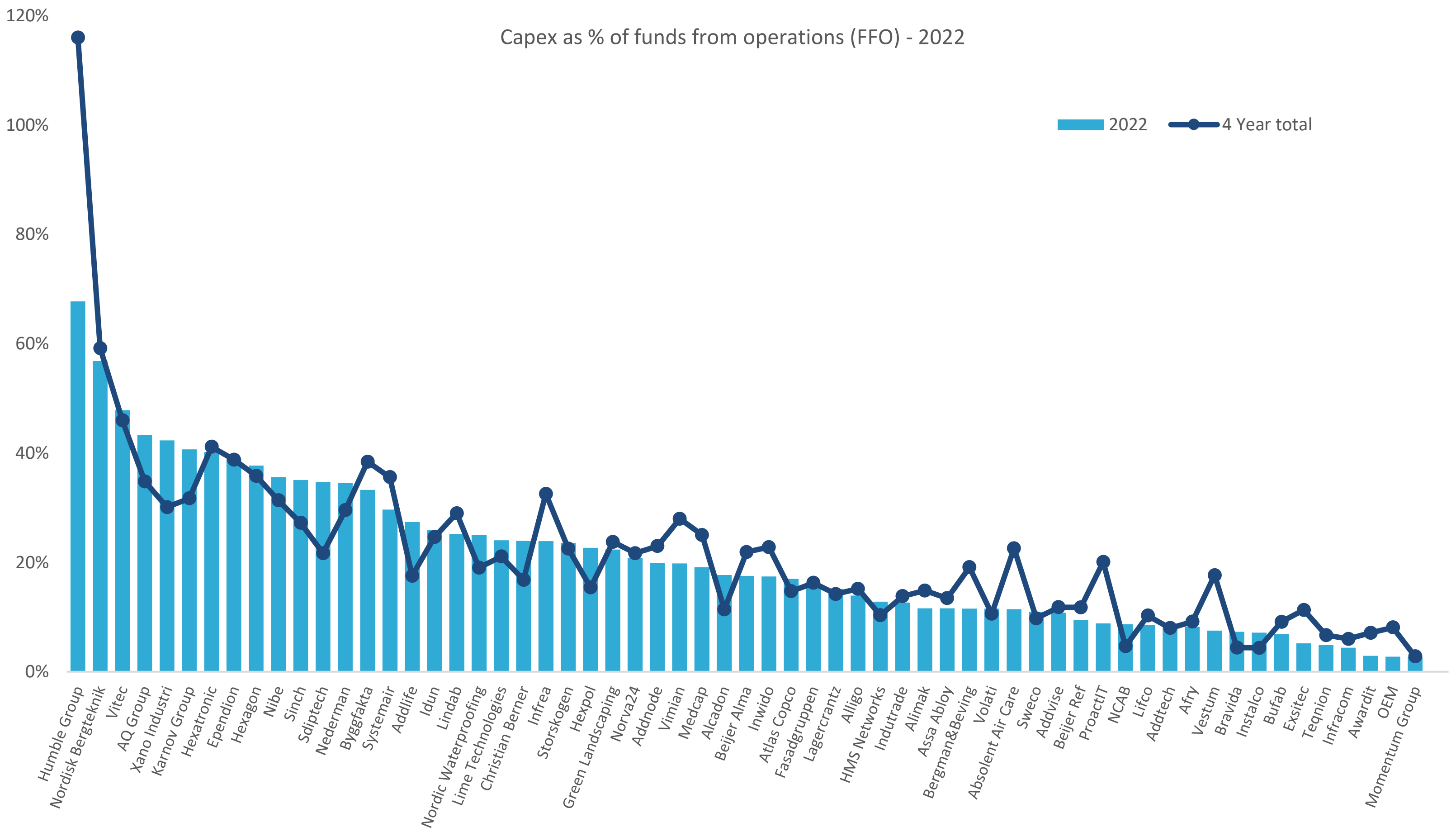
Source: Company reports

Capital Efficiency

Capex as % of FFO



- When studying how capital light the companies are, we also need to consider how much they spend on capex.
- Many of the long-term winners like Addtech, Lifco, OEM, Bufab, Beijer Ref etc have very low capex-levels, which makes room for a higher capital allocation to value accretive M&A.
- The chart displays capex as % of FFO during 2022 and a 4-year period (2019-2022).

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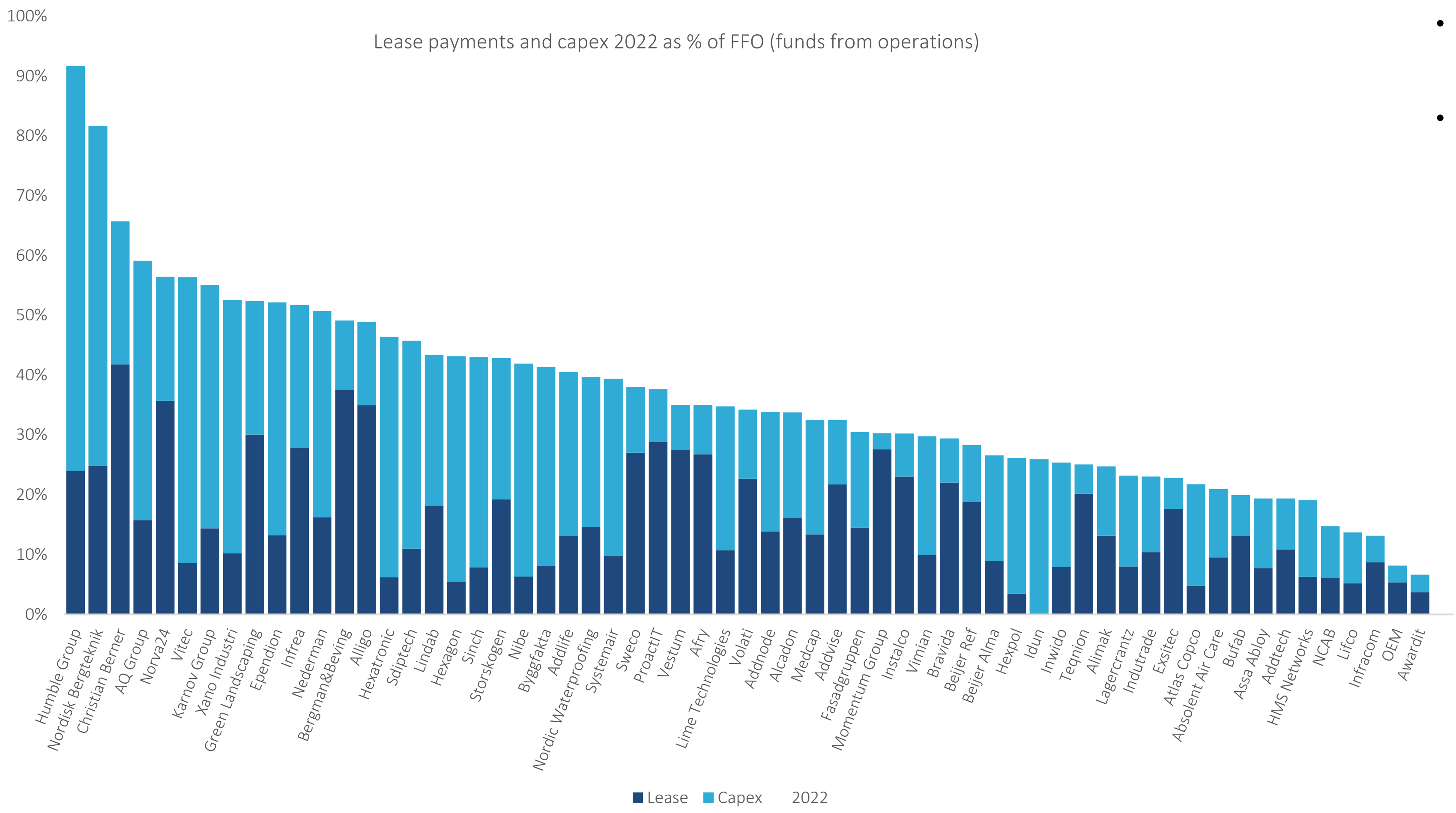
Source: Company reports

Capital Efficiency

Capex as % of FFO

Capital Allocation and Cash Flows



- Combining these two, we can spot large variations in capital efficiency.
- In our Nordic portfolio, the majority of the companies we own are below average on this chart, meaning that we invest in companies that display high capital efficiency.

Source: Company reports

The Value of a Strong Balance Sheet

REQ CAPITAL
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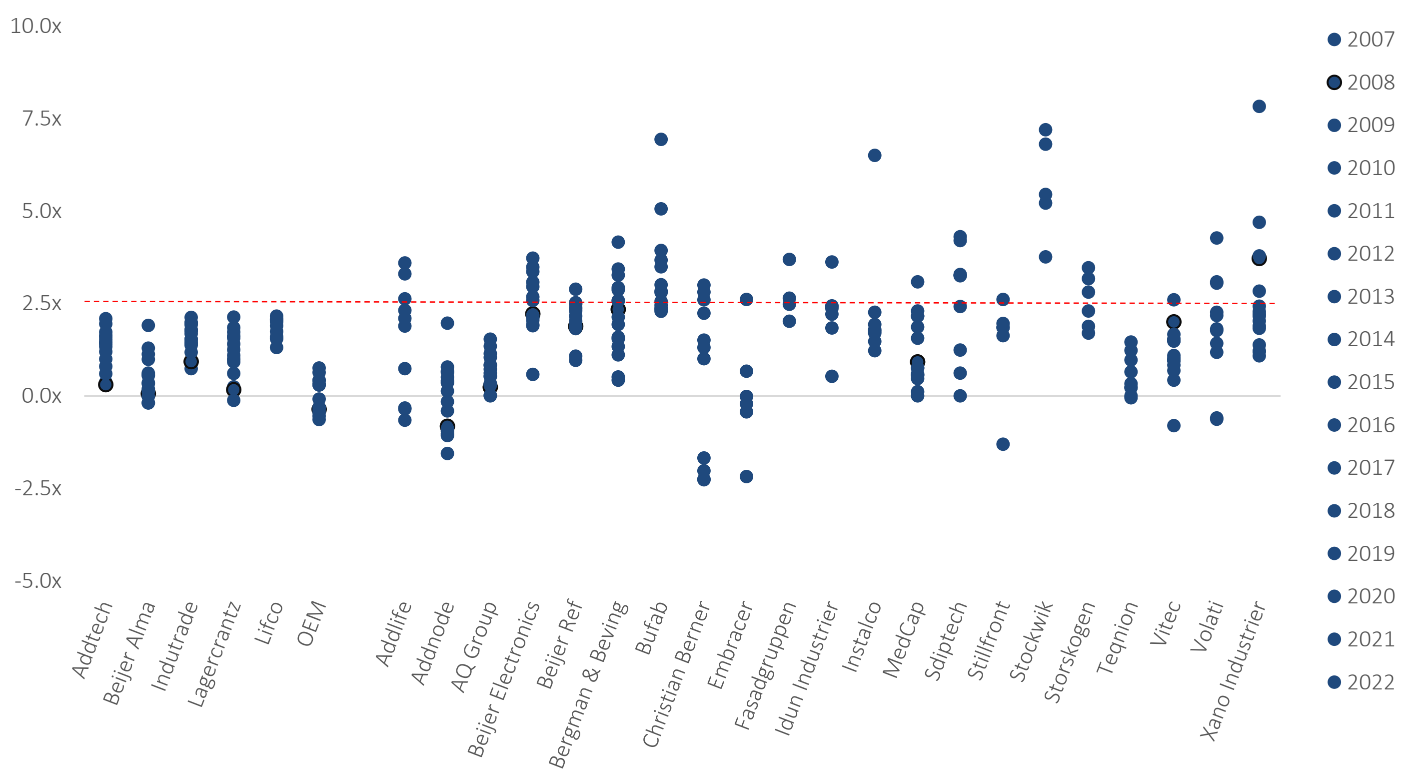
Net Debt to EBITDA-levels



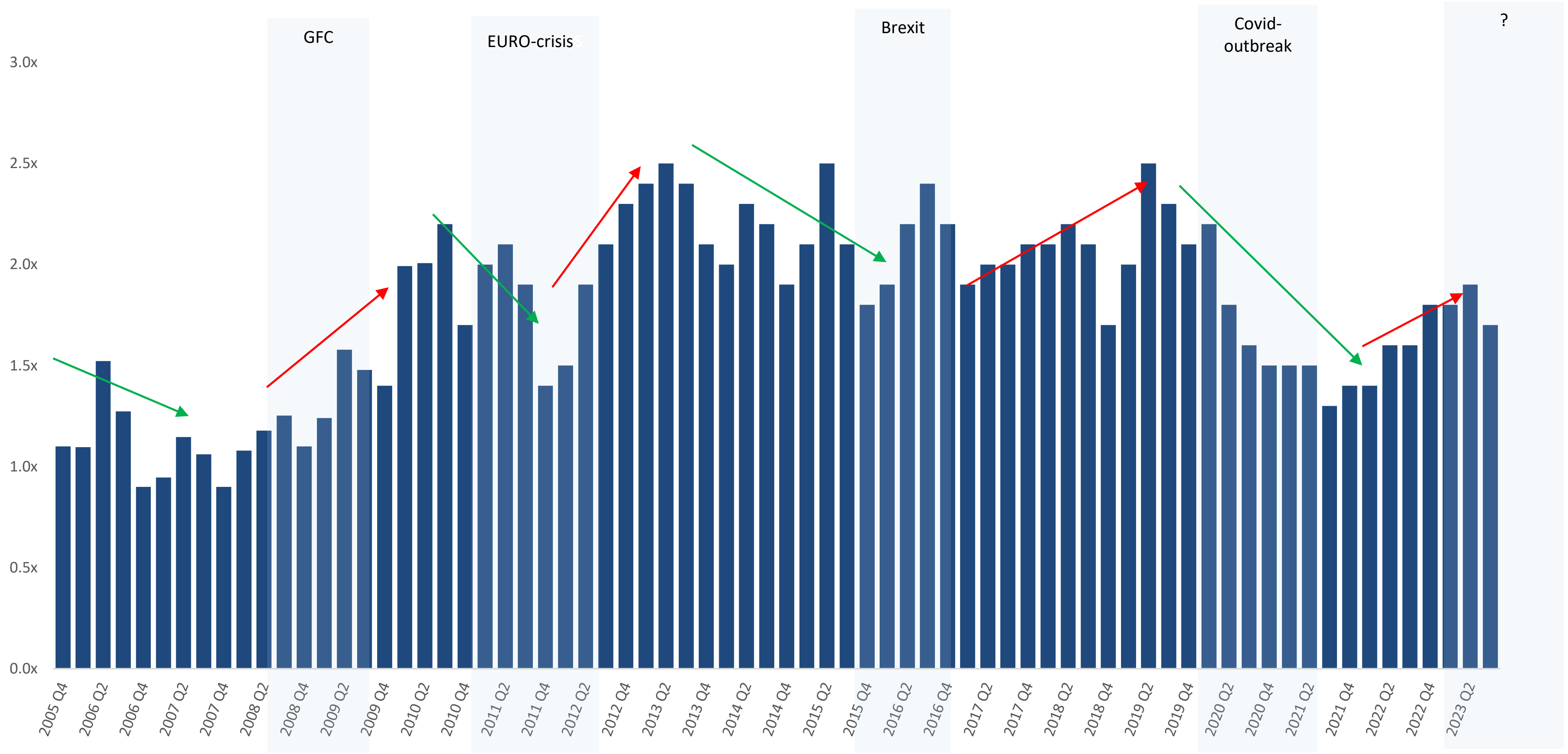
- What we see from the best Acquisition-driven Compounders like Addtech, Lifco, Lagercrantz and Indutrade is that they exceed 2.5x in Net debt to EBITDA.
- They always operate and think “through the cycle” with a long-term mindset.

Source: Company reports

Case in Point - Indutrade

Decreasing leverage in good times and investing through poor times

The Value of a Strong Balance Sheet



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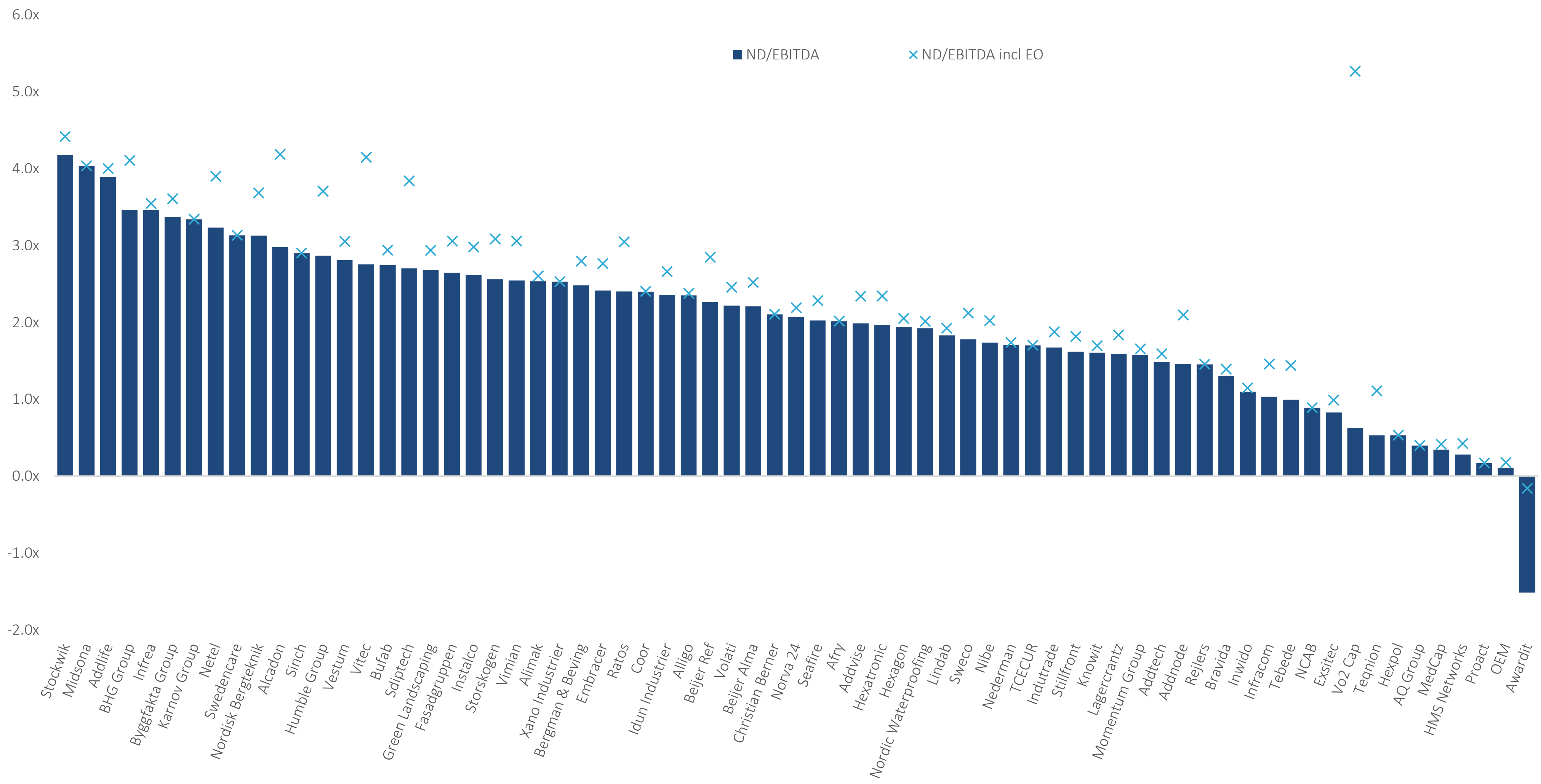
Source: Company reports

Net Debt to EBITDA – Current Trading

Net debt to EBITDA (incl. Leasing) 2023 Q3 (x represent incl. Earn-outs on balance sheet)

The Value of a Strong Balance Sheet

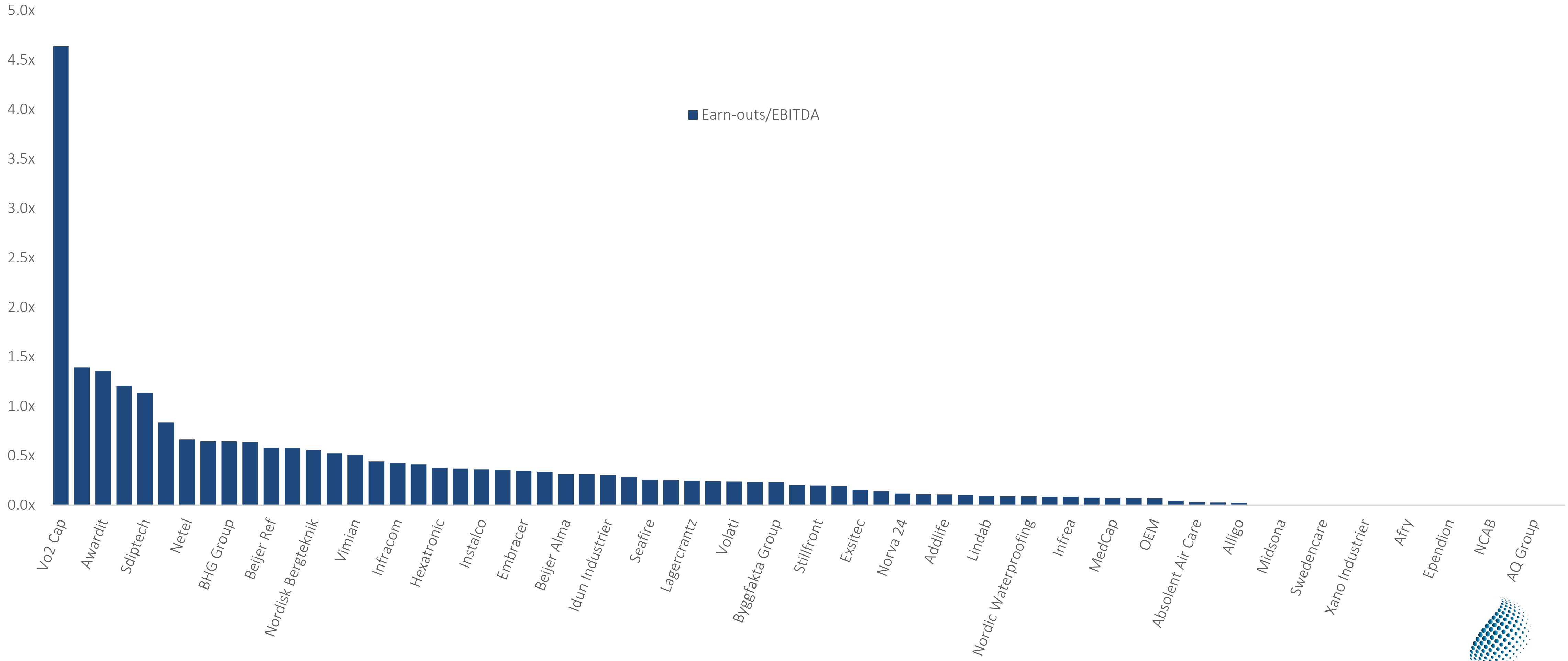


Source: Company reports

Contingent Considerations to EBITDA

As per 2023 Q3

The Value of a Strong Balance Sheet

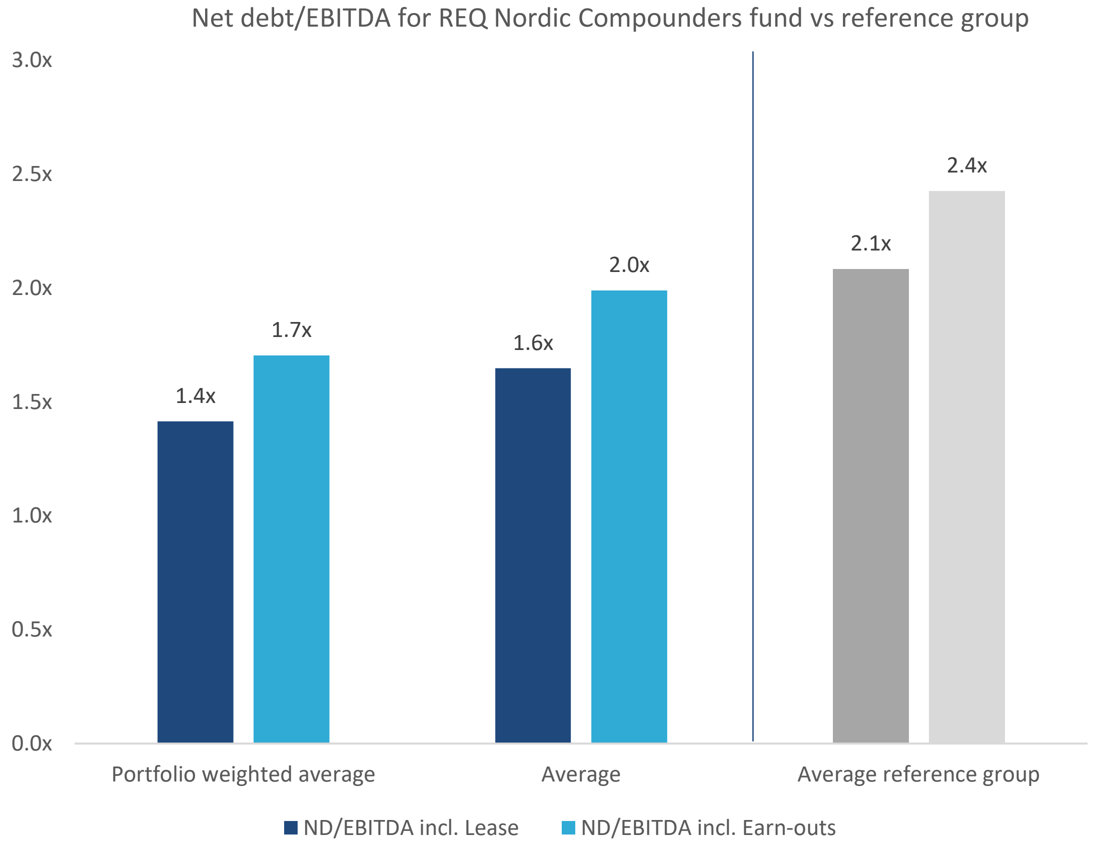


Source: Company reports

Lower Leverage Levels REQ Nordic Compounders vs Peer Group

Net debt/EBITDA per 2023-09-30 inlcuding lease liabilities

The Value of a Strong Balance Sheet



- Our REQ Nordic Compounders fund has on average lower leverage levels compared to the reference/peer group.
- On a portfolio-weighted basis, the Nordic Compounders fund has a Net debt/EBITDA ratio of 1.4x, compared to 2.1x for the peer group.
- When adjusting for lease liabilities, Net debt/EBITDA ratios are lower as lease liabilities on average constitute 10-15% of total gross interest-bearing debt.
- If all companies in the Nordic Compounders portfolio were equally weighted, the leverage ratio would be 1.6x, which still is significantly lower than the peer group.
- The leverage for the Nordic Compounders portfolio is also lower when earn-out liabilities (contingent considerations) are taken into account, compared to the peer group.

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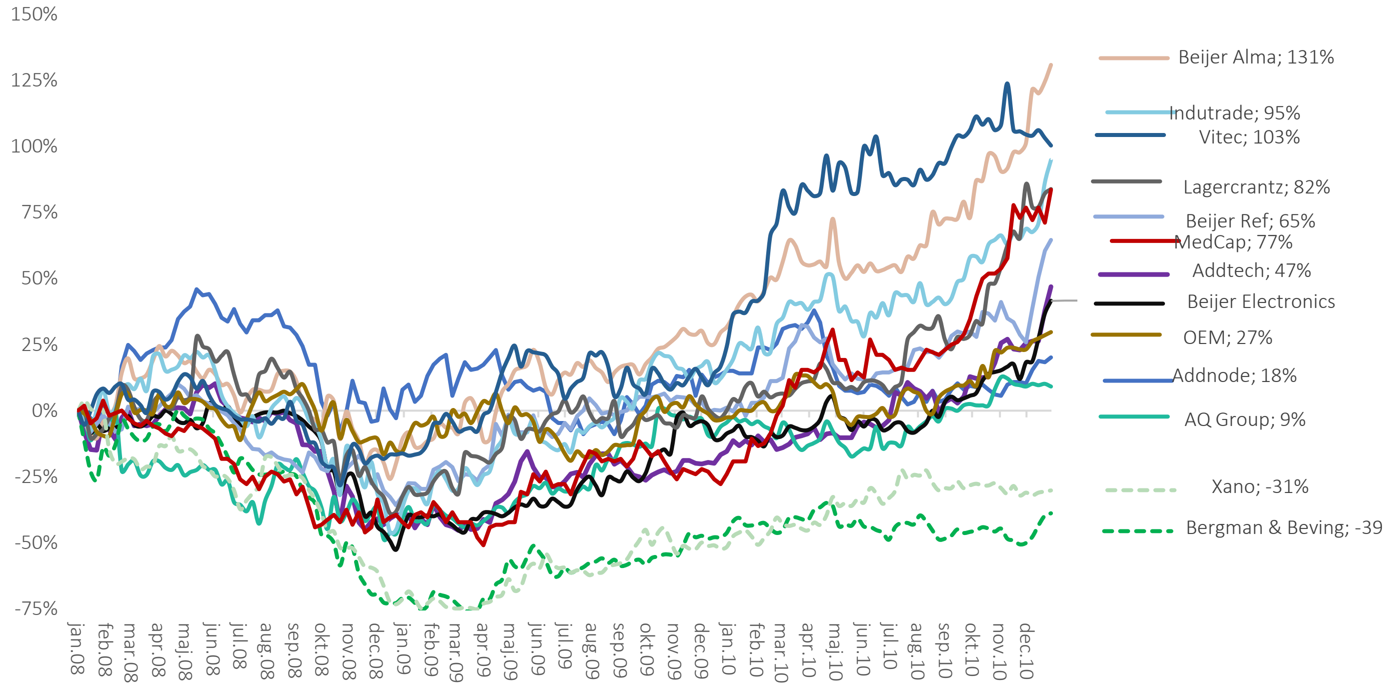
Source: Company reports & REQ data on positions

The Value of a Strong Balance Sheet

Share price performance during GFC (Great Financial Crisis) 2008-2010



	EBITDA-margin				NIBD/EBITDA				Maximum drawdown
	2007	2008	2009	2010	2007	2008	2009	2010	GFC
Addnode	12.8%	11.7%	6.7%	7.4%	-1.1x	-0.8x	-1.6x	-0.9x	-8.9%
Addtech	11.2%	10.1%	8.0%	10.4%	0.4x	0.3x	-0.1x	0.4x	-45.4%
AQ Group	9.1%	9.1%	6.8%	6.9%	0.6x	0.2x	0.3x	0.5x	-48.8%
Beijer Alma	21.5%	19.8%	19.7%	20.8%	0.1x	0.1x	-0.2x	-0.2x	-25.9%
Beijer Electronics	10.5%	10.9%	8.5%	12.7%	0.6x	2.2x	2.1x	2.0x	-52.7%
Beijer Ref	10.7%	9.9%	6.7%	6.9%	1.8x	1.9x	1.1x	1.0x	-35.9%
Bergman & Beving	8.1%	7.4%	4.3%	5.2%	1.9x	2.3x	4.2x	3.4x	-76.2%
Indutrade	12.6%	13.2%	11.0%	11.9%	0.7x	0.9x	1.2x	1.5x	-46.0%
Lagercrantz	6.4%	7.1%	5.3%	8.7%	0.2x	0.2x	-0.1x	1.1x	-38.9%
Medcap	6.9%	3.1%	9.8%	11.2%	0,1x	-0,1x	0,6x	0,1x	-51.0%
OEM	9.4%	10.1%	7.8%	11.6%	-0.3x	-0.4x	-0.5x	-0.5x	-19.0%
Vitec	16.5%	13.3%	12.6%	13.2%	2.6x	2.0x	1.7x	-0.8x	-28.3%
Xano	14.1%	11.8%	8.5%	12.4%	2.8x	3.7x	7.8x	2.2x	-75.2%

Source: Company reports & Factset (2023-11-15)

- In economic downturns, investors tend to focus more on balance sheets and thus leverage.
- Even though we provide a view of a small sample of companies, we can see that there is some correlation between share price performance and leverage (at least in the short and medium term).
- From year-end 2007 and throughout the Great Financial Crisis, the companies with the highest NIBD/EBITDA levels also had the largest draw downs in share price; Bergman & Beving –76% and Xano -75%.
- In addition to having the largest draw downs, their share prices did not recover in the near-term post crisis period as strongly as the winners.
- The two companies with the lowest (and negative) NIBD/EBITDA levels experienced the smallest drawdowns (Addnode -9% and OEM -19%).

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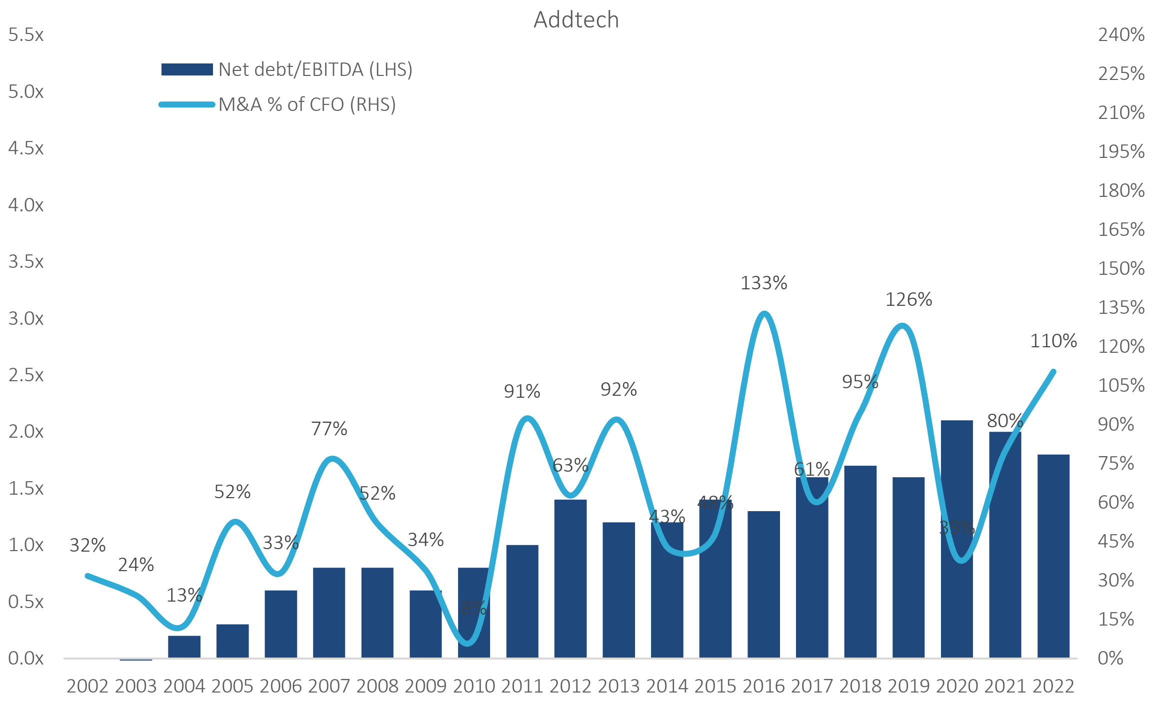
Case Study – Addtech & Bergman & Beving (BB Tools)

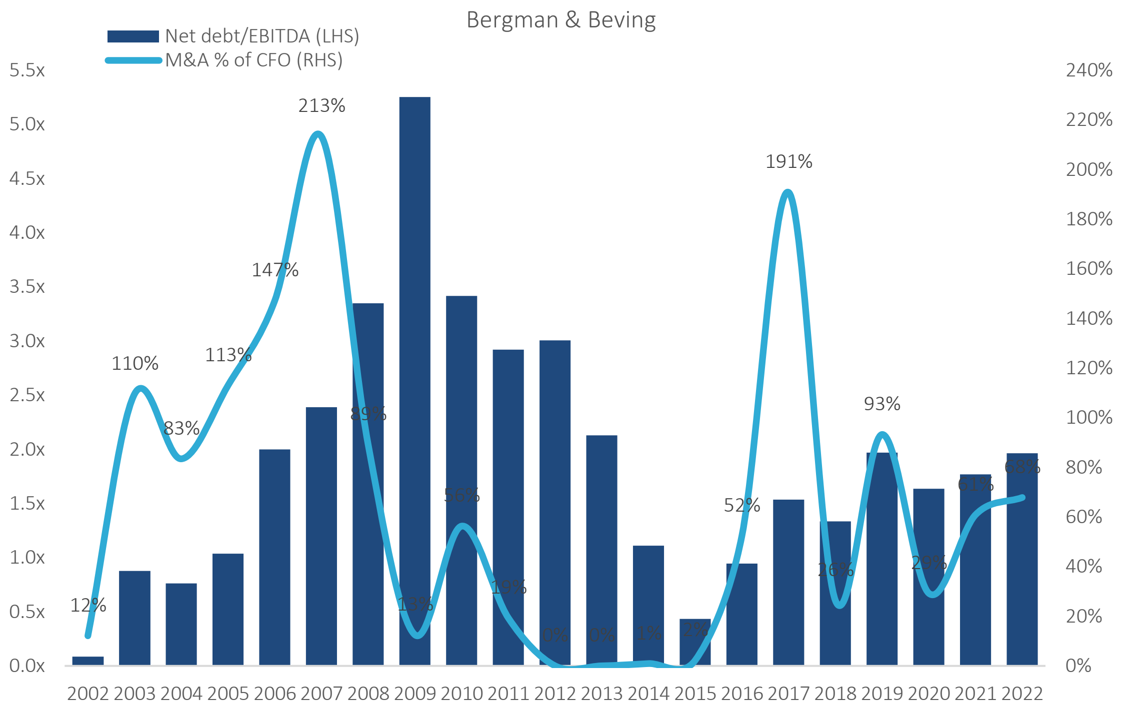
Why a solid balance sheet matters

The Value of a Strong Balance Sheet

Addtech – net debt/EBITDA and M&A spend as % of CFO



Bergman & Beving – net debt/EBITDA and M&A spend as % of CFO



Source: Company reports

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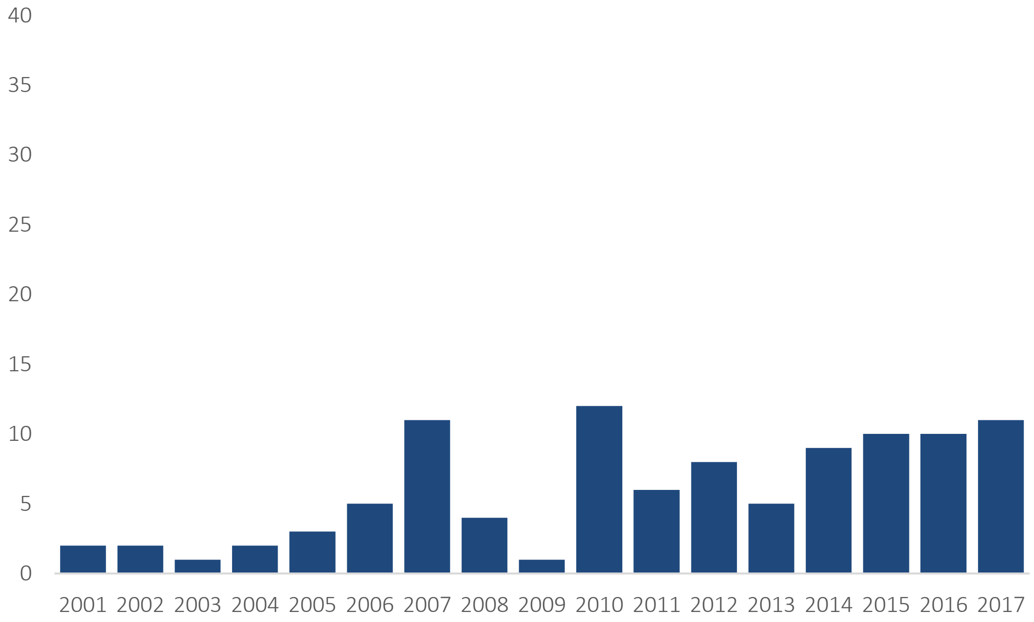
Case Study – Addtech & Bergman & Beving (BB Tools)

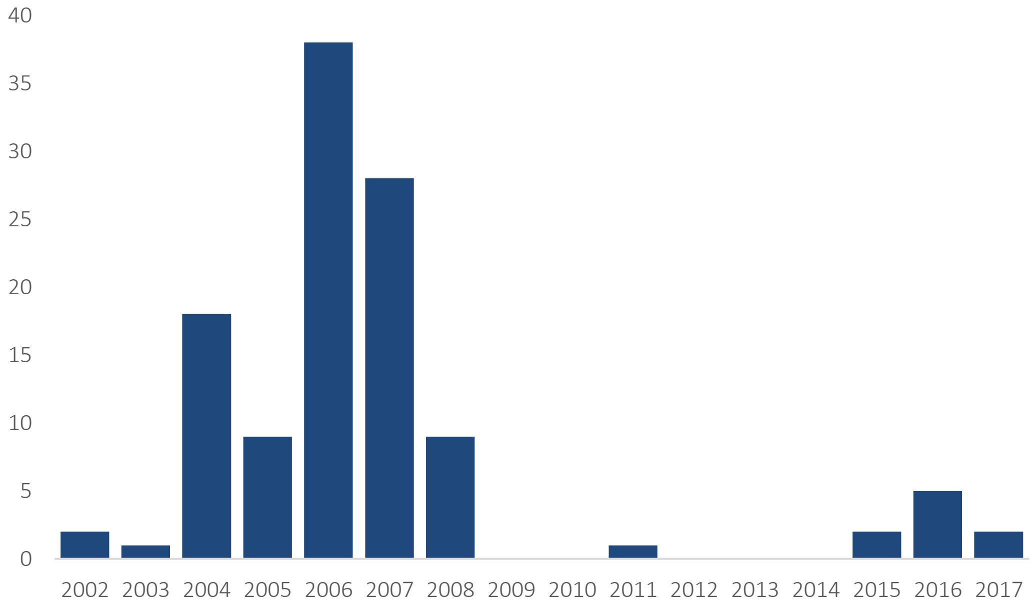
Why a solid balance sheet matters

The Value of a Strong Balance Sheet

# of acquisitions Addtech



# of acquisitions Bergman&Beving



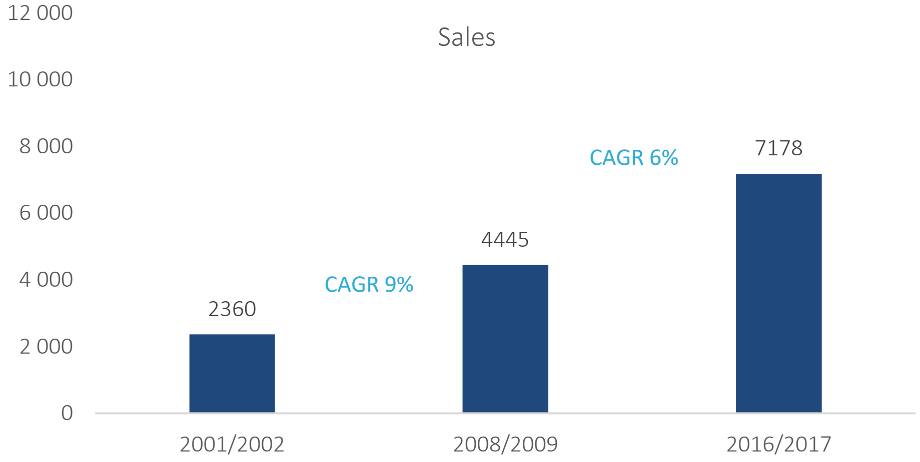
Source: Company reports

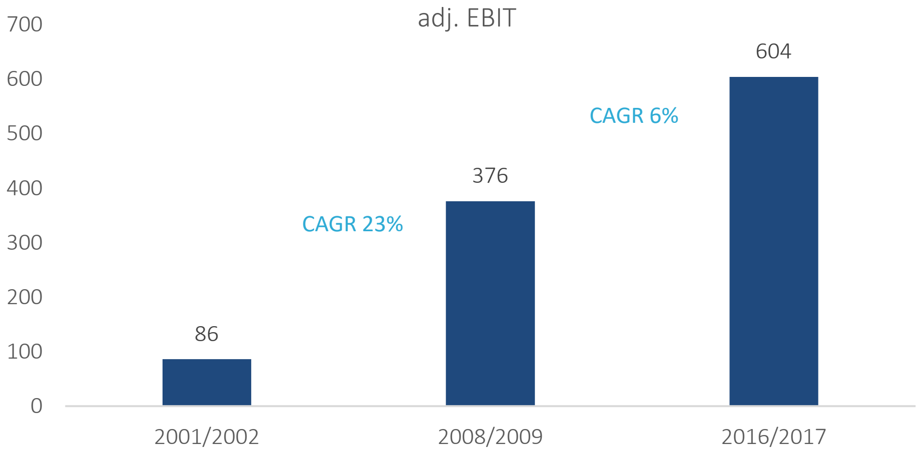
Case Study – Addtech & Bergman & Beving (BB Tools)

Why a solid balance sheet matters

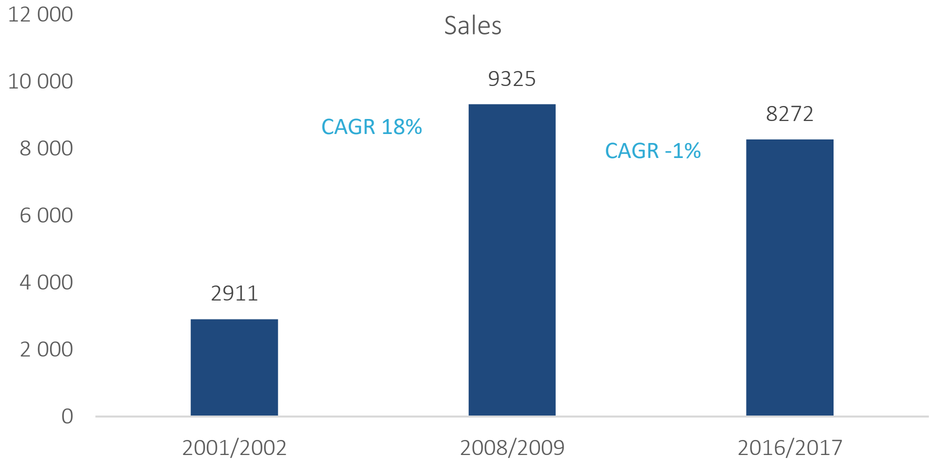
The Value of a Strong Balance Sheet

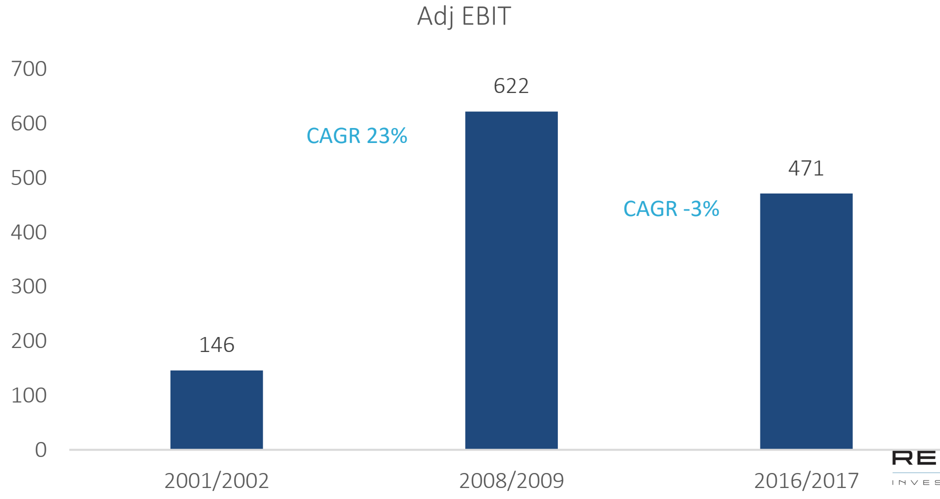
Growth in sales/EBIT - Addtech





Growth in sales/EBIT - Bergman&Beving





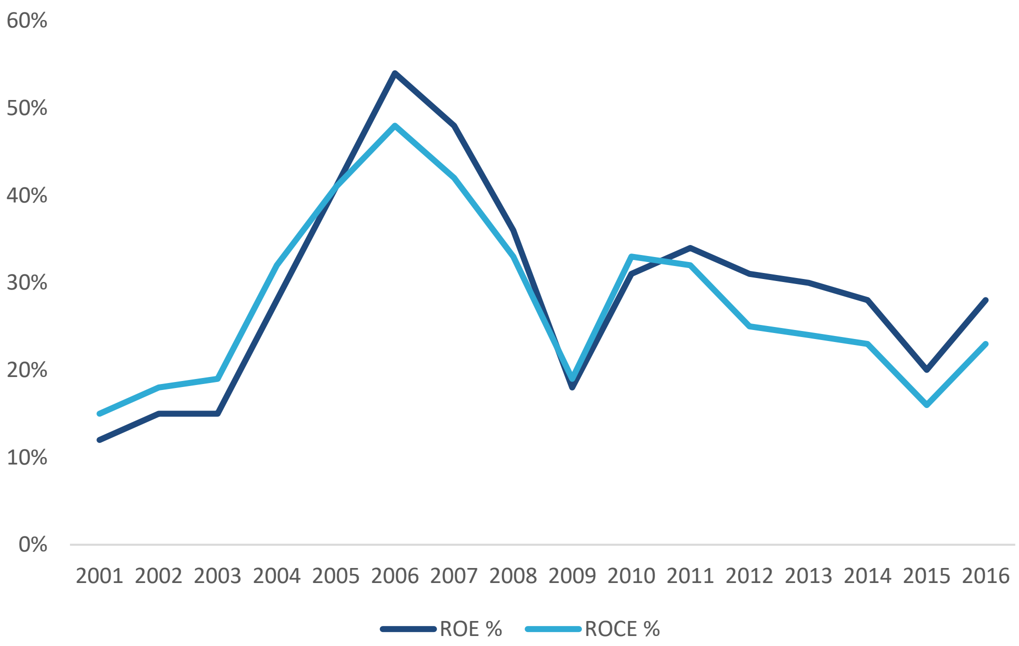
Source: Company reports

Case Study – Addtech & Bergman & Beving (BB Tools)

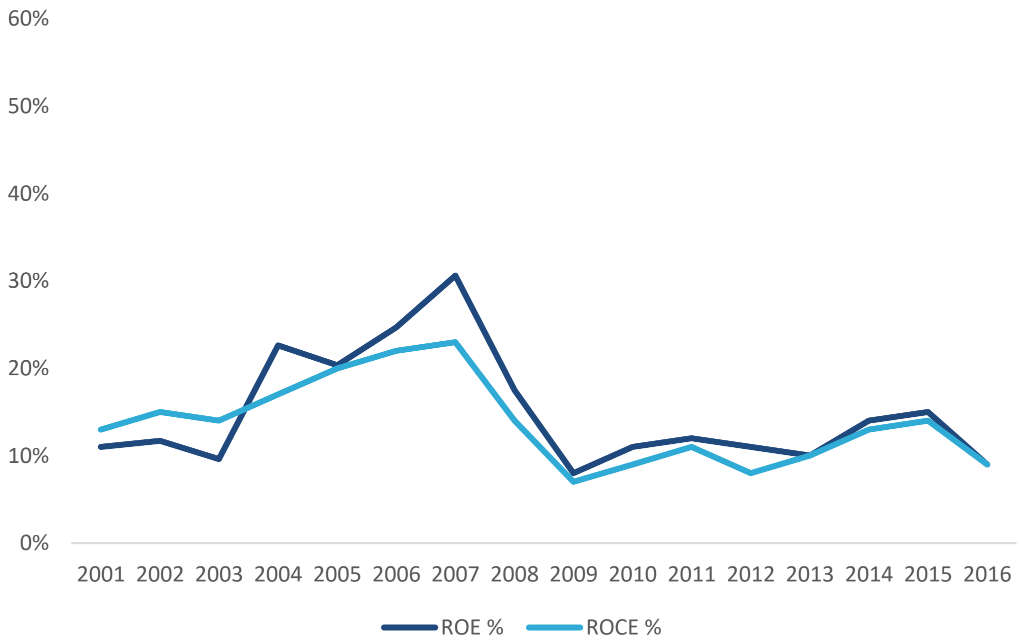
Why a solid balance sheet matters

The Value of a Strong Balance Sheet

ROE and ROCE - Addtech



ROE and ROCE - Bergman&Beving



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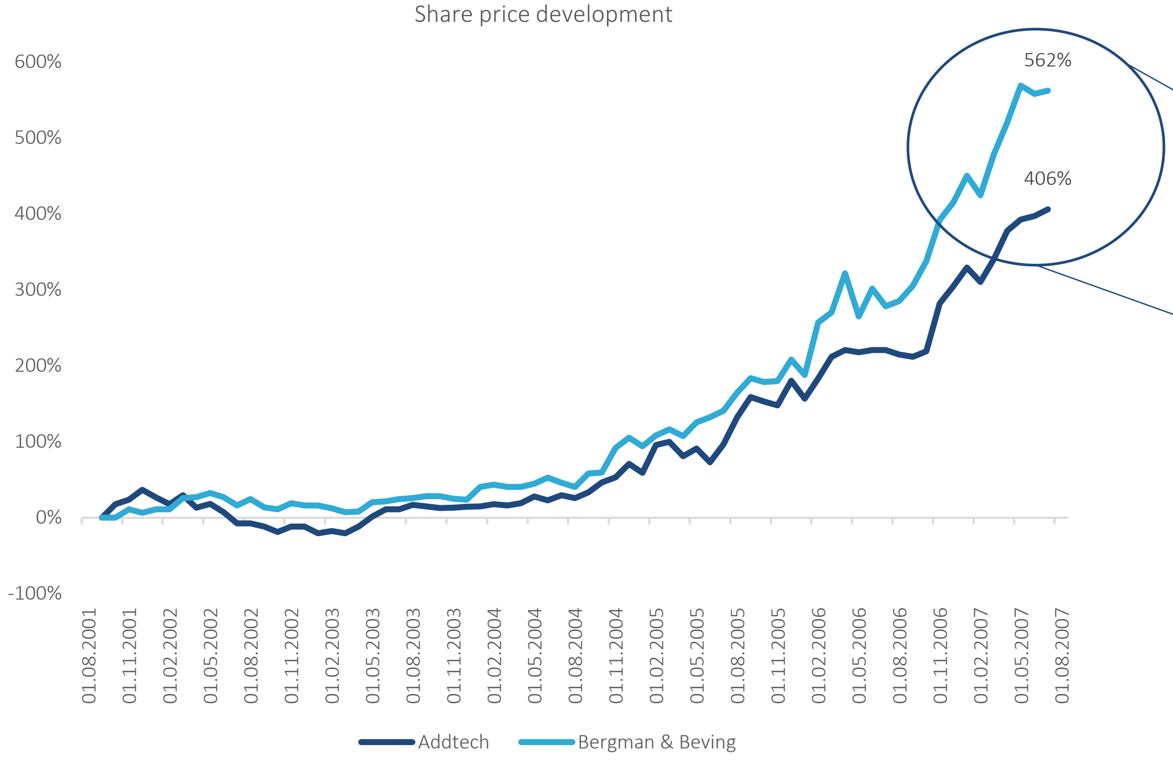
Source: Company reports

Case Study – Addtech & Bergman & Beving (BB Tools)

Why a solid balance sheet matters

The Value of a Strong Balance Sheet

Bergman & Beving had a better share price development from 2001- July 2007…



…but the too aggressive M&A agenda and high leverage proved to destroy shareholder value

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Source: Factset

Case Study – Addtech & Bergman & Beving (BB Tools)

Why a solid balance sheet matters

The Value of a Strong Balance Sheet

Over a 6-year span from 2001 to 2007, the experiences of Addtech and Bergman&Beving (at that time called BB Tools) ("B&B") offer valuable insights. One notable observation is that, in the short term, the market tends to favor acquirers embracing a more aggressive stance in M&A, actively pursuing high growth by deploying more capital in M&A activities than they generate in cash flow.

Examining Addtech and Bergman&Beving during this timeframe reveals that, between 2001 and mid-2007, the market rewarded Bergman&Beving's growth and a more aggressive capital allocation strategy, despite lower returns on capital (ROE and ROCE), displaying the markets in some periods short-term focus on mainly the profit and loss statement.

During this period, Bergman&Beving, then operating under the name BB Tools, shifted its strategy from full decentralization to a more centralized approach, consolidating tool chain stores as part of its expansion in the Nordic tools market. The CEO of B&B stated in the 2002/2003 annual report; "all industries will in due time be consolidated", setting the stage for an acquisition spree that culminated in over 100 acquisitions by 2009.

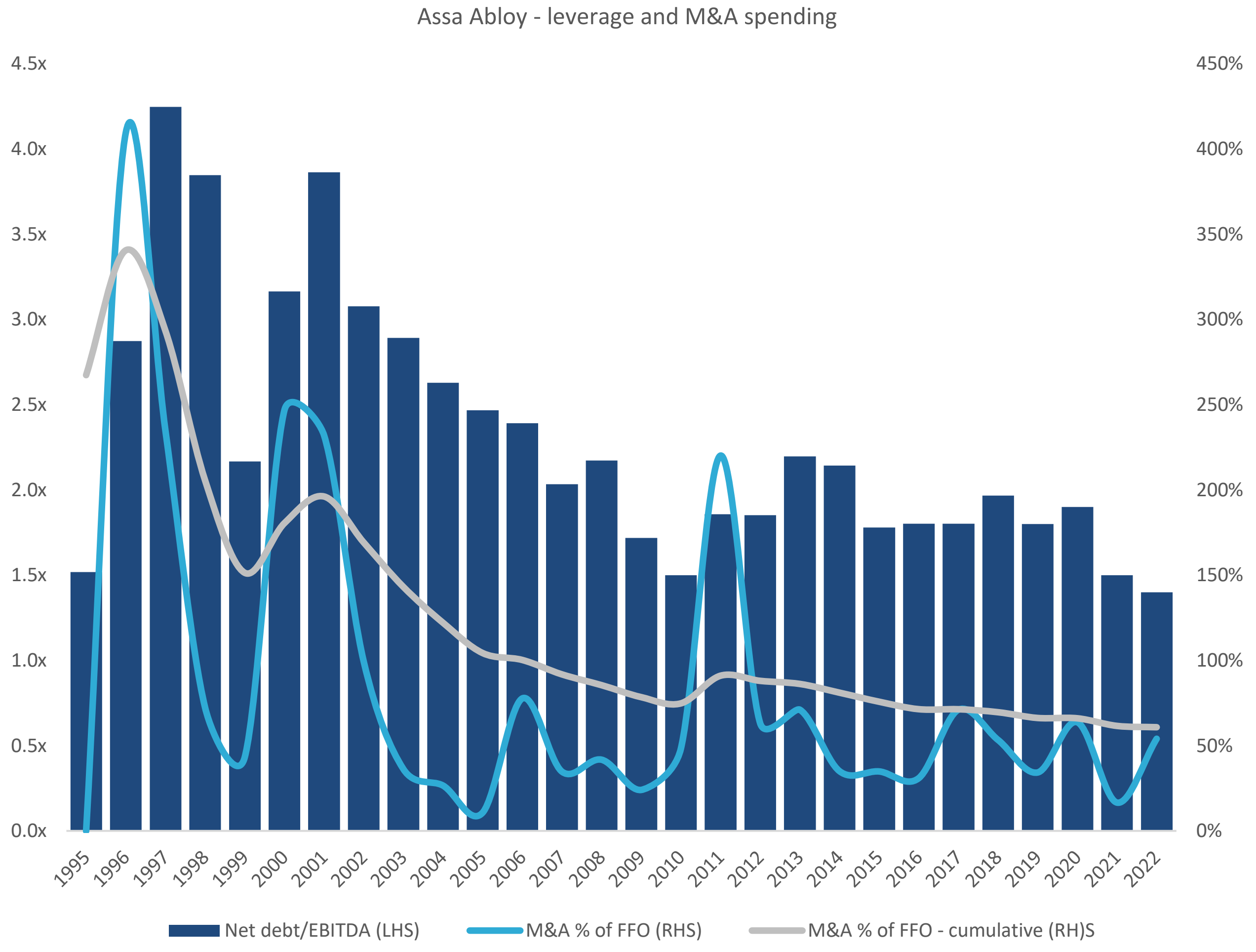
Although the stock market favored BB Tools over Addtech until 2007, the excessively aggressive acquisition spree, coupled with escalating debt levels—worsened by even higher relative leverage during the 2008/2009 profit downturn—ultimately eroded shareholder value over an extended period. In contrast, Addtech adopted a more disciplined approach to M&A and managed its balance sheet wisely, resulting in long-term outperformance compared to Bergman&Beving.

In our search for the best acquirers, we emphasize the significance of a disciplined M&A approach, high returns on capital and a prudent perspective on risk and capital allocation. The sustained outperformance of Addtech over an extended duration serves as a compelling illustration of the rewards associated with such a strategic and balanced approach.

Assa Abloy – A Case Study

Capital allocation priorities and outcomes in different phases of the company

The Value of a Strong Balance Sheet



- As we on the previous slides showcased BB Tools and Addtech with regards to different capital allocation priorities and leverage, we will on coming slides show Assa Abloy from 27-year perspective.
- Illustrated by the chart, we can see that Assa Abloy the first years post IPO (IPO by the end of 1994), spent more than 100% of its cash flow from operations (FFO) and operated with a high leverage of between 2-4x EBITDA.
- From 1995 to 2002, Assa Abloy completed close to 60 acquisitions, spending >SEK 20bn on M&A.
- From IPO in November 1994 to mid-2001 the share price increased by 3,300%.
- However, from mid-2001 to mid-2012 the share price was flat for Assa Abloy so the question is what happened?
- On the next slide we will show Assa Abloy from a capital allocation perspective and then discuss our thoughts.

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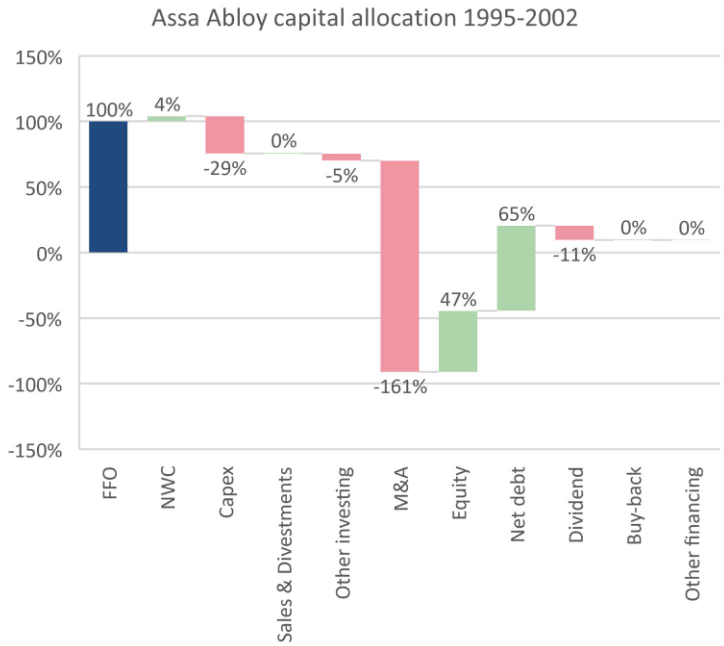
Source: Company reports

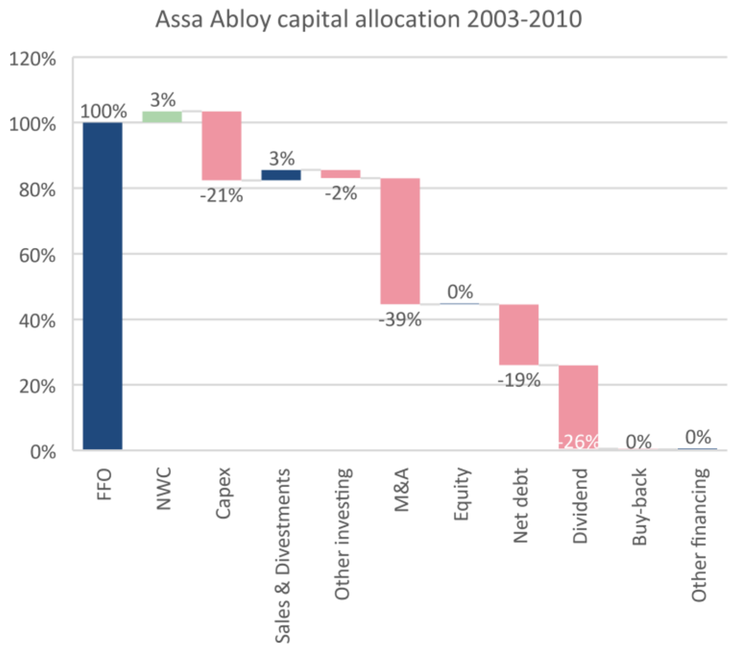
Assa Abloy – A Case Study

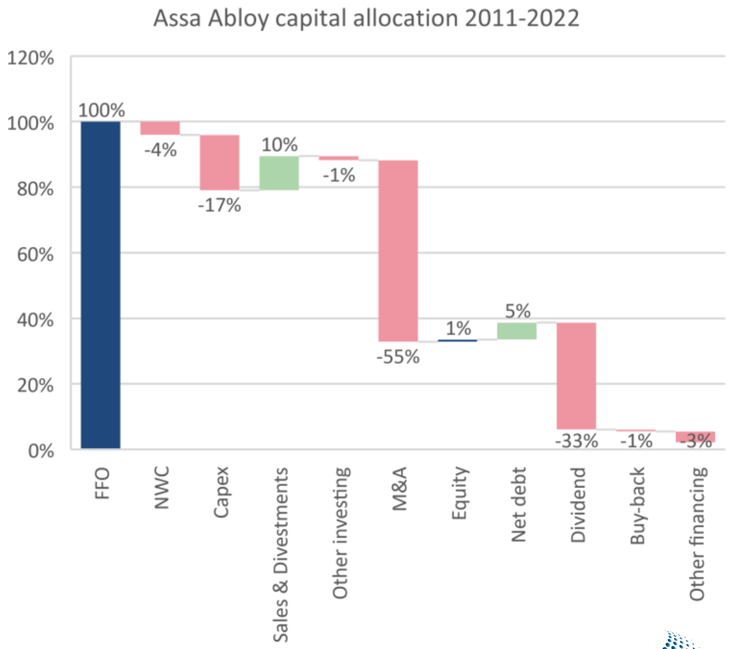
Capital allocation priorities and outcomes in different phases of the company

[The Value of a Strong Balance Sheet]

- We devide Assa Abloy in three phases from a capital allocation perspective;
  1) Super growth supported by a strong M&A pace financed by increased debt and equity issues of around SEK 5.6bn (Sales CAGR 28%)
  2) Consolidation with low growth of acquired entities and focus on strengthening the balance (Sales CAGR 5%)
  3) Re-activated growth mode in a more modest pace (Sales CAGR 10%)







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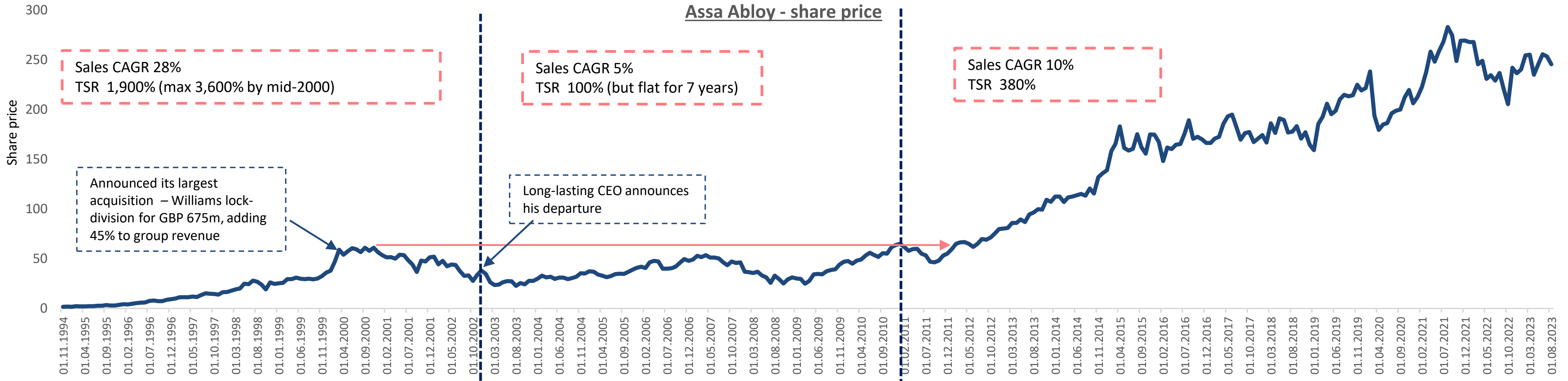
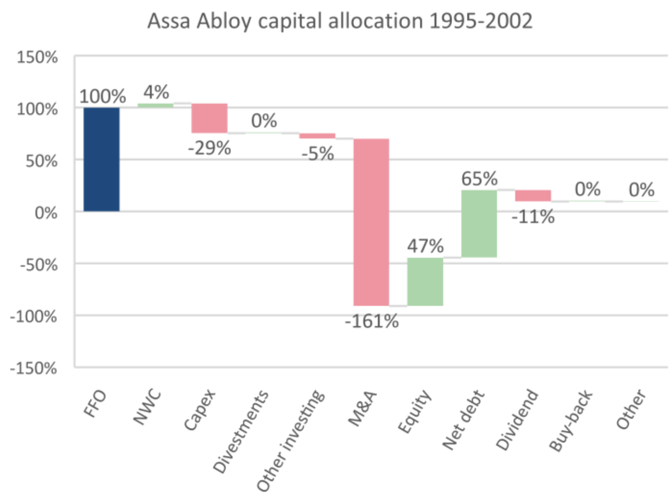
Source: Company reports

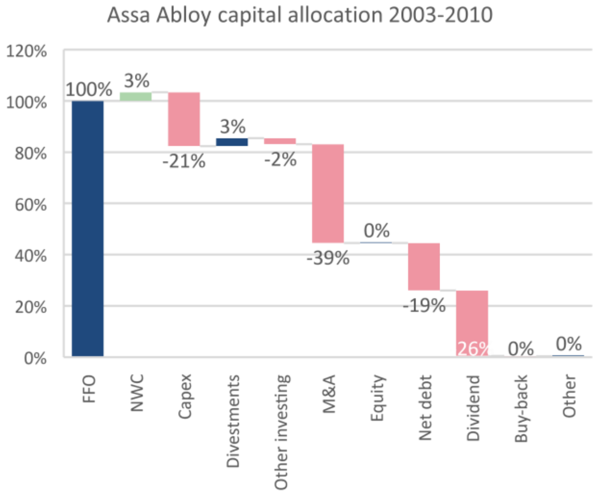
Assa Abloy – A Case Study

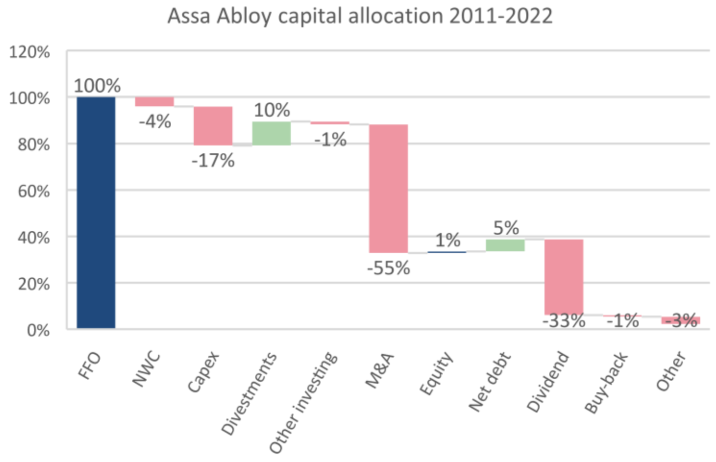
Capital allocation priorities and outcomes in different phases of the company

The Value of a Strong Balance Sheet







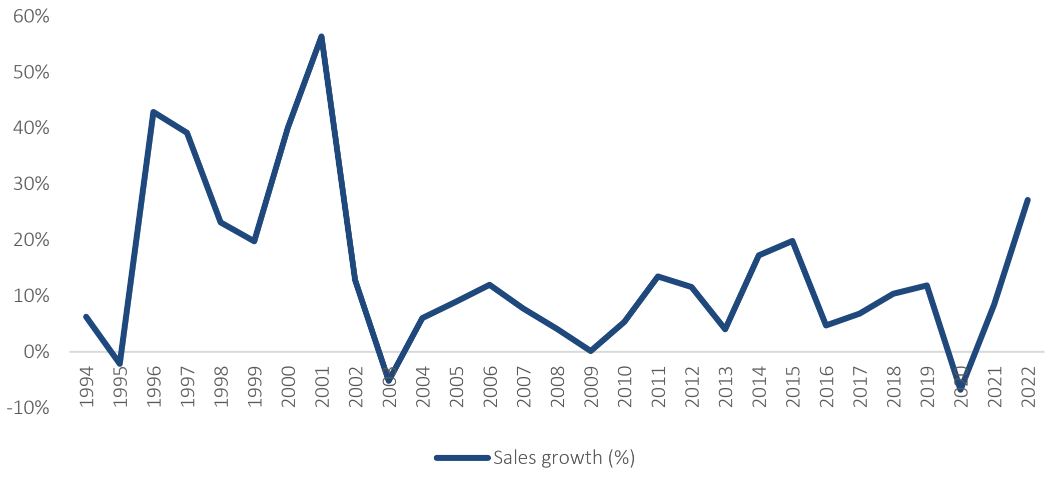


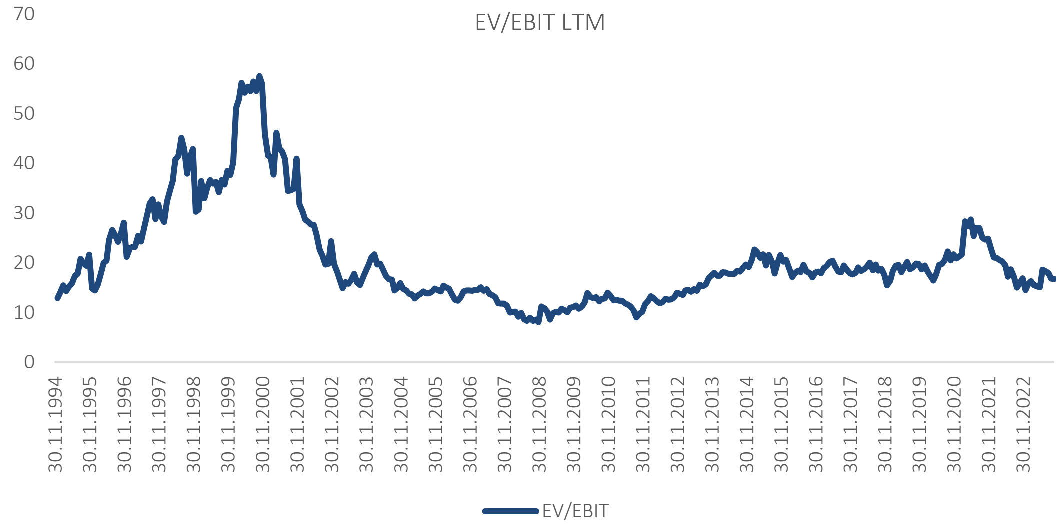
Source: Company reports & Factset

Assa Abloy – A Case Study

Capital allocation priorities and outcomes in different phases of the company

The Value of a Strong Balance Sheet





When growth slowed down for Assa Abloy, the company also saw its valuation multiples falling.

From the peak in 2020, valuation multiples (measured as EV/EBIT) comperessed from 57x to 8x by 2018.

In the third phase of the company when they used 50-60% of its operating cash flow to acquire companies (a level of that we see in other acquirers), embracing a prudent approach to capital allocation and risk, we see that multiples have increased since to around 15-20x, in line with many other larger industrial companies.

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Source: Company reports & Factset

Assa Abloy – A Case Study

Lessons from Assa Abloy

Assa Abloy serves as a compelling case study when considering both short-term and long-term perspectives. In the initial years following its IPO/spin-off from Securitas, the company embarked on an aggressive M&A spree, acquiring approximately 60 companies and investing over SEK 20 billion in acquisitions, coupled with an additional SEK 3.5 billion in capital expenditures.

During this initial phase, Assa Abloy experienced a significant increase in its share price, driven by high growth in earnings per share and free cash flow per share, marking a remarkable 40% and 42% increase, respectively. The accelerated growth was enabled by equity issuances and increased leverage, evident in the rise of net debt from SEK 0.6 billion to SEK 15.5 billion in 2021, displayed by an increase in net debt/EBITDA from 1.5x to 3.9x from 1995 to 2001. In the early 2000s, Assa Abloy announced its largest acquisition to date, acquiring William PLC’s lock division, inclusive of the well-known brand Yale, for GBP 675 million (which partly was financed with own shares).

Although the stock market initially rewarded Assa Abloy's rapid growth with remarkable returns, the aggressive M&A strategy resulted in higher leverage. Despite the long-term benefits of the Yale acquisition, it took until 2012 for the share price to surpass the levels observed at the end of 2000. While Assa Abloy ultimately achieved long-term success, the second phase of its trajectory yielded a Total Shareholder Return (TSR) of 100%, yet the share price remained flat between 2000 and 2012 during a consolidation phase.

In the third phase, characterized by capital allocation priorities aligned with other acquisition-driven compounders (M&A constituting 50-80% of funds from operations), Assa Abloy successfully reignited growth, rewarding shareholders with EPS growth as well as a valuation multiple expansion.

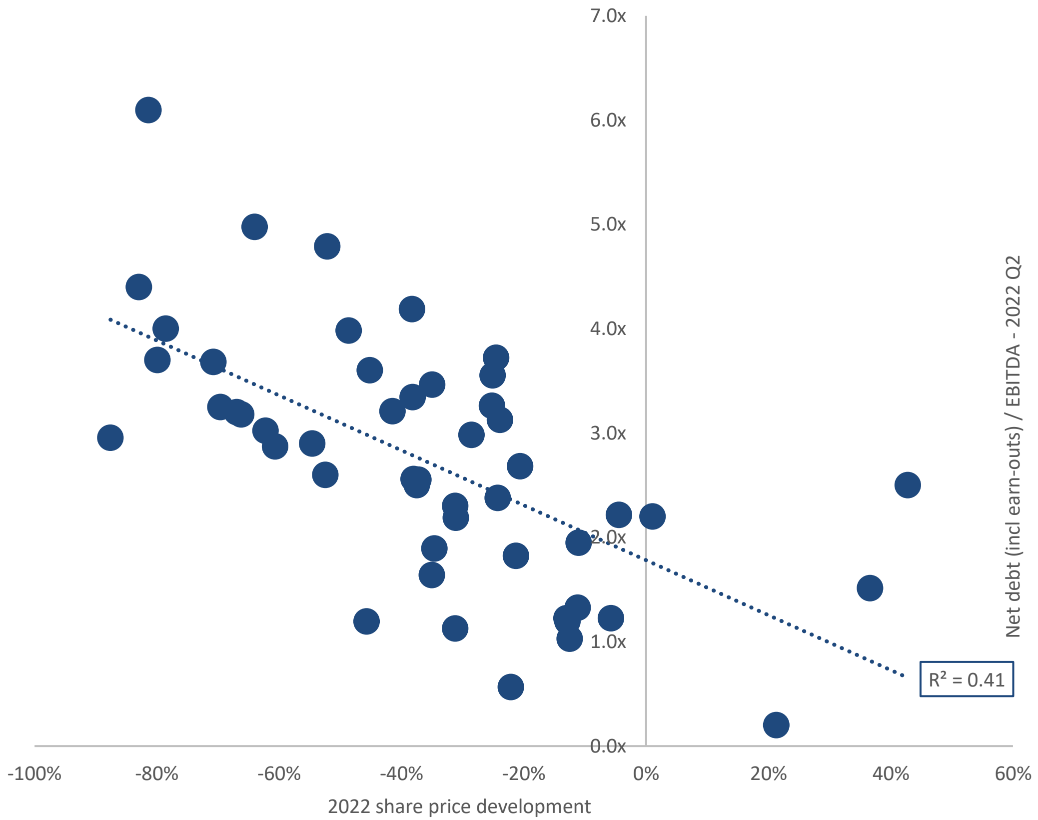
In conclusion, sustained success is derived from maintaining a balanced-risk profile and following core strategies. While large and transformative acquisitions may appear lucrative, they also entail higher risks compared to the acquisition of numerous smaller add-ons. Assa Abloy stands out as a success story, boasting a TSR of 25,000% (CAGR 21%) since 1994. However, as illustrated, the journey to success for Assa Abloy was not without its challenges.

For investors, it is easy to drawn into high growth while multiples expand, but those trajectories should be more closely analyzed by shareholders.

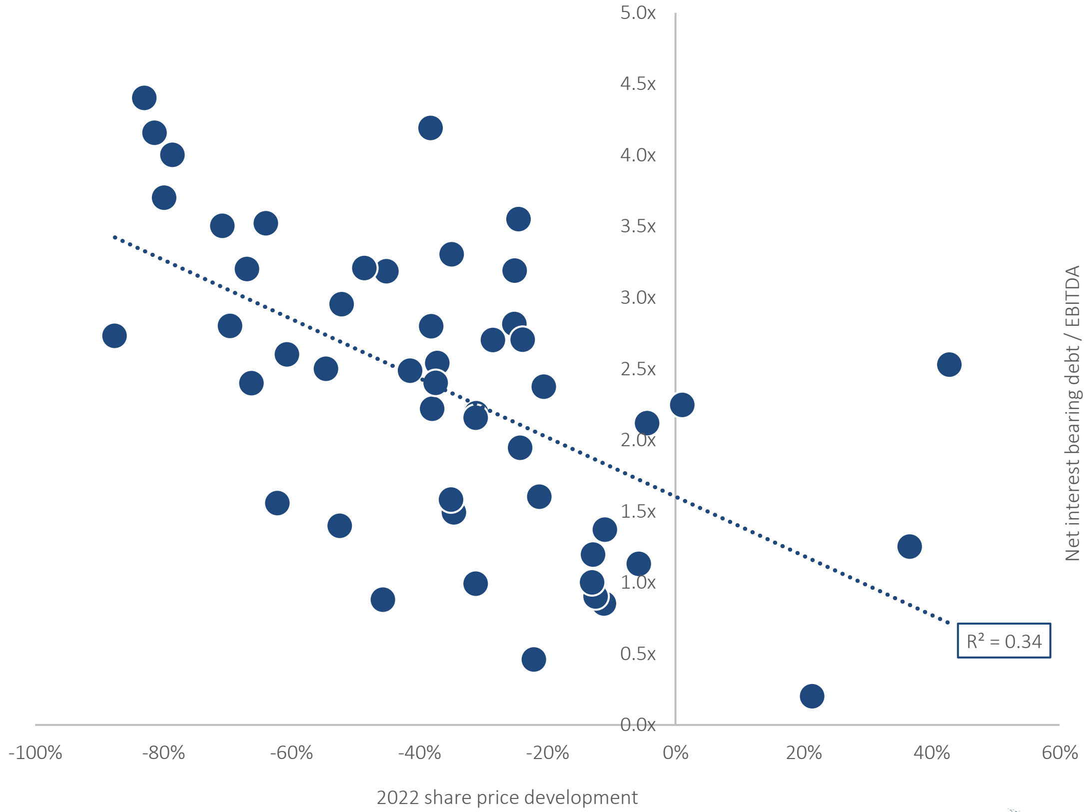
The Value of a Strong Balance Sheet

In 2022, share prices of companies with weak balance sheets were punished harder

Share price 2022 vs net debt/EBITDA incl. earn-outs



Share price YTD 2022 vs net debt/EBITDA excl. earn-outs

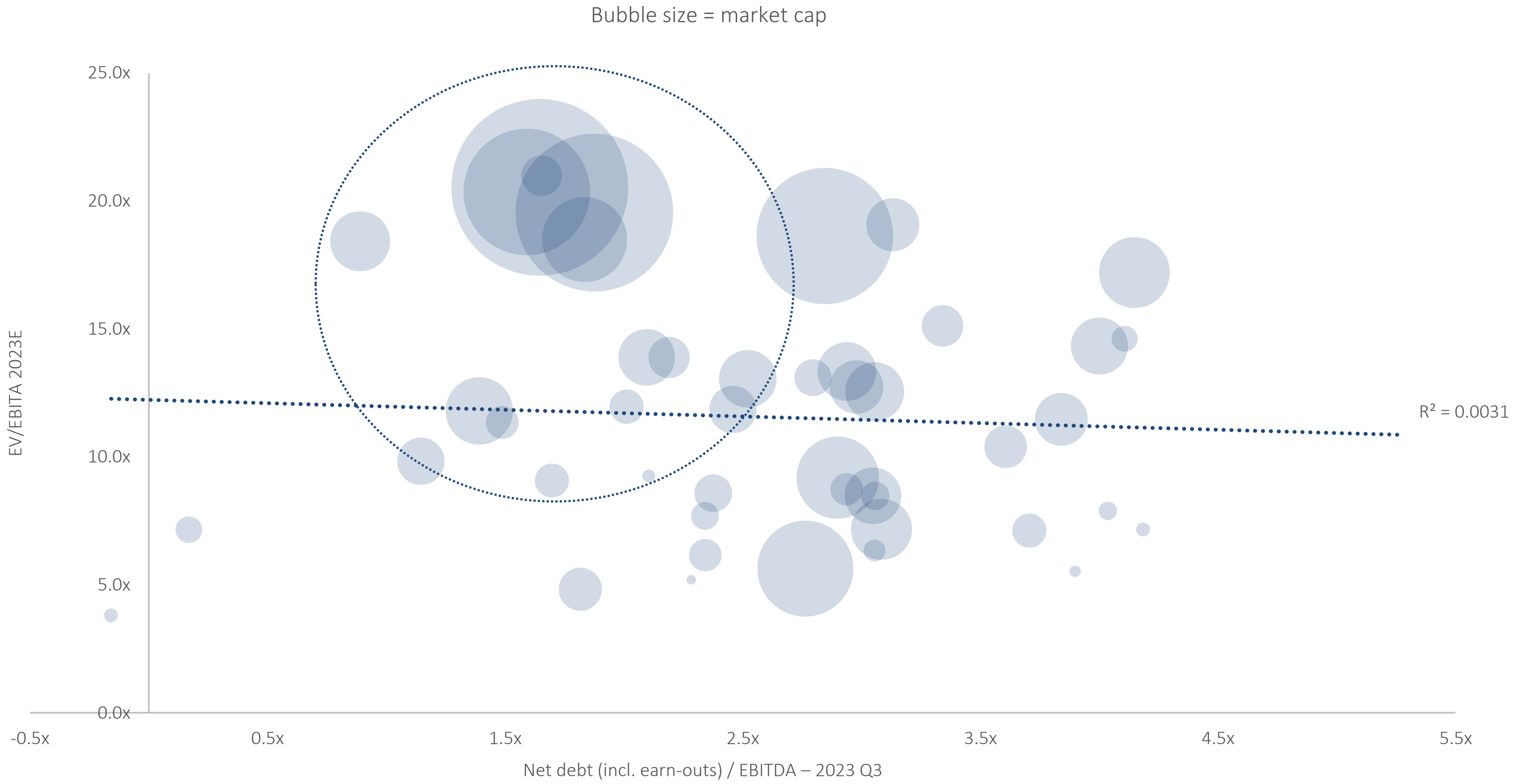


Source: Company reports & Factset

Too High Leverage Entails Lower Valuations

EV/EBITA 2023E as of 2023-12-01

The Value of a Strong Balance Sheet



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Source: Company reports & Factset

A Closer Look at Nordic M&A and Deal Characteristics

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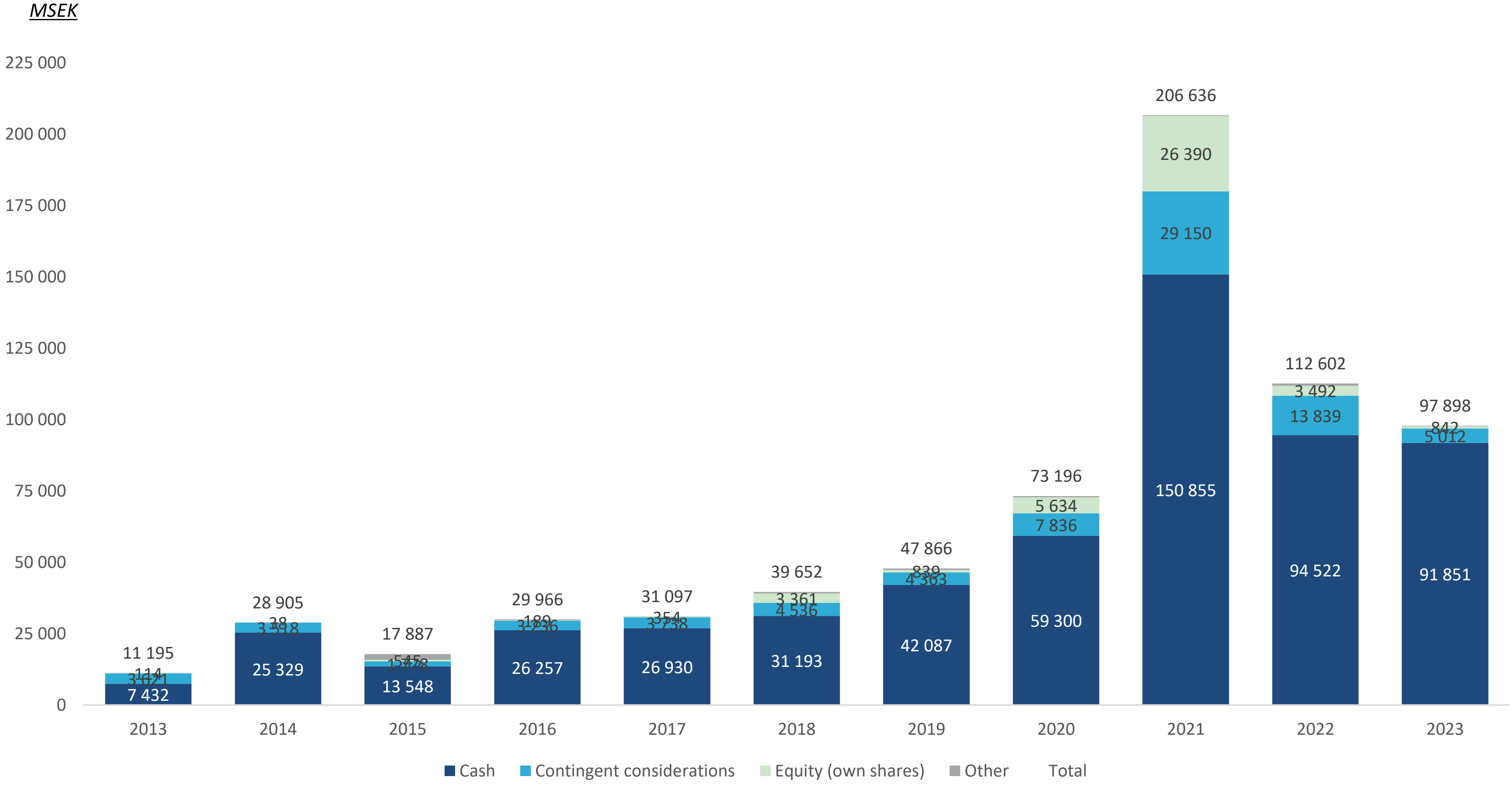
Nordic M&A Spending

Historical overview of M&A spending for Acquisition-driven Compounders

A Closer Look at Nordic M&A and Deal Characteristics

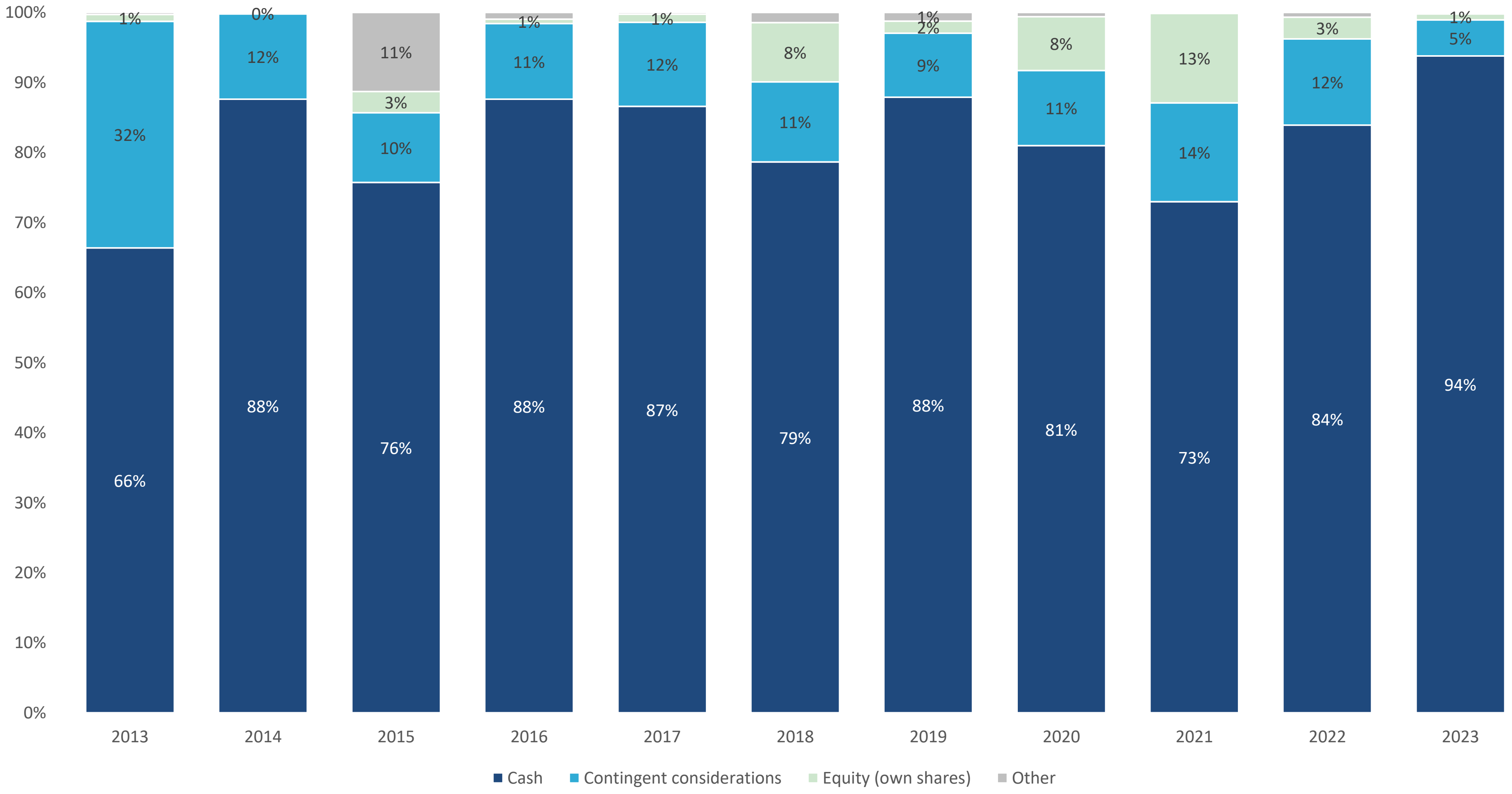


Source: Company reports

Nordic M&A Spending – Deal Structures

A historical view on deal structures for Acquisition-driven Compounders

A Closer Look at Nordic M&A and Deal Characteristics

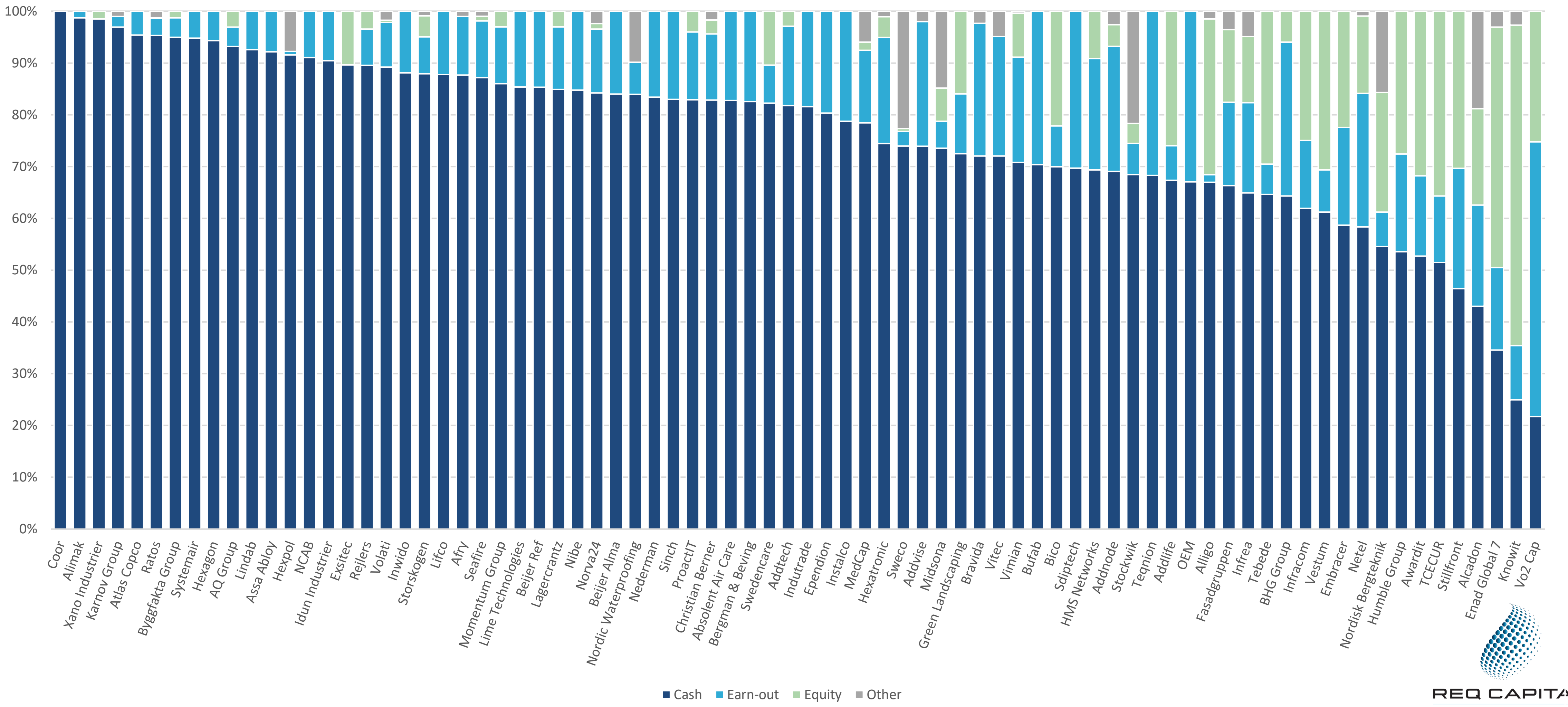


Source: Company reports

Nordic M&A Spending – Deal Structures 2013-2023

A historical view on deal structures

A Closer Look at Nordic M&A and Deal Characteristics



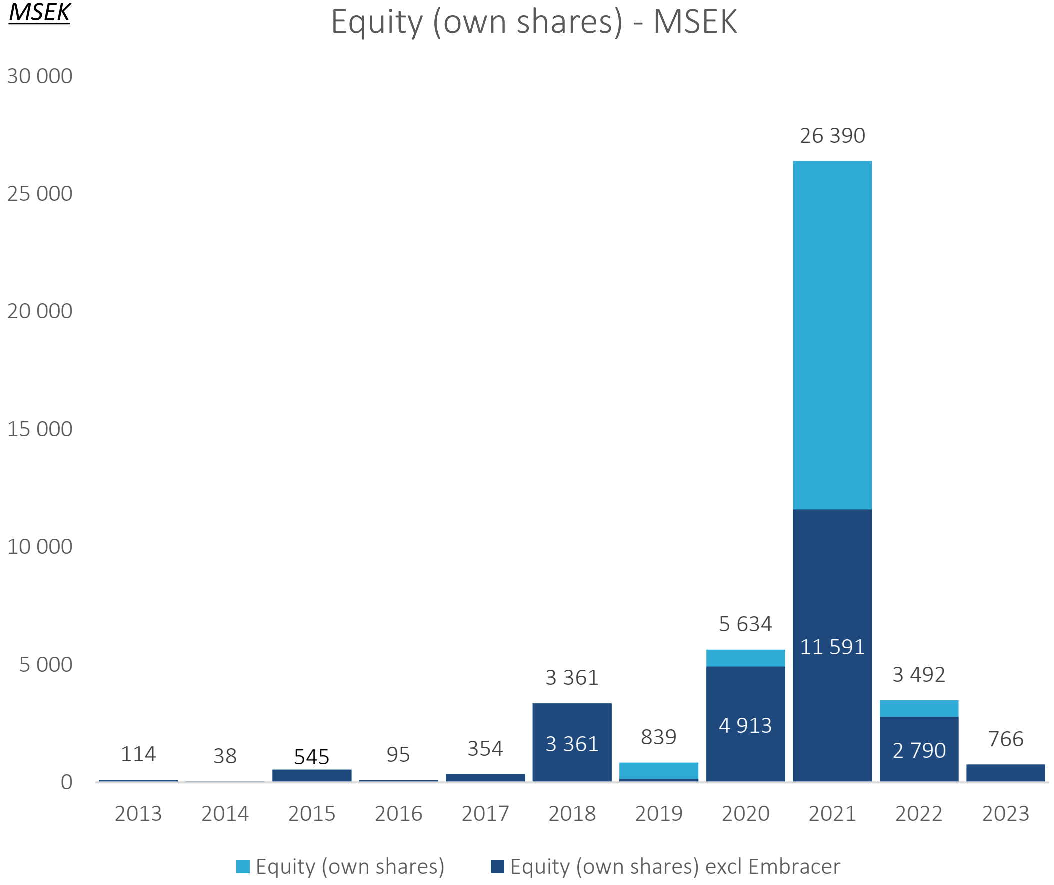
Source: Company reports

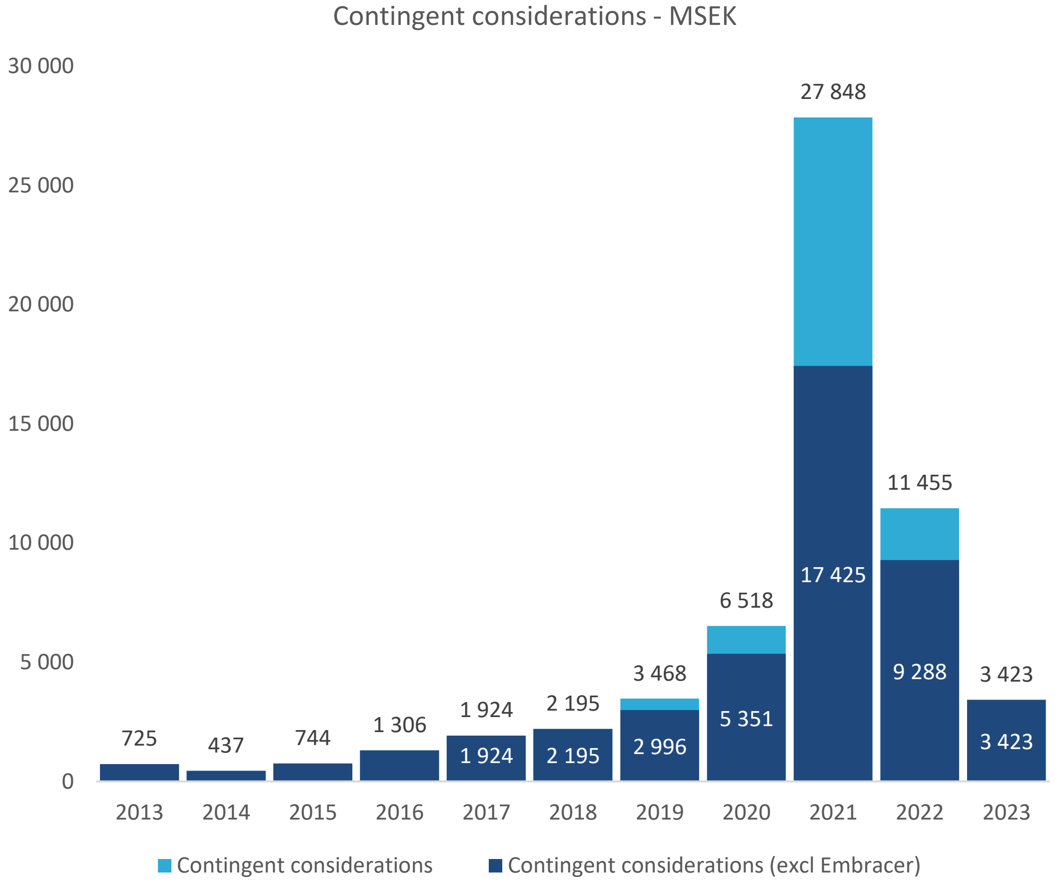
Nordic M&A Spending – Deal Structures

Overview on how much of the M&A is funded by payment with own shares & earn-outs

A Closer Look at Nordic M&A and Deal Characteristics

MSEK



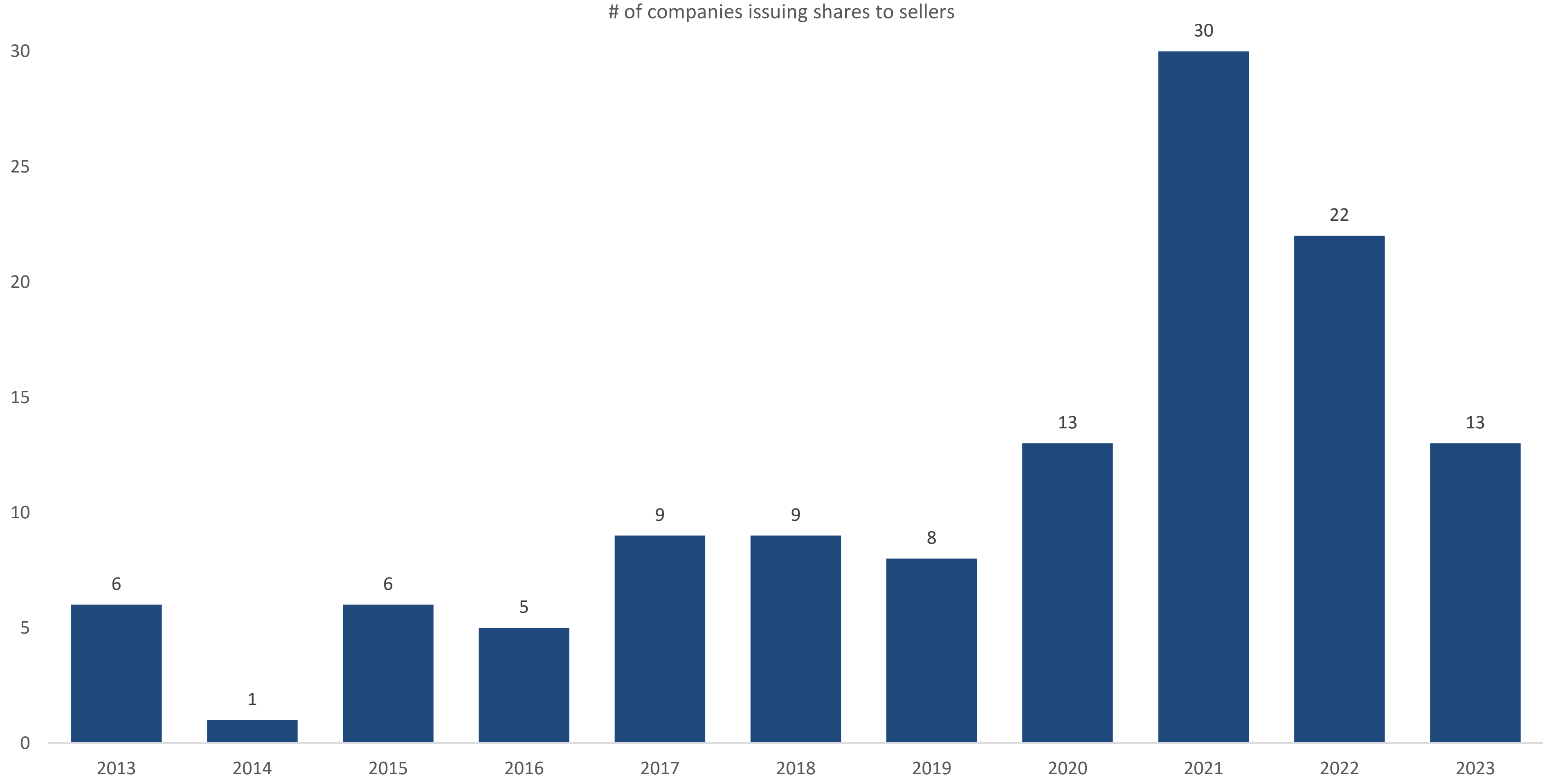


Source: Company reports

Nordic M&A Spending – Own Shares as Payment

How many companies have issued own shares to sellers

A Closer Look at Nordic M&A and Deal Characteristics



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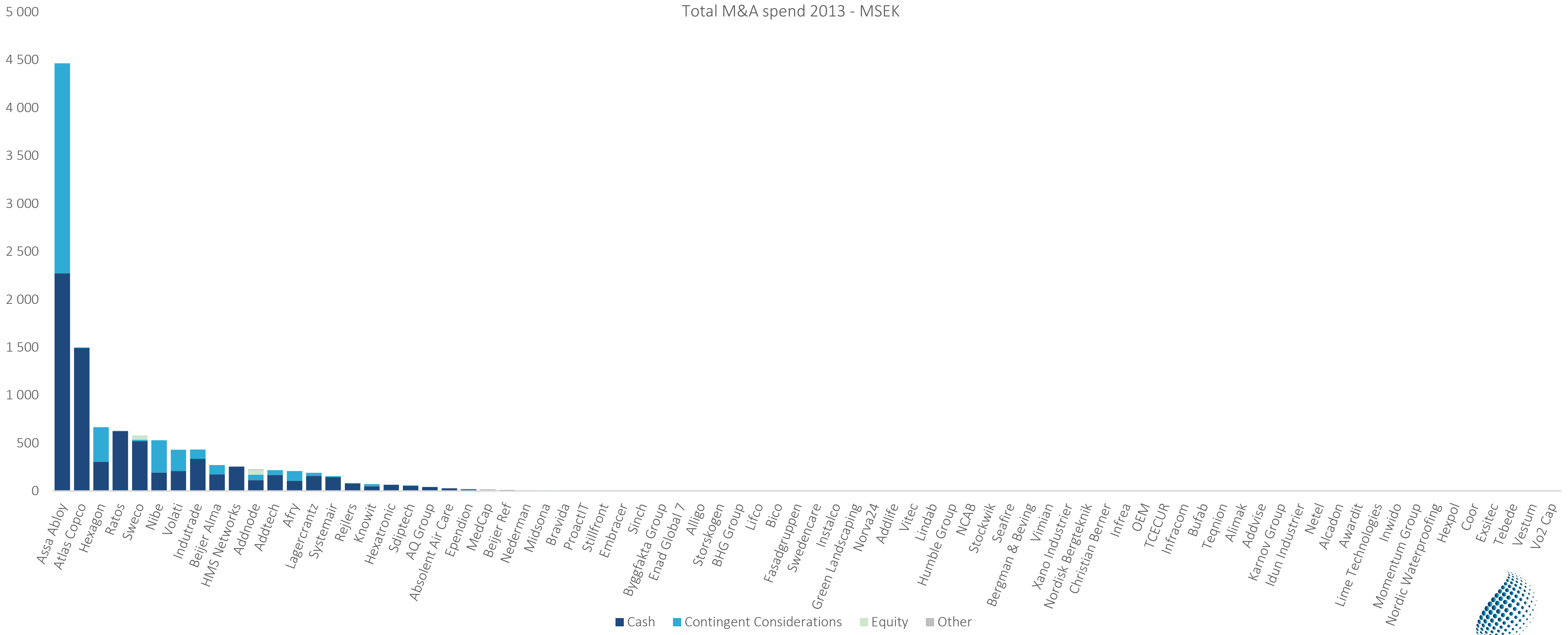
Source: Company reports

Nordic Transaction Value 2013

A Closer Look at Nordic M&A and Deal Characteristics

Total M&A spend on a company level

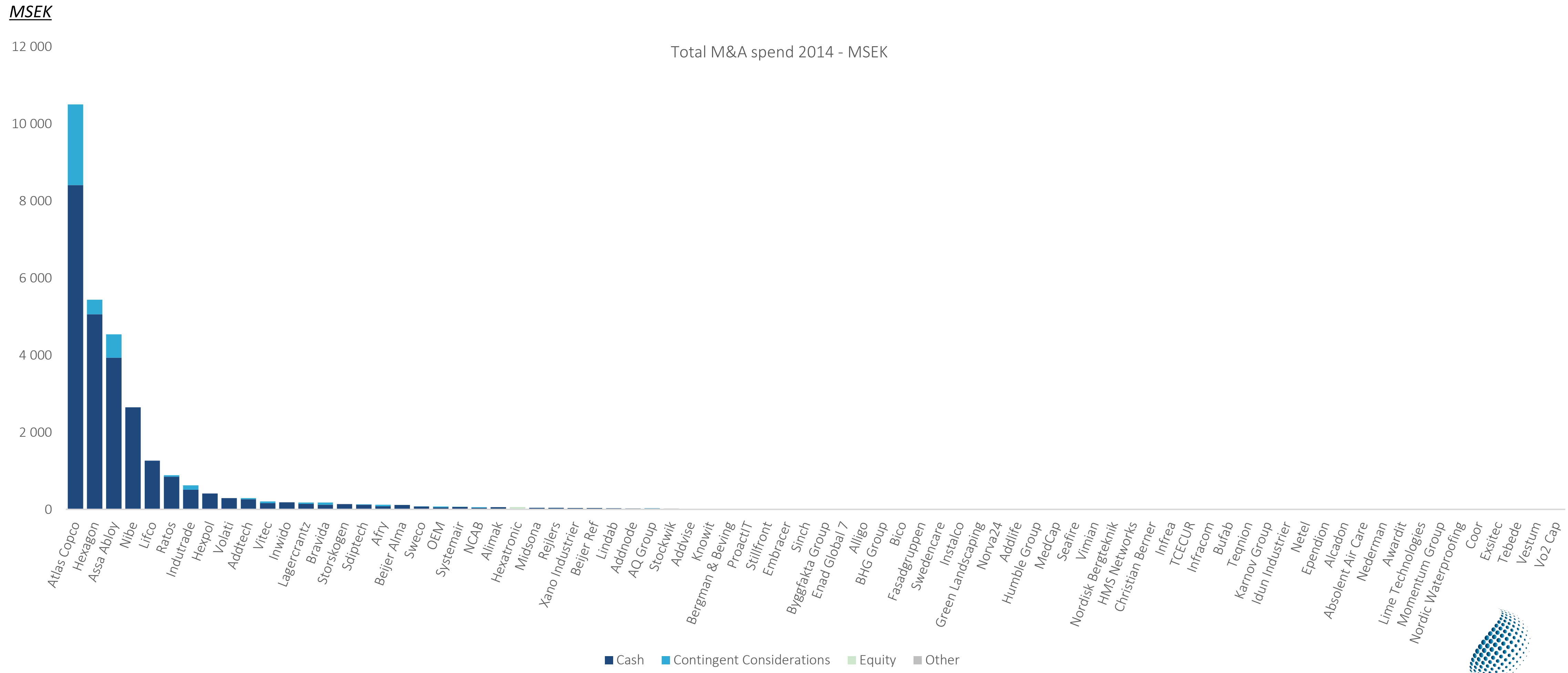
MSEK



Source: Company reports

Nordic Transaction Value 2014

Total M&A spend on a company level



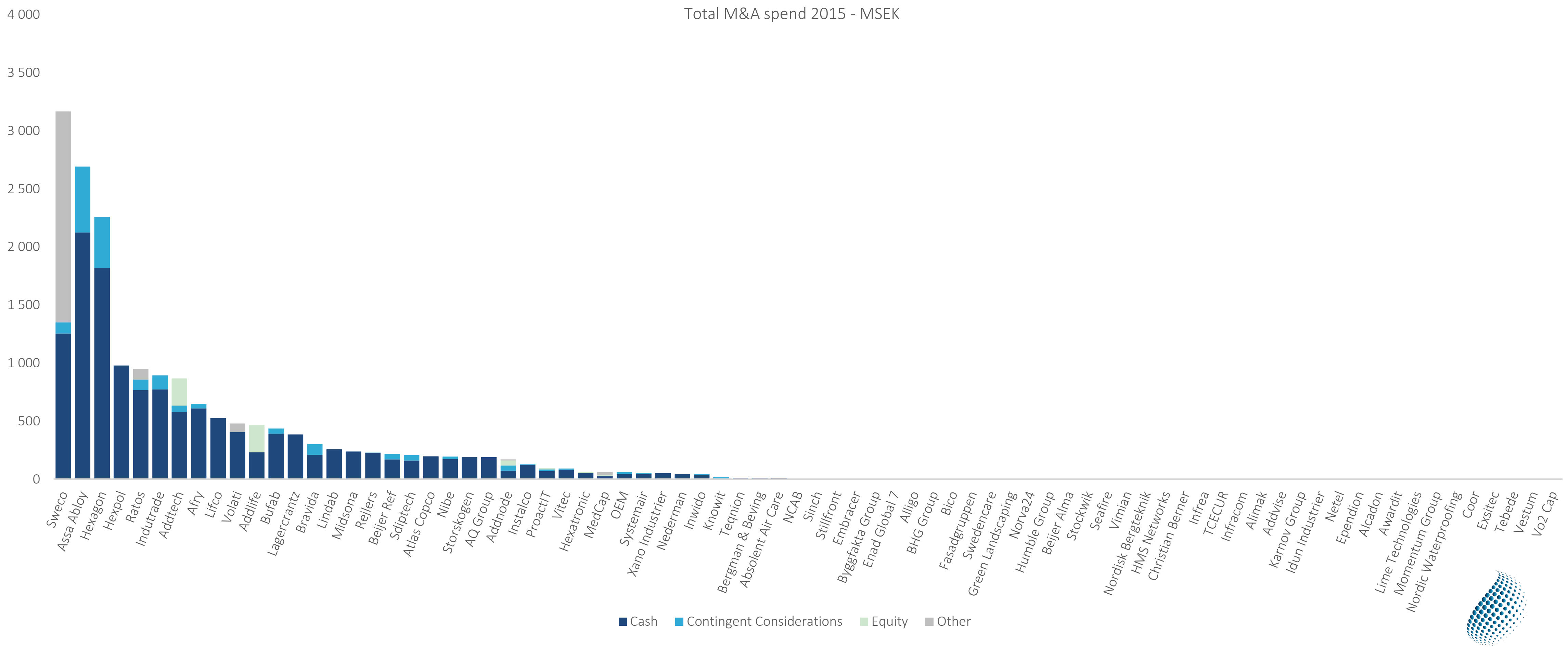
Source: Company reports

Nordic Transaction Value 2015

Total M&A spend on a company level

A Closer Look at Nordic M&A and Deal Characteristics

MSEK



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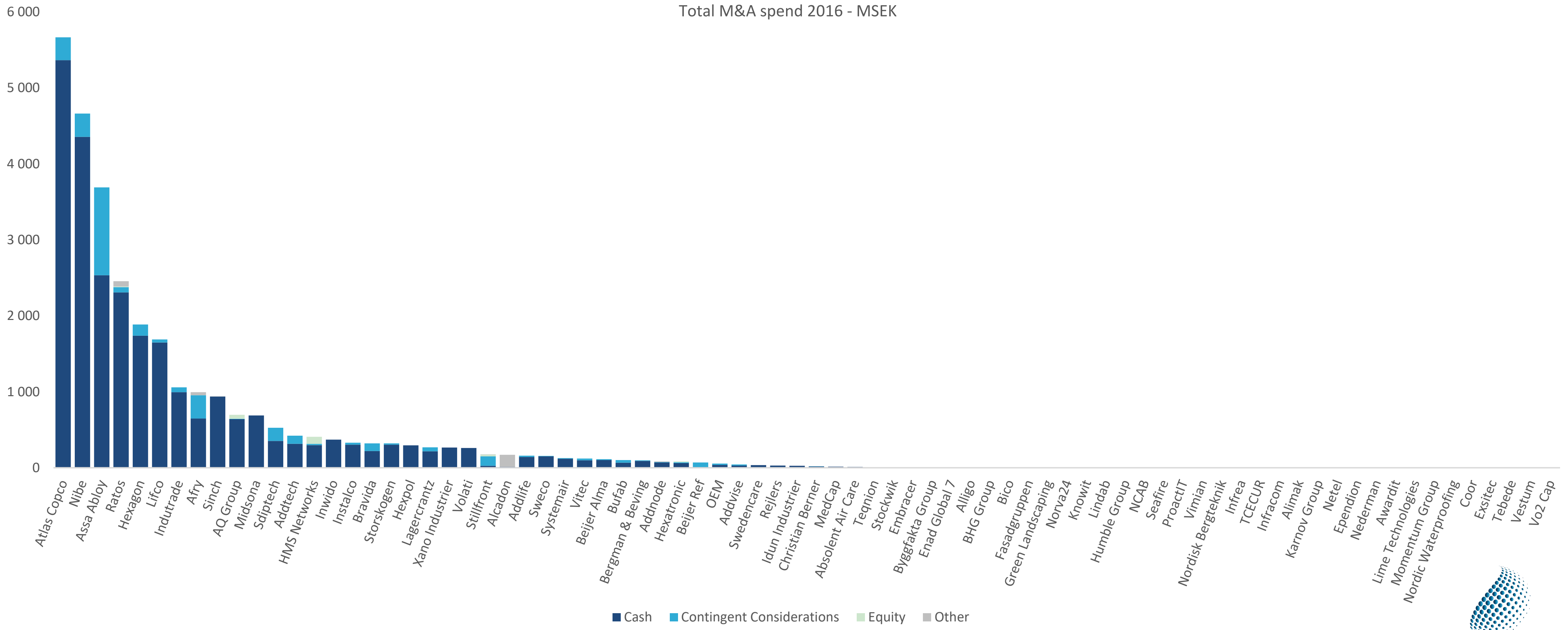
Source: Company reports

Nordic Transaction Value 2016

Total M&A spend on a company level

A Closer Look at Nordic M&A and Deal Characteristics

MSEK

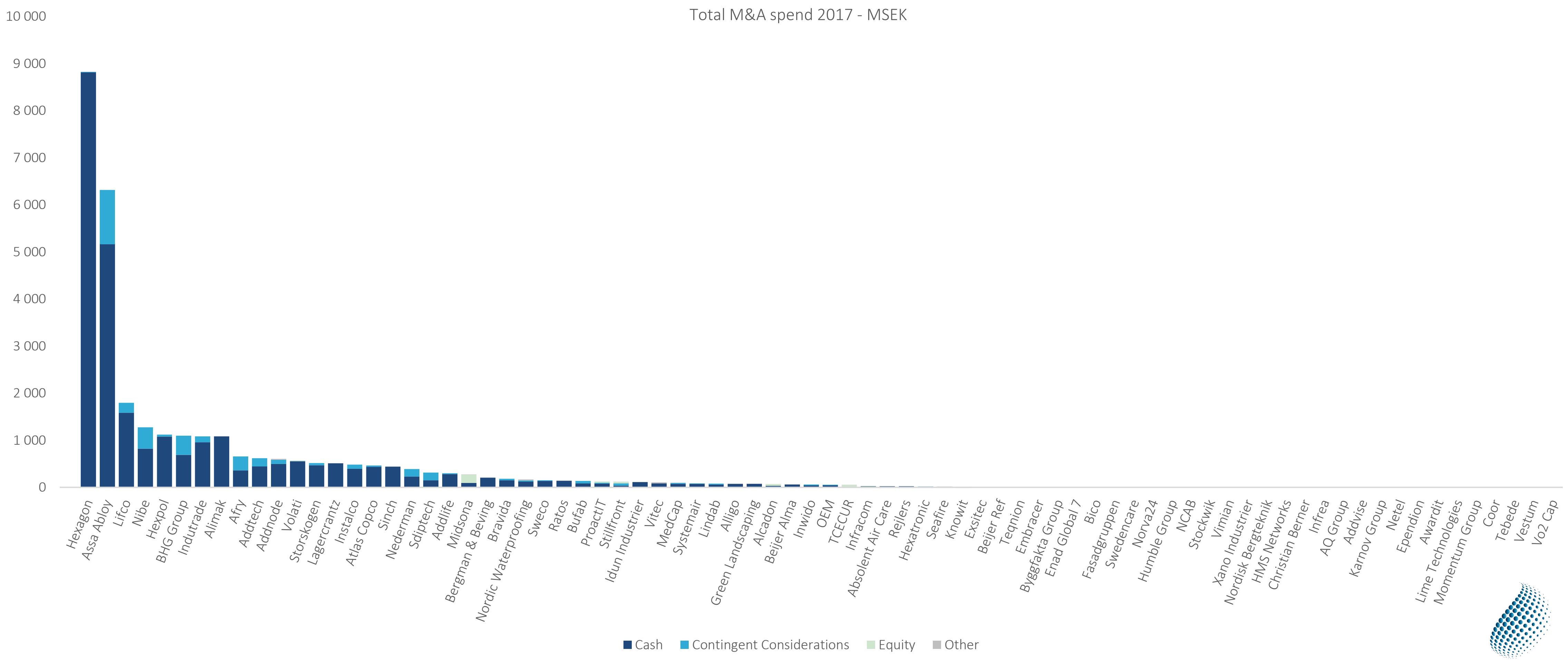


Source: Company reports

Nordic Transaction Value 2017

Total M&A spend on a company level

MSEK



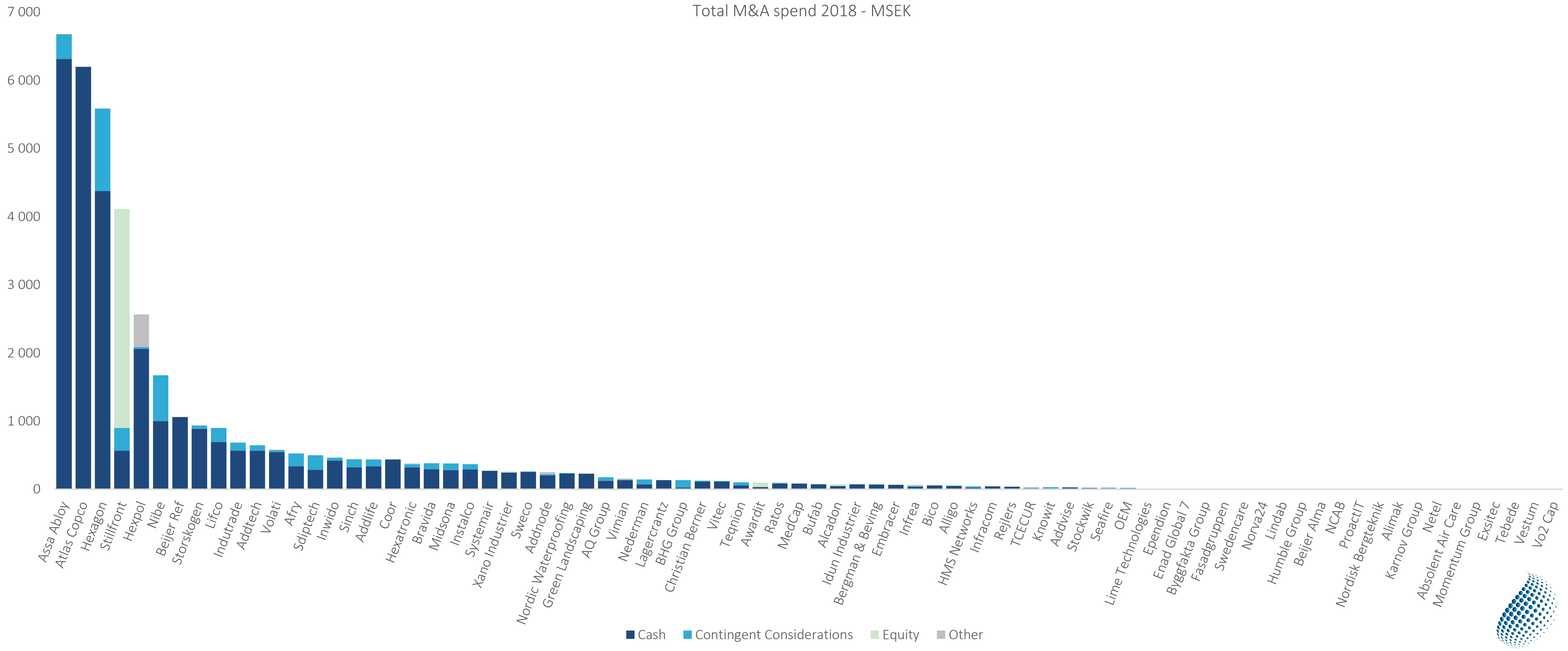
Source: Company reports

Nordic Transaction Value 2018

[A Closer Look at Nordic M&A and Deal Characteristics](#)

Total M&A spend on a company level

MSEK



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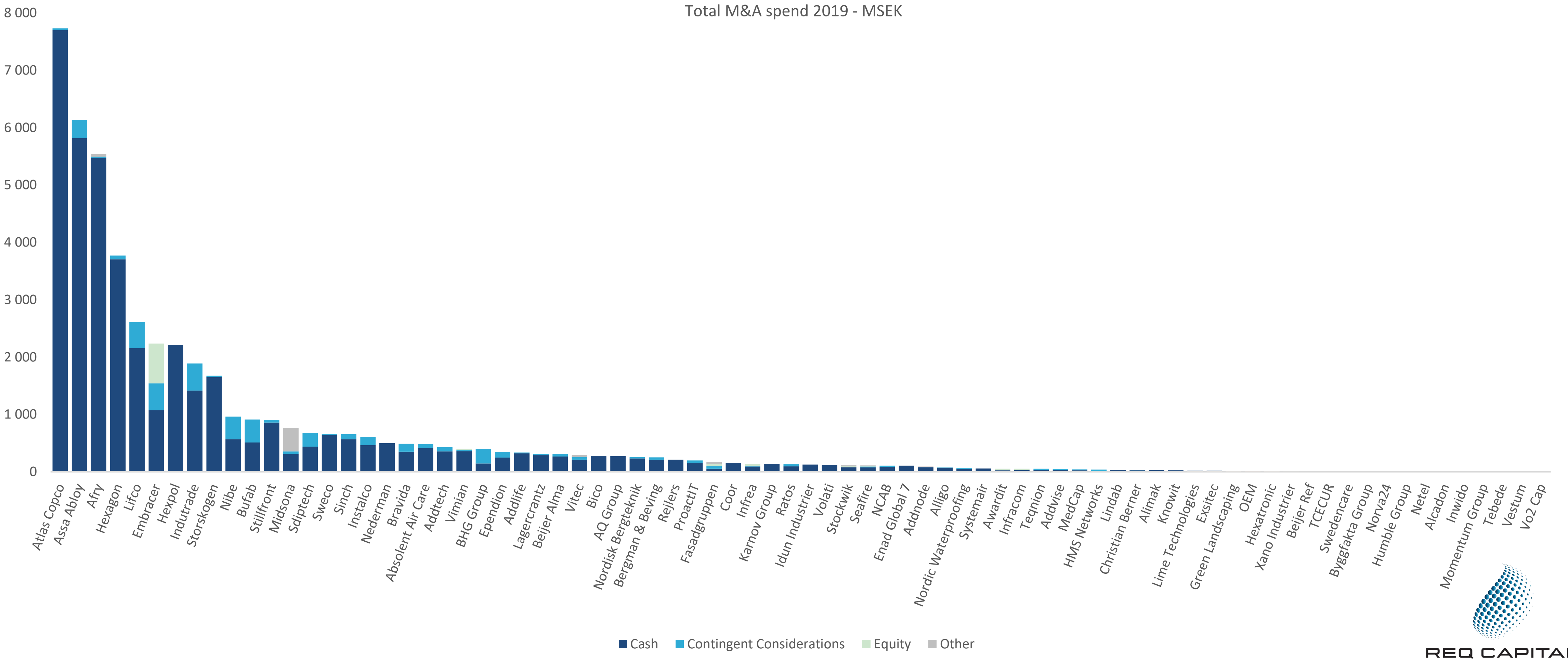
Source: Company reports

Nordic Transaction Value 2019

Total M&A spend on a company level

A Closer Look at Nordic M&A and Deal Characteristics

MSEK



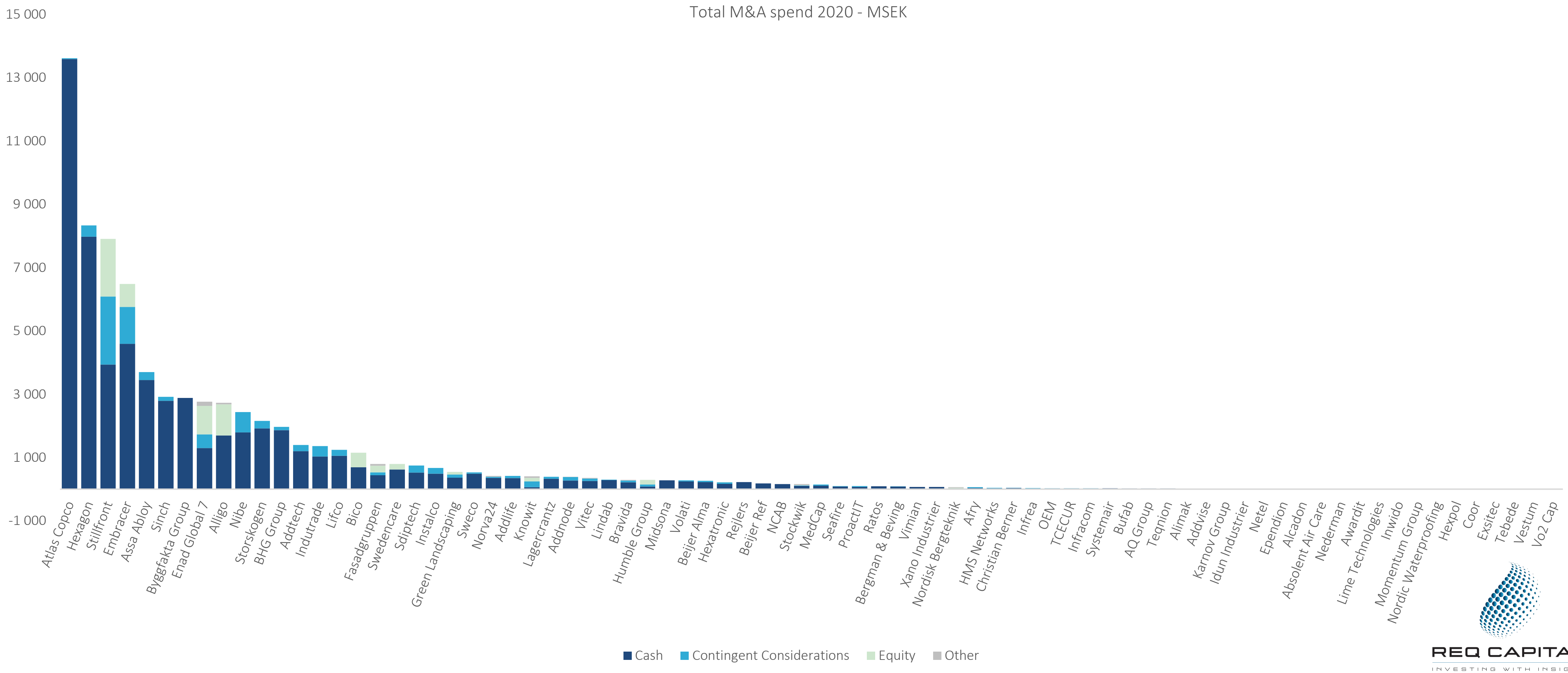
Source: Company reports

Nordic Transaction Value 2020

Total M&A spend 2020 on a company level

A Closer Look at Nordic M&A and Deal Characteristics

MSEK



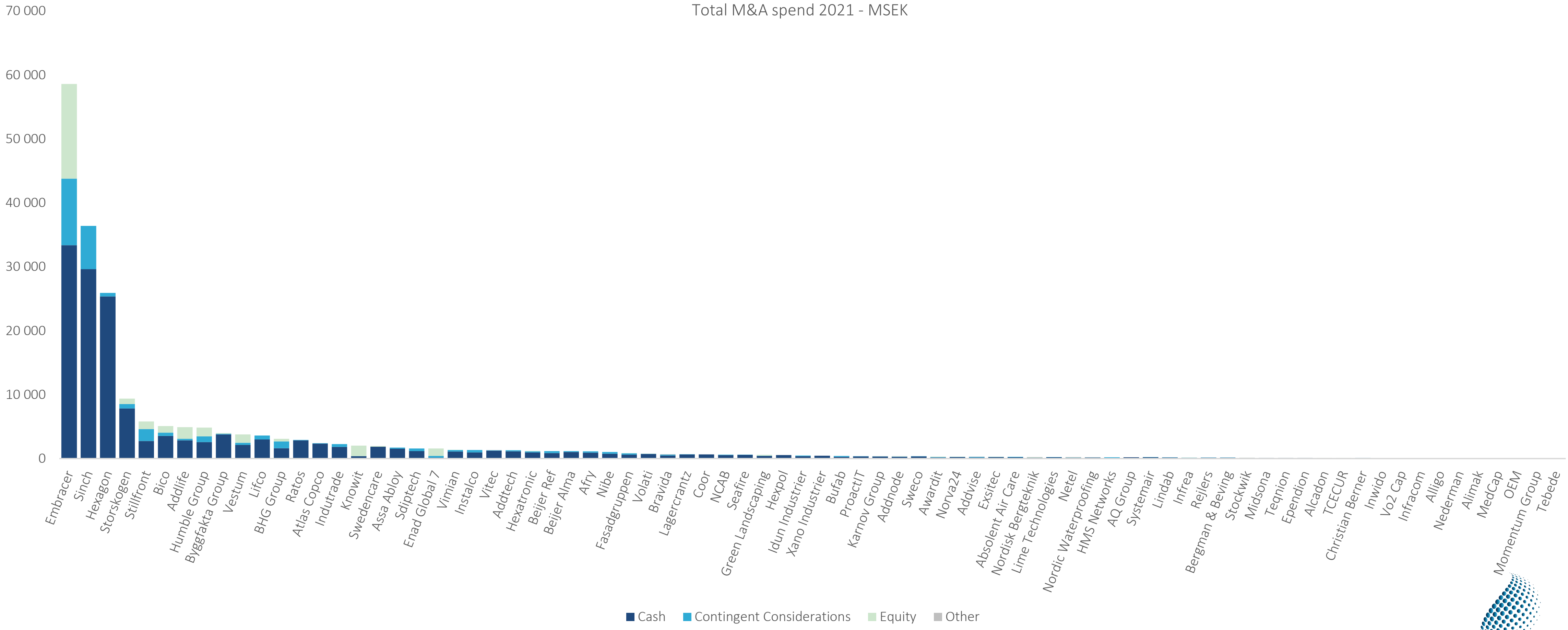
Source: Company reports

Nordic Transaction Value 2021

Total M&A spend 2021 on a company level

A Closer Look at Nordic M&A and Deal Characteristics

MSEK



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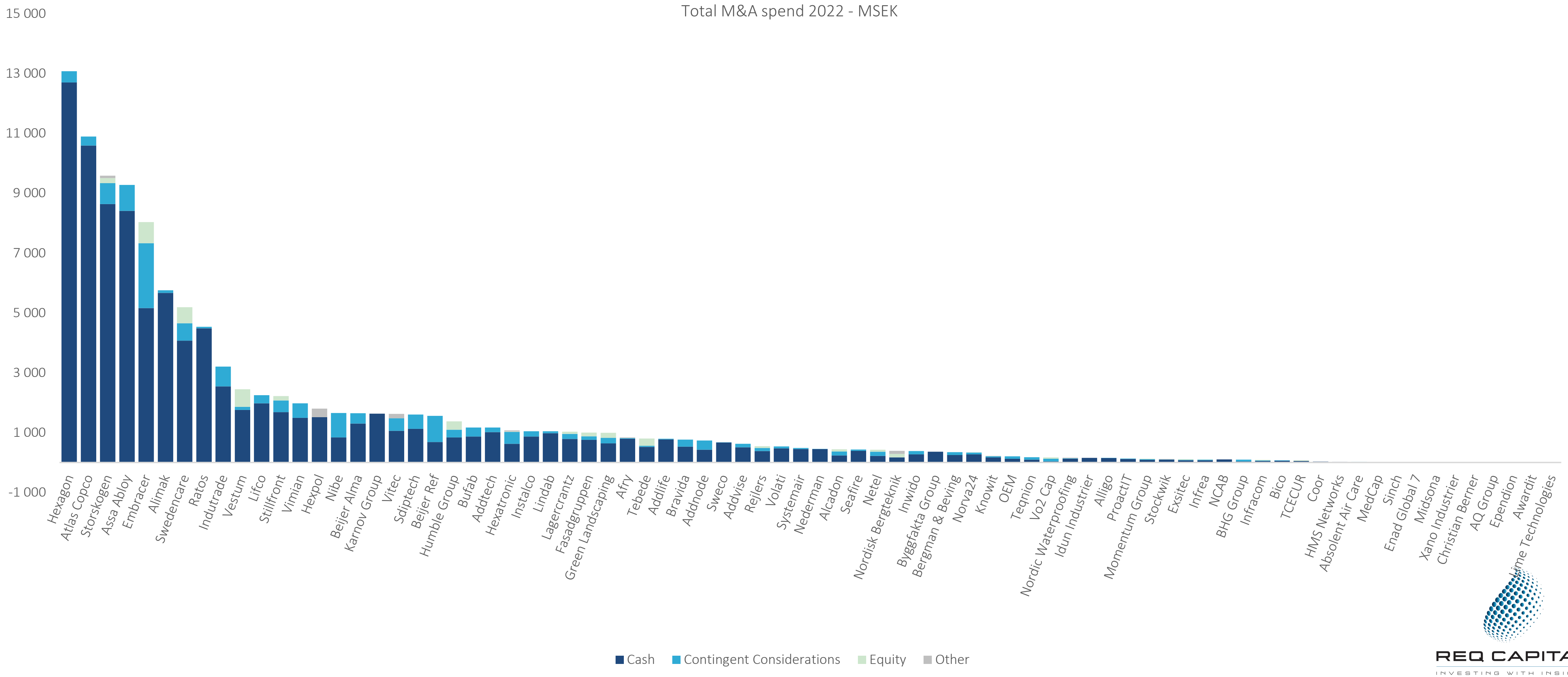
Source: Company reports

Nordic Transaction Value 2022

Total M&A spend 2022 on a company level

A Closer Look at Nordic M&A and Deal Characteristics

MSEK



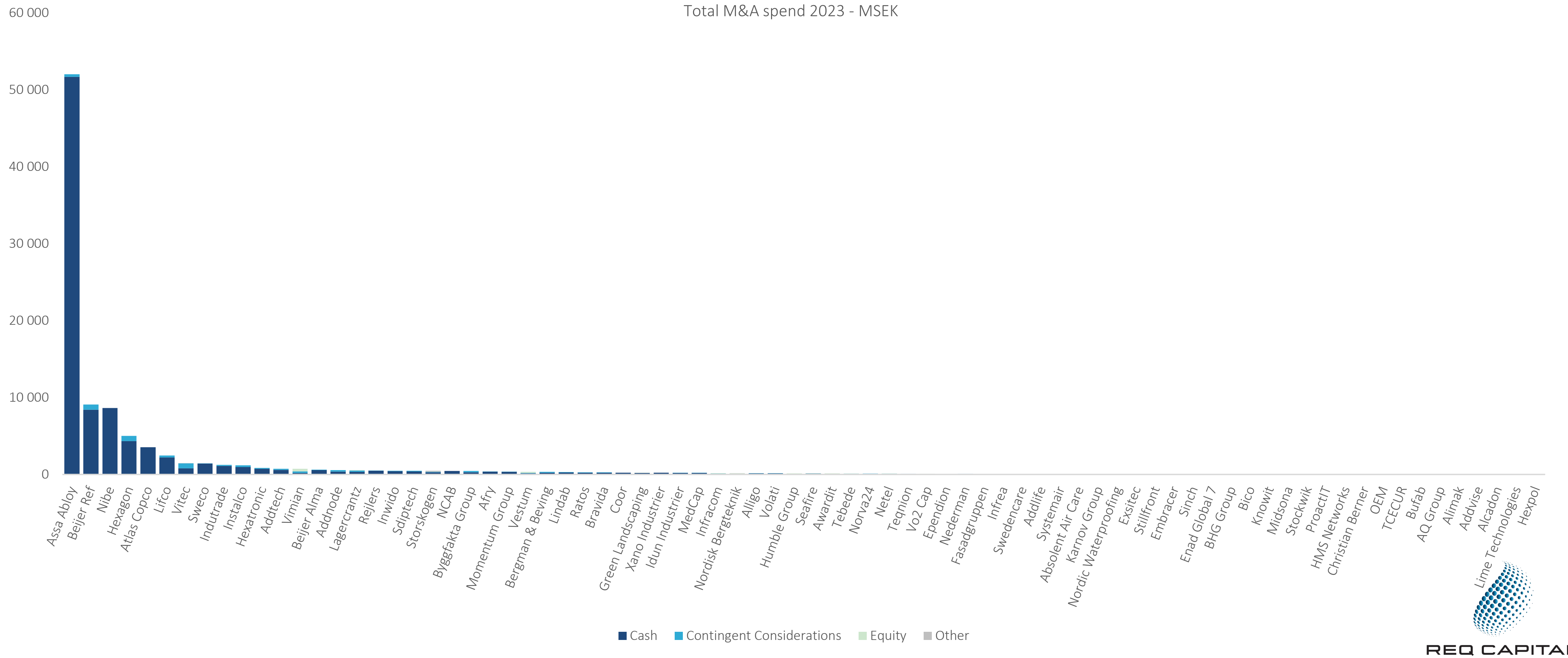
Source: Company reports

Transaction Value 2023

Total M&A spend 2023 on a company level

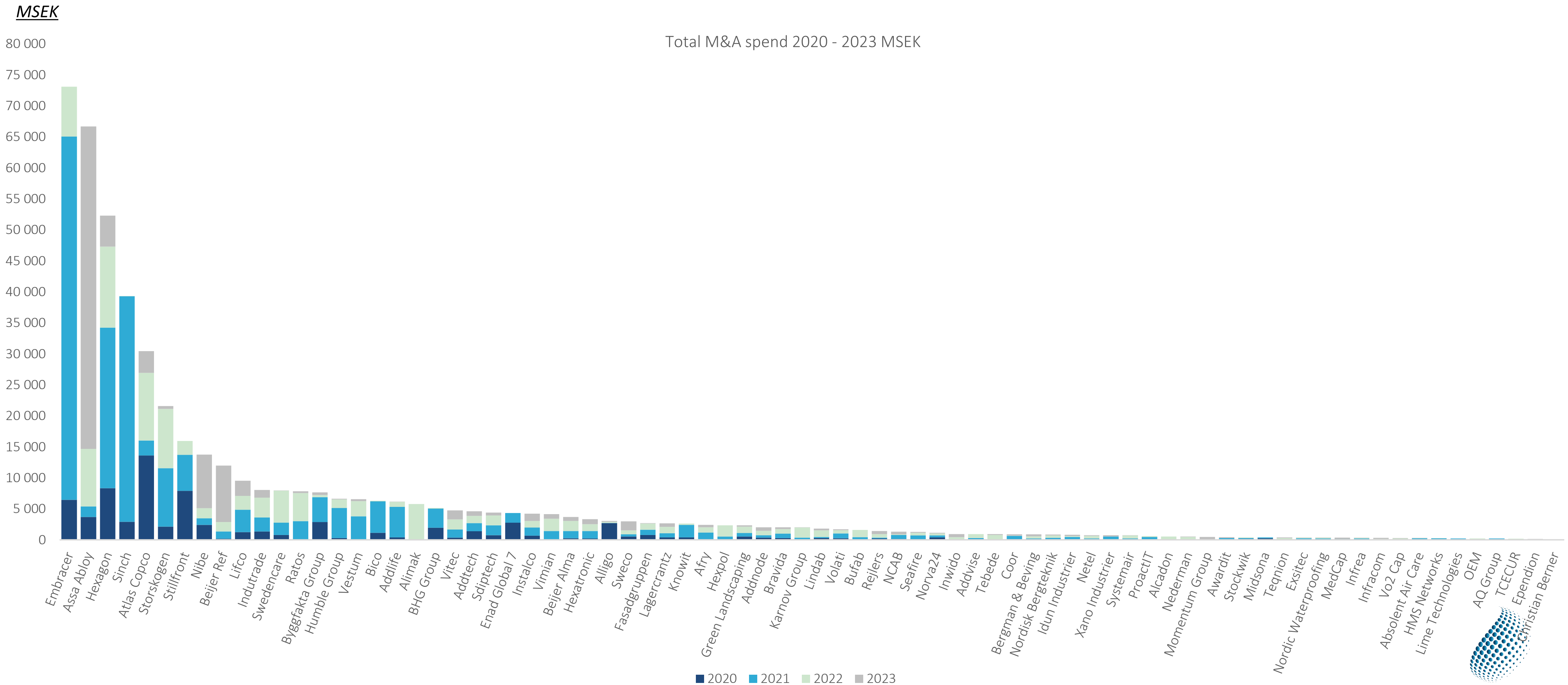
A Closer Look at Nordic M&A and Deal Characteristics

MSEK



Source: Company reports

Total transaction Value 2020-2023



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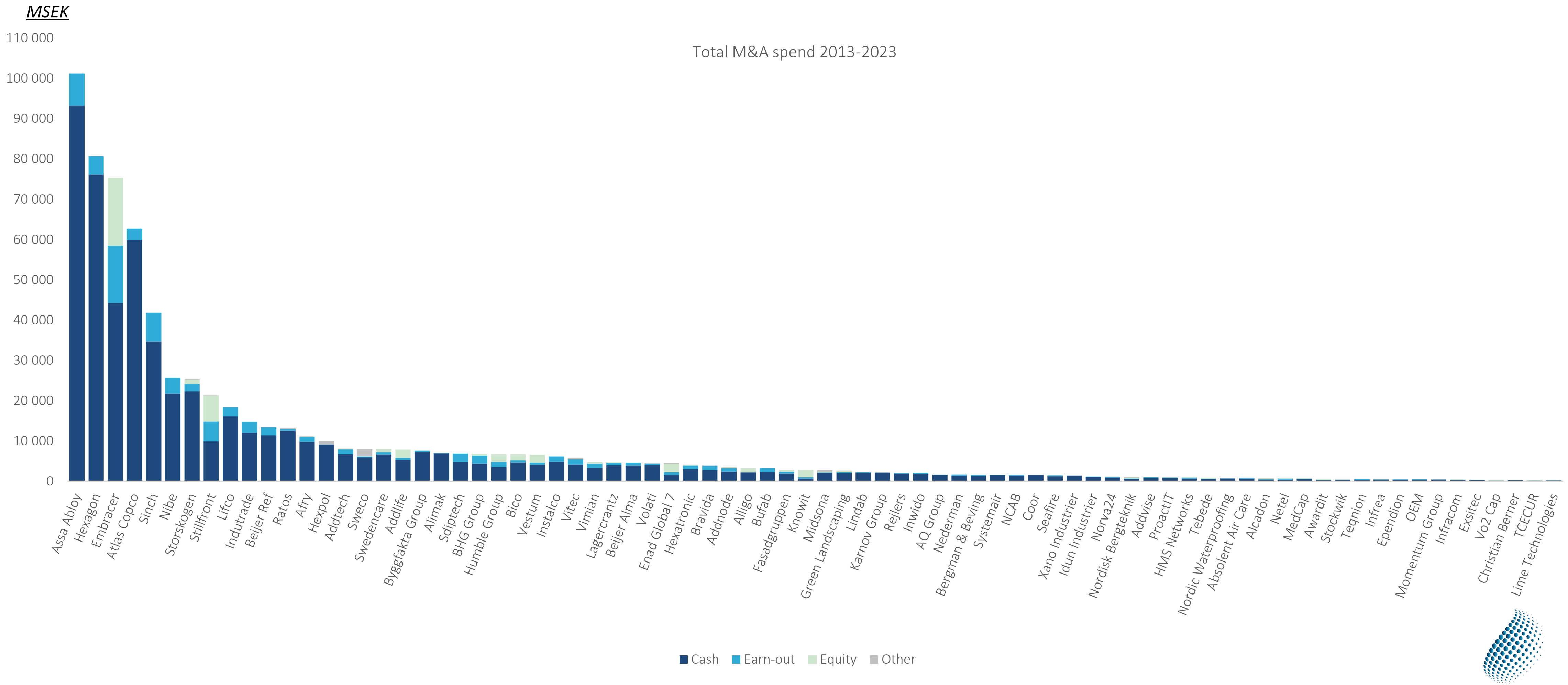
Source: Company reports

Total transaction Value 2013-2023

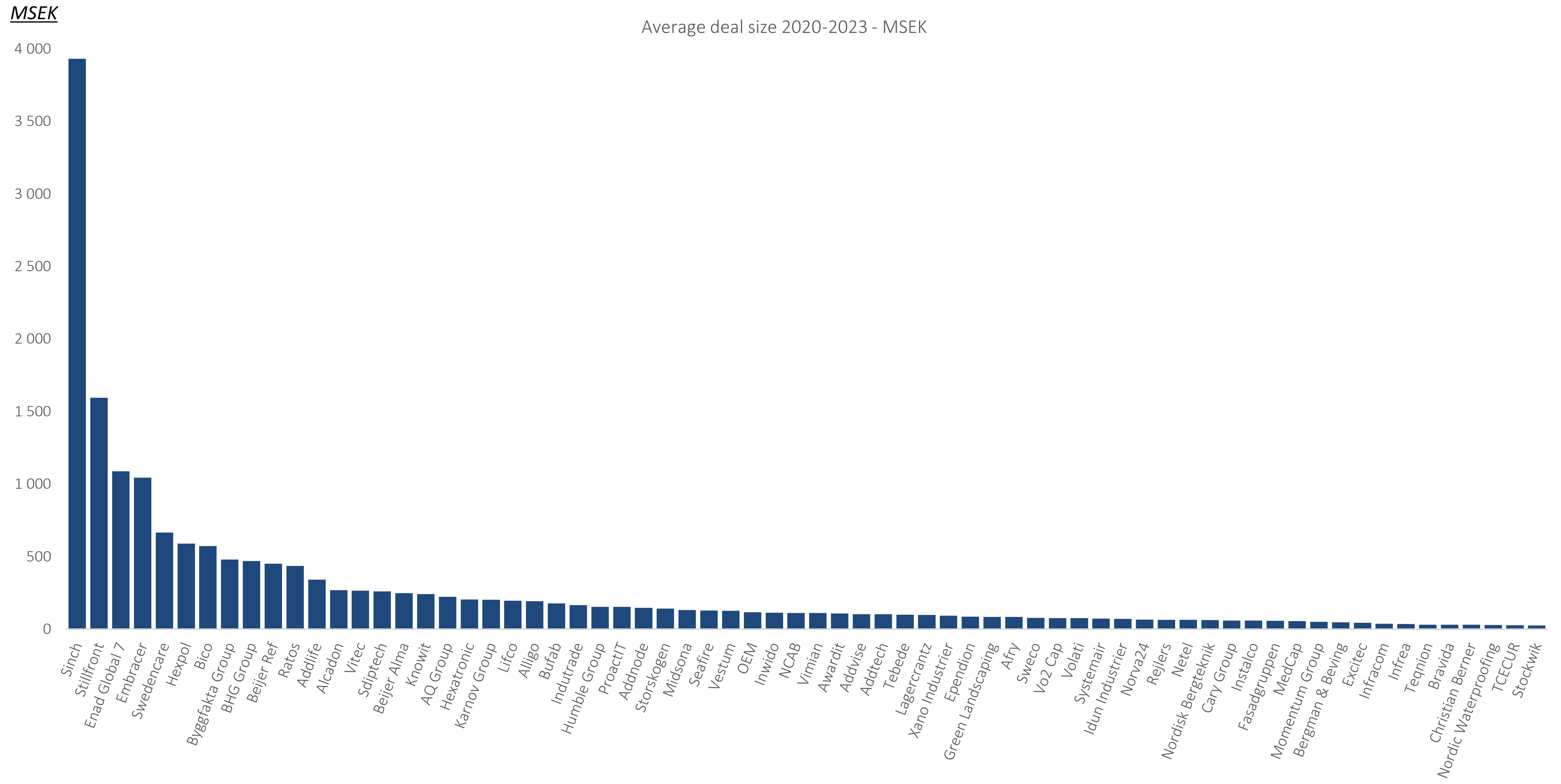


Source: Company reports

Average Deal Size 2020-2023

Combined average deal size last 4 years

A Closer Look at Nordic M&A and Deal Characteristics



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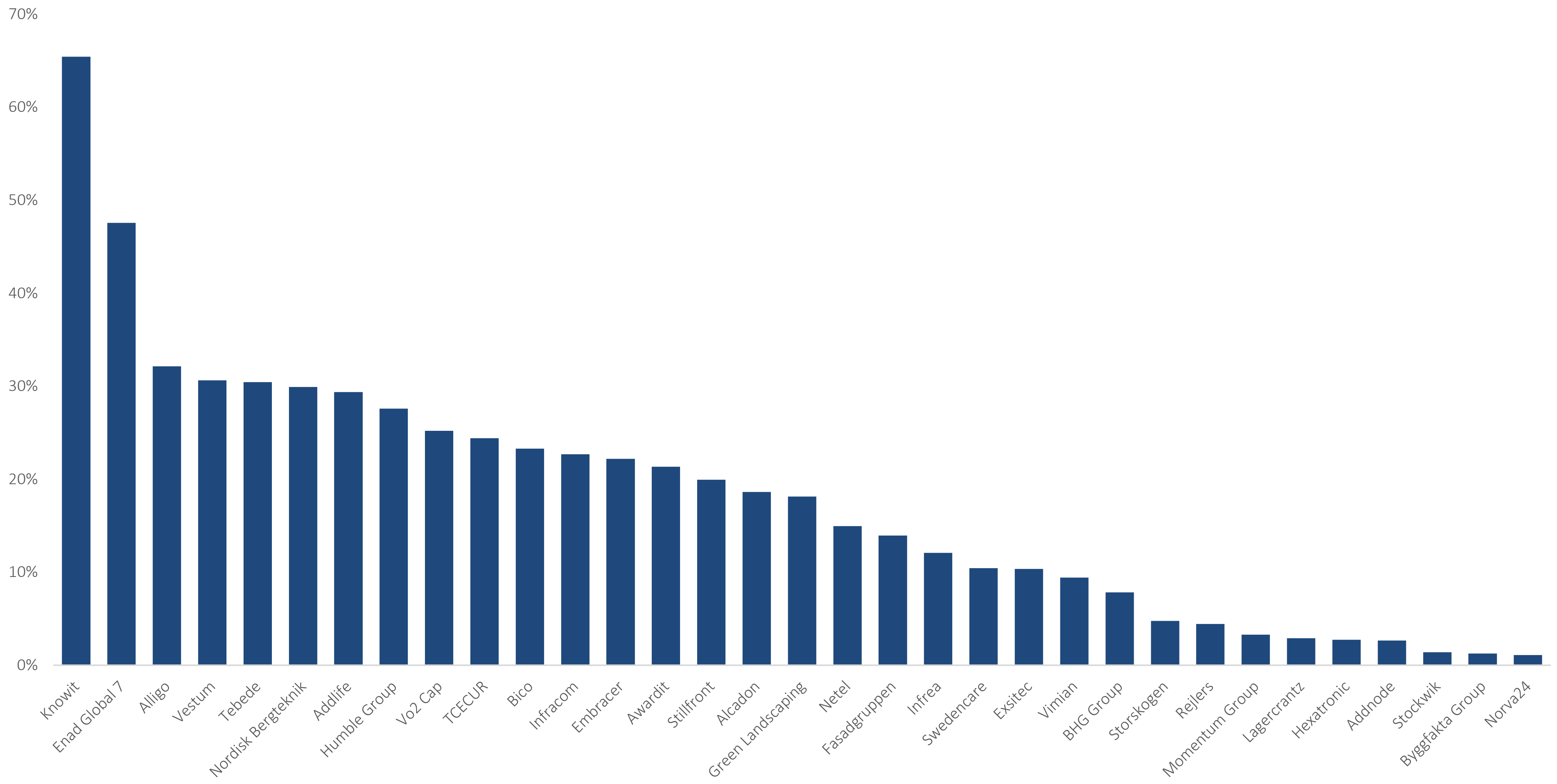
Source: Company reports

Acquisitions Financed with Own Shares

Non-cash issues to sellers 2020-2023 as % of total transaction value

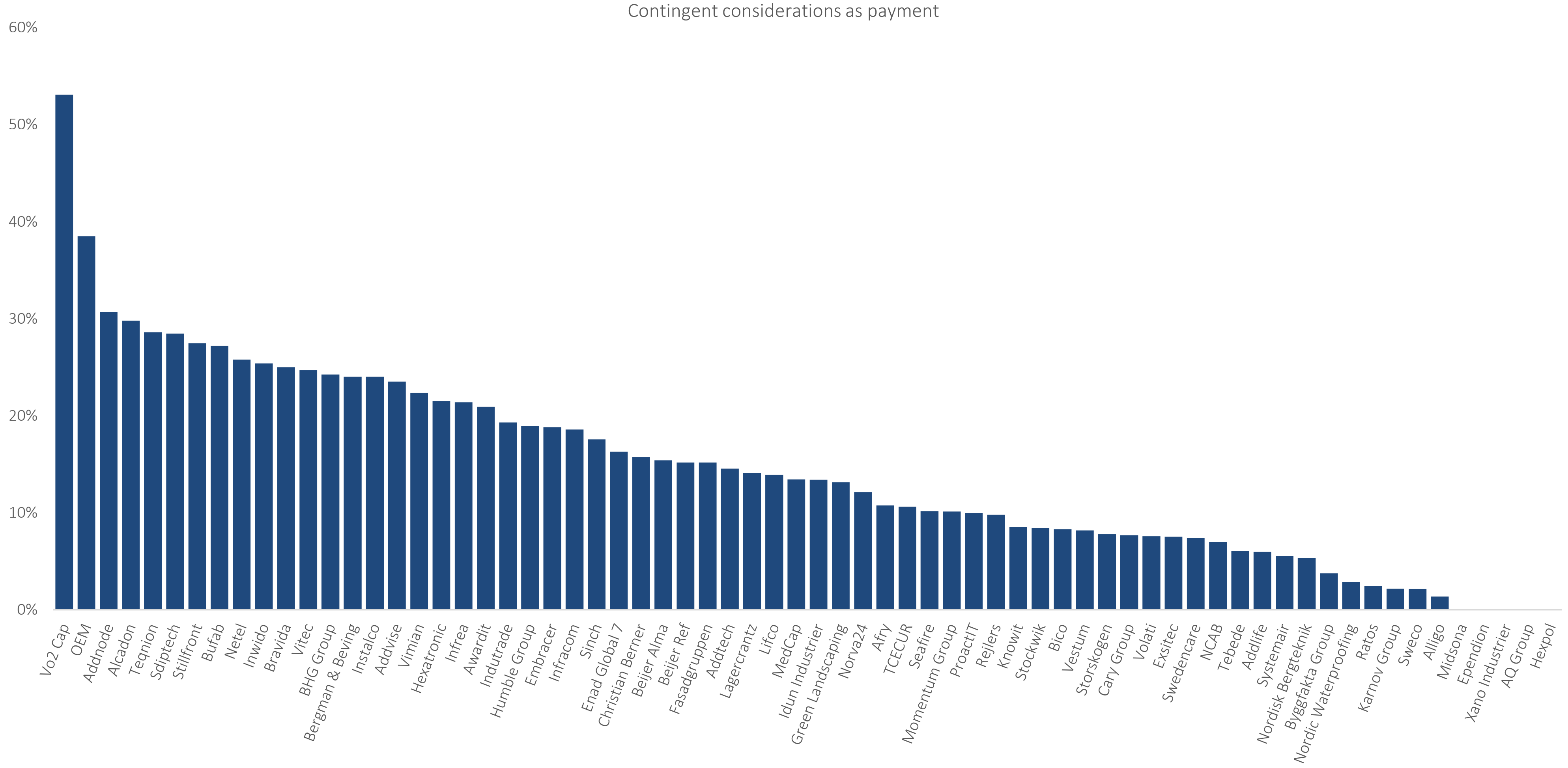
A Closer Look at Nordic M&A and Deal Characteristics



Source: Company reports

Contingent Considerations in Deal Structures

Contingent considerations/earn-outs to sellers 2020-2023 as % of total transaction value

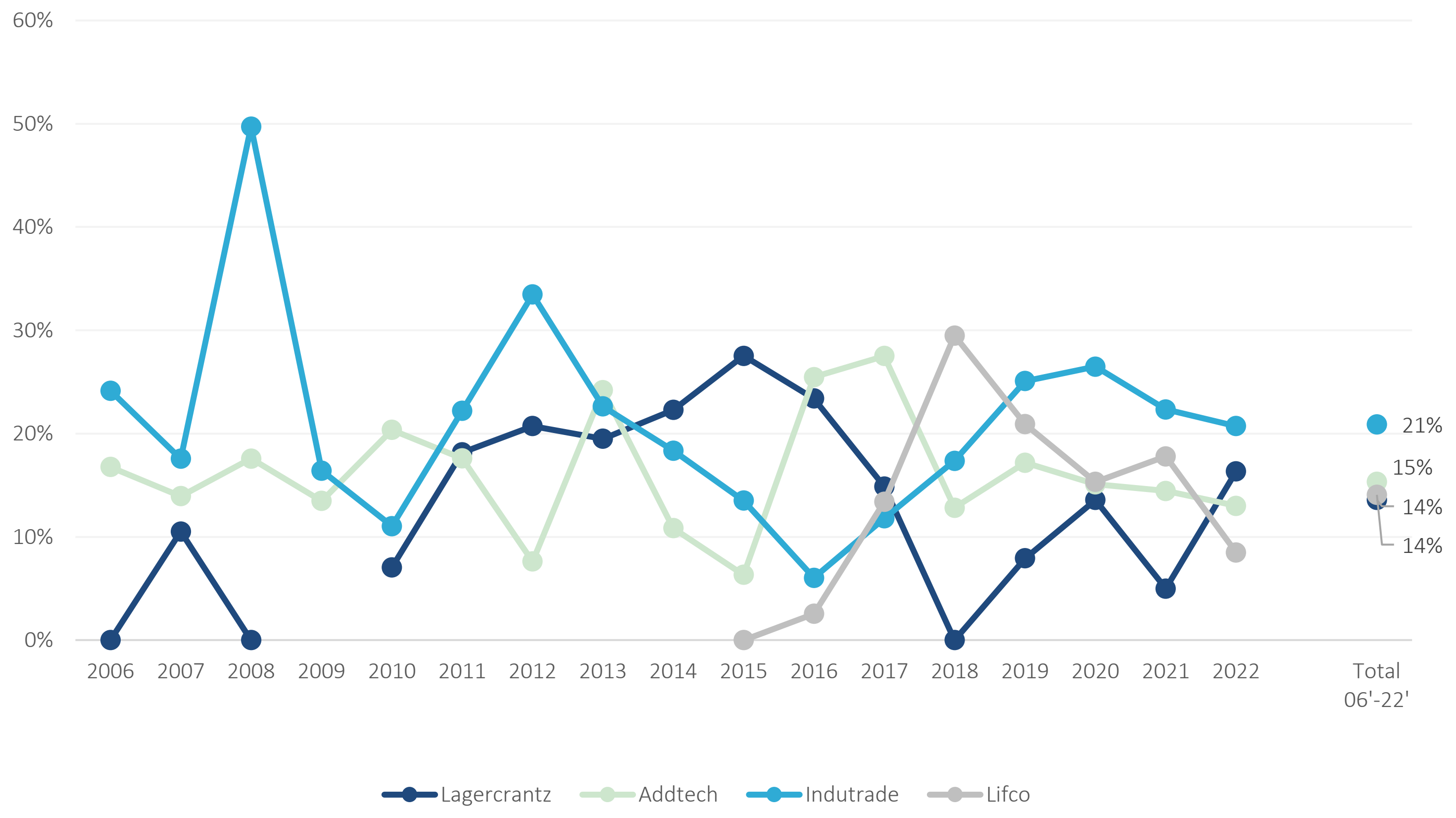


Source: Company reports

Contingent Considerations in Deal Structures

Contingent considerations/earn-outs for Addtech, Lagercrantz, Lifco & Indutrade

A Closer Look at Nordic M&A and Deal Characteristics

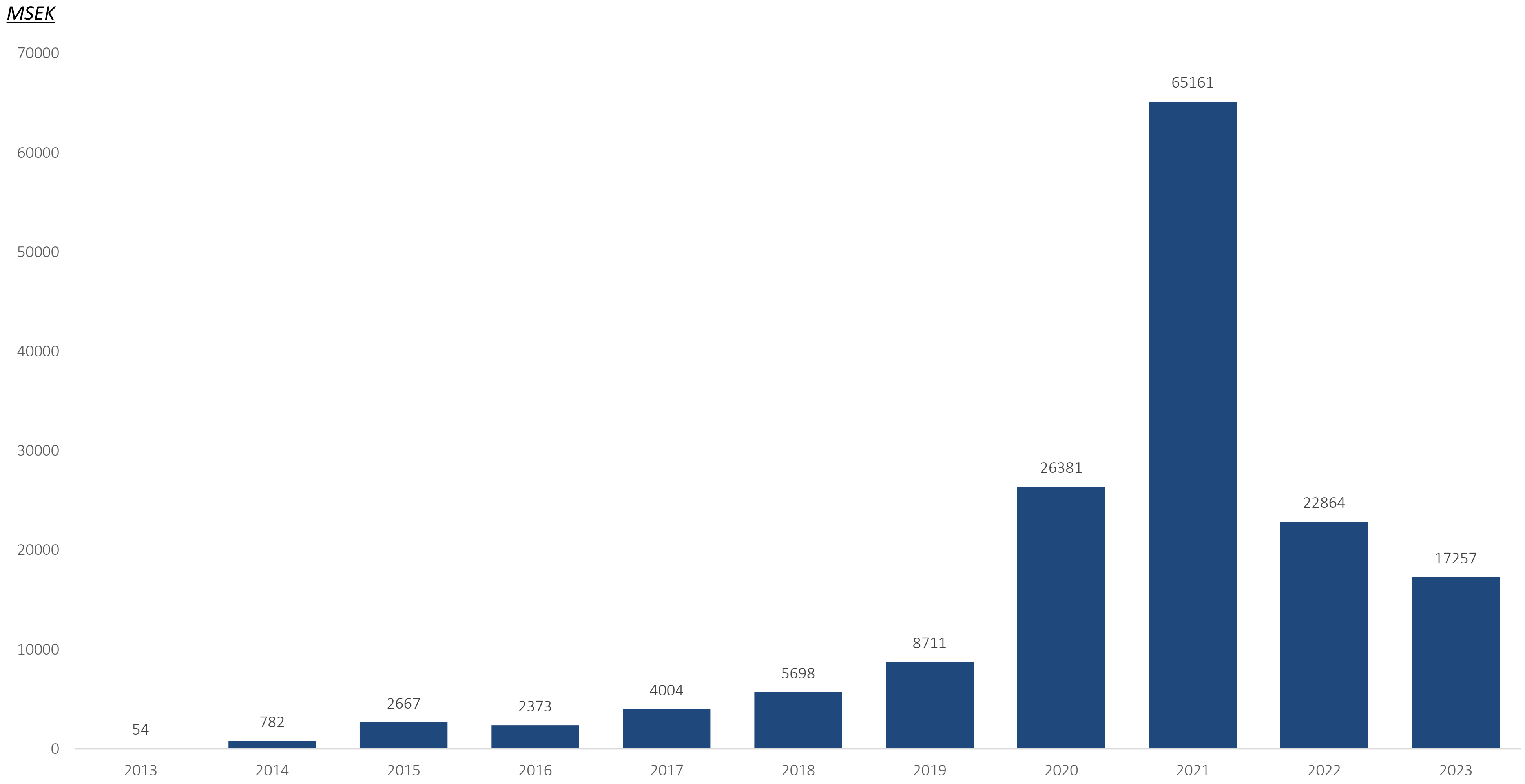


- These well-known companies that have generated a lot of shareholder value through the years tend over time to be very disciplined and similar in terms of how much contingent consideration amount to as % of total transaction value.

Source: Company reports

Equity Issues

Cash equity issues 2013-2023

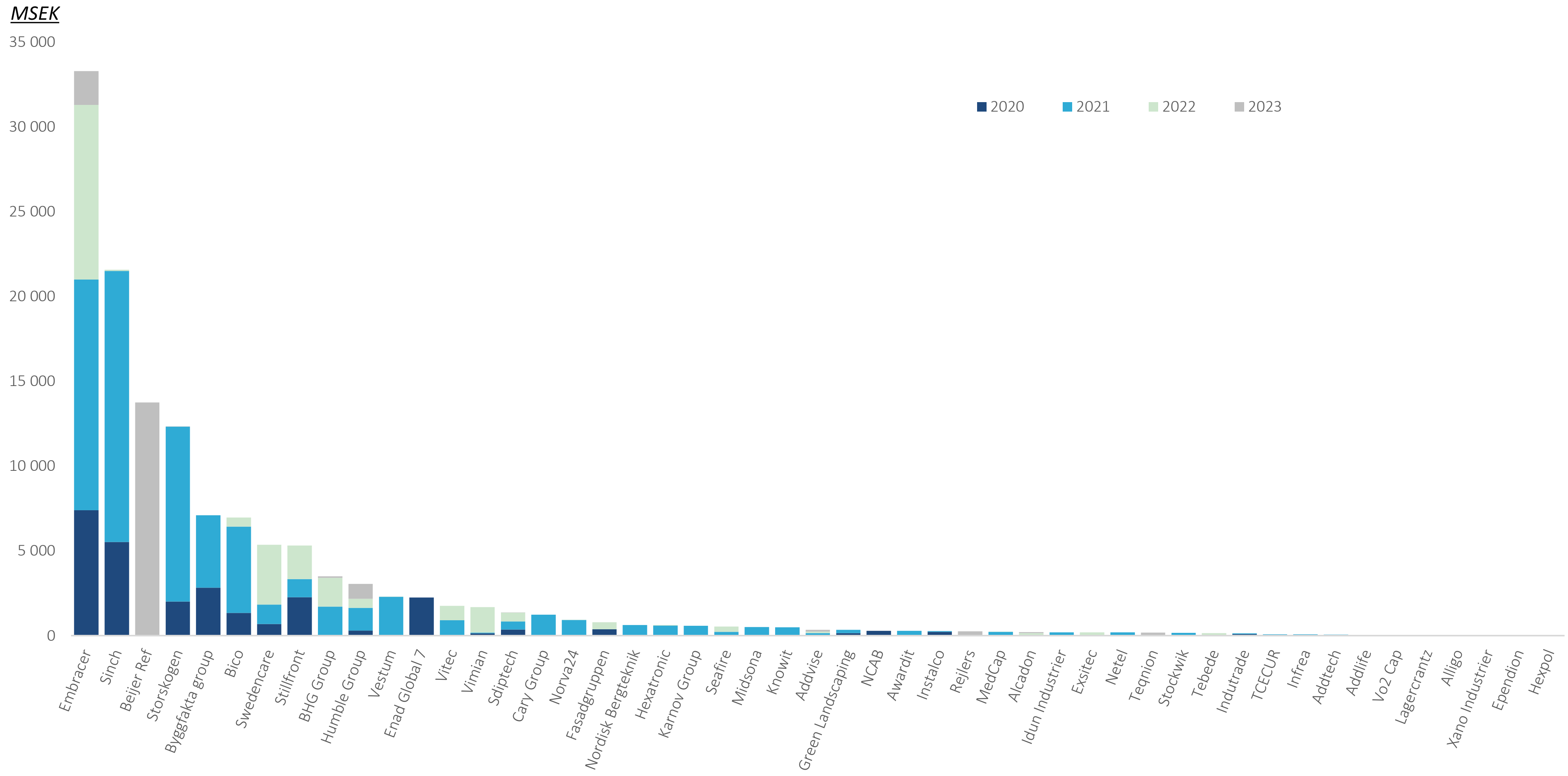


Source: Company reports

Equity Issues 2020-2023

Cash equity issues 2020-2023

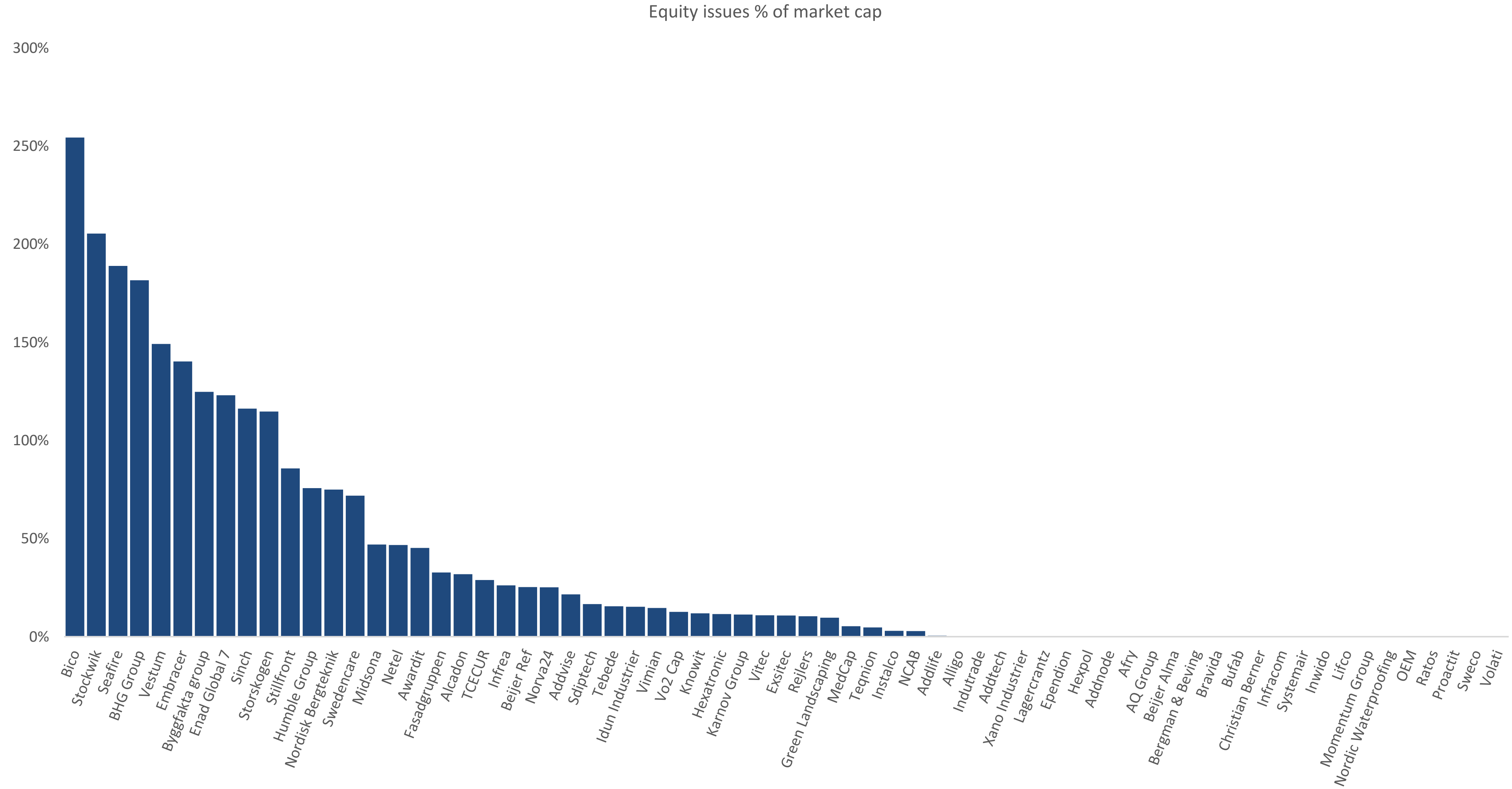
A Closer Look at Nordic M&A and Deal Characteristics



Source: Company reports

Equity Issues 2020-2023 as % of Current Market Cap

Market cap at 2023-11-07



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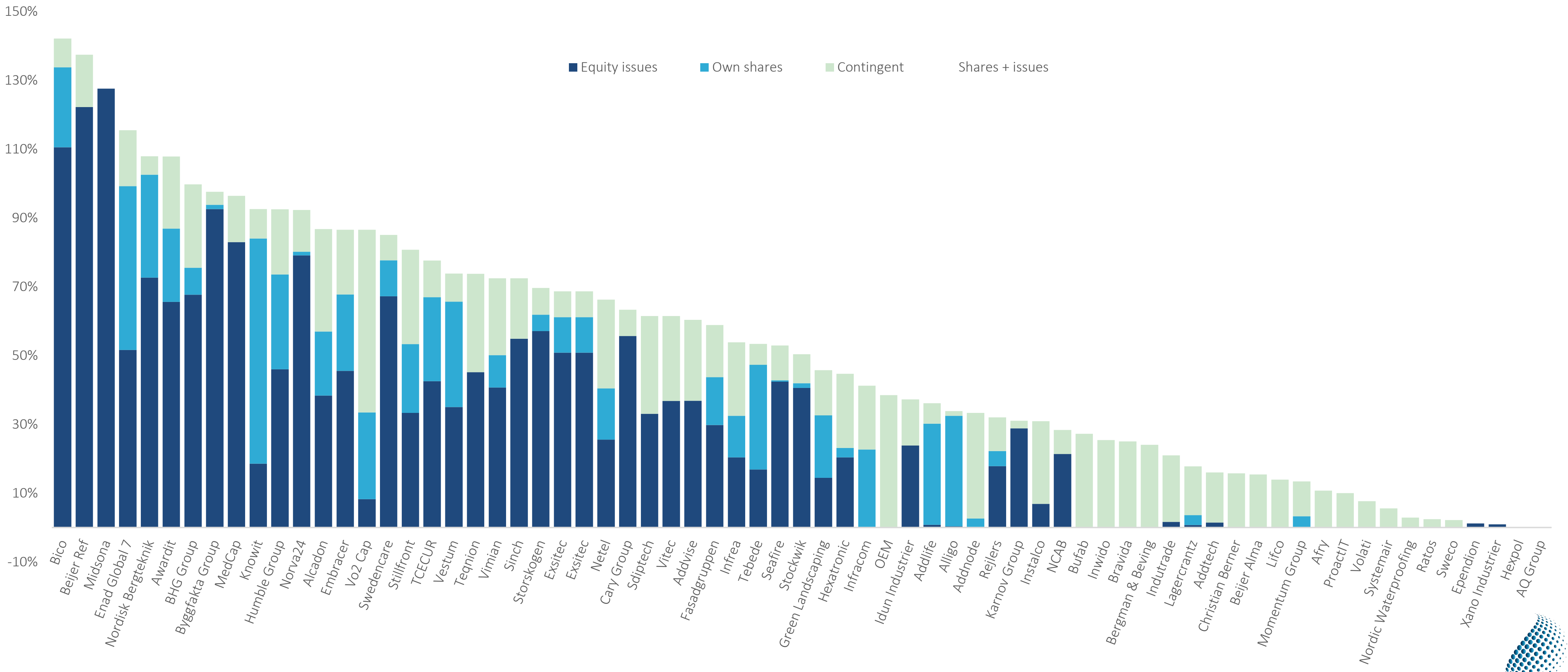
Source: Company reports & Factset (2023-11-07)

Total Deal Structure 2020-2023

Deal structure 2020-2023 incl cash equity issues



Source: Company reports

Issuing Shares for M&A: Learnings & Key Findings

- Our findings show issuing new shares as a method of payment in M&A transactions was during 2020 and 2021 increasing both in nominal terms but also in relative terms to total M&A. We also saw an increase in the total number of companies using equity as means for M&A.
- Many "newly" listed companies or companies with changed strategy towards a more aggressive M&A-agenda use equity raises or payment with shares as a way to accelerate growth.
- The more traditional Acquisition-driven Compounders like Addtech, Addnode, Indutrade, Lagercrantz and Lifco have chosen to not use equity as a tool for growth, as it dilutes current shareholders. Their capital allocation strategy is to compound their capital through cash flow and debt with high returns on incremental invested capital.
- When using debt to support growth, it is important not to have too much leverage as it reduces the ability to act opportunistically in economic downturns. Too much debt can also force companies to divest assets at distressed valuation.
- Companies with too much debt sees their stock prices decline to a larger extent in poor economic times, making share issuance on low valuations/distressed an even more expensive alternative.
- Too much debt can also be viewed negatively from both an equity and debt perspective, leading to e.g. downgrading of ratings, higher cost of capital that with a combined low return on invested capital can destroy shareholder value.

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* Credit Suisse: To Buy or Not To Buy – A checklist for assessing Mergers and Acquisitions by Michael J. Mauboussin, Dan Callahan & Darius Majd

Issuing Shares for M&A: Learnings & Key Findings (2)

Pros and cons with issuing new shares to support the M&A agenda

Issuing new shares is a fast way to grow and support an aggressive M&A agenda. There are both pros and cons with that, some of which we list below.

To finance an M&A story with issuance of new shares can be an attractive alternative to the buyer as:

- Issuing new shares at high valuations is attractive as it can raise a lot of capital with a small dilution of current shareholders
- Make sure sellers' agenda is aligned with its own
- Get new and respectable institutional or private long-term investors as owners – which can increase the attractiveness of the share and increase valuation
- A fast and time efficient way to finance acquisitions (e.g. via directed share issues)

There are however also down-side risk with having share issuance as an integrated part of an M&A agenda:

- Issuing new shares destroys shareholder value when stock is undervalued
- In a bad market sentiment (or declining share prices), sellers can demand to be paid in cash
- Can create a selling flood when lock-ups expire and hence putting pressure on share prices
- Potential badwill within the organization if previous sellers are "out-of-money" due to declining share prices – leading to a deteriorating operational performance

A study* also found that the market responds more favourably to cash deals than to stock deals. "One potential explanation is that in cash deal the buyer takes all of the risk and enjoys all the reward, indicating that the buyer is confident that the deal will create value when paying with cash. A buyer that is unsure whether it can capture the synergies that premium demands can hedge its position by using stock."

At the very outset with Halma we decided that since our overriding objective was to increase earnings per share, our best policy was not to issue any more shares. That sounds crazy to many people. The conventional view and the road most people choose towards success is to establish a high rating for their shares and then issue them.

Again, this illustrates the difference between the short-term and the long-term approach. The short-term manager, once he has achieved highly rated shares, logically sets out to issue as many as possible, seeing this as a source of cheap money or else a means of acquiring companies he could not otherwise afford.

The long-term manager, equally logically, perceives that he is (or else hopes he soon will be) managing an unusually successful company; one which, for example, is making 40% return on capital employed and is growing consistently. Al! common sense says that if you are fortunate enough to own such a company then don't sell it.

If that logic is true, it is equally true not to issue further shares. Why share the ownership of this gain with anyone else?

David Barber, former CEO and Chairman of the Board Halma PLC
October 1997 Strategy Speech

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* Credit Suisse: To Buy or Not To Buy – A checklist for assessing Mergers and Acquisitions by Michael J. Mauboussin, Dan Callahan & Darius Majd

A Closer Look at Acquisitions

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Nordic Acquisitions

[A Closer Look at Acquisitions](#)

# Acquisitions	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Average
Absolent Air Care									x	x	x	x	x	x	x	x	x	x	x	2
Addlife											x	x	x	x	x	x	x	x	x	5
Addnode	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	4
Addtech	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	9
Addvise						x	x	x	x	x	x	x	x	x	x	x	x	x	x	1
Afry	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	8
Alcadon													x	x	x	x	x	x	x	1
Alimak										x	x	x	x	x	x	x	x	x	x	1
Alligo													x	x	x	x	x	x	x	4
AQ Group	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	1
Assa Abloy	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	14
Atlas Copco	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	11
Aw ardit													x	x	x	x	x	x	x	1
Beijer Alma				x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	2
Ependion							x	x	x	x	x	x	x	x	x	x	x	x	x	0
Beijer Ref	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	4
Bergman & Beving	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	6
Bico														x	x	x	x	x	x	3
BHG Group														x	x	x	x	x	x	4
Bravida								x	x	x	x	x	x	x	x	x	x	x	x	12
Bufab	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	1
Byggfakta Group																x	x	x	x	5
Coor										x	x	x	x	x	x	x	x	x	x	1
Christian Berner									x	x	x	x	x	x	x	x	x	x	x	1
Embracer													x	x	x	x	x	x	x	15
Enad Global 7														x	x	x	x	x	x	2
Exsitec													x	x	x	x	x	x	x	2
Fasadgruppen													x	x	x	x	x	x	x	10
Green Landscaping												x	x	x	x	x	x	x	x	6
Hexagon	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	8
Hexatronic														x	x	x	x	x	x	4
Hexpol				x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	1
HMS Netw orks			x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	1
Humble Group																x	x	x	x	13
Idun Industrier										x	x	x	x	x	x	x	x	x	x	3
Indutrade	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	11
Infracom														x	x	x	x	x	x	2
Infrea															x	x	x	x	x	3
Instalco										x	x	x	x	x	x	x	x	x	x	15
Inw ido								x	x	x	x	x	x	x	x	x	x	x	x	1
Karnov Group															x	x	x	x	x	3
Know it	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	2
Lagercrantz	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	4
Lime Technologies														x	x	x	x	x	x	1
Lindab								x	x	x	x	x	x	x	x	x	x	x	x	3
Lifco			x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	7
MedCap				x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	1
Midsona							x	x	x	x	x	x	x	x	x	x	x	x	x	1
Momentum Group																		x	x	4
NCAB								x	x	x	x	x	x	x	x	x	x	x	x	1
Nederman						x	x	x	x	x	x	x	x	x	x	x	x	x	x	1
Netel													x	x	x	x	x	x	x	2
Nibe	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	4
Nordic Waterproofing													x	x	x	x	x	x	x	4
Nordisk Bergteknik															x	x	x	x	x	4
Norva24											x	x	x	x	x	x	x	x	x	5
OEM	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	2
ProactIT					x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	1
Ratos																x	x	x	x	5
Rejlers	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	4
Sdiptech											x	x	x	x	x	x	x	x	x	5
Seafire																x	x	x	x	3
Sinch															x	x	x	x	x	3
Soltech															x	x	x	x	x	7
Stillfront														x	x	x	x	x	x	3
Stockw ik												x	x	x	x	x	x	x	x	4
Storskogen								x	x	x	x	x	x	x	x	x	x	x	x	19
Sw eco	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	9
Sw edencare												x	x	x	x	x	x	x	x	2
Systemair			x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	3
TCECUR													x	x	x	x	x	x	x	2
Tebede																		x	x	5
Teqnion													x	x	x	x	x	x	x	3
Vestum																	x	x	x	26
Vimian																	x	x	x	16
Vitec	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	2
Vo2 Cap																	x	x	x	2
Volati	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	2
Xano Industrier	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	1
Maximum Entertainment																x	x	x	x	1
Total	**62**	**113**	**151**	**112**	**56**	**99**	**109**	**119**	**102**	**156**	**174**	**200**	**214**	**245**	**294**	**329**	**586**	**509**	**292**	

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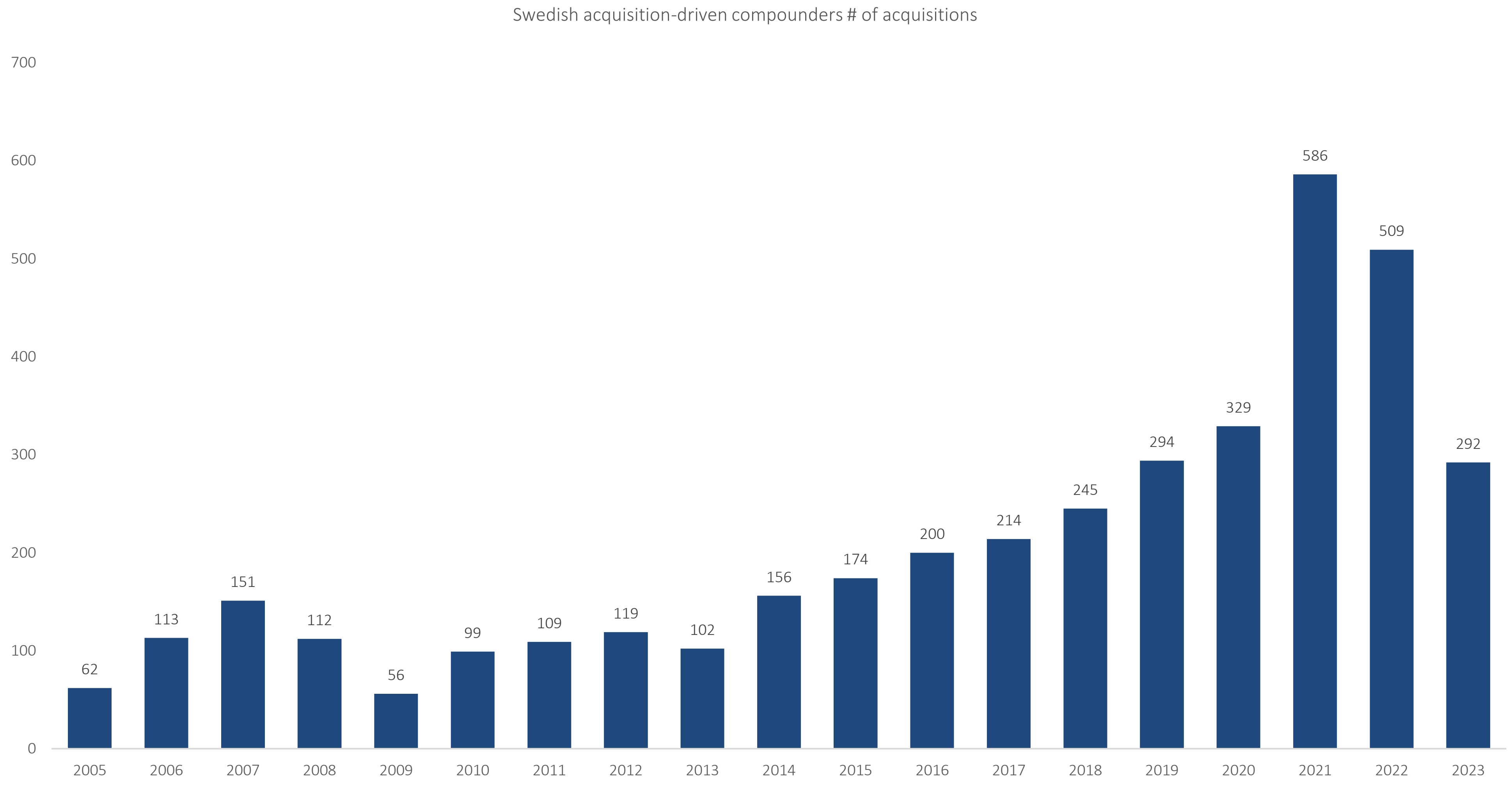
Nordic Acquisitions

Swedish Acquisition-driven Compounders # of acquisitions

[A Closer Look at Acquisitions]



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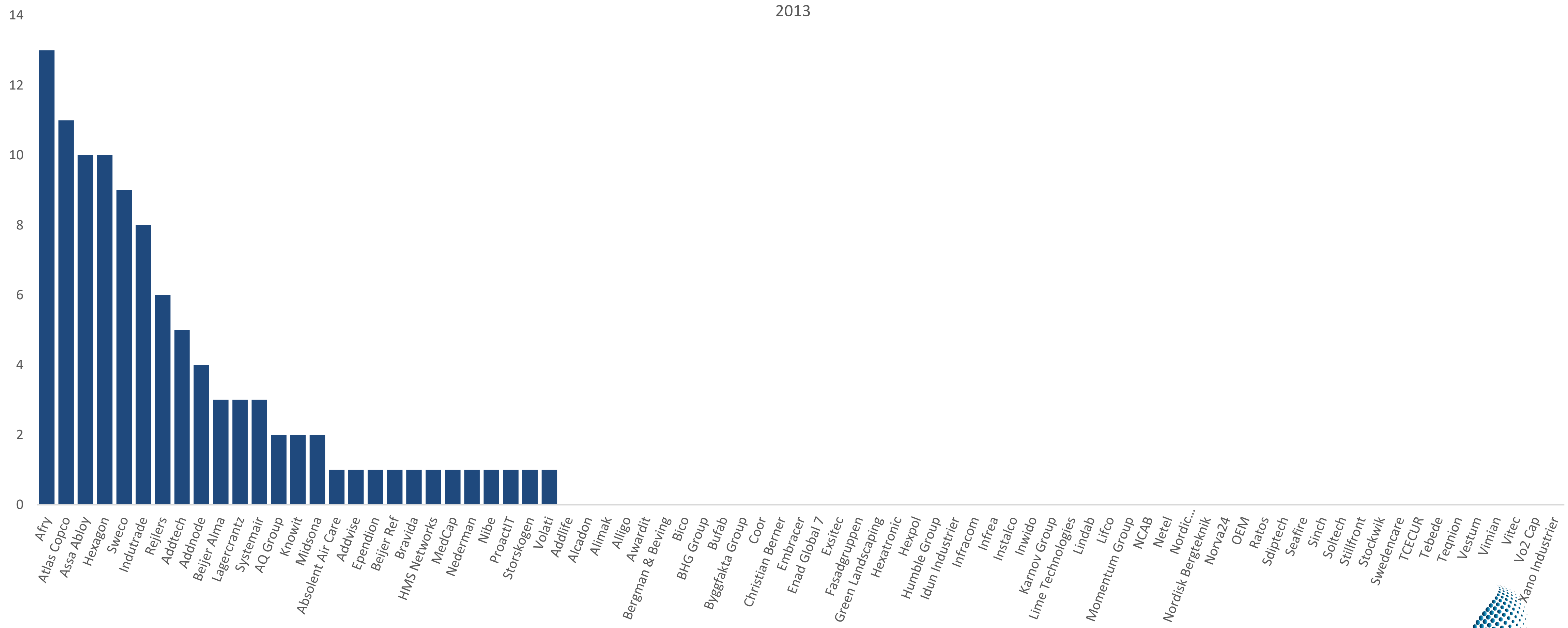
Source: Company reports

Nordic Acquisitions in 2013

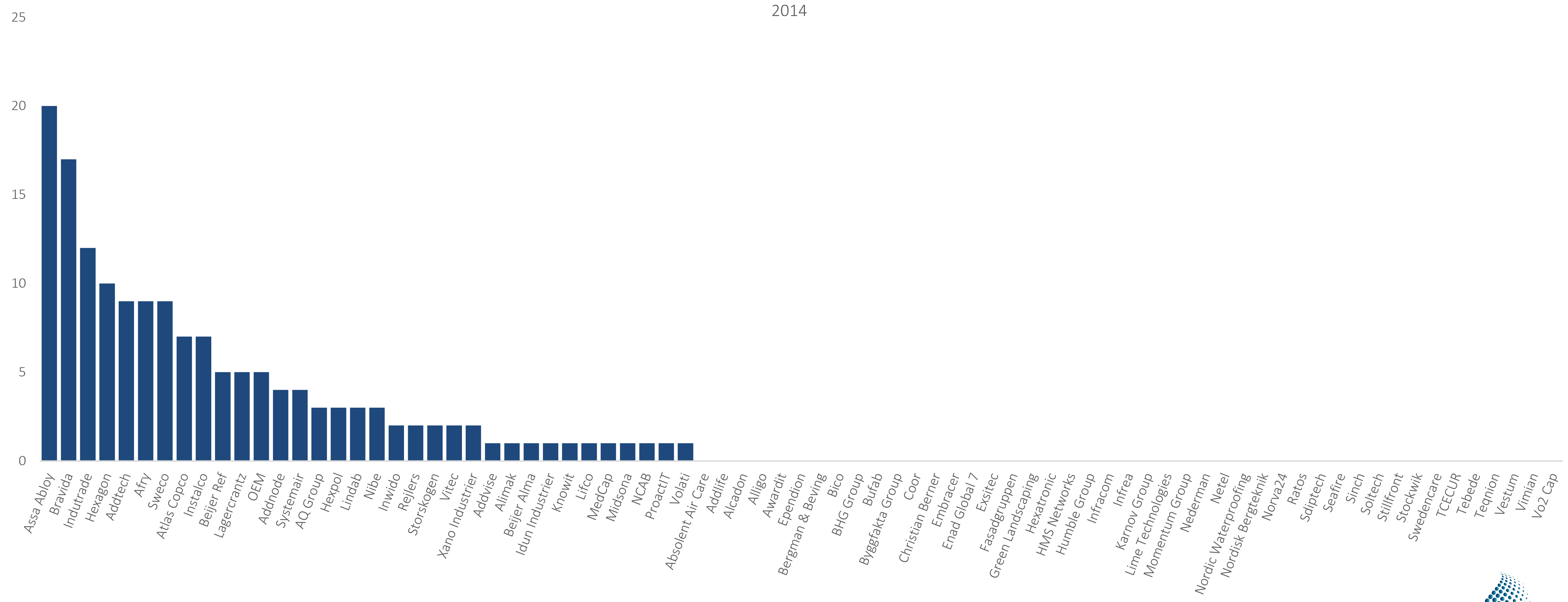
A Closer Look at Acquisitions



Source: Company reports

Nordic Acquisitions in 2014

A Closer Look at Acquisitions



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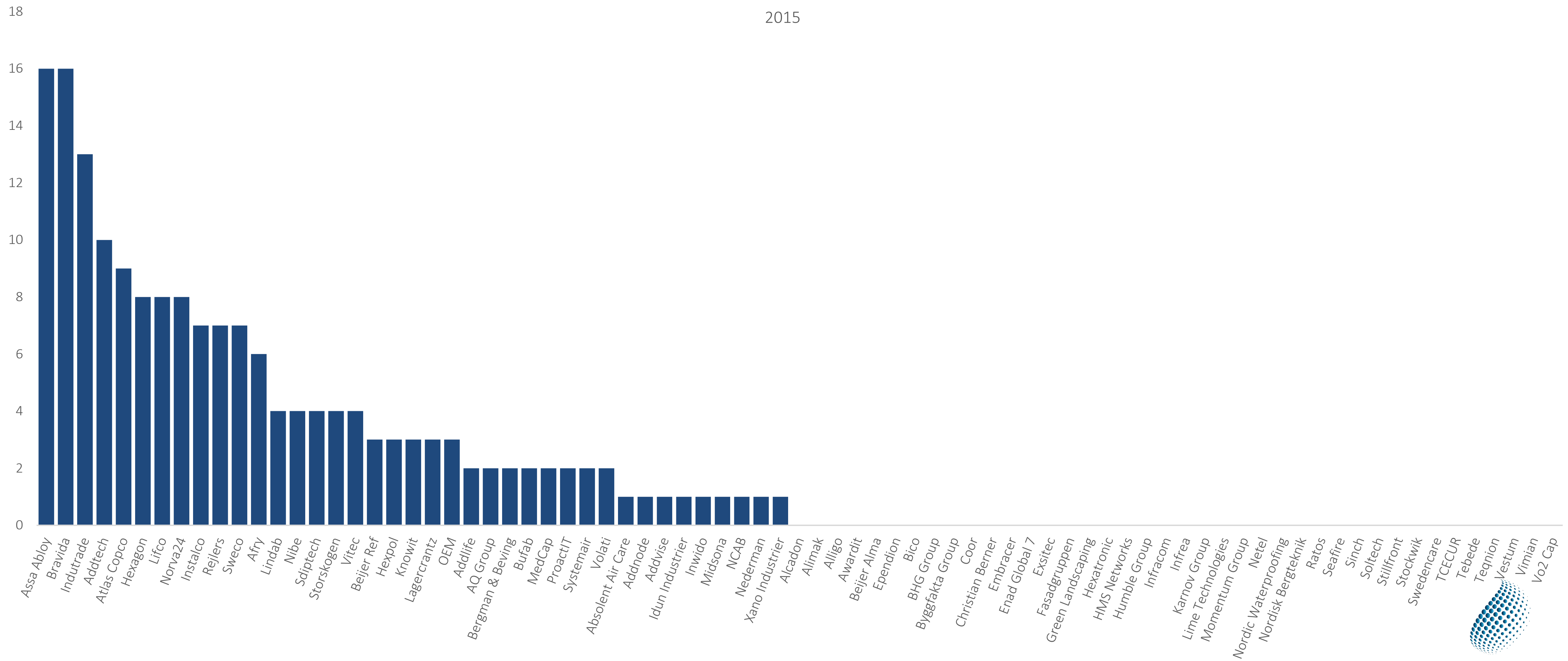
Source: Company reports

Nordic Acquisitions in 2015

A Closer Look at Acquisitions



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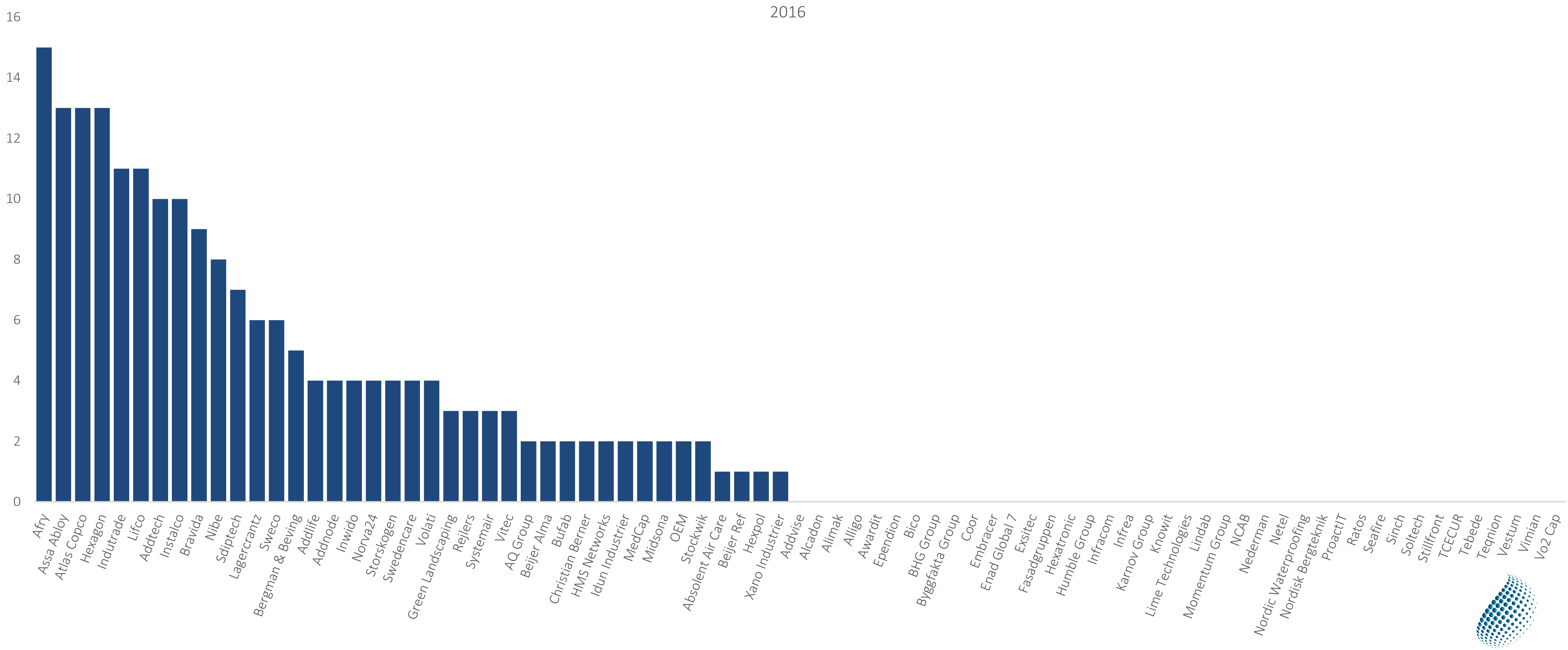
Source: Company reports

Nordic Acquisitions in 2016

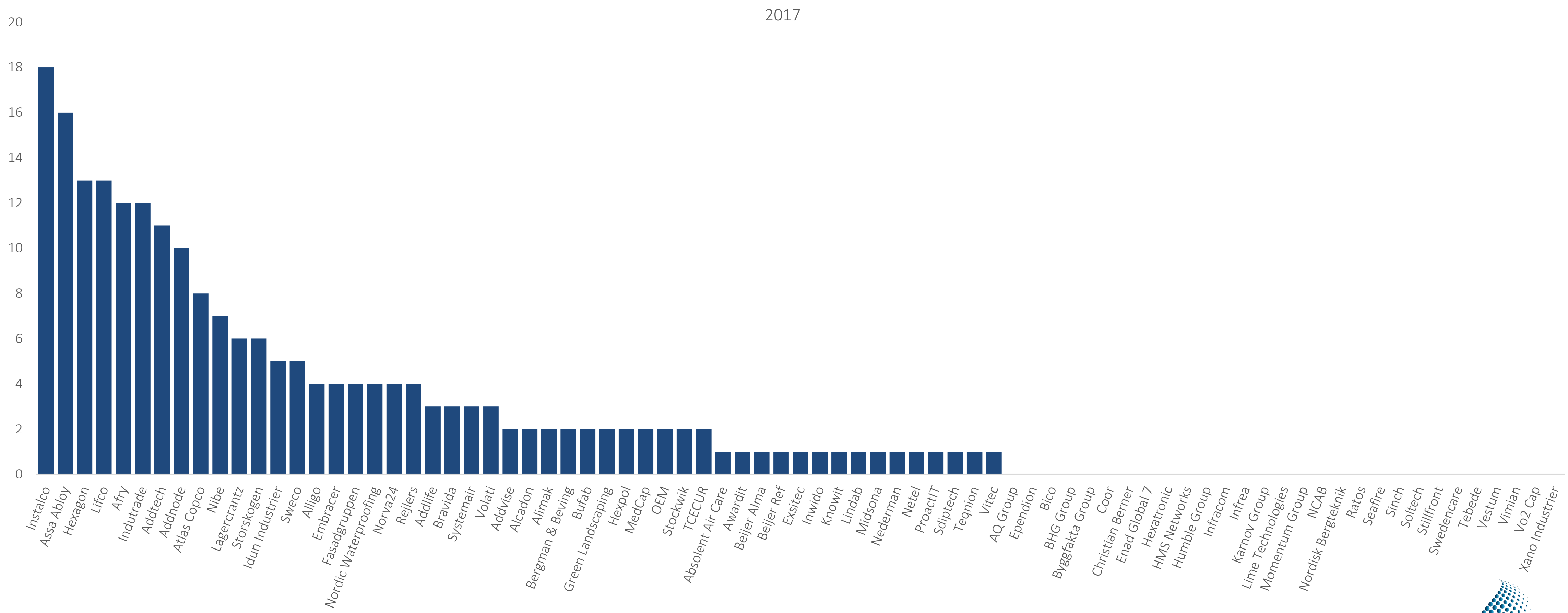
A Closer Look at Acquisitions



Source: Company reports

Nordic Acquisitions in 2017

A Closer Look at Acquisitions



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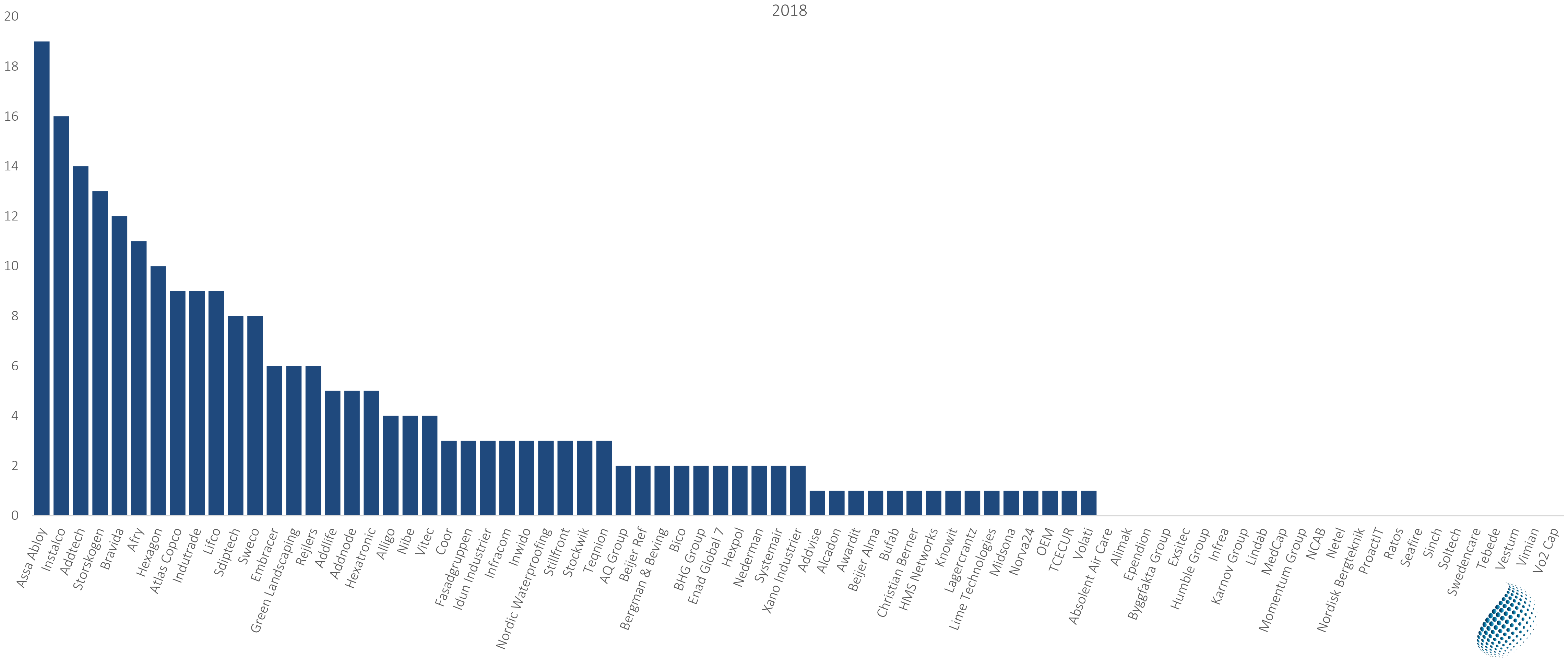
Source: Company reports

Nordic Acquisitions in 2018

A Closer Look at Acquisitions



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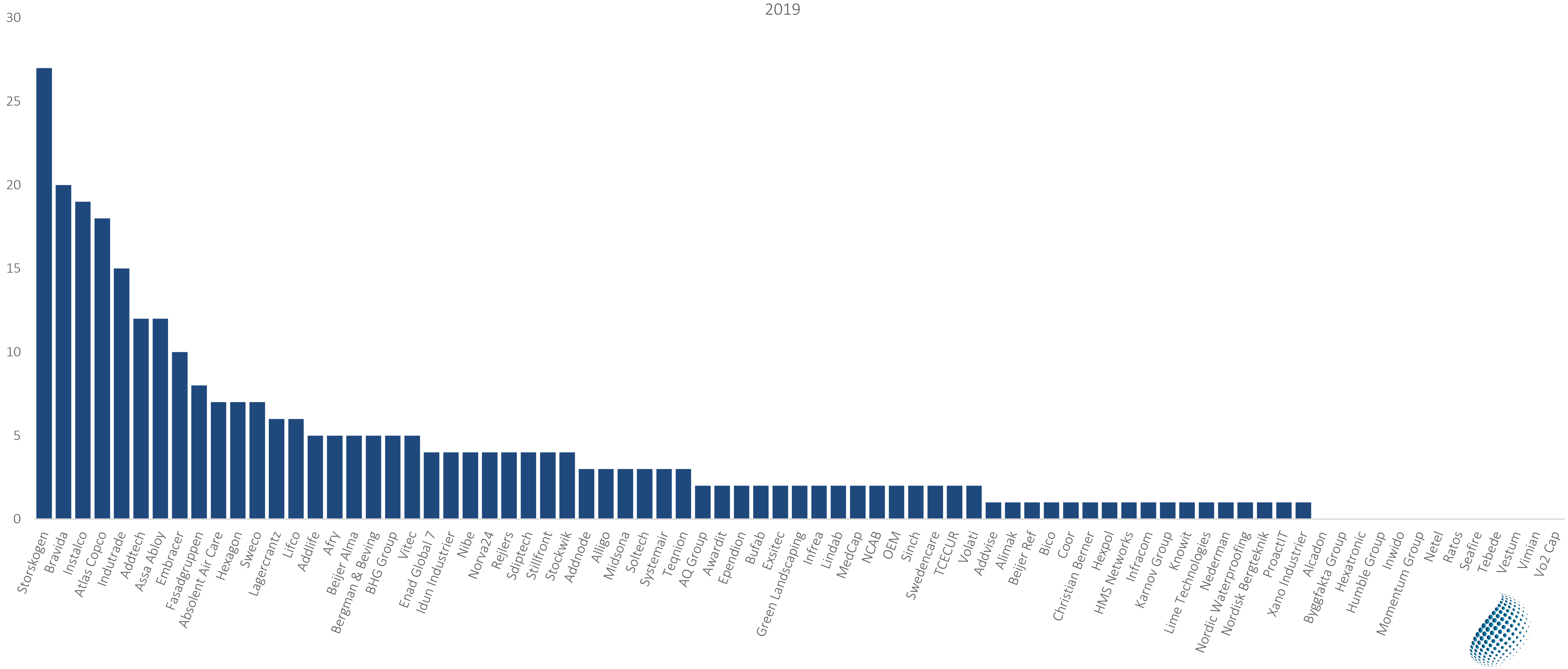
Source: Company reports

Nordic Acquisitions in 2019

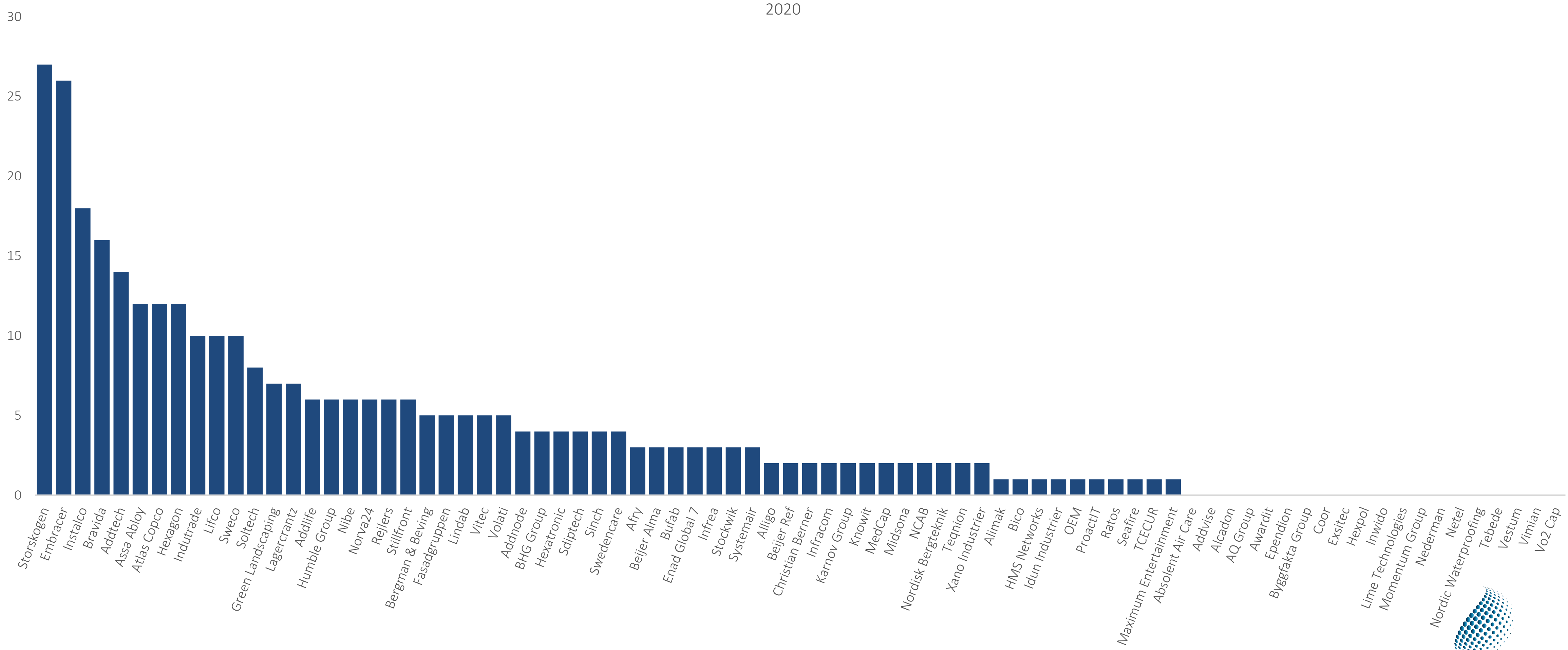
A Closer Look at Acquisitions



Source: Company reports

Nordic Acquisitions in 2020

A Closer Look at Acquisitions



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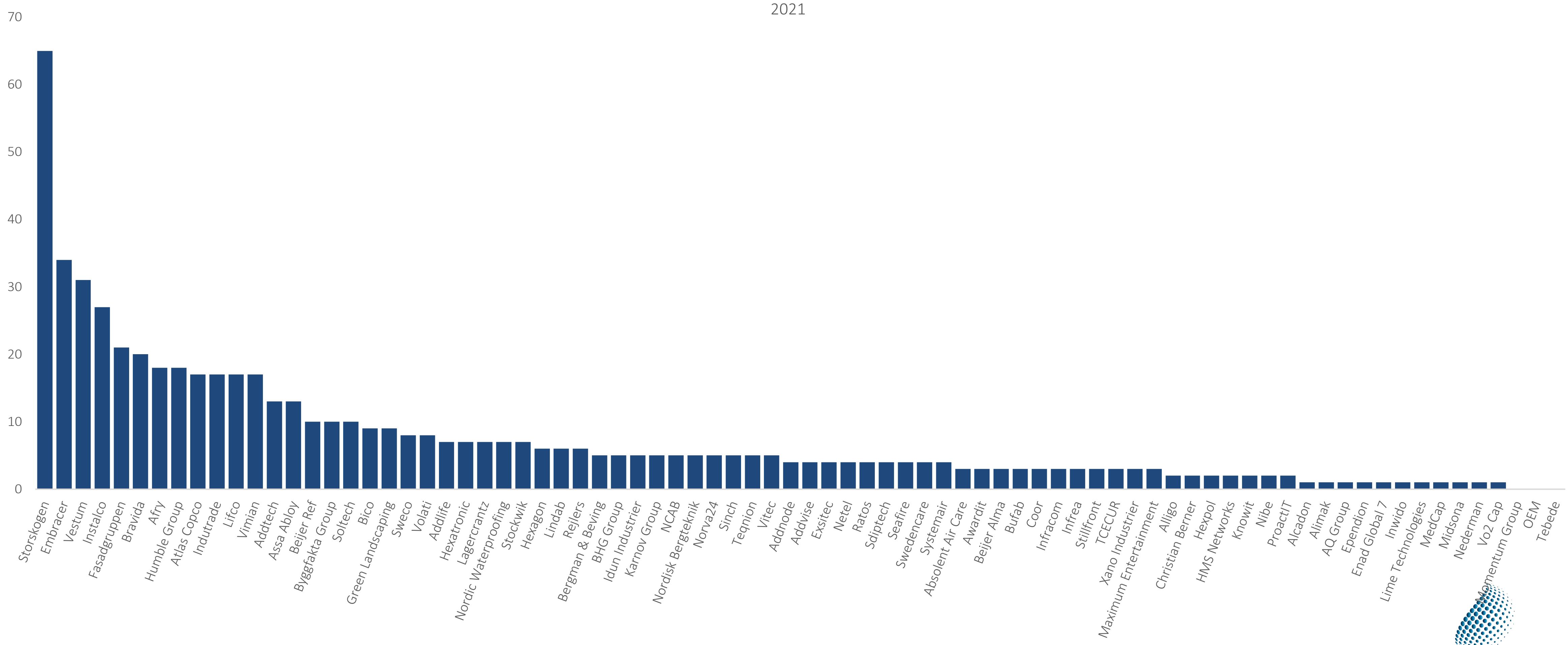
Source: Company reports

Nordic Acquisitions in 2021

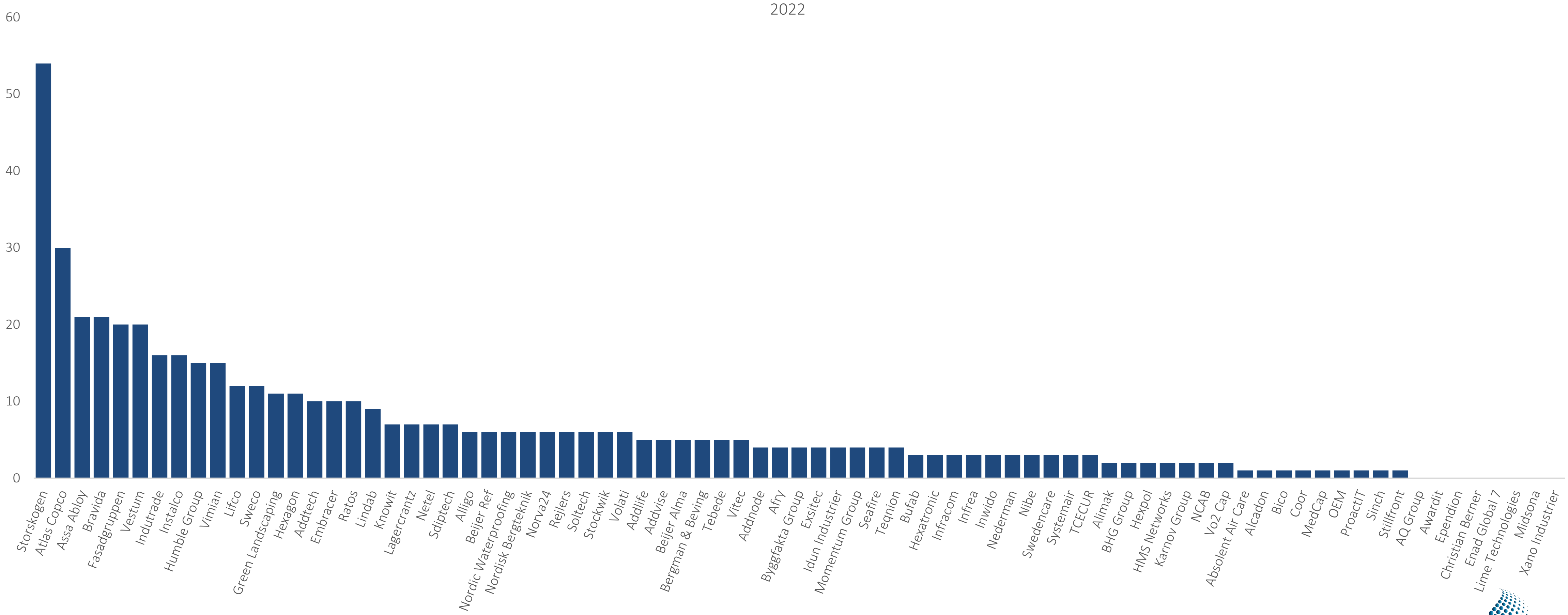
A Closer Look at Acquisitions



Source: Company reports

Nordic Acquisitions in 2022

A Closer Look at Acquisitions



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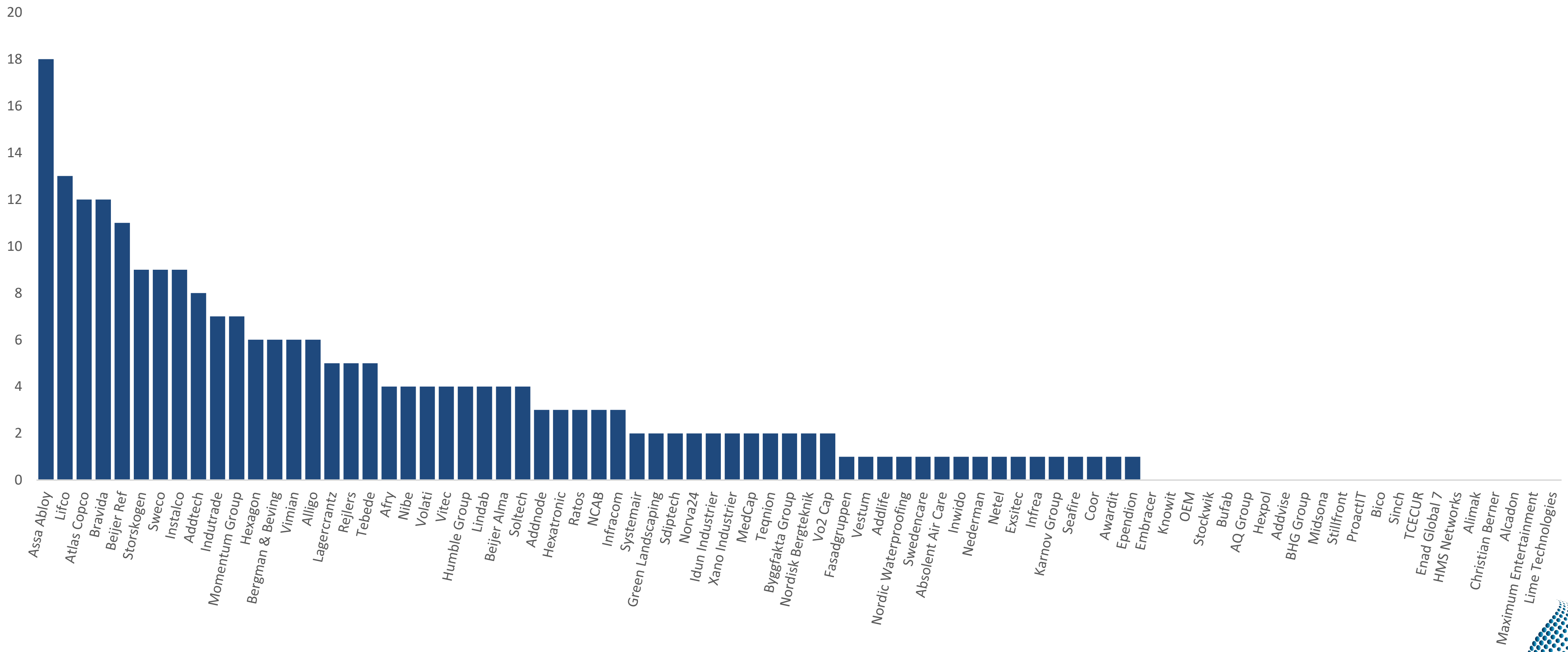
Source: Company reports

Nordic Acquisitions in 2023

As per 2023 Q3 YTD

A Closer Look at Acquisitions



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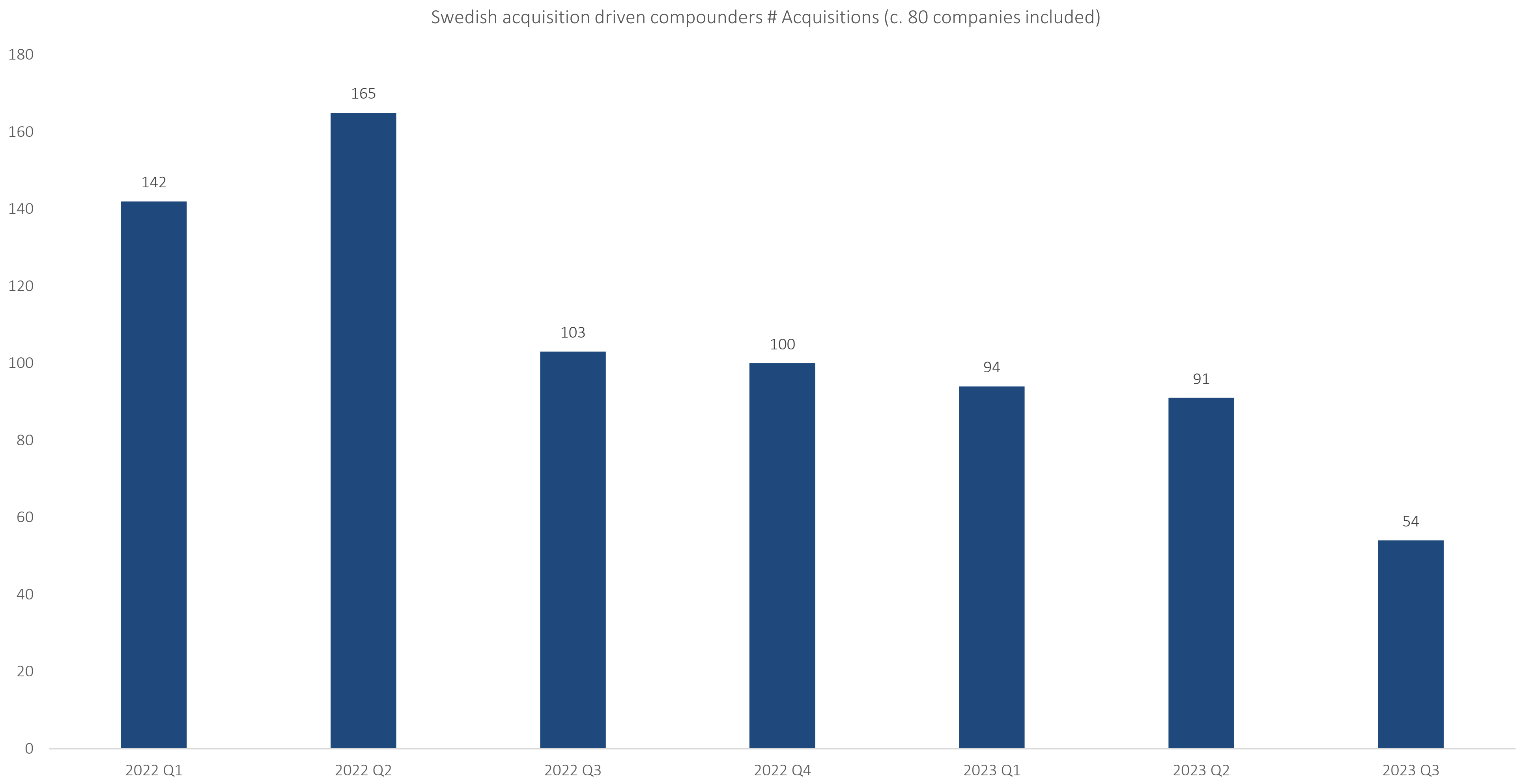
Source: Company reports

Nordic Acquisitions 2022-2023

Quarterly # of acquisitions

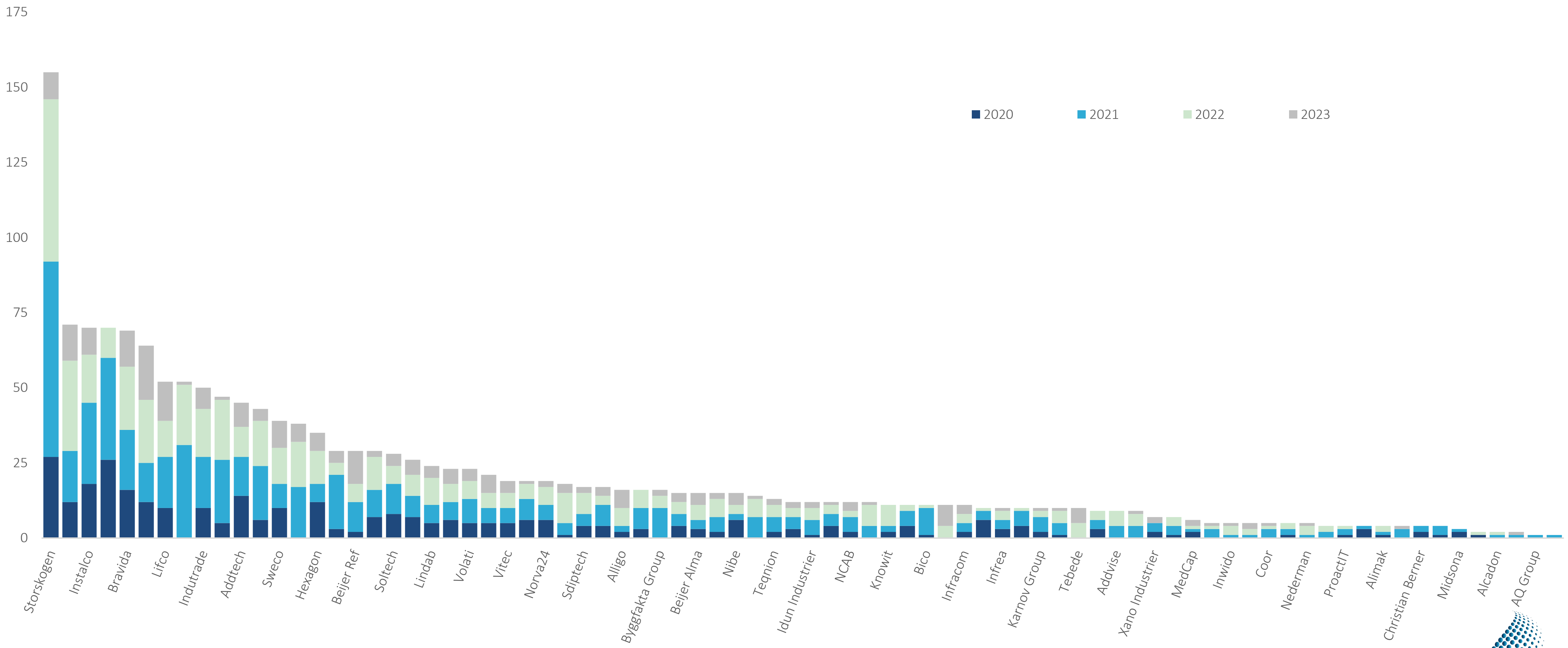
A Closer Look at Acquisitions



Source: Company reports

Nordic Acquisitions 2020-2023

A Closer Look at Acquisitions



Source: Company reports

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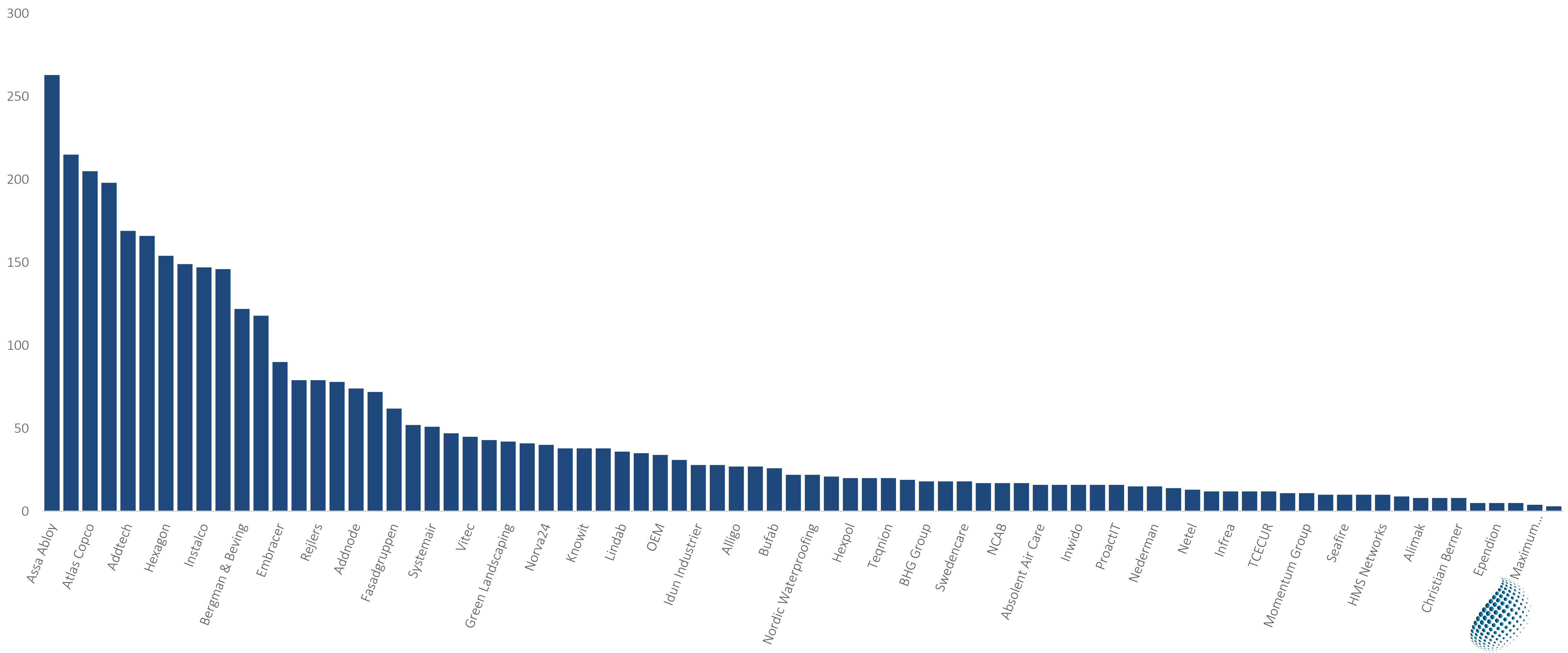
Nordic Acquisitions 2005-2023

A Closer Look at Acquisitions

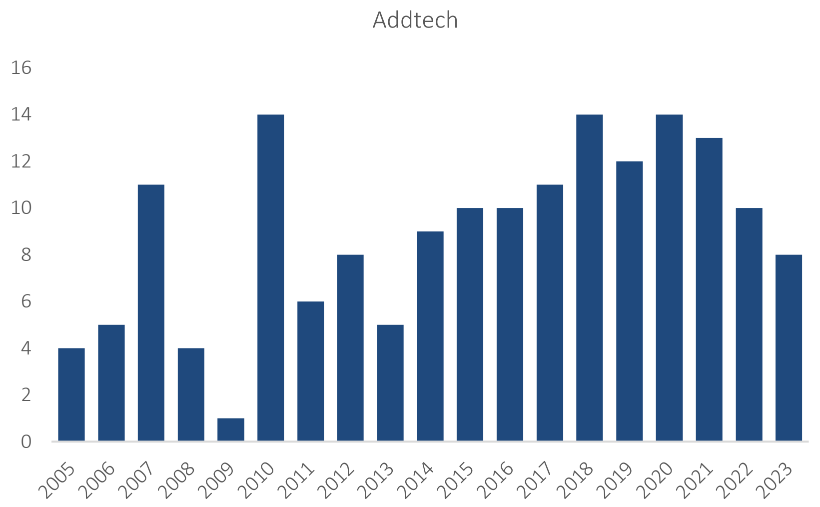


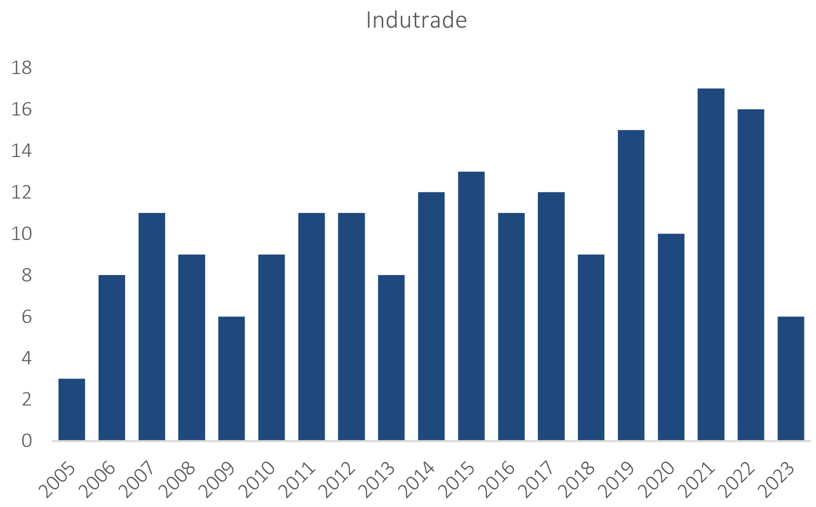
Source: Company reports

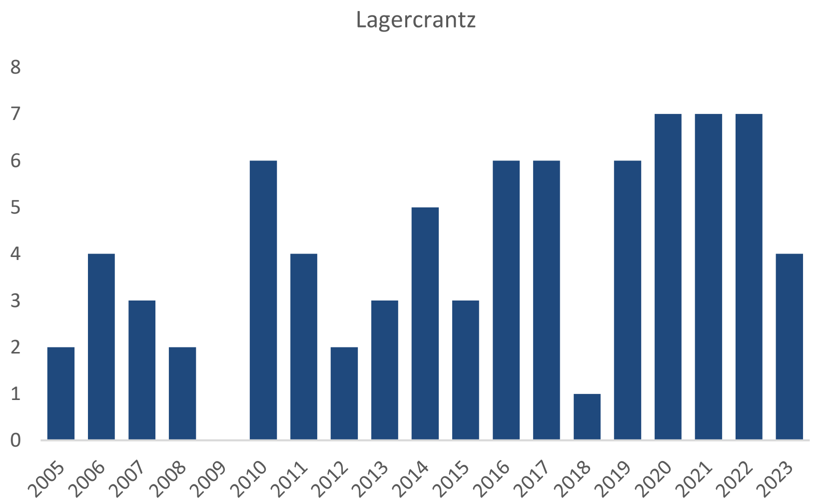
Acquisitions for Selected Companies

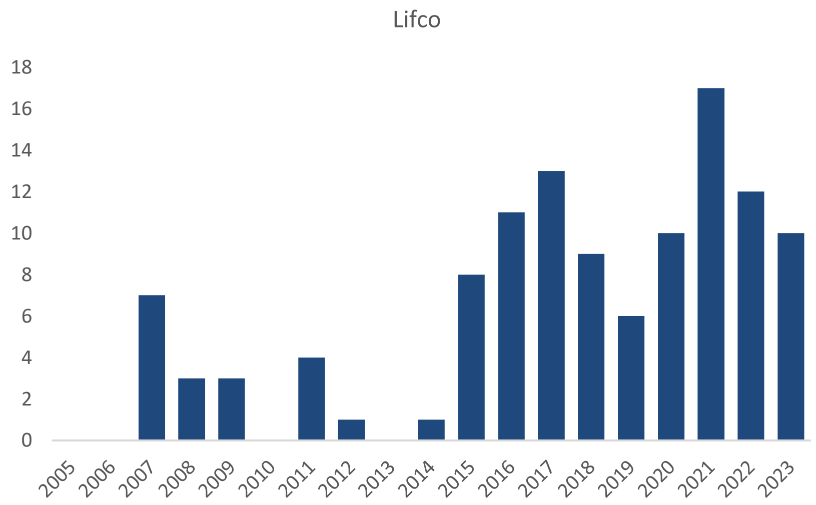
Scaling acquisitions over time

A Closer Look at Acquisitions









Source: Company reports

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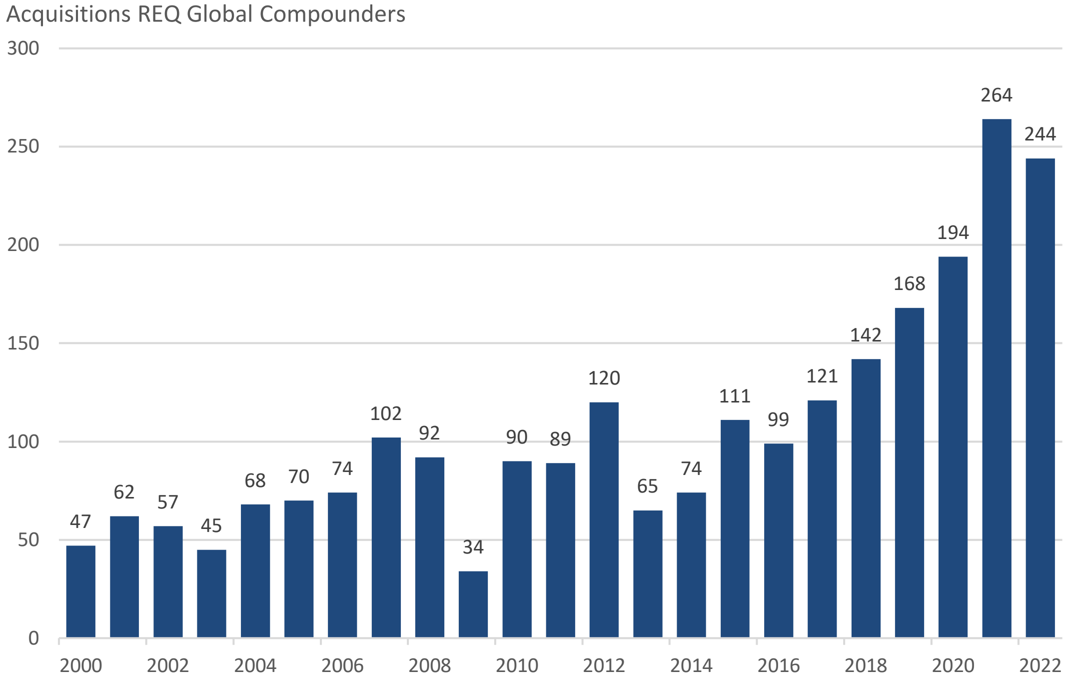
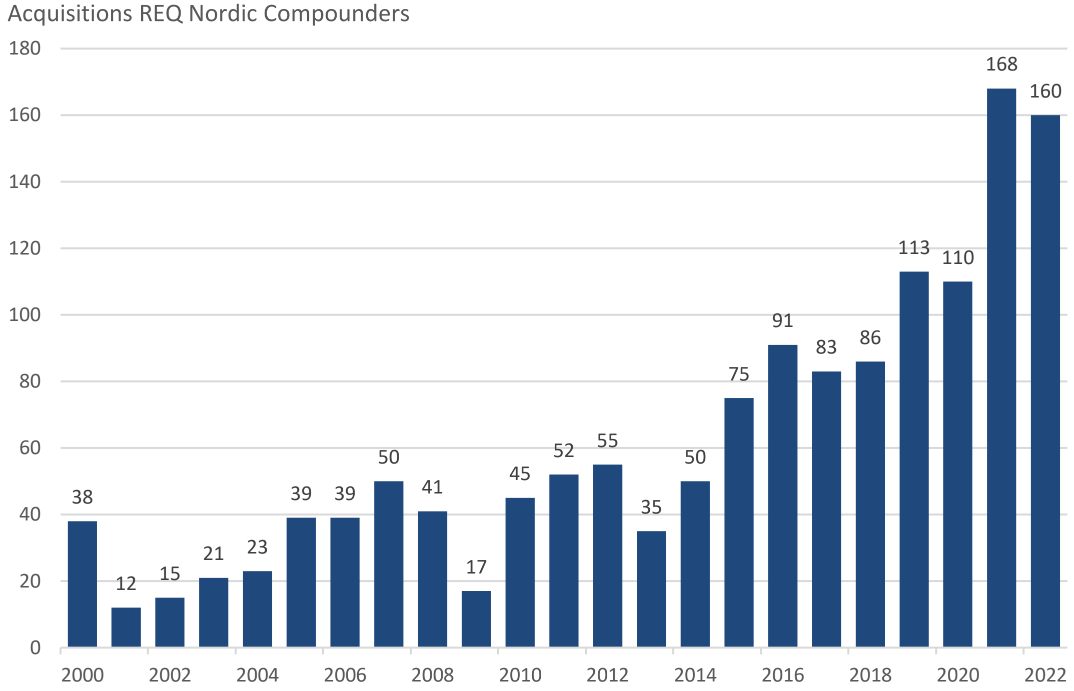
Number of Acquisitions in Our Portfolios the Last 20 Years (Aggregate Portfolio Level)

REQ Global Compounders & REQ Nordic Compounders

A Closer Look at Acquisitions





Source: Company press releases. As of 30th December 2022

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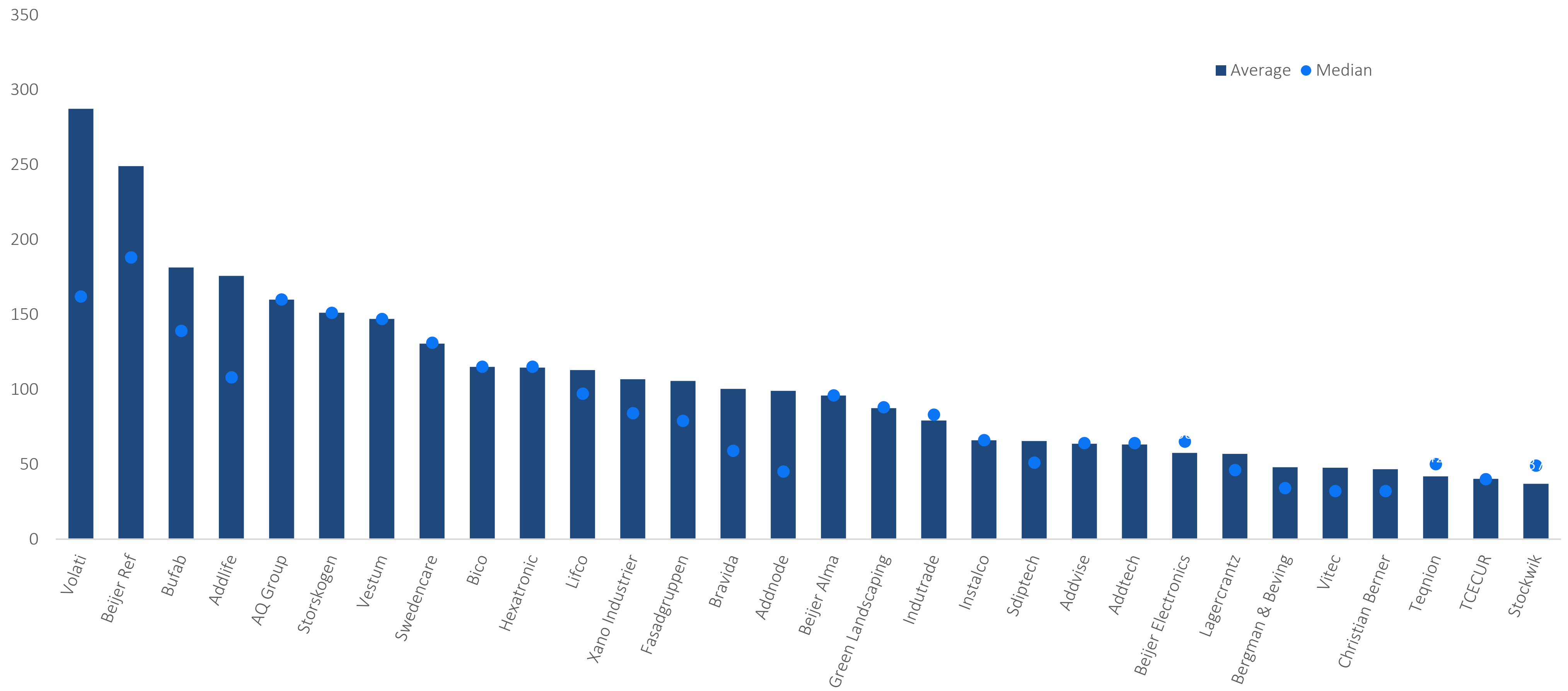
Average Sales of Acquired Companies

Average acquisition size 2008-2021

A Closer Look at Acquisitions



Source: Company reports

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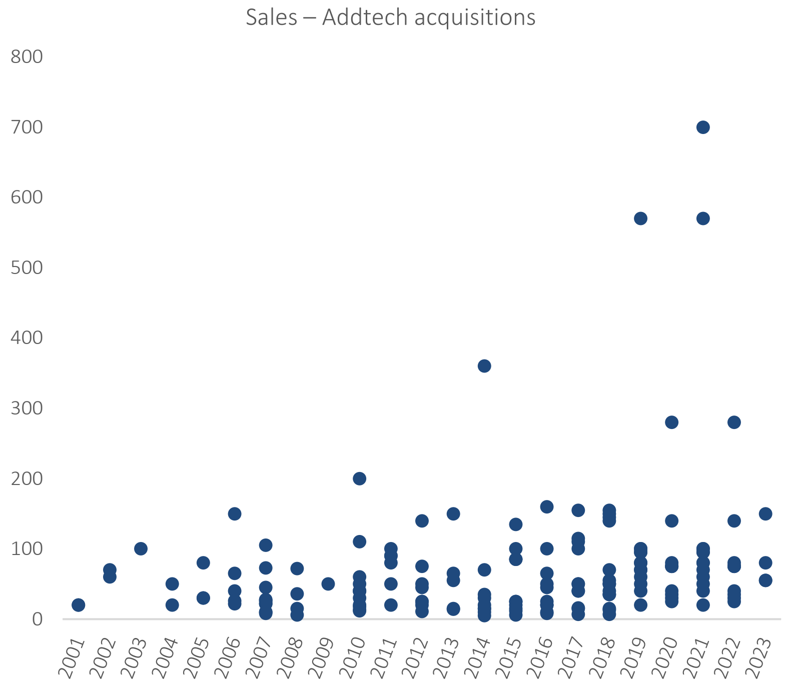
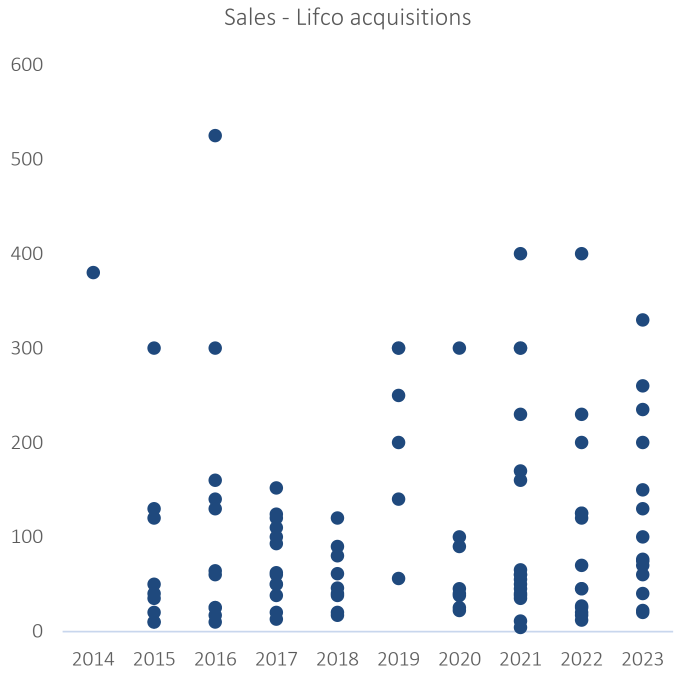
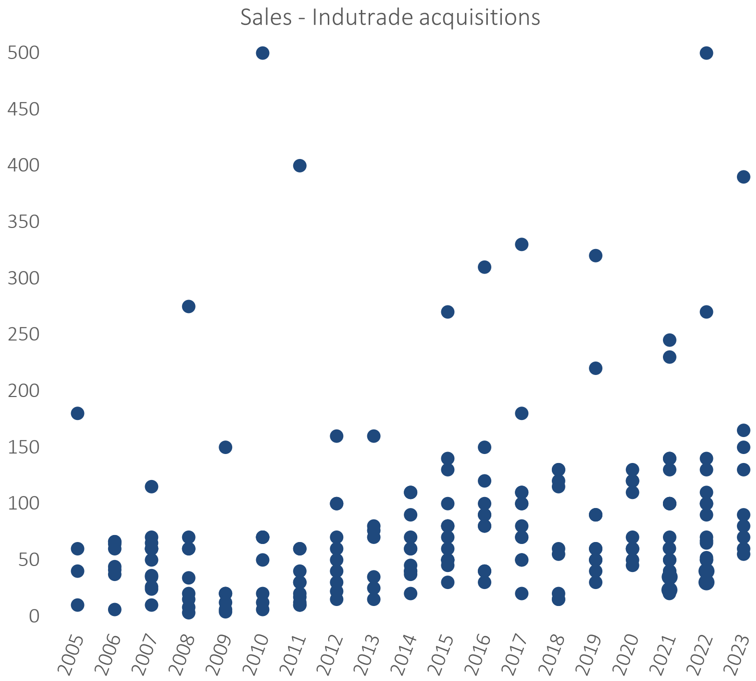
Acquisition Size Within Strategy

Over a long period of time, Addtech, Indutrade and Lifco have stayed true to their strategy or small acquisitions

[A Closer Look at Acquisitions](#)







REQ CAPITAL
INVESTING WITH INSIGHT

Source: Company reports

Acquisition Examples

REQ CAPITAL
INVESTING WITH INSIGHT

Case example: Addtech acquires Fey Elektronik GmbH

March 2022

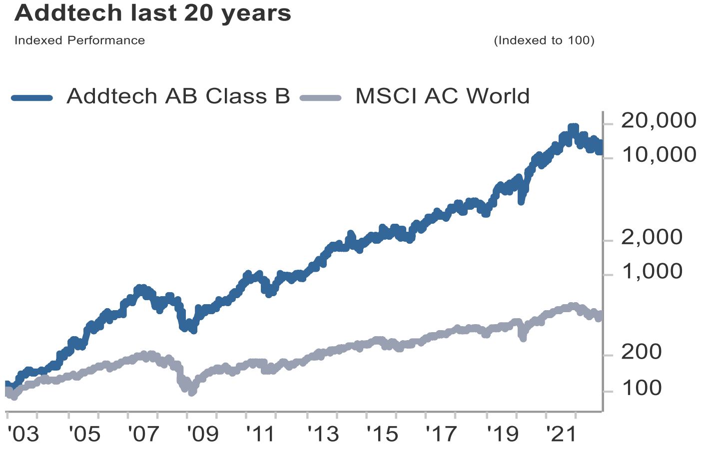
Acquisition Examples

Transaction details

- German provider of customized battery solutions.
- Established in 1991, based in Seevetal, Germany
- Annual sales: EUR 55 million, 3,4% of Addtech's total sales
- CEO Michael Witte continues in his role with 10% ownership
- Full autonomy and financial support

Products

Share price



REQ CAPITAL
INVESTING WITH INSIGHT

Source: Company reports, websites & Factset

Case example: SDI acquires Fraser Anti-Static Techniques

October 2022

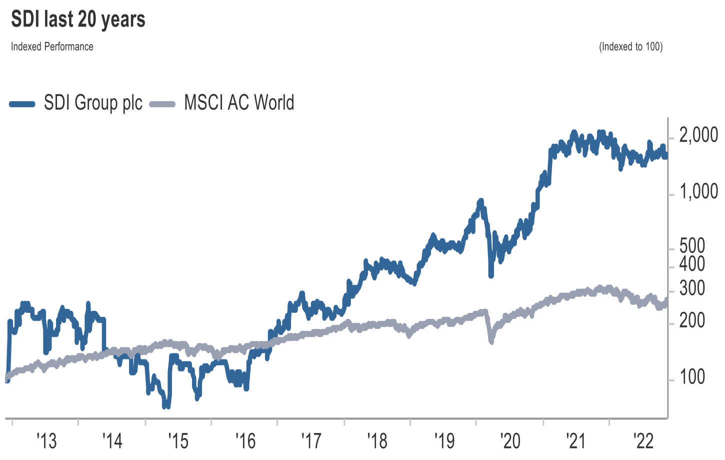
Acquisition Examples

Transaction details

Products

Share price

- UK manufacturer of anti-static products which eliminate, clean and measure static electricity in a variety of industries including plastics, packaging, medical and pharma
- 47 employees, 22% EBIT margins
- EV of £16.9m – multiple of 8.1x EBIT
- Existing management continues to run the company



Source: Company reports, websites & Factset

Case example: Lifco acquires Geax

April 2023

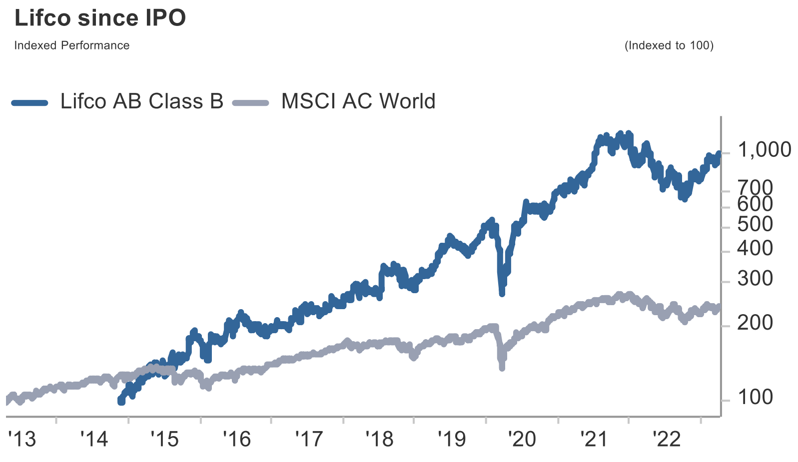
Acquisition Examples

Transaction details

Products

Share price

- Italian manufacturer of compact piling rigs and drilling machinery
- Established in 2006 by Adriano Pesaresi
- 26 employees and sales of EUR 15m, 0,8% of Lifco's total sales
- Based in Montefano



REQ CAPITAL
INVESTING WITH INSIGHT

Source: Company reports, websites & Factset

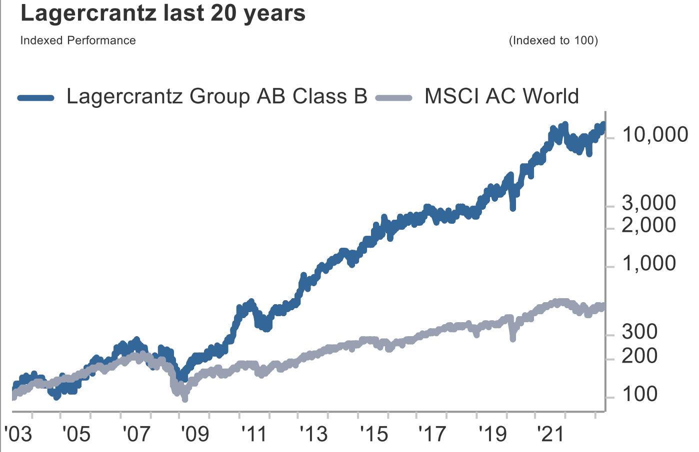
Case example: Lagercrantz acquires Supply Plus Limited

April 2023

Acquisition Examples

Transaction details	Products	Share price

- Supply Plus designs, manufactures and distribute fire rescue equipment. Main products: Fire ladders and hose reels
- Customers: Fire and rescue, police and military service. 60% of sales from UK
- Annual sales: GBP 7 million, 1,2% of Lagercrantz's total sales
- CEO and owner Derek Gotts continues in his role with 20% minority position



REQ CAPITAL
INVESTING WITH INSIGHT

Source: Company reports, websites & Factset

Case example: Lifco acquires Ortho-Care

October 2023

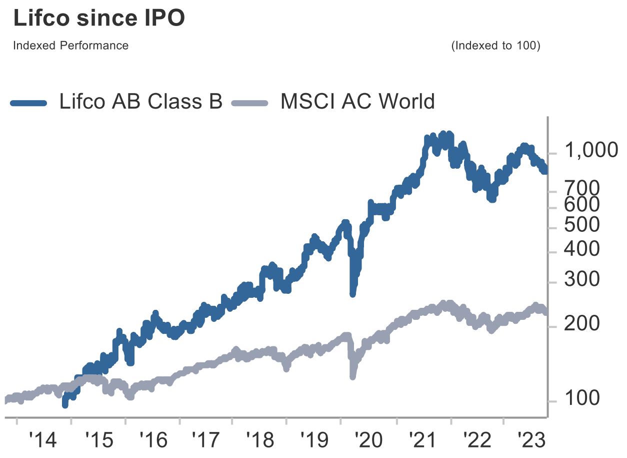
Acquisition Examples

Transaction details

Products

Share price

- One of the largest orthodontic supply companies in the UK.
- Next day delivery to dentists across the UK
- Annual sales: GBP 10 million, 0,6% of Lifco's total sales.
- Established in 1982, 40 employees
- Based in Saltaire, West Yorkshire



REQ CAPITAL
INVESTING WITH INSIGHT

Source: Company reports, websites & Factset

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March 2022

Acquisition Examples

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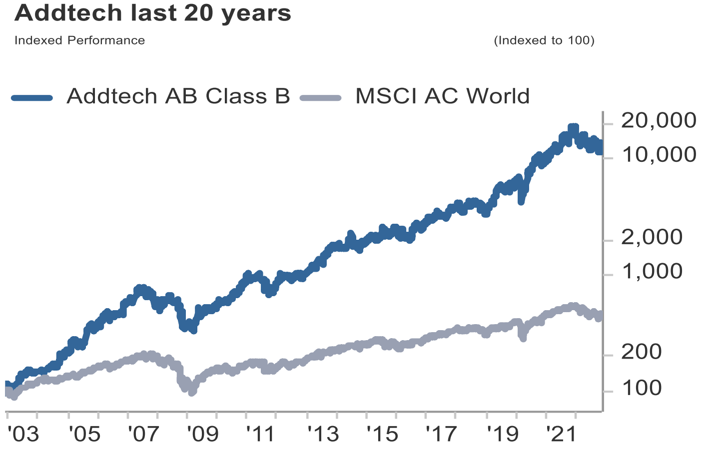


REQ CAPITAL
INVESTING WITH INSIGHT

Source: Company reports, websites & Factset

Case example: Halma acquires Sensitron Spa

May 2022

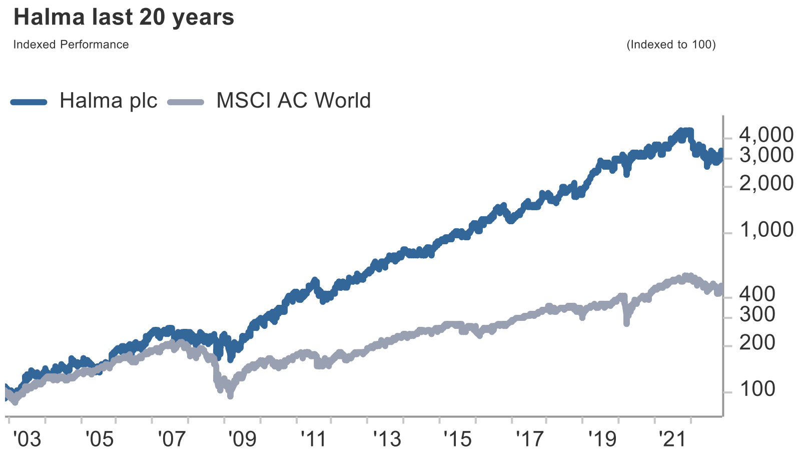
Acquisition Examples

Transaction details

Products

Share price

- Italian manufacturer of gas detection equipment for hazardous locations and for refrigerant gases. Detection of CO2, ammonia etc.
- Established in 1988
- Sales of EUR 8m, 0,4% of Halma's total sales
- Based in Milan



Source: Company reports, websites & Factset

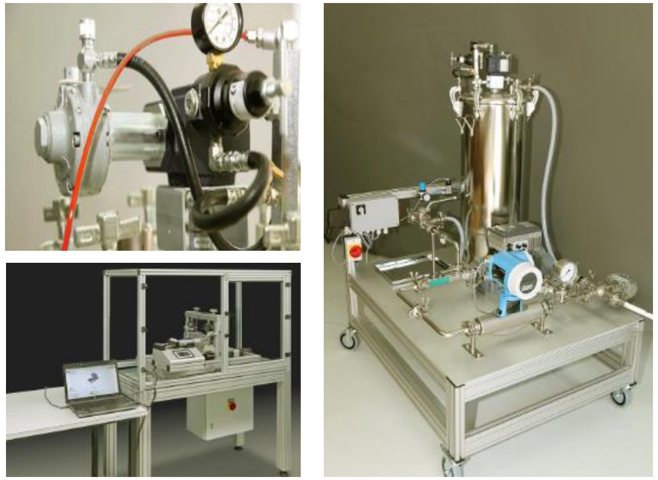
Case example: Indutrade acquires TSE Troller

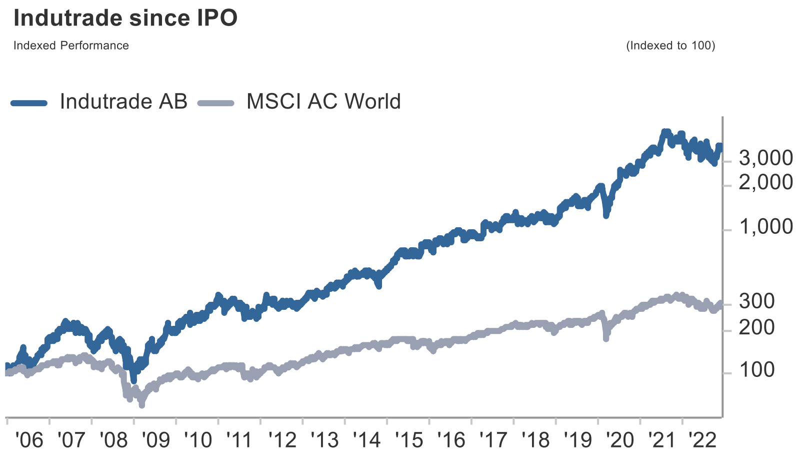
October 2023

Acquisition Examples

Transaction details	Products	Share price

- Swiss company that develops, manufactures and distributes high-quality coating dies for high-precision coating in various industries.
- Exposure to sectors like electronics, packaging, paper&board, and food.
- Based in Murgenthal, Switzerland
- Established in 1961. Currently 30 employees
- Sales of CHF 8m, 0,3% of Indutrade's total sales.





REQ CAPITAL
INVESTING WITH INSIGHT

Source: Company reports, websites & Factset

Case example: Lagercrantz acquires Libra Plast AS

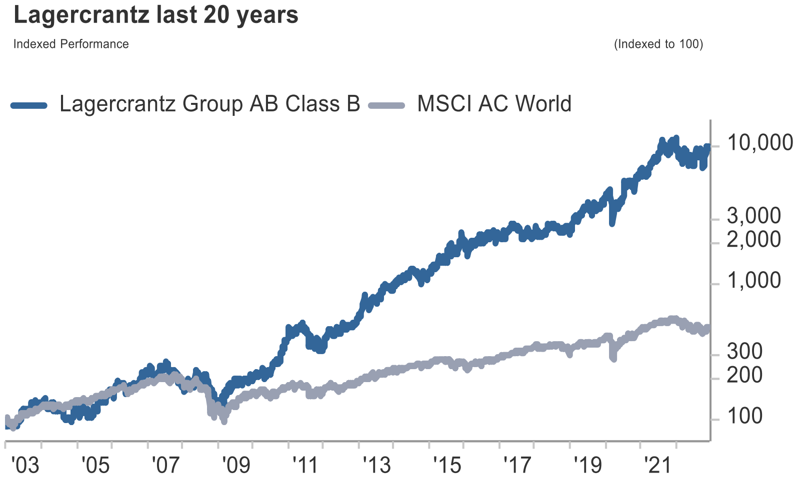
May 2021

Acquisition Examples

Transaction details	Products	Share price

- Norwegian manufacturer of premium doors and hatches for the marine industry
- Based in Hareid, Norway
- Established in 1988. Currently 36 employees
- Sales of NOK 177m, 3,2% of Lagercrants's total sales. 16% operating margins
- The Lillebø-family continues to own 25%
- CEO Einar Pieroth continues in his role as CEO
- EV/EBITA of 6,2x*

Libra™ MARINE DOORS



Source: Company reports, websites & Factset

*Source: Own estimate based on aggregate transaction multiples for Lagercrantz

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INVESTING WITH INSIGHT

Case example: Heico acquires Sensor Systems Inc

September 2022

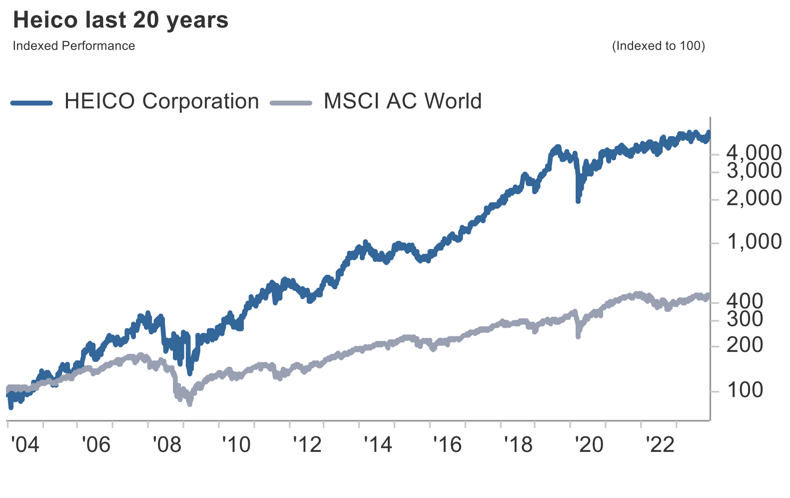
Acquisition Examples

Transaction details

- US company that designs and manufactures airborne antennas for commercial and military applications.
- Sensor's antennas are found on nearly all large commercial aircrafts built in the last 50 years.
- Company founded in 1961 by Harvey Bazar and Mary Bazar. Currently 200 employees.
- Heico buys 80% of the company. Payment in cash and shares in Heico stock.

Products

Share price



Source: Company reports, websites & Factset

Case example: Constellation Software acquires LDSOFT

September 2022

Acquisition Examples

Transaction details

Products

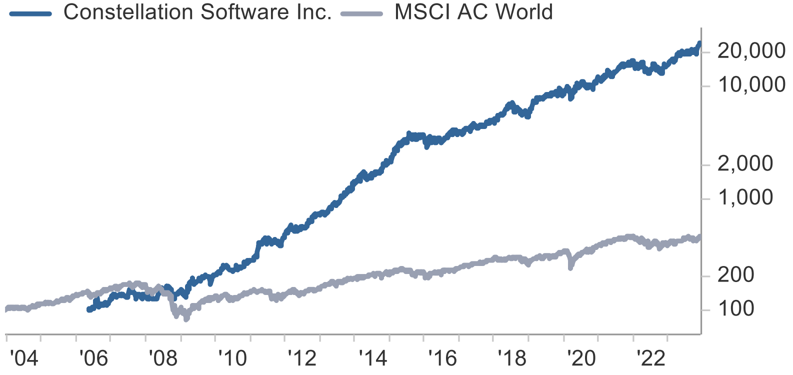
Share price

- Constellation Software, through Vela, acquires LDSOFT, a leader in software for intellectual property solutions in Brazil.
- 800 customers.
- Vela has over the last few years acquired several companies within the legal technology market in Brazil.
- CEO Luiz Duffles founded LDSOFT in 1993.

LDSOFT

Constellation Software since IPO

Indexed Performance (Indexed to 100)



REQ CAPITAL
INVESTING WITH INSIGHT

Source: Company reports, websites & Factset

Valuation of Private Companies

Acquisition Examples

Nobody will bid more than 7-8x earnings. There should be a significant discount when you buy a private company dependent on one person or two suppliers or five or six large customers. For a small company there should definitely be a 30% to 50% discount. That is how you end up with 5x earnings multiples.

Former Addtech business unit CEO

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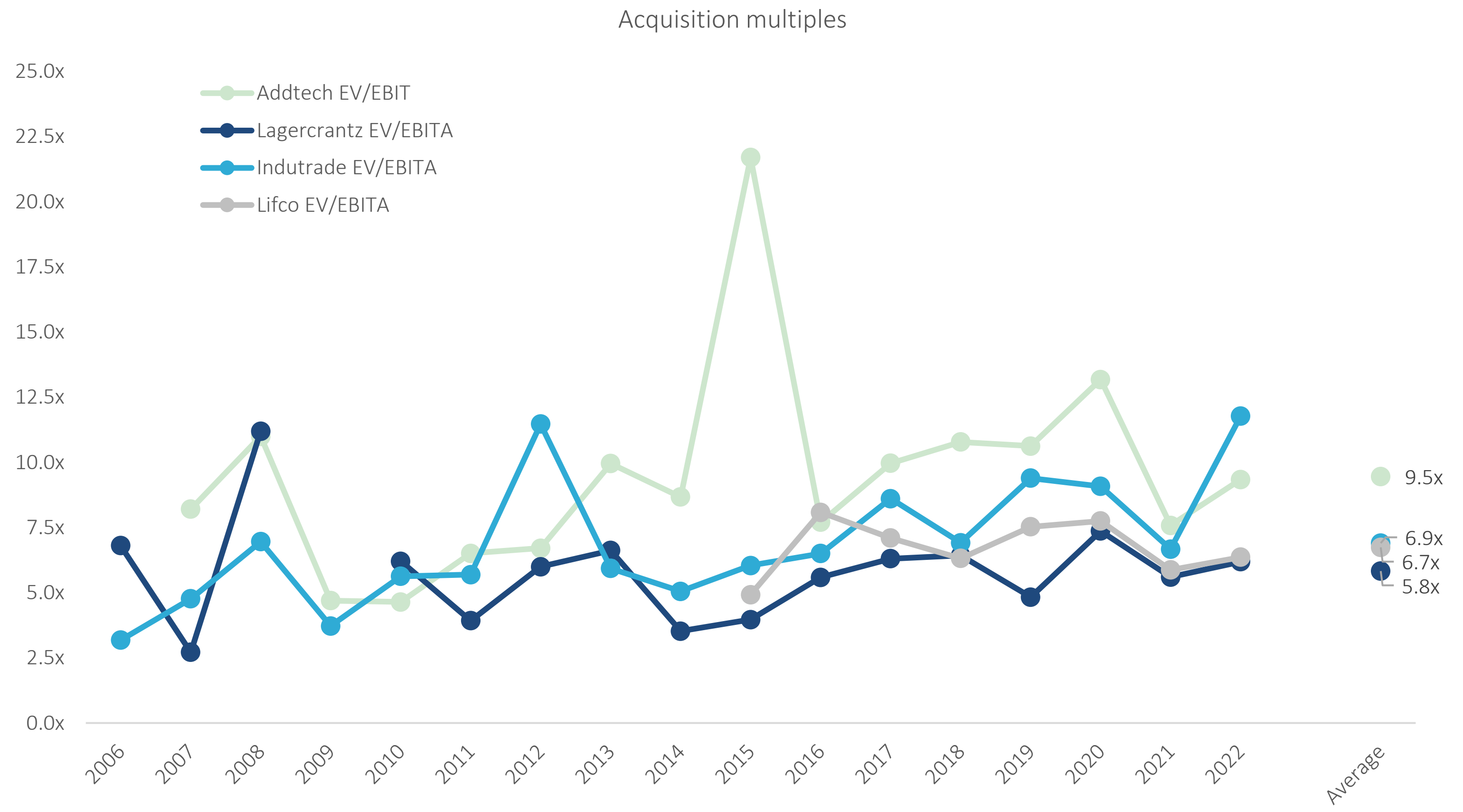
INVESTING WITH INSIGHT

Acquisition multiples

Acquisition multiples for Addtech, Lagercrantz, Lifco & Indutrade

Acquisition Examples



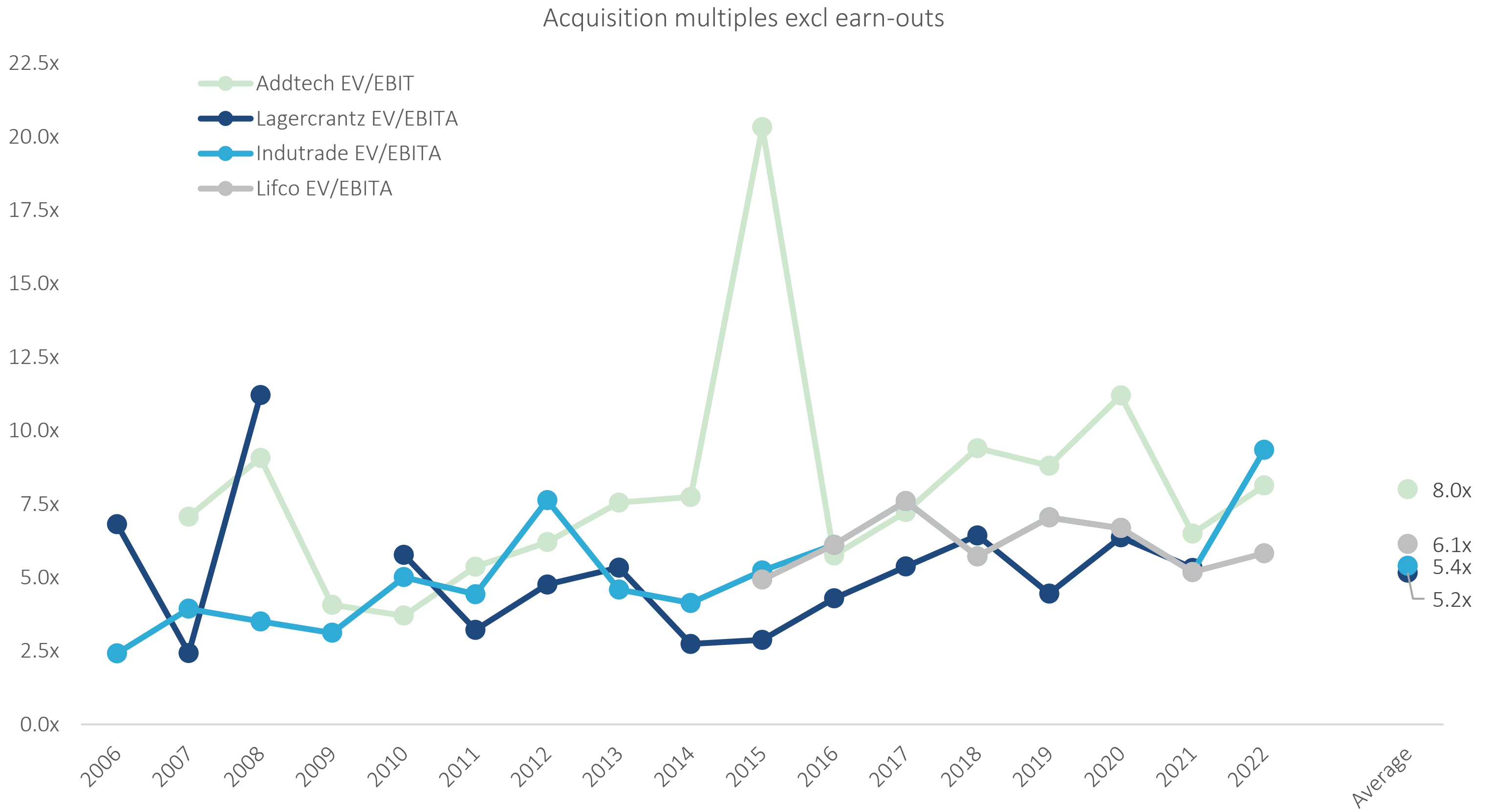
- These well-known companies that have generated a lot of shareholder value through the years tend over time to be very disciplined in terms of multiples they pay for acquisitions.

Source: Company reports

Acquisition multiples

Acquisition multiples for Addtech, Lagercrantz, Lifco & Indutrade

Acquisition Examples



- These well-known companies that have generated a lot of shareholder value through the years tend over time to be very disciplined in terms of multiples they pay for acquisitions.

Source: Company reports

Case Studies

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INVESTING WITH INSIGHT

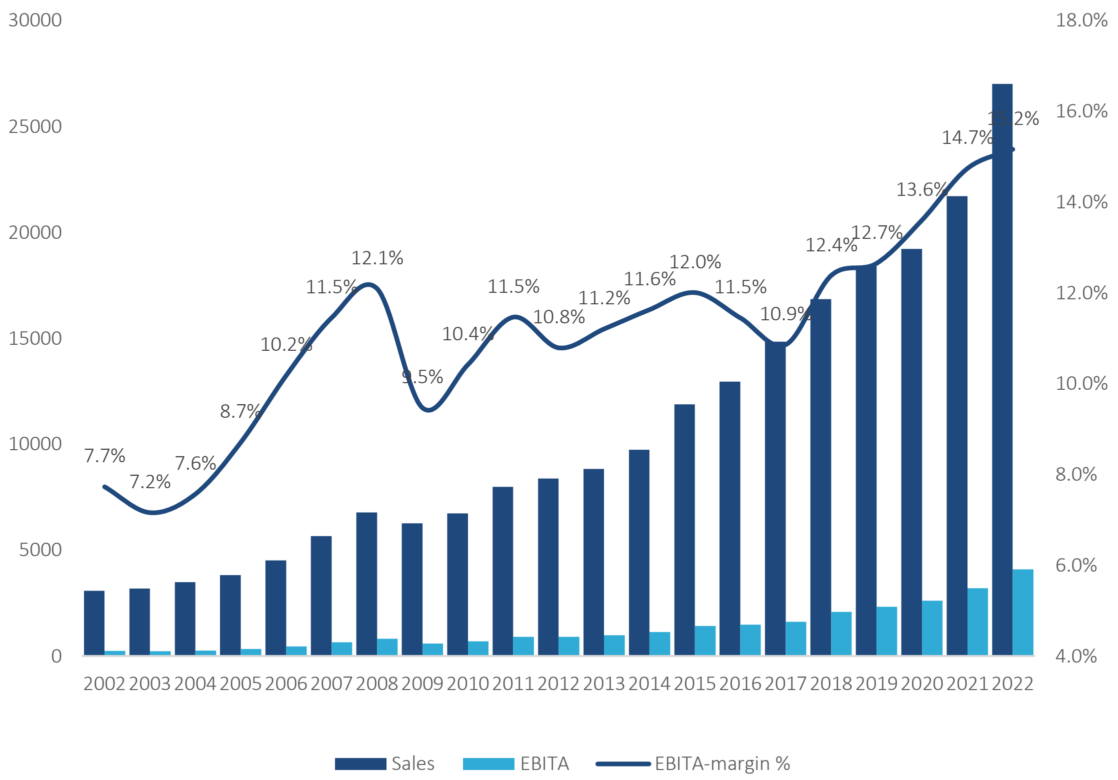
Case Study - Indutrade

Case Study - Indutrade

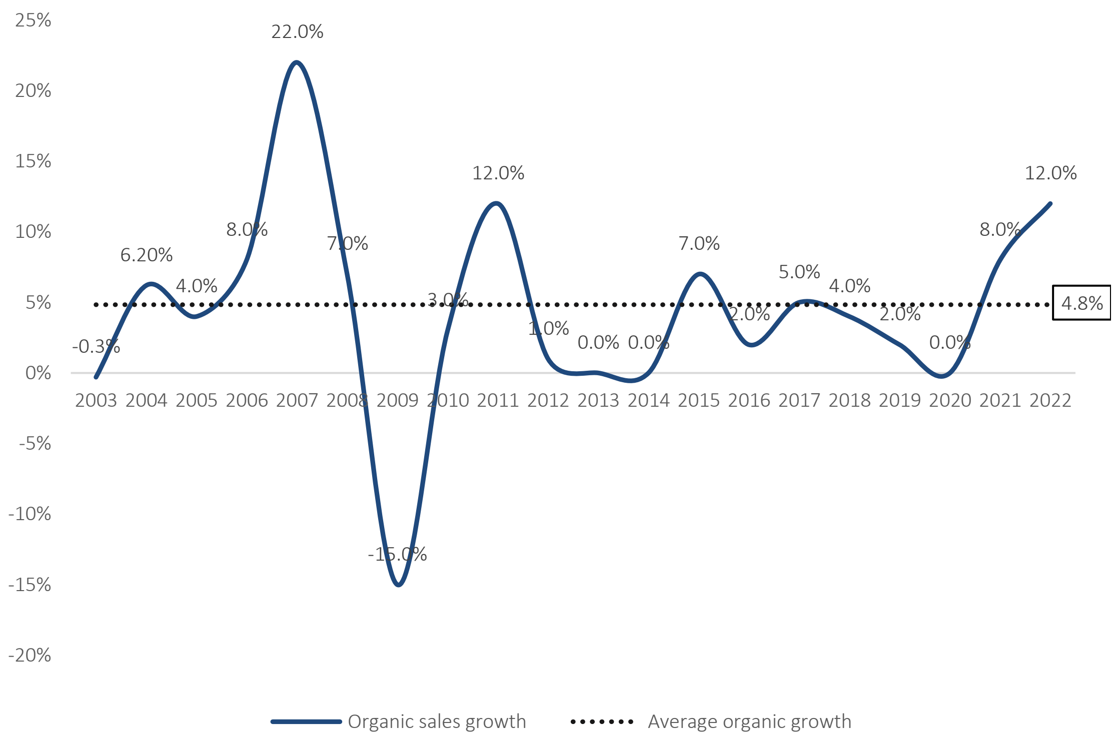
Constistency is key to longterm success

Case Studies

Stable sales and EBITA growth over time with increasing margins…



…and a solid organic growth of almost 5% since 2003



REQ CAPITAL
INVESTING WITH INSIGHT

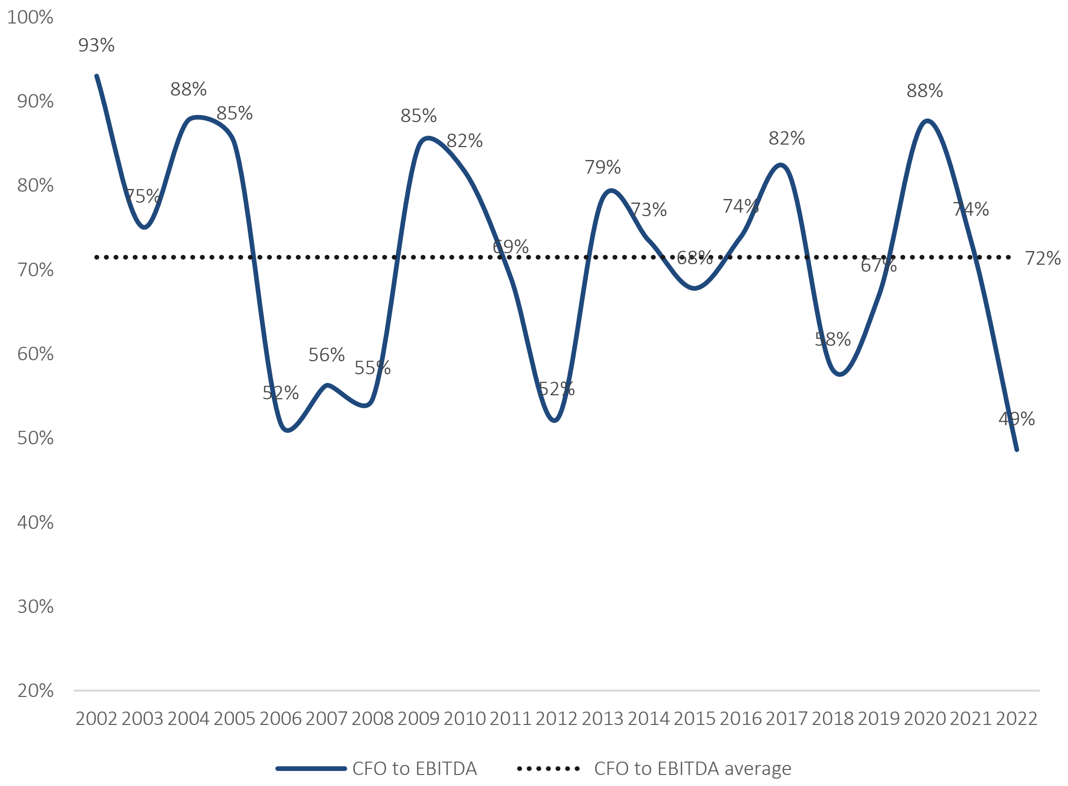
Source: Company reports

Case Study - Indutrade

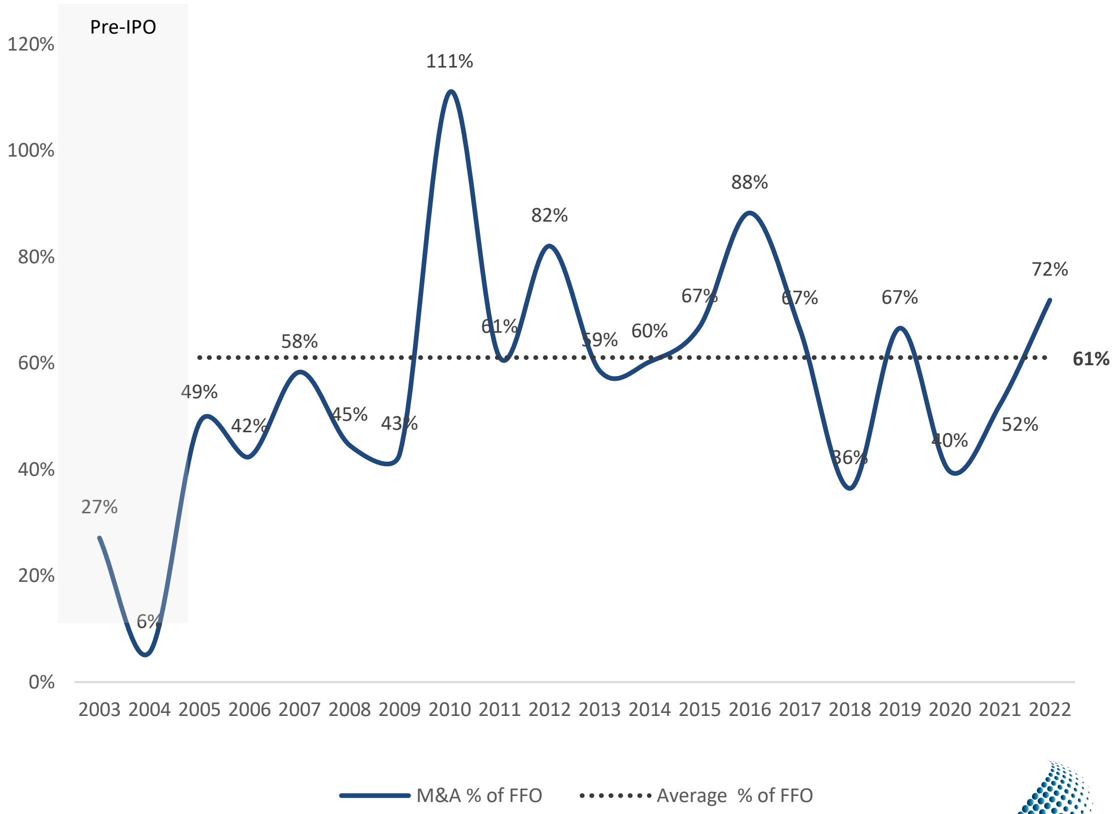
Constistency is key to longterm success

Case Studies

...with a decent cash conversion rate on average of 72%...



...gave pathway for this consistent high reinvestment rate (M&A) over time...



REQ CAPITAL
INVESTING WITH INSIGHT

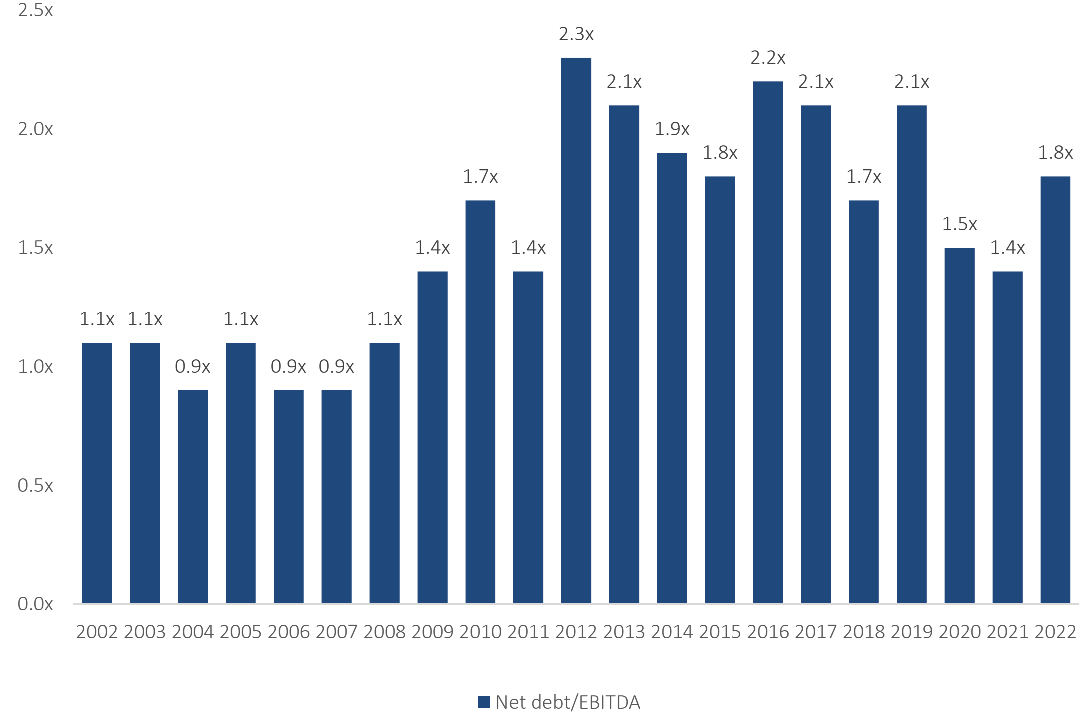
Source: Company reports

Case Study - Indutrade

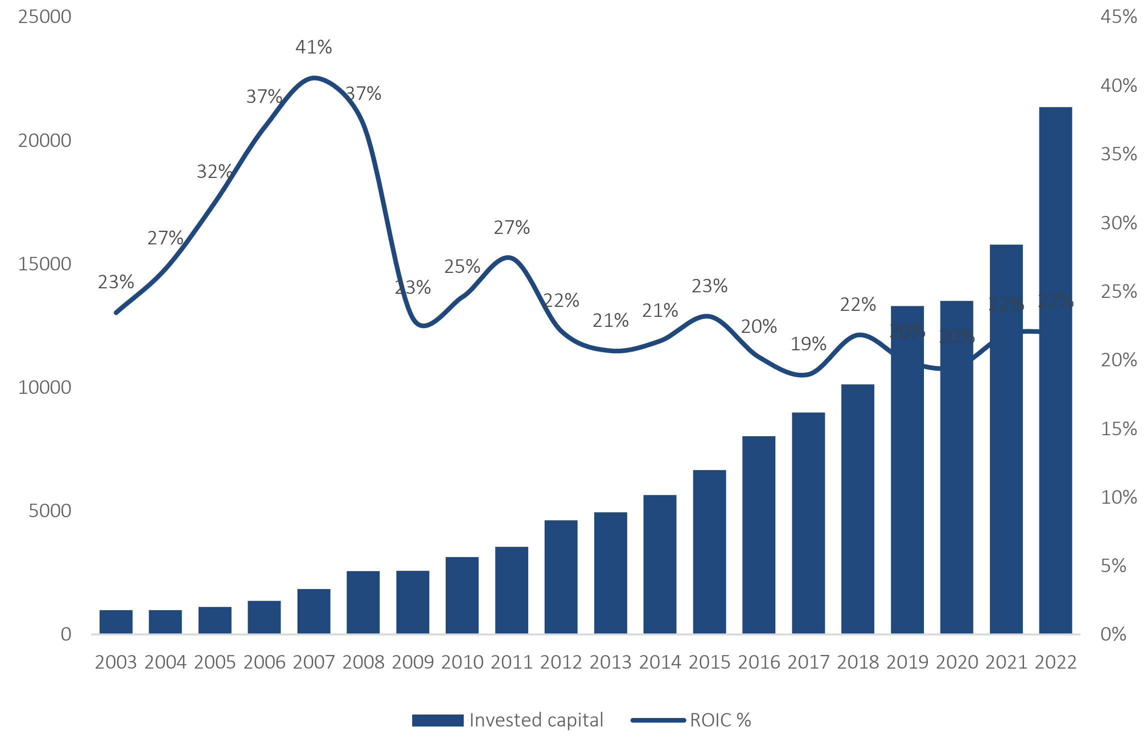
Constistency is key to longterm success

Case Studies

…and a maintained sound debt profile…



…with high and consistent returns on (incremental) capital >20%…

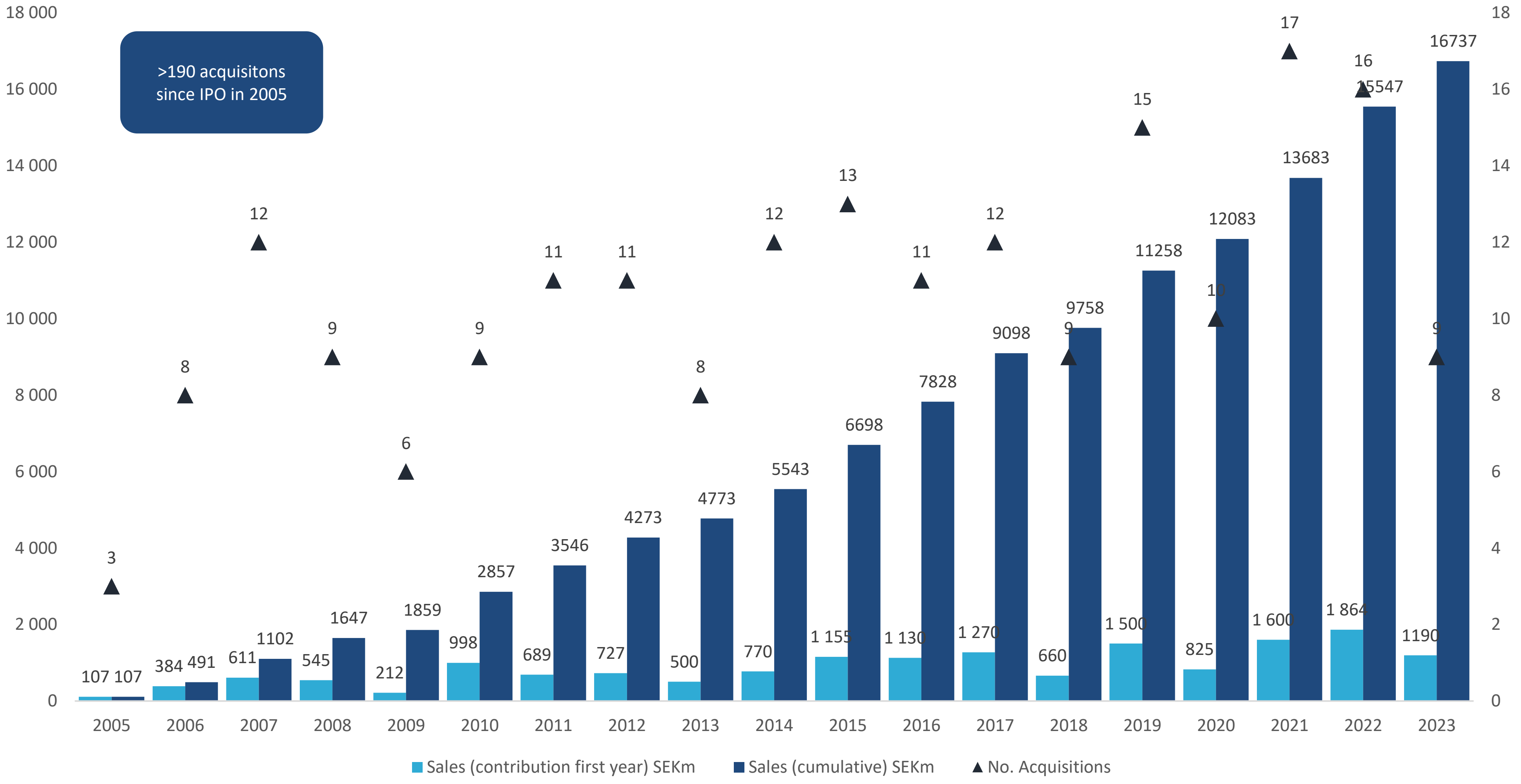


REQ CAPITAL
INVESTING WITH INSIGHT

Source: Company reports

Case Study - Indutrade

Scaling M&A



Source: Company reports

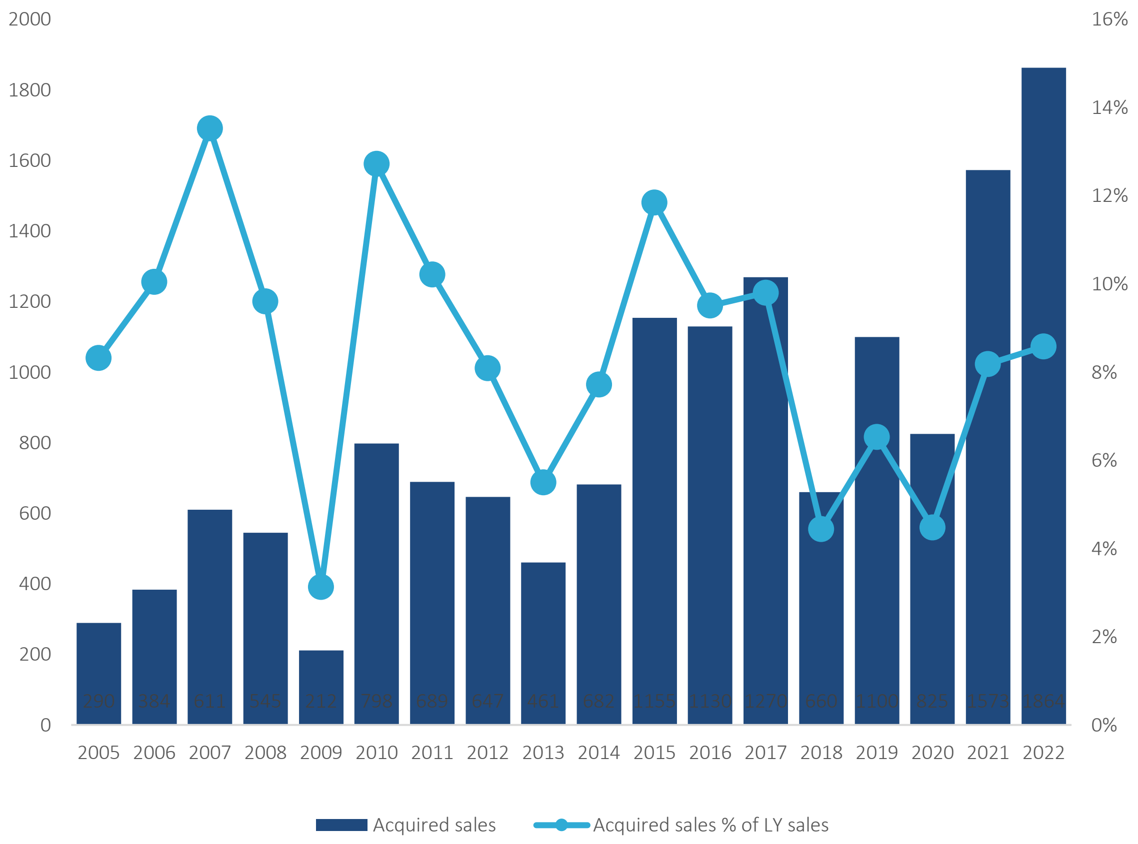
REQ CAPITAL
INVESTING WITH INSIGHT

Case Study - Indutrade

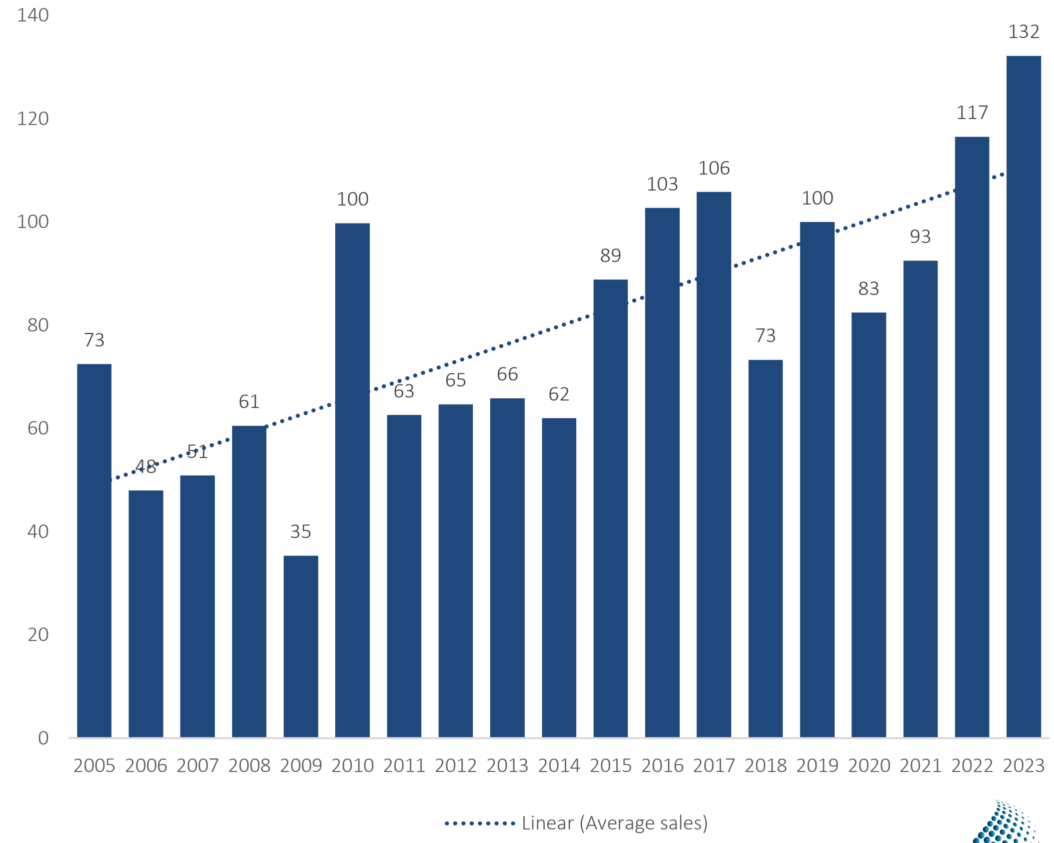
Scaling M&A

Case Studies

Acquired annual sales & acquired sales & of last year sales



Average sales acquired companies



REQ CAPITAL
INVESTING WITH INSIGHT

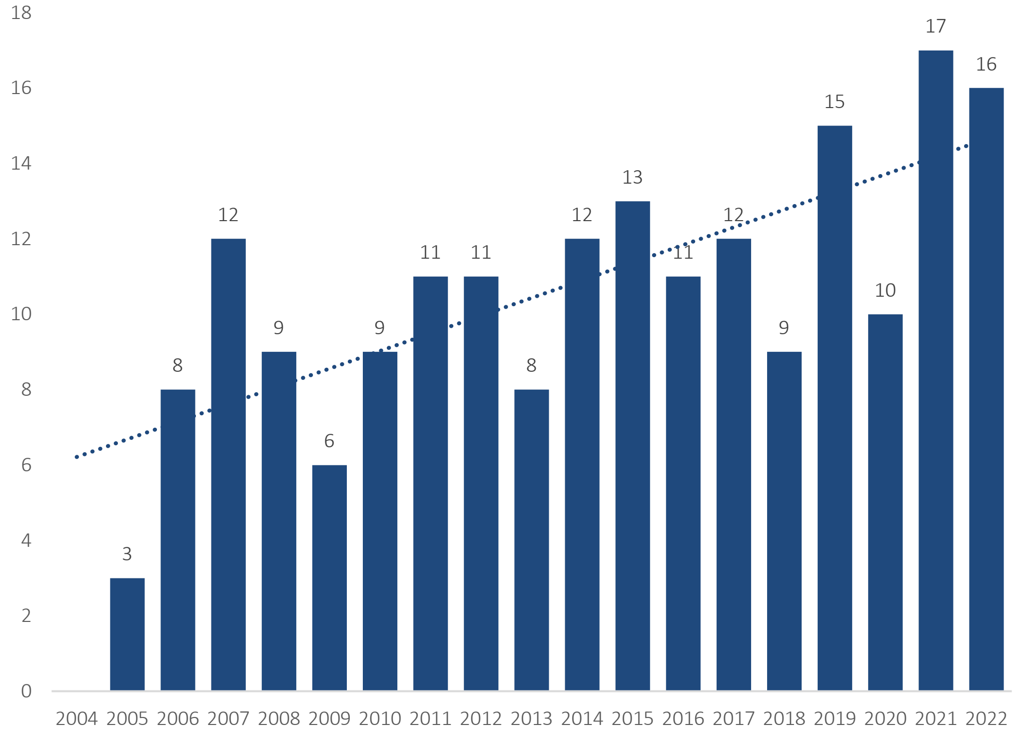
Source: Company reports

Case Study - Indutrade

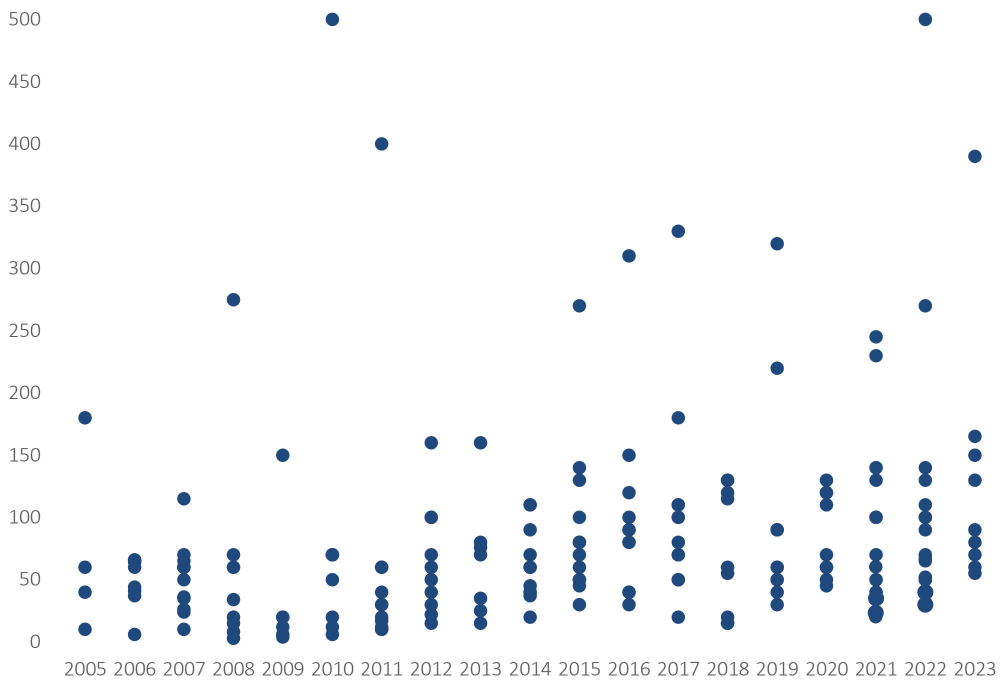
Scaling M&A

Case Studies

Acquisitions



Sales of all acquired companies (at the time of acquisition)



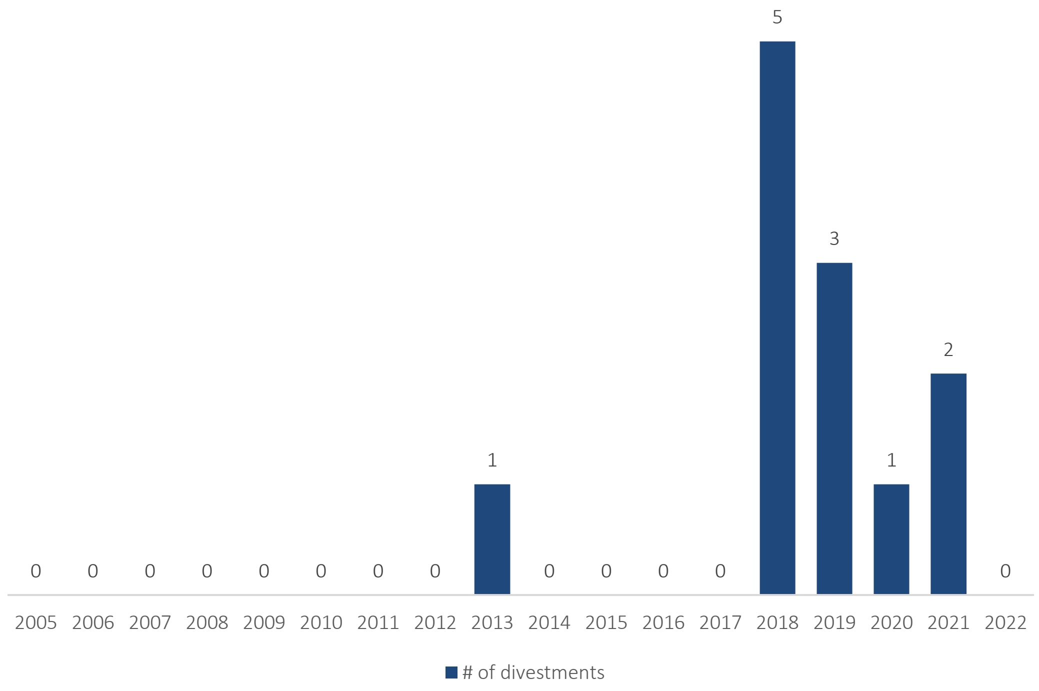
REQ CAPITAL
INVESTING WITH INSIGHT

Source: Company reports

Case Study - Indutrade

Scaling M&A

Divestments



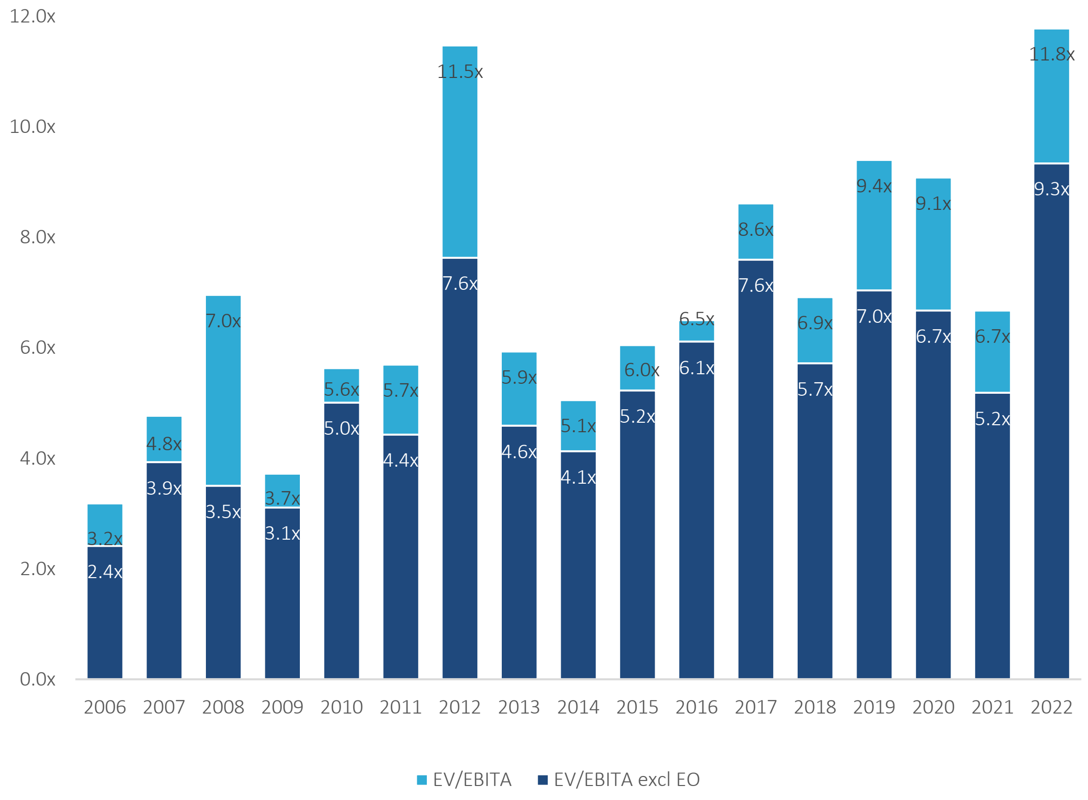
Source: Company reports

Case Study - Indutrade

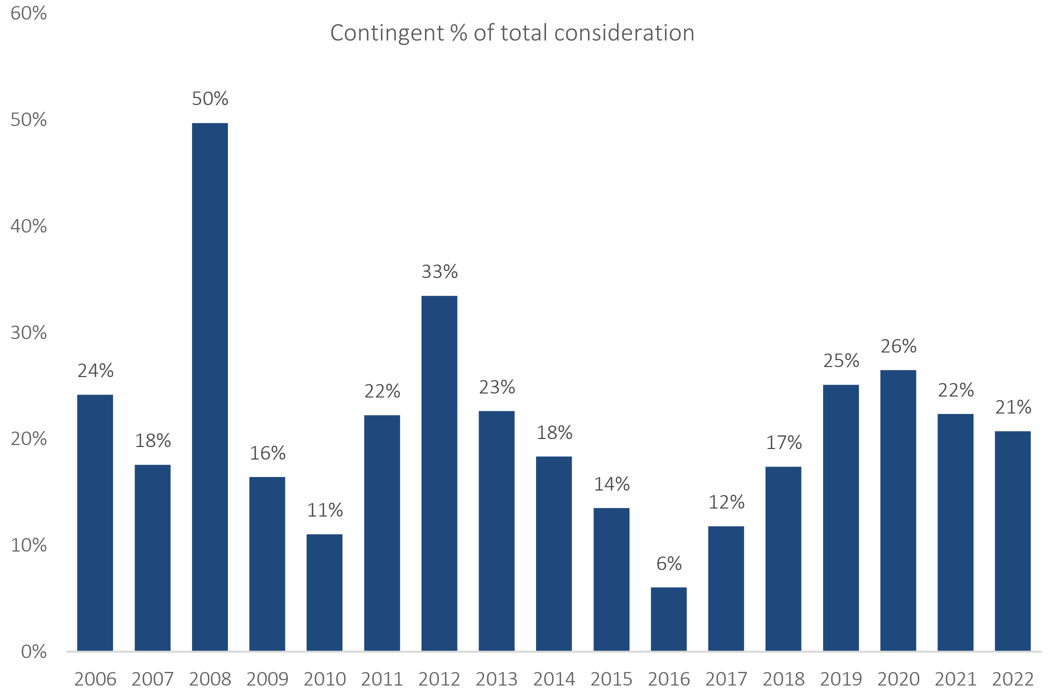
Deal structure

Case Studies

Acquisition multiples paid



Deal structure – earn-outs as % of total transaction value



Source: Company reports

Case Study - Indutrade

Are acquisitions value accretive?

Case Studies

Indutrade serves as a compelling example of how to be a successful acquisition-driven compounder with many of the ingredients for long-term success that we at REQ search for and has since IPO in October 2005 provided a TSR of 4,300% (CAGR 23%).

Since IPO, Indutrade has increased its sales from SEK 3.8bn to SEK 31.2bn at the end of 2023 Q3 (trailing twelve months), while EBITA has increased from SEK 333m to SEK 4.7bn. EPS has at the same time increased from SEK 0.62 to SEK 7.78 – a CAGR of 15%. During this period, Indutrade has slowly and continuously managed to increase its EBITA-margin from 9% to 20%, demonstrating a predictability in its profits.

Supported by a strong balance sheet (net debt/EBITDA never > 2.5x) and coupled with a strong cash conversion, Indutrade has every year since IPO managed to complete acquisitions, at lowest 9 acquisitions in 2009 despite the Great Financial Crisis. Looking through the lens of M&A as a percentage of operating cash flow (FFO = before NWC changes), Indutrade has at its lowest point (2018) spent 36% on M&A.

Indutrade has also scaled its M&A in a controllable way, completing 8-10 acquisitions on average between 2006-2013 and in recent years 13-15 acquisitions. Also, the average sales acquired has been slowly increasing, meaning that Indutrade over time has both increased the number of acquisitions completed, but also the size of those, even though they are still on levels that are in the sweet spot from private transactions for these types of companies. With only few exceptions, Indutrade has impressively managed to refrain from acquiring companies with > SEK 250m in sales.

During the time since IPO, Indutrade has also stayed disciplined in their acquisition processes, paying around 5-7x EBITA for acquisitions.

In summary, Indutrade has demonstrated a lot that we like to see in an acquisition-driven compounder; low leverage, continuously high reinvestment rates, higher returns on capital, disciplined M&A, focus on organic uplift in acquired companies, nicely scaling M&A, continuous margin improvements and good cash conversion. Supported by a large owner with multi-decade view on ownership and low CEO turnover (second CEO since IPO), Indutrade has stay true to their core strategy and provided shareholders with superior returns.

Case Study – Instalco vs Bravida

Instalco vs Bravida

A glance at the companies' business strategies

Case Studies

Instalco

"Instalco works as a united corporate group with strong local units. The companies that are acquired by Instalco keep their previous name."

Instalco's business model

The business model combines local proximity with a large company's opportunities to offer end-to-end solutions for the customers.

The business model is based on the following:
•Local proximity – choosing the optimal company for each project.
•End-to-end solutions between technical areas, cross sales between companies.
•Best practice – learn from each other and use the best methods.
•Efficient internal organization – decentralized responsibility and a strong leadership culture.
•Acquisitions and organic growth in selected regions.
•Both installation and service.

Acquisitions are made based on four clear requirements:
•Strong local market position.
•Strong financial position and many years of experience.
•Competent entrepreneurs as leaders.
•Culture and values on par with Instalco's set of values.

Bravida

"Our business model is based on us operating as ONE company: all our branches share the same corporate culture, working methods and strategies. Together, we provide the best customer offering on the market. We call it the Bravida Way. "

Bravida wants to be where its customers are. They want the customers to be the most satisfied in the market and to be the leading provider in those regions where Bravida has a presence.

That's why Bravida created a decentralized organization with businesses throughout the Nordic region. The local branches decide how they work with their customers and how to market themselves in their area. But, in addition, they benefit from central Group functions like financial management, purchasing and IT.

Bravida's organization has four main levels – branch, region, division and Group.

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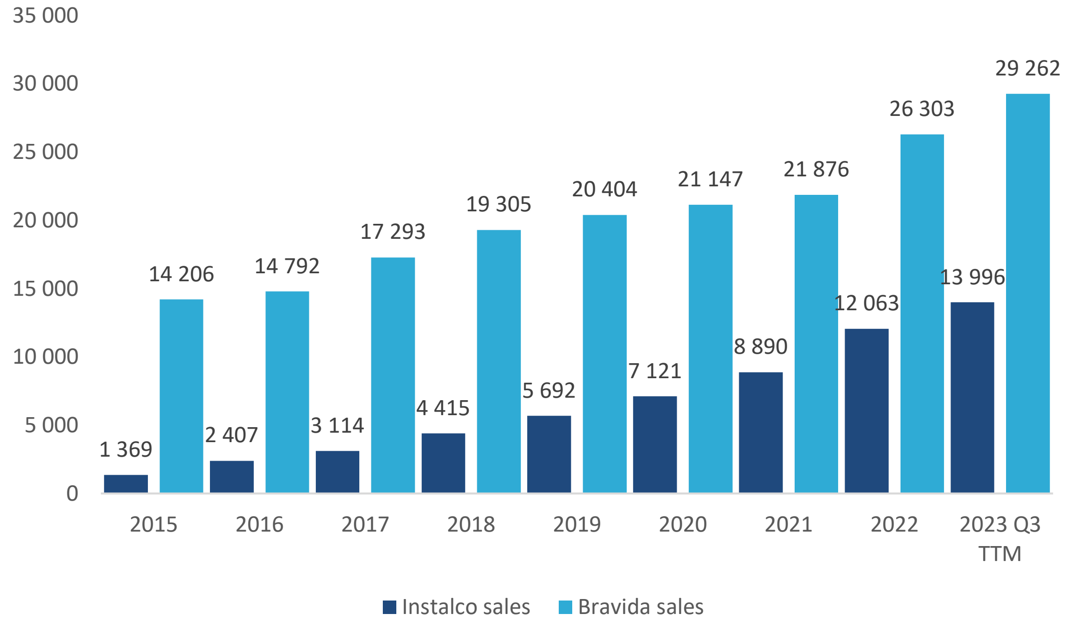
Source: Company reports

Instalco vs Bravida

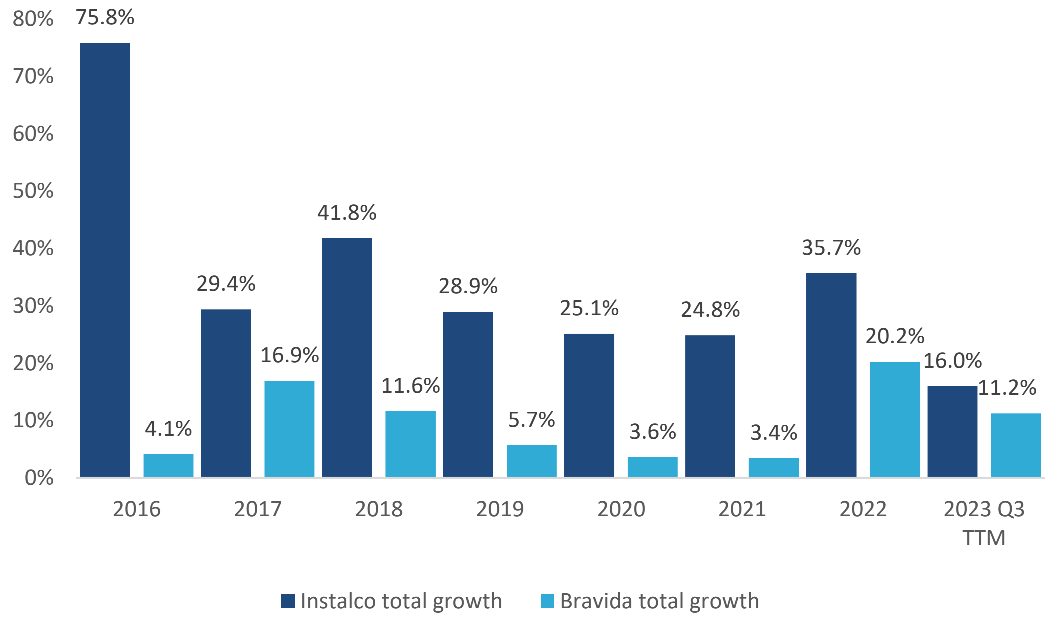
Growth

Case Studies

Total sales



Total sales growth



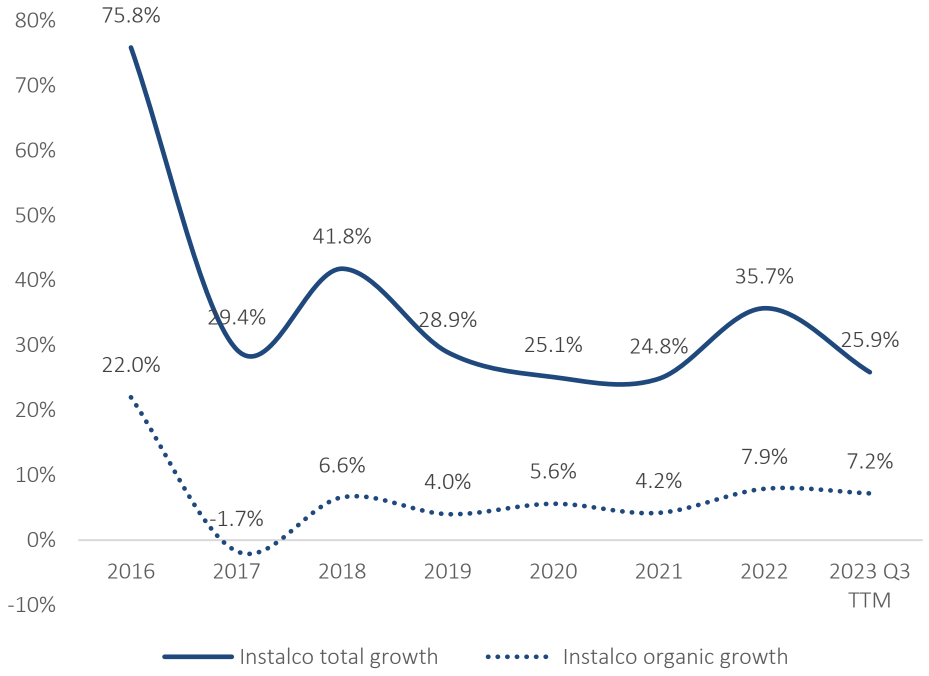
Source: Company reports

Instalco vs Bravida

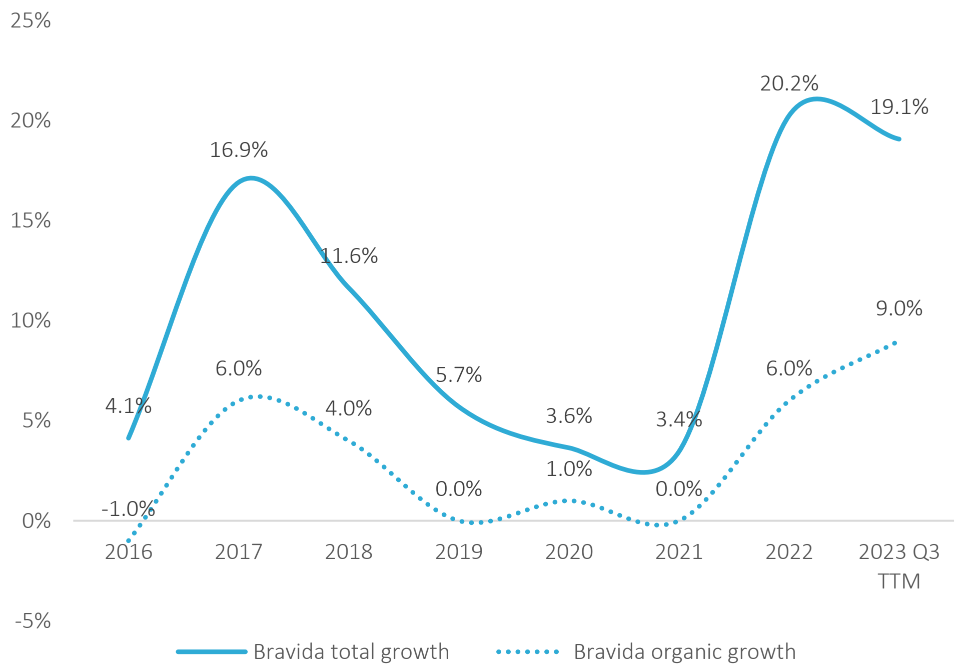
Total and original growth

Case Studies

Instalco



Bravida



REQ CAPITAL
INVESTING WITH INSIGHT

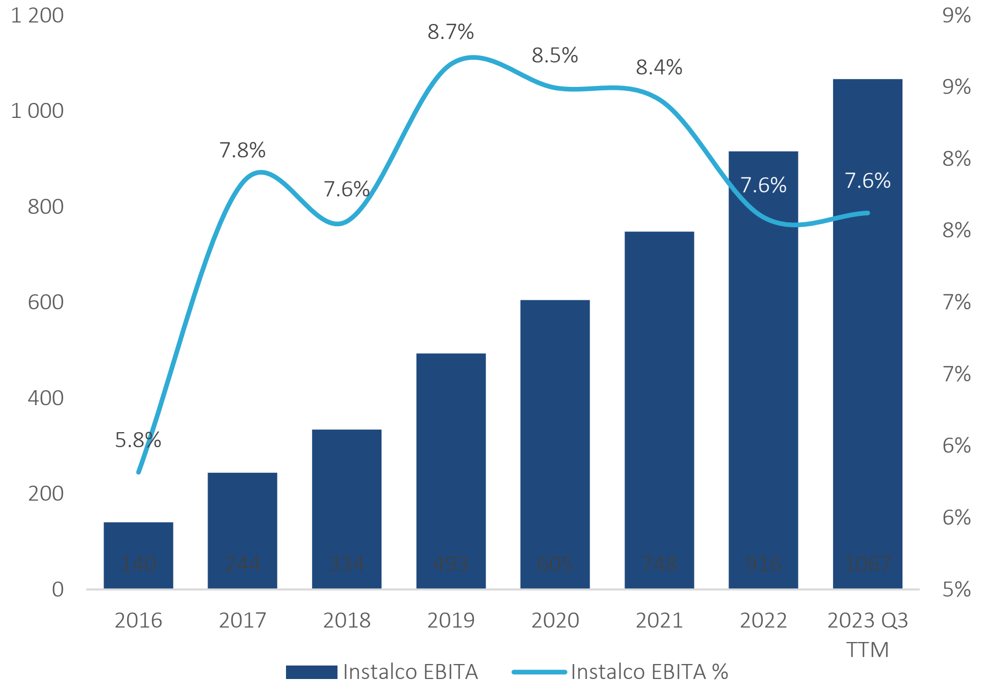
Source: Company reports

Instalco vs Bravida

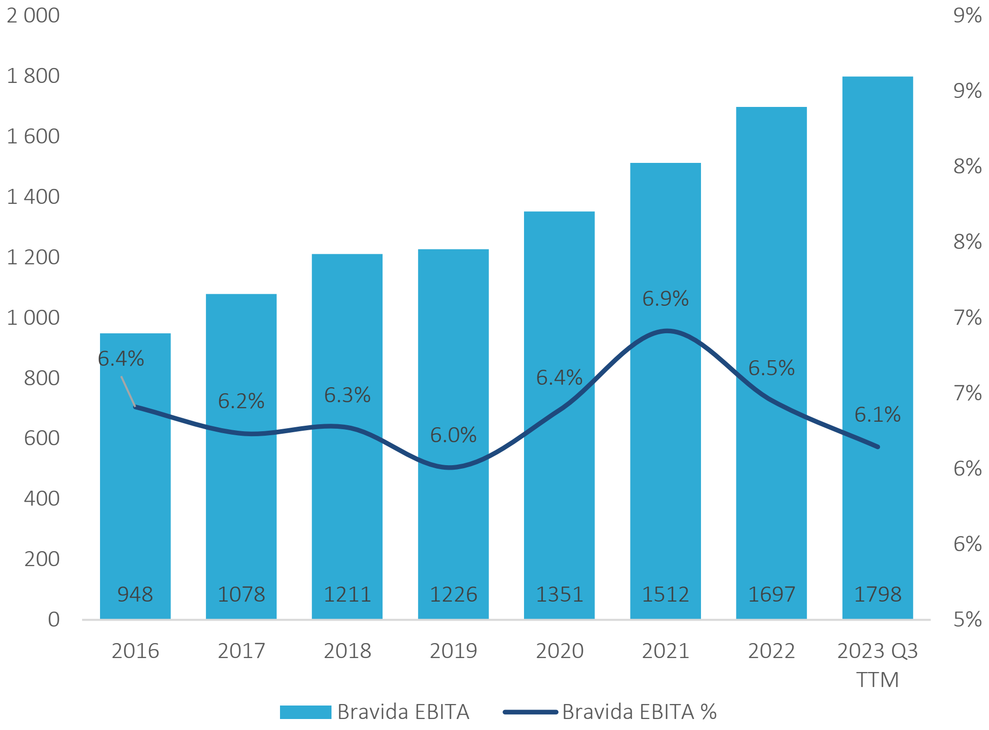
Margins

Case Studies

Instalco



Bravida



REQ CAPITAL
INVESTING WITH INSIGHT

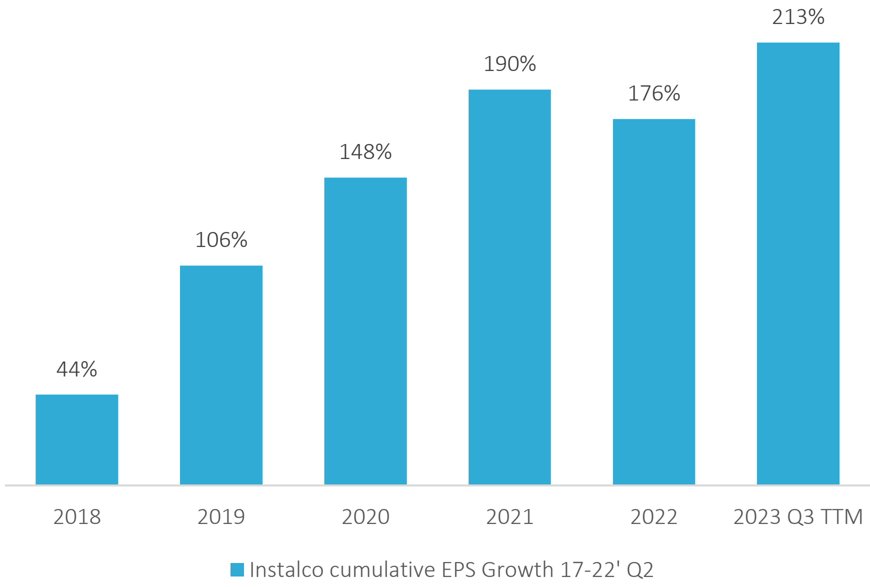
Source: Company reports

Instalco vs Bravida

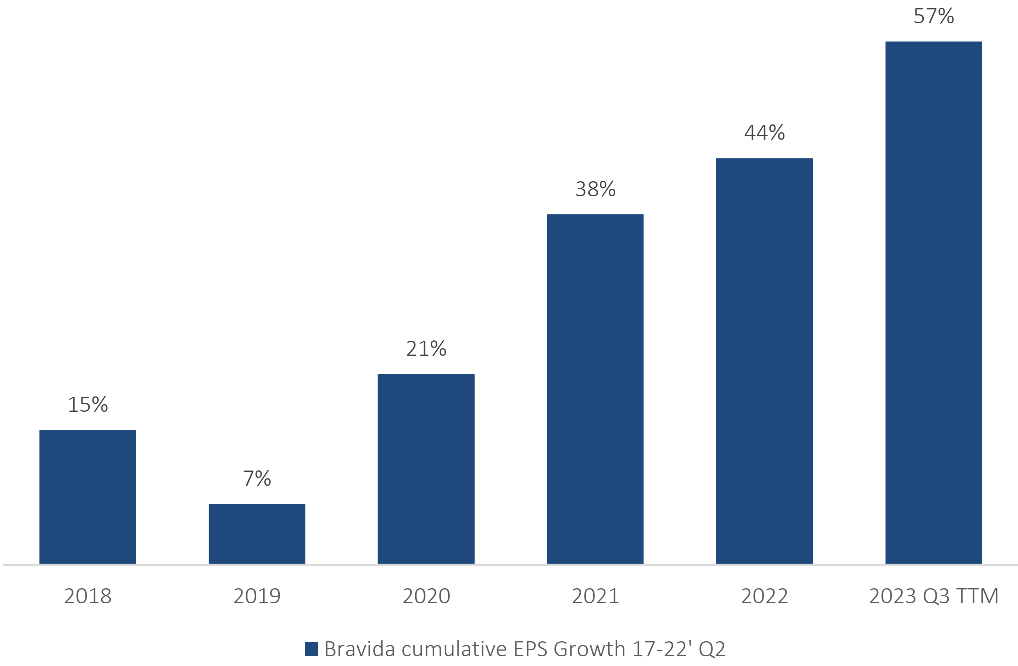
EPS growth

Case Studies

Instalco EPS Growth



Bravida EPS growth



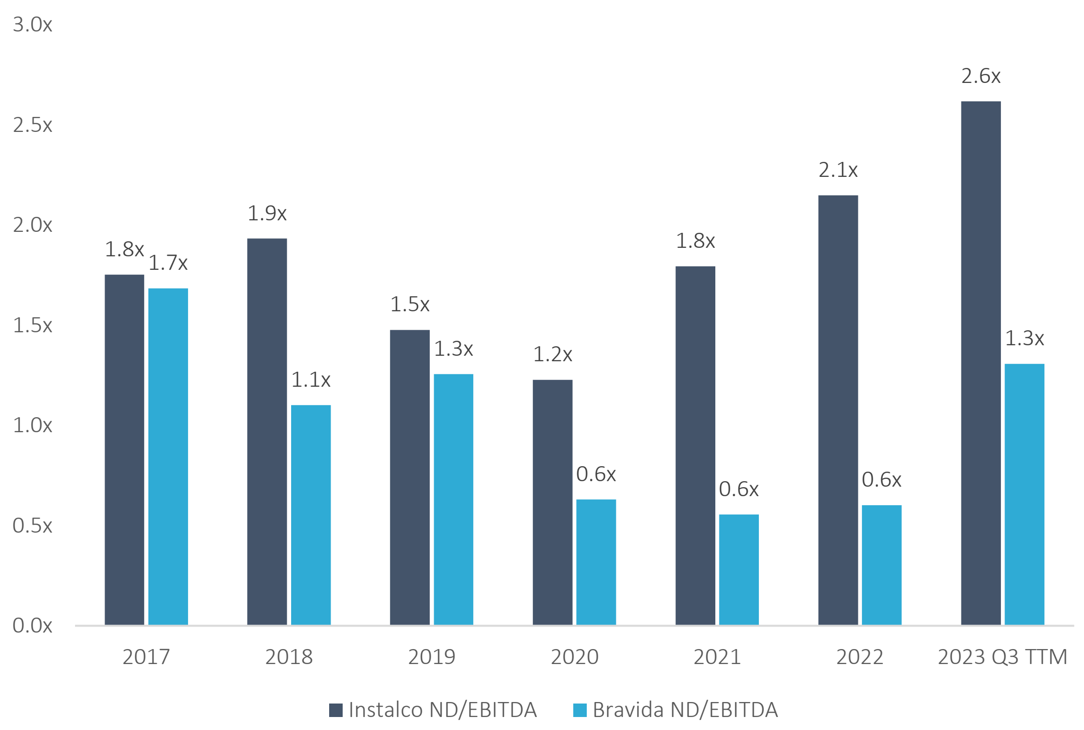
Source: Company reports

Instalco vs Bravida

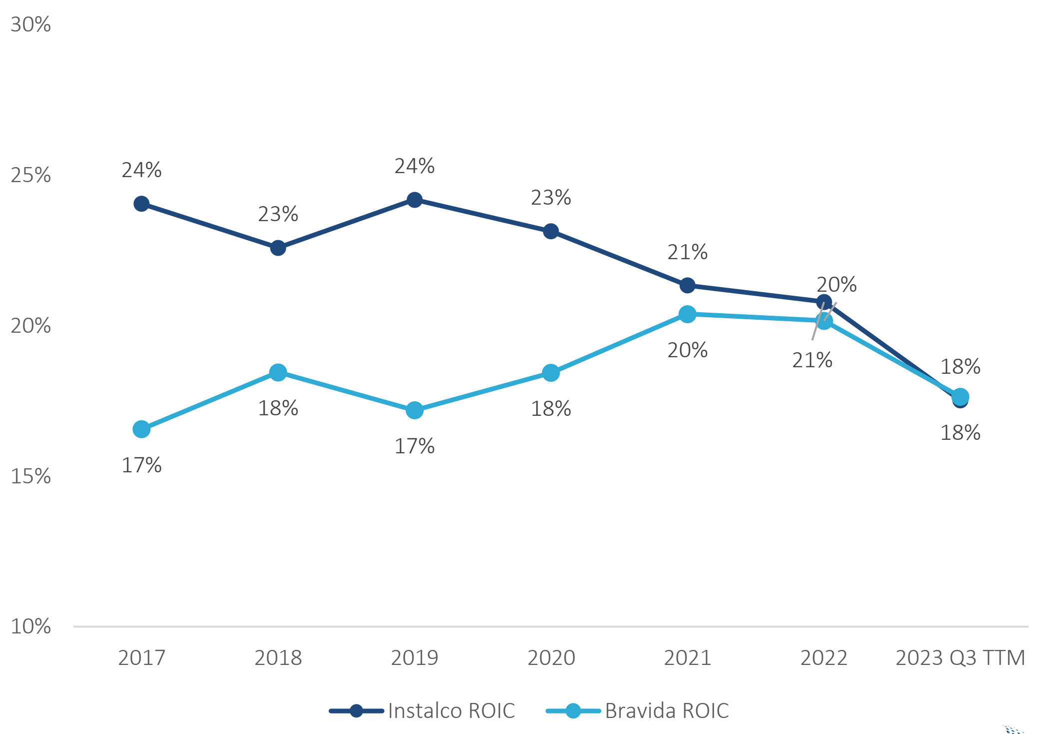
Financial KPI's

Case Studies

Net debt to EBITDA



Return on invested capital



* ROIC = EBITA / (ND + Equity)

Source: Company reports

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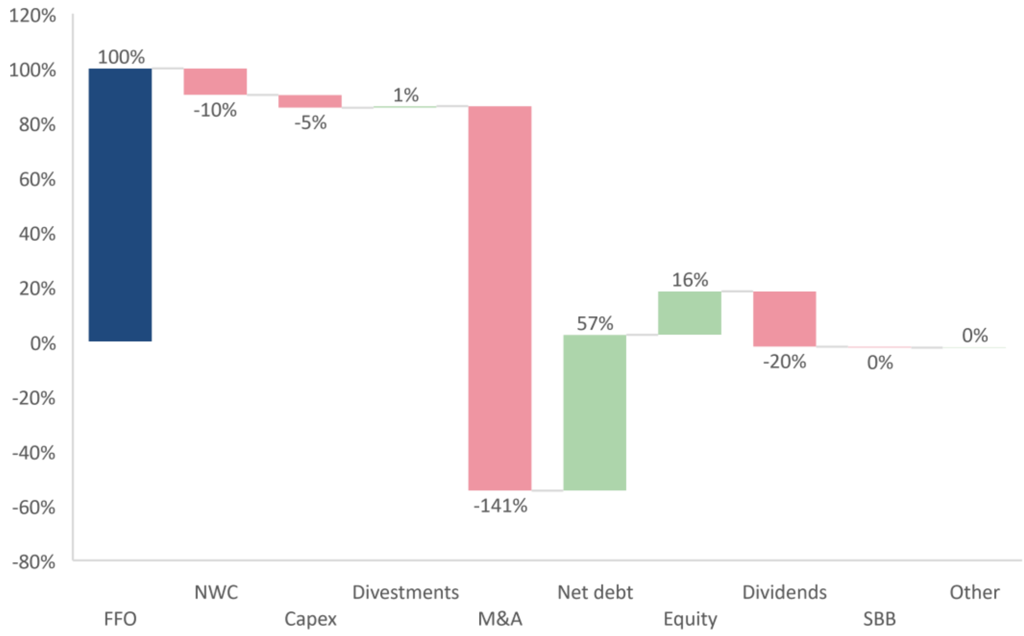
Instalco vs Bravida

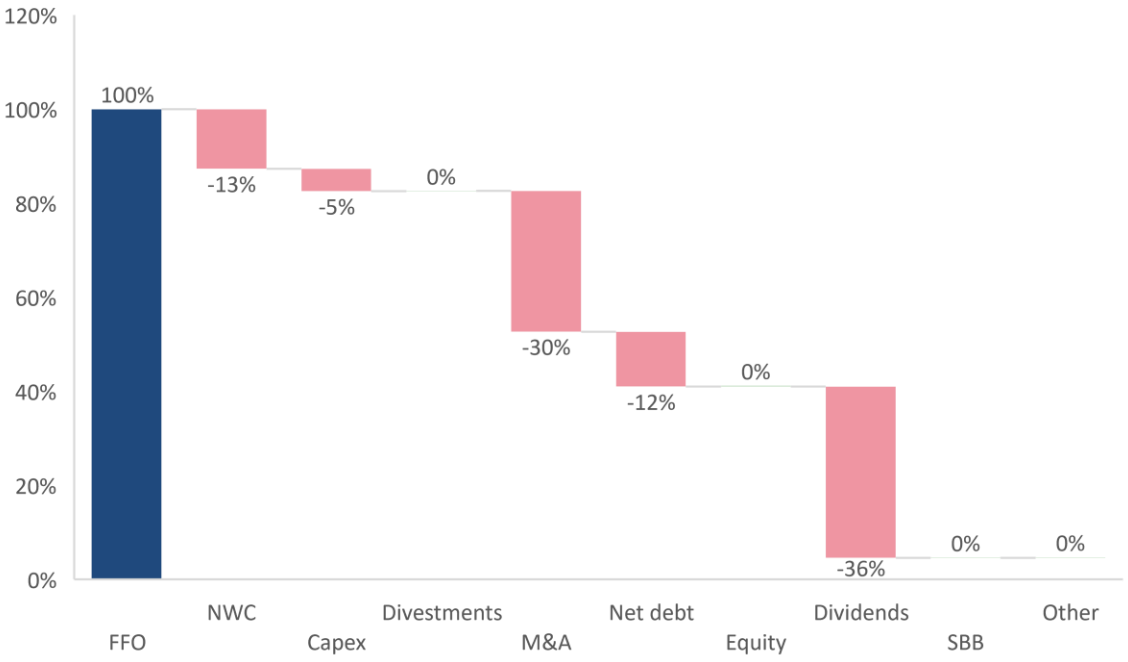
Capital allocation 2017 – 2023 Q3

Case Studies

Instalco



Bravida



REQ CAPITAL
INVESTING WITH INSIGHT

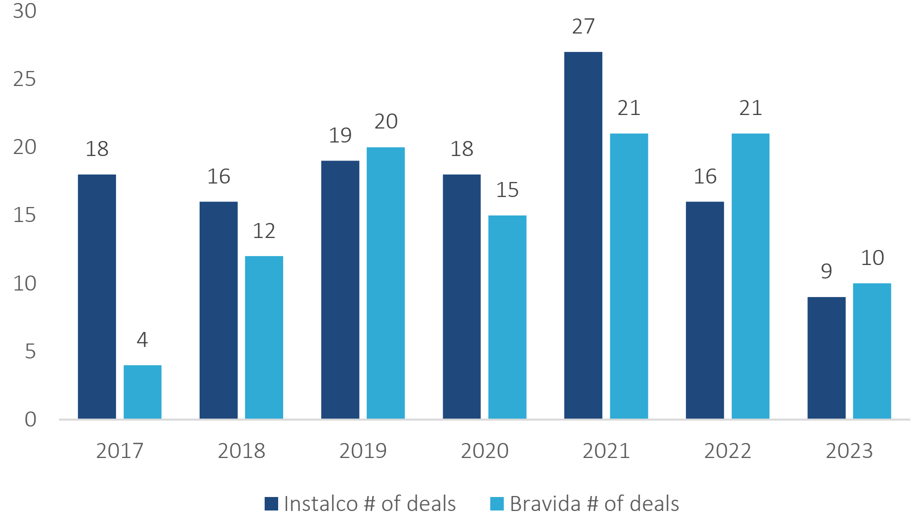
Source: Company reports

Instalco vs Bravida

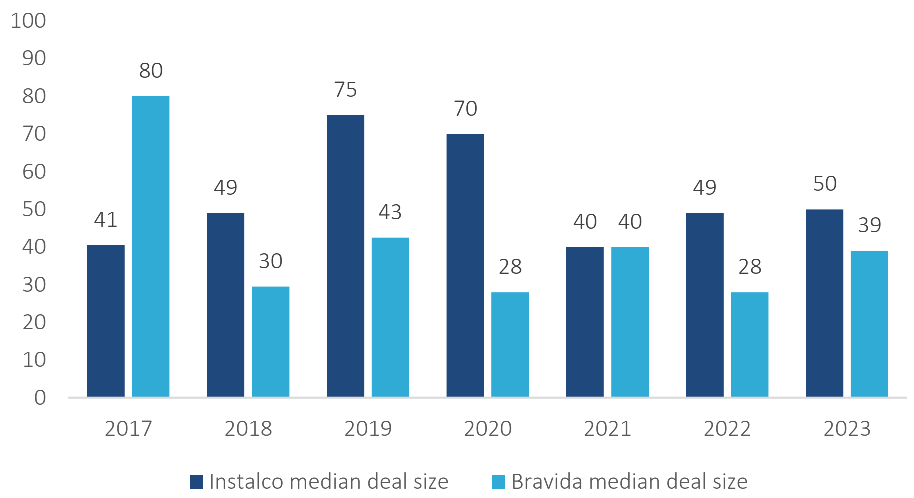
A deeper look into acquisitions

Case Studies

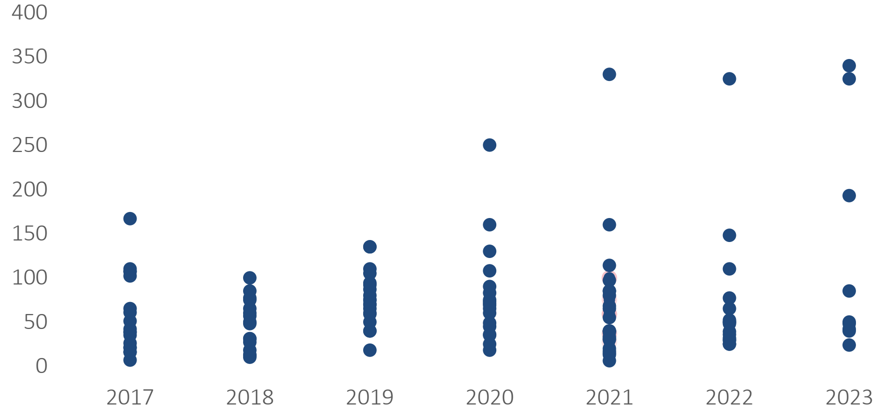
of deals 2017 – 2023 Q3



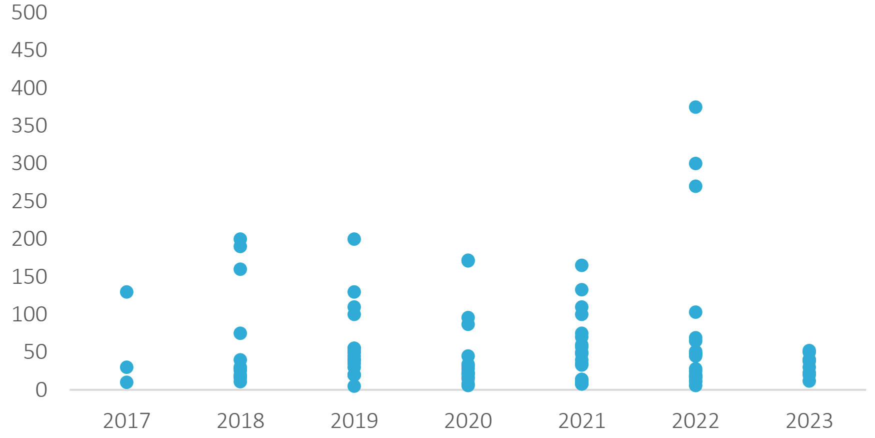
Median deal size 2017 – 2023 Q3



Instalco - Sales of the acquired companies



Bravida - Sales of the acquired companies



Source: Company reports

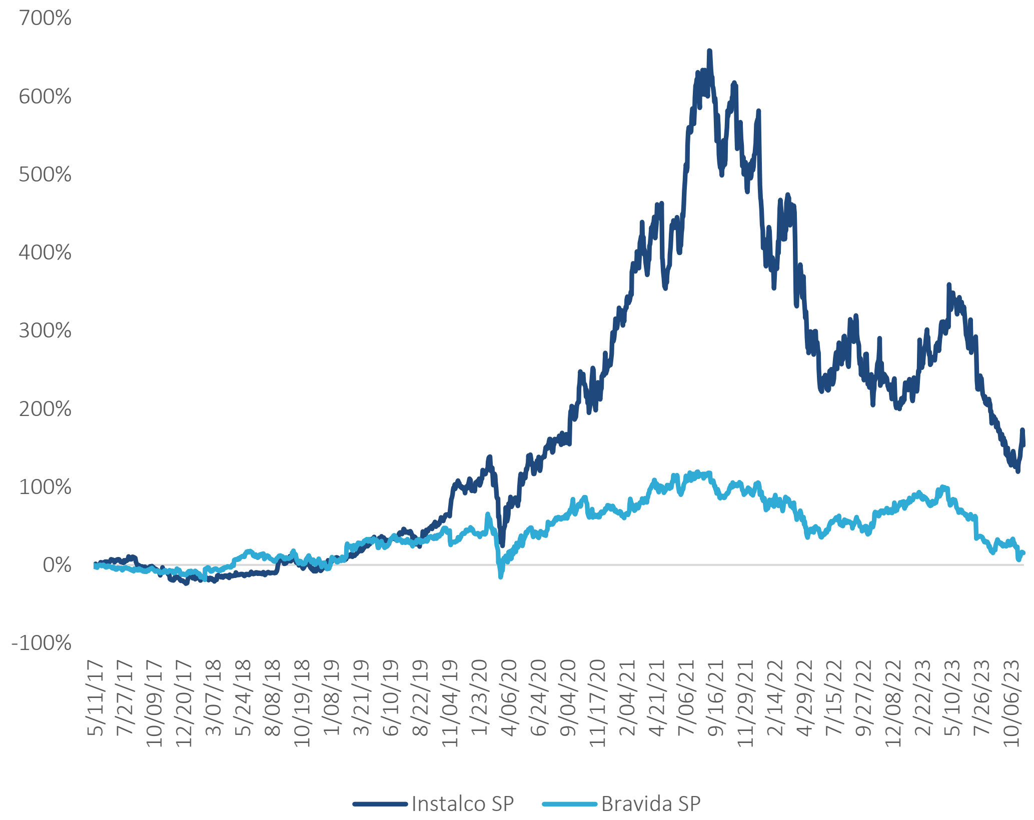
REQ CAPITAL
INVESTING WITH INSIGHT

Instalco vs Bravida

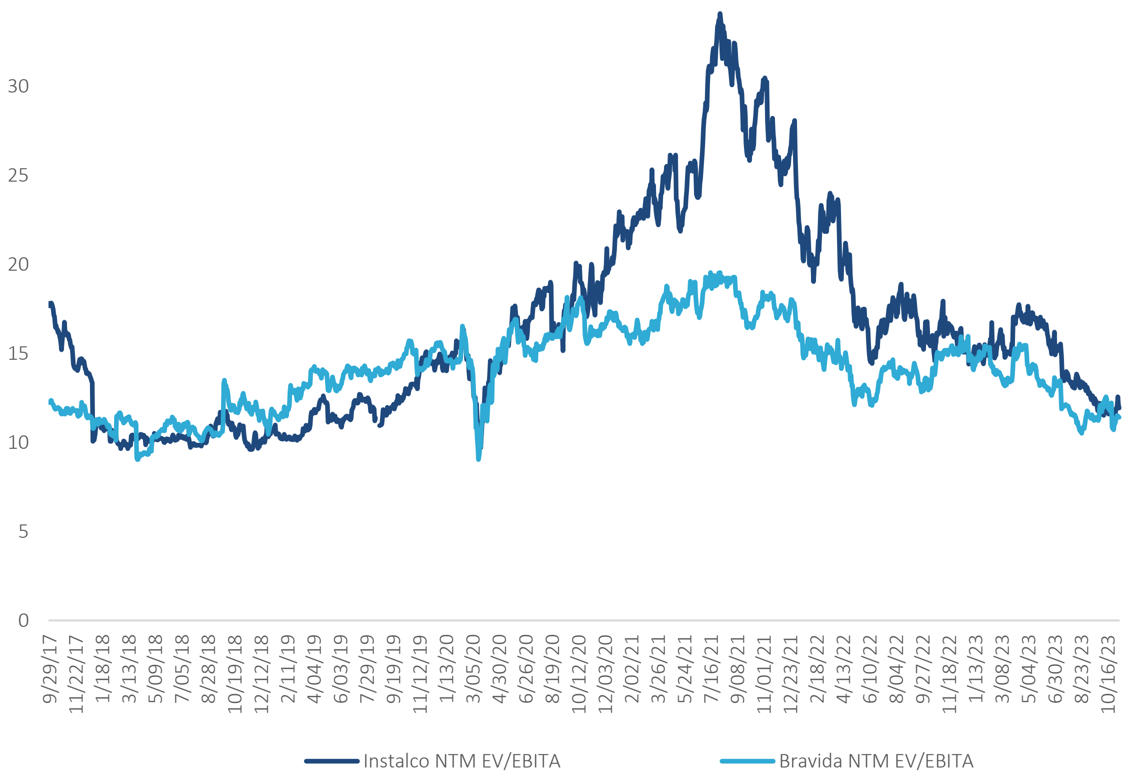
Share price development and valuation

Case Studies

Share price performance



Valuation – NTM EV/EBITA



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Source: Factset 2023-12-01

Instalco vs Bravida

Comments on the case study

Case Studies

Examining the companies from a growth standpoint, Instalco has outpaced Bravida in terms of growth, even though it started from a lower baseline. On a relative scale, Instalco's sales have surged from SEK 1.3 billion in 2015 to SEK 14 billion by Q3 2023 (an increase of SEK +12.7 billion), while Bravida's sales have risen from SEK 14.2 billion to SEK 29.2 billion (an increase of SEK +15.0 billion) during the same period. Additionally, Instalco has consistently demonstrated higher and more stable organic growth compared to Bravida. Analyzing the profit margins of both companies, Instalco has consistently maintained higher margins over the period. However, it's noteworthy that Instalco's EBITA margins peaked in 2019, whereas Bravida's margins hit a bottom during the same period.

In terms of total EPS growth from 2017 to Q3 2023, Instalco and Bravida have experienced growth rates of 213% and 57%, respectively. Instalco has increased its EPS at a faster pace, driven by equity issues, increased leverage, and robust cash flows. Throughout this period, Instalco has consistently operated with higher leverage compared to Bravida, with Instalco's ND/EBITDA reaching 2.6x by the end of Q3 2023, compared to Bravida's 1.3x. Notably, the historically higher ROIC of Instalco is now on par with Bravida.

The divergence in growth strategies is evident in the capital allocation priorities of the companies. Instalco has heavily focused on M&A (constituting 141% of funds from operations), while Bravida allocated only 30% to M&A. Instead, Bravida predominantly used its cash flow to distribute dividends (36% of funds from operations) from 2017 to Q3 2023.

Instalco's rapid growth has translated into a higher share price appreciation and valuation, particularly post the COVID-induced downturn in early 2020. Interestingly, the valuation gap between Instalco and Bravida observed in 2020 and 2021 has now closed, with both companies having similar valuations (measured as NTM EV/EBITA).

In summary, the stock market has rewarded Instalco's faster growth and increasing EPS in recent years, leading to higher valuation multiples in 2020/2021 (like many other fast-growing acquisition-driven compounders), and superior overall share price performance since Instalco's IPO. While high growth initially was valued higher, our experience is that over time, the stock market will put more emphasis on durable growth.

Operating with somewhat higher leverage and experiencing decreasing margins and negative organic EBITA growth, Instalco has seen a total drawdown of approximately -60% from its all-time high, compared to a drawdown of -45% for Bravida. For long-term investors, the key factors to monitor is high cash flow generation, maintaining stable or increasing margins, adopting a prudent approach to capital allocation and M&A, proving that the growth is durable and upholding an overall sound risk profile.

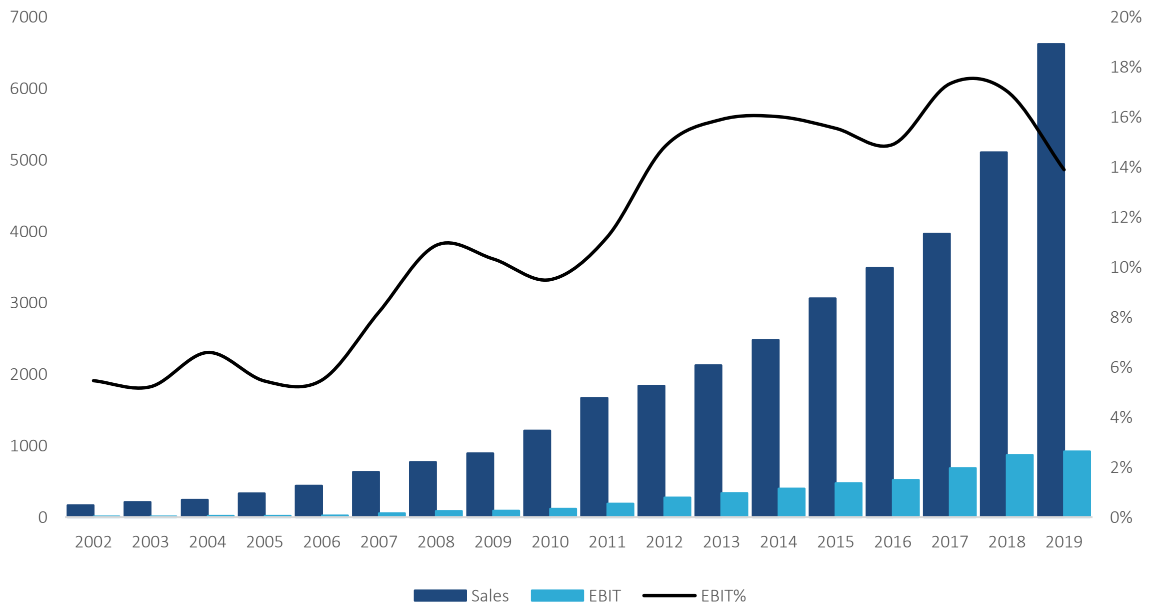
Case Study – Constellation Software

Case Study - Constellation Software

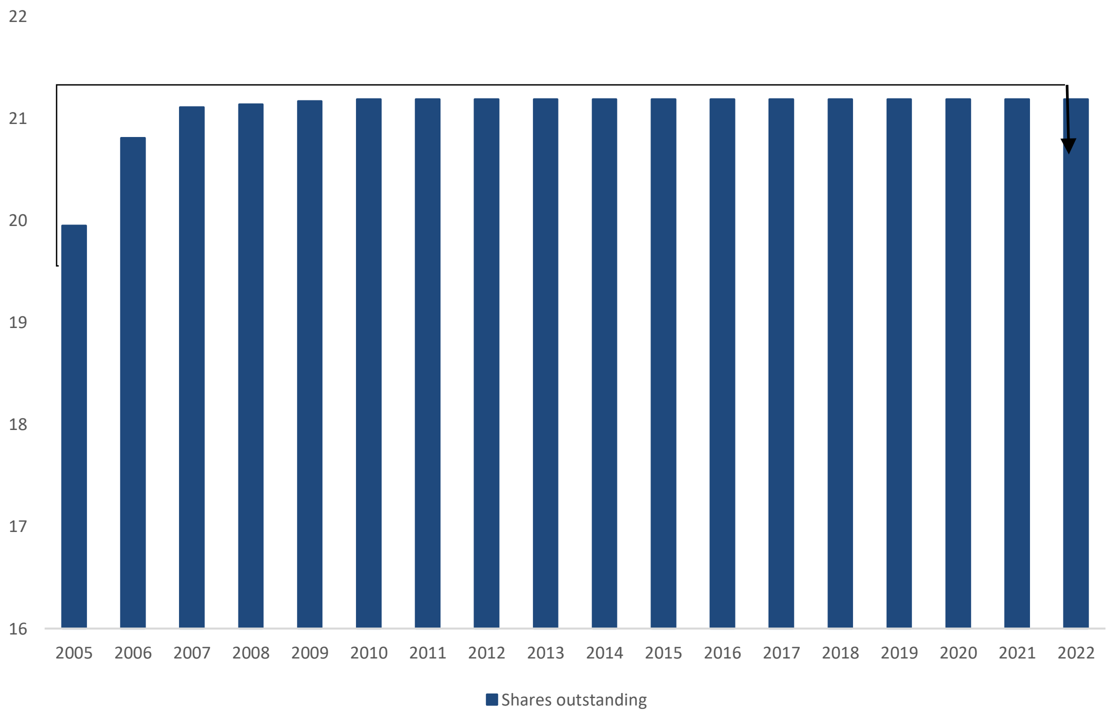
A deeper look into acquisitions (all numbers in USD)

Case Studies

Strong growth despite fighting an increasingly larger base…



…with no dilution



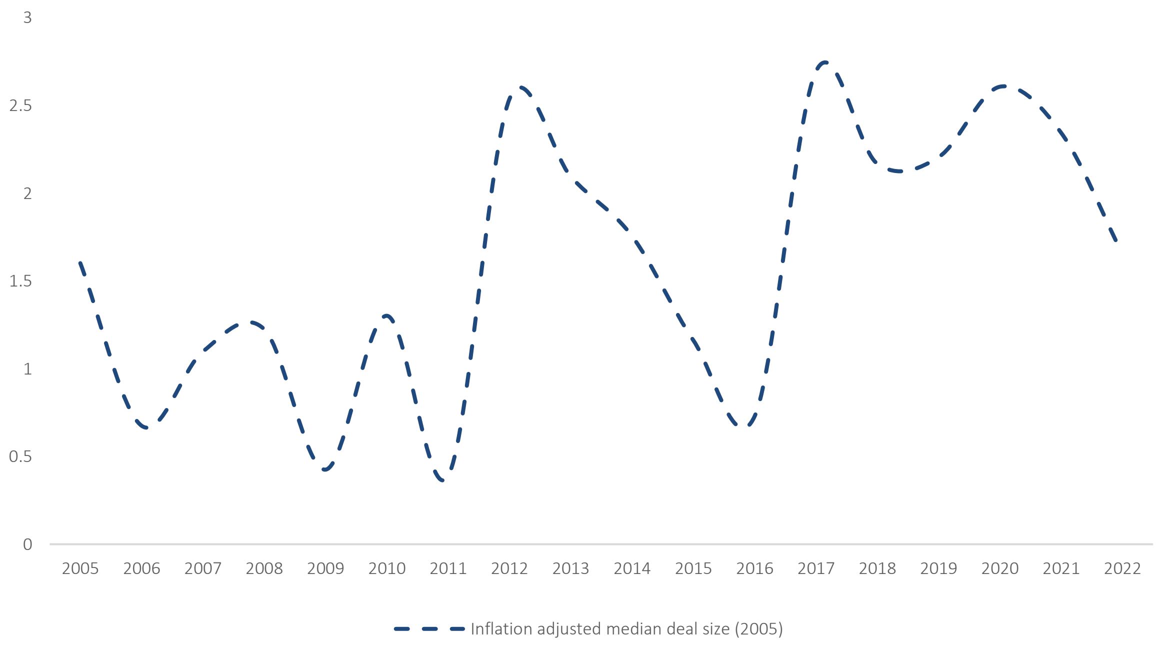
Source: Company reports, Factset

Case Study - Constellation Software

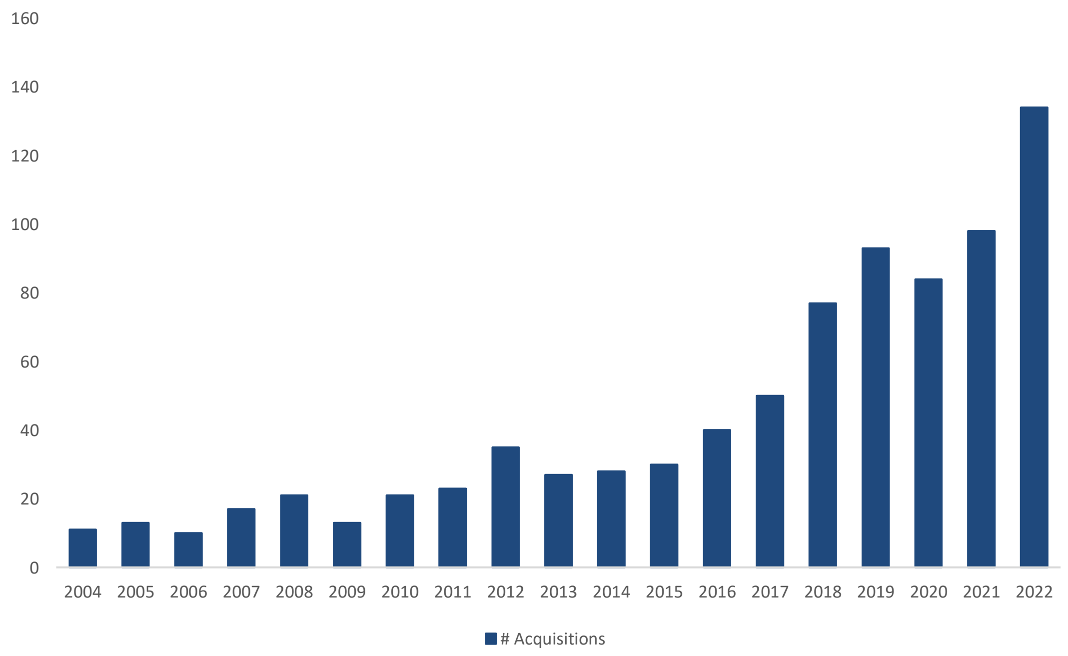
Breaking the laws of financial gravity

Case Studies

Inflation adjusted deal size has been remarkable consistent…



…and scaling deal volume at this level is nothing short of remarkable



Source: RBC, Company reports, Factset

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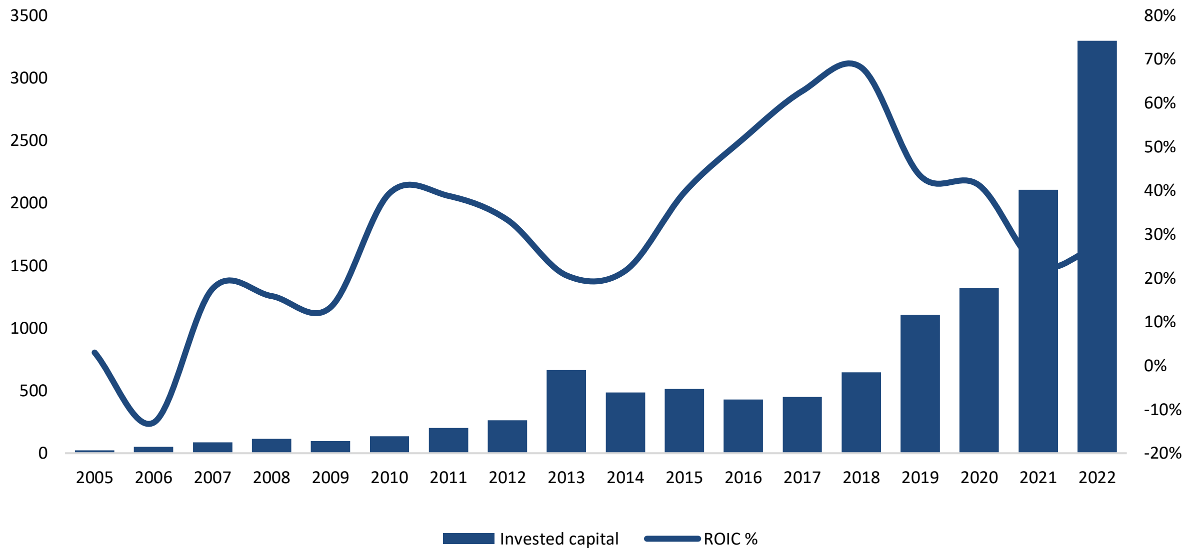
INVESTING WITH INSIGHT

Case Study - Constellation Software

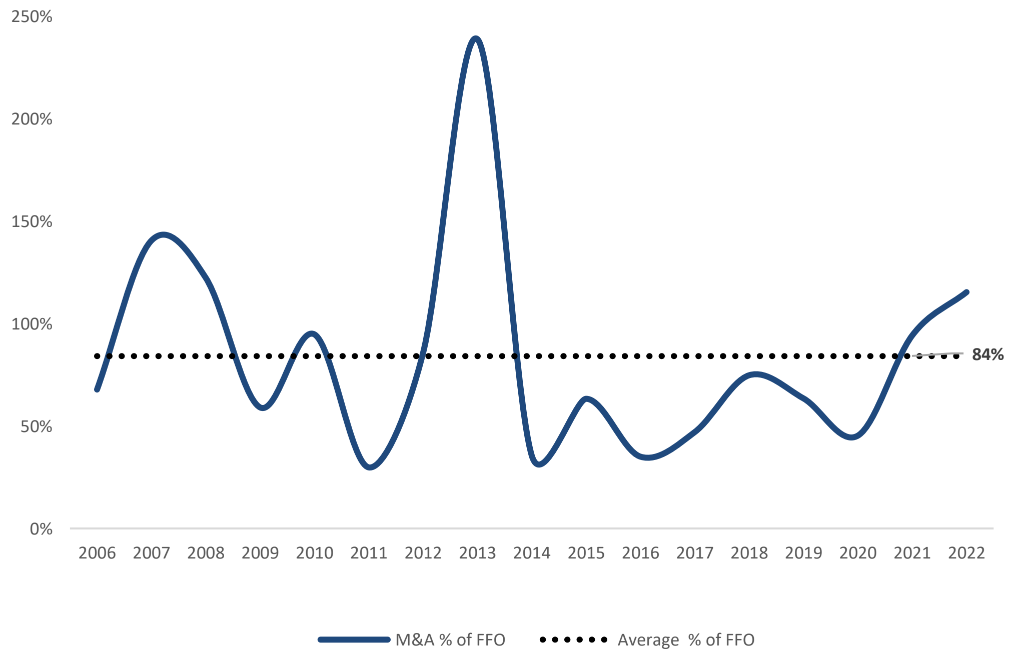
A deeper look into acquisitions

Case Studies

Return on capital has held up well despite strong growth in capital deployed…



…coupled with a high reinvestment ratio



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INVESTING WITH INSIGHT

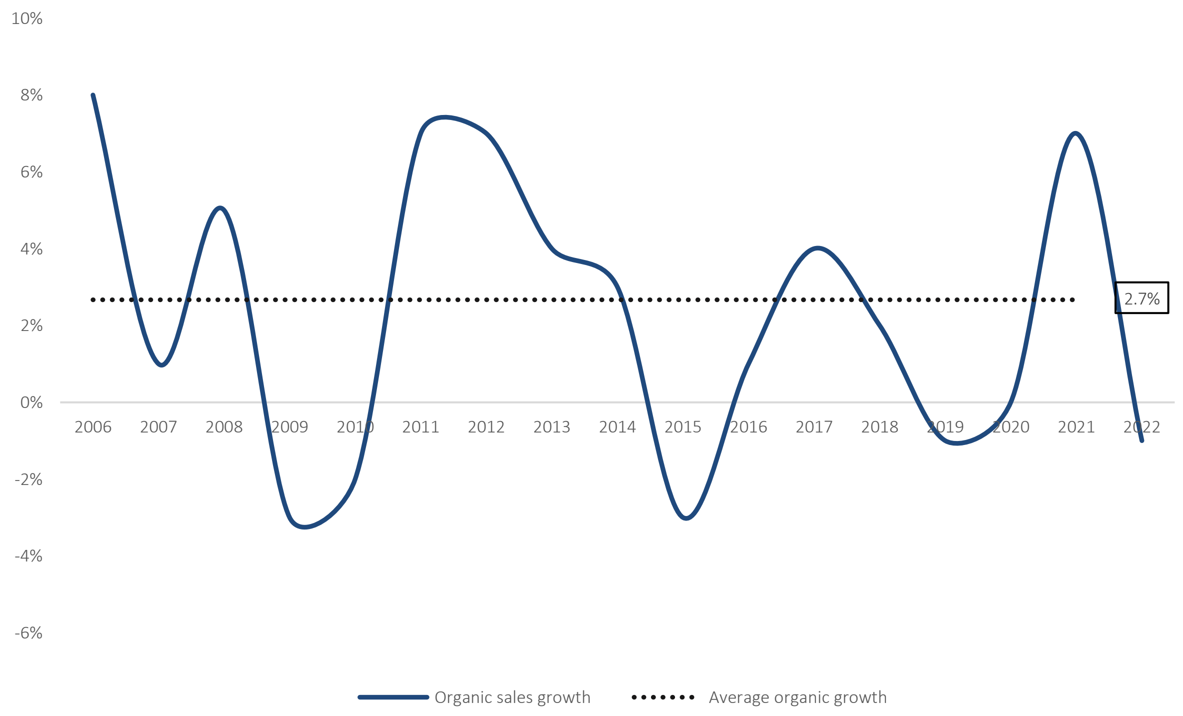
Source: Company reports, Factset

Case Study - Constellation Software

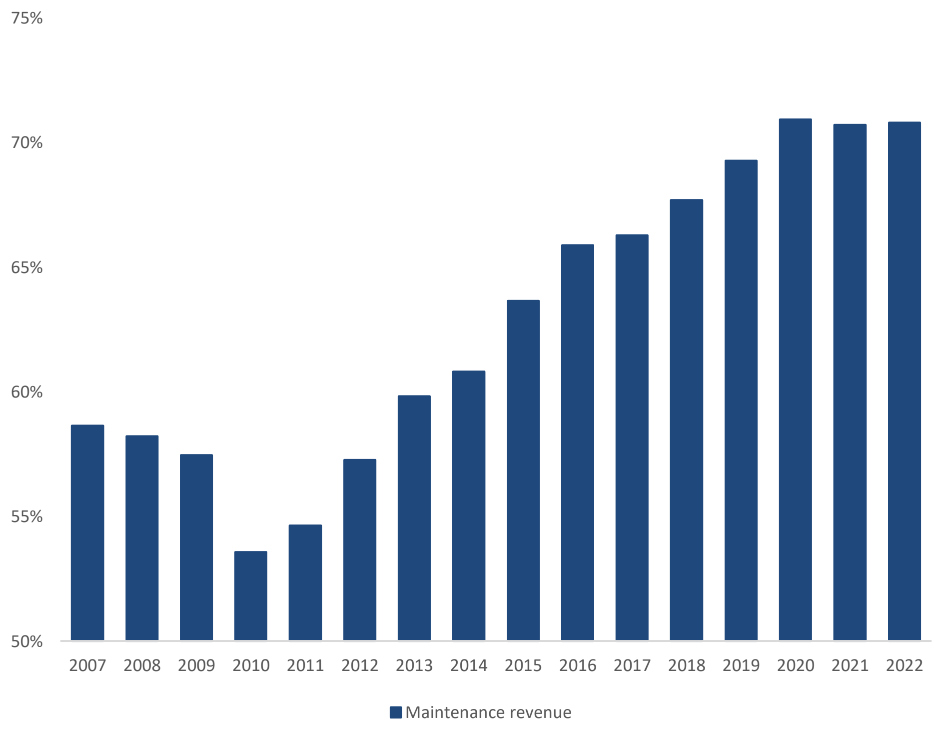
A deeper look into acquisitions

Case Studies

Organic growth also contributing as one of the two engines for growth…



…coupled with a rising share of maintenance revenue of total revenue



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Source: Company reports, Factset

Global Capital Allocation Example

How do companies think about capital allocation and value creation?

Case Studies

Constellation Software Inc. – vertical market software compounder (CAD 60bn MCAP)

Our current policy is to invest all of our retained investor's capital (and then some) when we think we can achieve our targeted hurdle rates. When we can't find enough attractive investments, we plan to maintain our hurdle rates and build cash for as long as our shareholders and board will allow. We believe that long-term shareholders and boards should set those policies, which segues nicely into discussing shareholder democracy and the role of boards.

Mark Leonard - Constellation Software President, Letter 2018

One of our directors has been calling me irresponsible for years. His thesis goes like this: CSI can invest capital more effectively than the vast majority of CSI's shareholders, hence we should stop paying dividends and invest all of the cash that we produce, even if it means lowering our hurdle rates. I used to argue that we needed to maintain our hurdle rates because dropping them for a few marginal capital deployments would cause the returns on our entire portfolio to drop. The evidence supported my contention, so we kept the rates high for small and mid-sized vertical market software ("VMS") acquisitions and made very few exceptions for large VMS acquisitions. The by-product of that discipline has been a perennial inability to invest all of the cash that we generate.

Mark Leonard - Constellation Software President, Letter 2021

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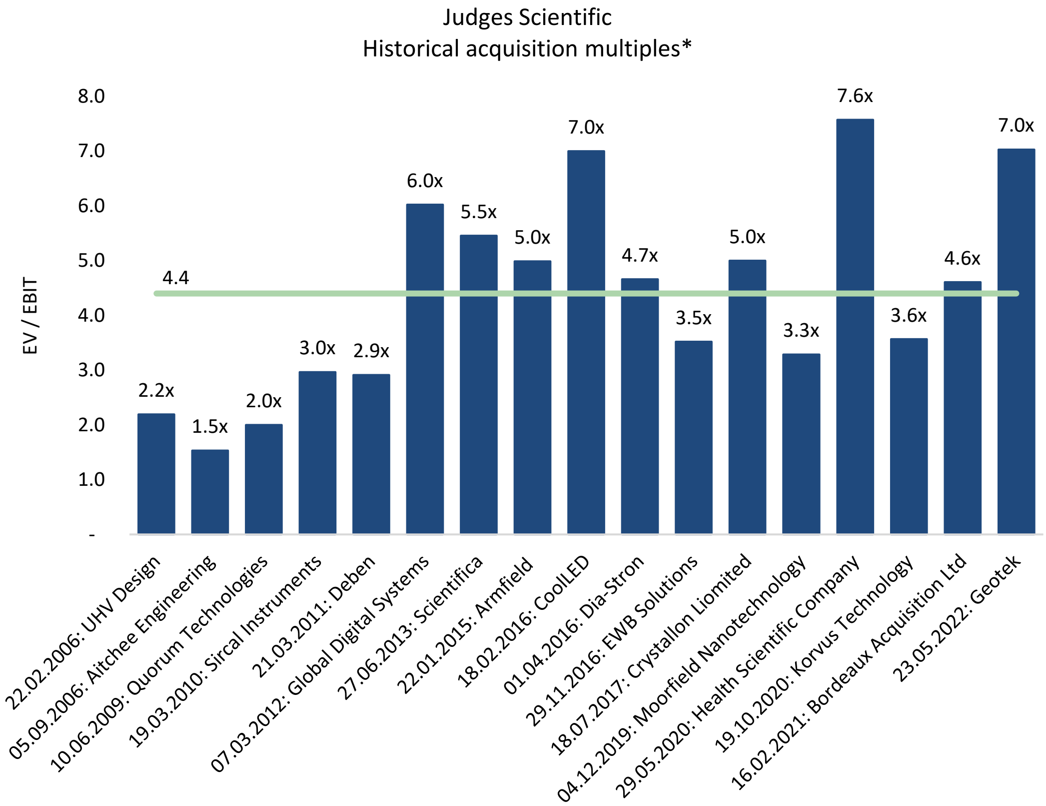
Case Study – Judges Scientific (UK)

Judges Scientific

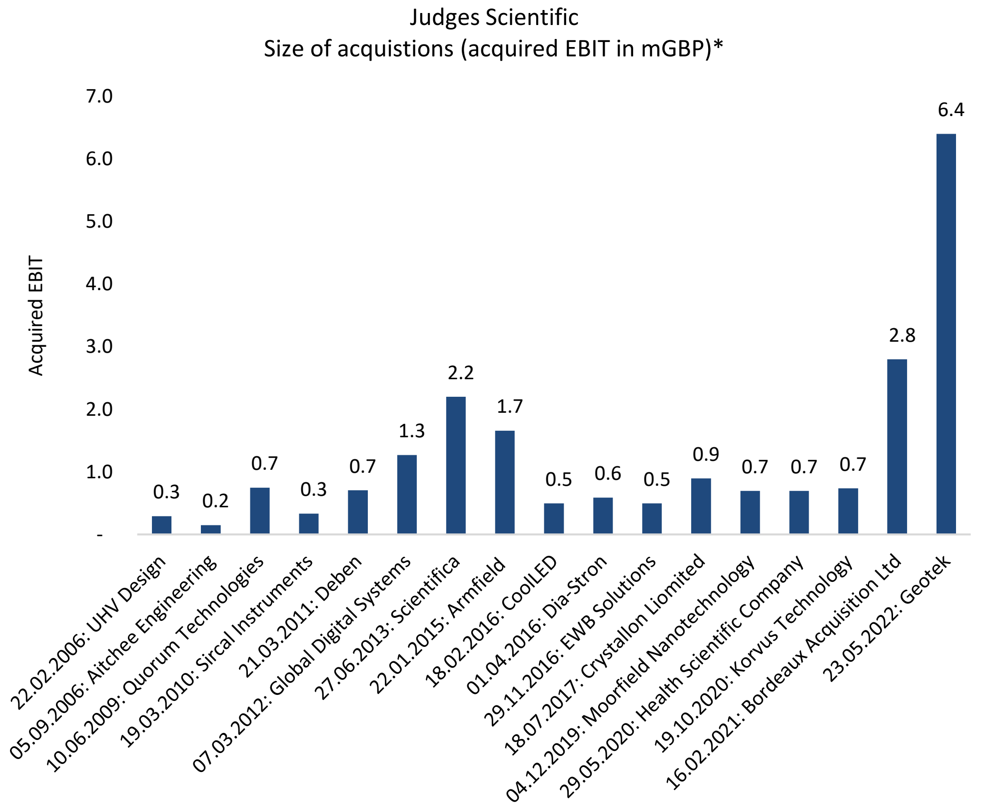
A deeper look into acquisitions

Case Studies

Acquisition multiples 2005 – 2023



Deal size 2005 – 2023



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Source: Company reports

Price Discipline and Cash Conversion

Avoiding Dilution and Excessive Leverage

Case Studies

The fact is, you don't need to invest a lot of money to grow these companies. And, we usually have about 80-90% conversion of EBITDA into cash, which is very important when the model is driven by debt because you need to borrow. You buy companies on a reasonable multiple, I mean, the first few deals we did were four times EBITA. And if you exclude Geotek, on average we've paid five times for all the other companies historically. So, on average, you get 20% on your money, and in the last few years, you were paying 4% on the debt. So, it's good, but you need to convert your profits into cash. Otherwise, you have to issue shares. And the big secret is don't issue a lot of shares. Shares are very precious.

David Cicurel, CEO of Judges Scientific

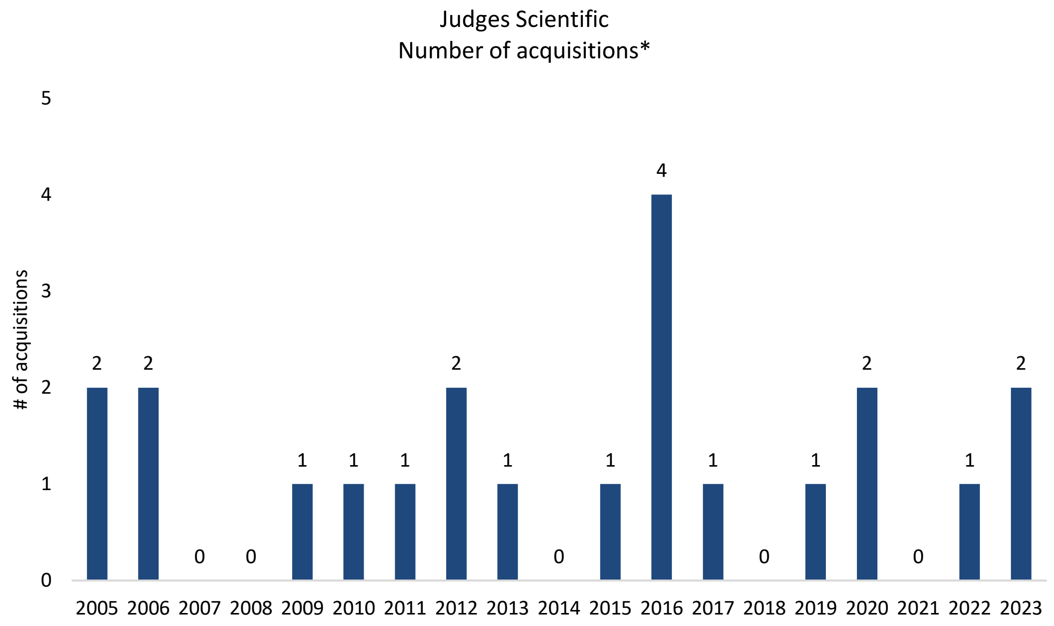
Podcast “Tu Dinero en Acciòn”, December 2023

Judges Scientific

A deeper look into acquisitions

Case Studies

of acquisitions 2005 - 2023



Total return (log scale)

Source: Company reports, REQ data & Factset

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INVESTING WITH INSIGHT

How We Think About Valuation and Pricing

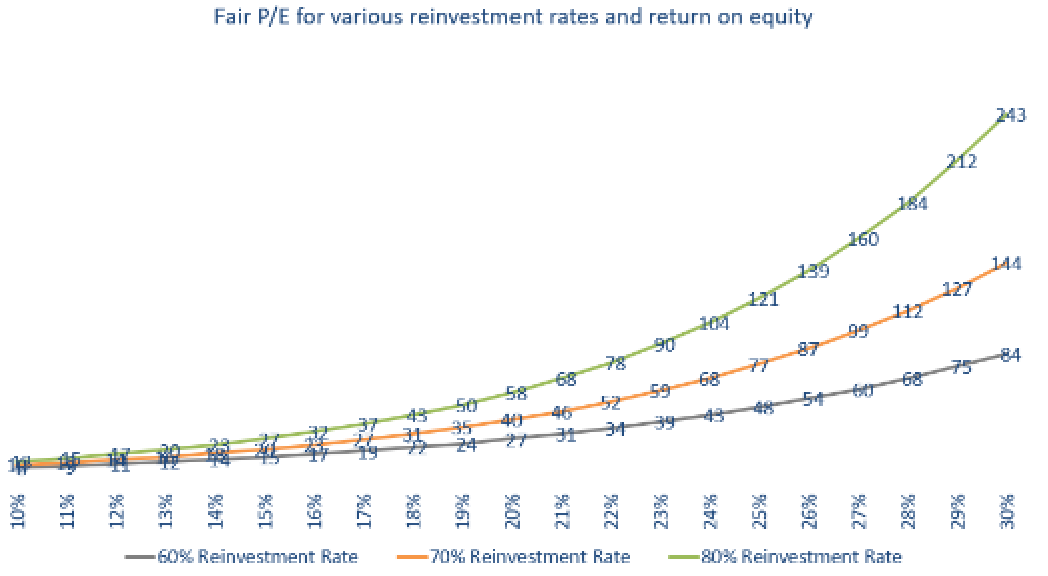
Reflections on Pricing

When you are a long-term investor in great businesses and enjoy 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 paid will affect long-term investment results, but the key is to evaluate long-term reinvestment opportunities.

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

We are careful about investing in too many companies that reinvest 100% of profits because these companies are vulnerable if they do not deliver on growth expectations. But as you can see from the chart, if you can 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 (continued)



A very special case of value investing, is the example of a company that is growing quickly, that the market expects to stop growing within the next 5-7 years, but that actually keeps growing quickly for much longer. If you can spot one of those, it may appear expensive on a PE basis, but actually be an attractive longterm investment on a “value investing” basis. Spotting this kind of investment requires the ability to foretell the distant future… which is extremely difficult to do with consistency.

Mark Leonard, CEO Constellation Software, Q&A, September 2018

REQ CAPITAL
INVESTING WITH INSIGHT

Reflections on Pricing

Return on capital, growth and pricing

How We Think About Valuation

An important lesson for us has been to be disciplined about the price we pay, but the paradox is that we need to feel comfortable owning businesses that sometimes trade at multiples where we would not buy them. We have learned that the businesses we own should not be sold based on price alone. There must be more than just a temporarily high multiple to make us sell a stock.

> *A stock can trade at 1,000x earnings and be undervalued. A stock can trade at 5x earnings and be overvalued. It took me years to embrace this concept.*

@BrianFeroldi

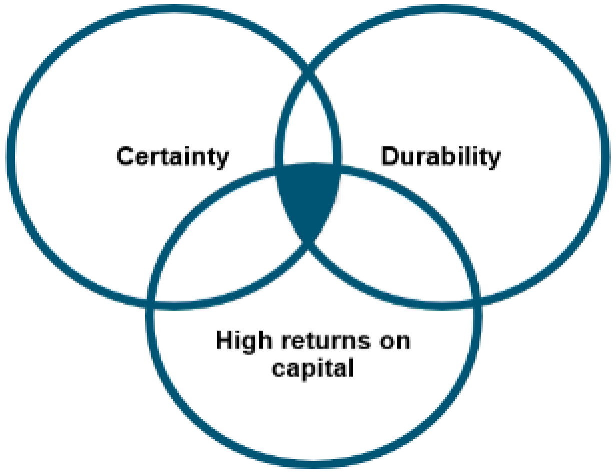
Think about this for a while when discussing market prices. Exceptional companies are worth more than you can imagine.

REQ CAPITAL
INVESTING WITH INSIGHT

Reflections on Pricing

How We Think About Valuation

The essence of these calculations lies in the fundamental factors contributing to successful long-term investments. A requisite blend includes durability in reinvestment opportunities, a high return on capital, and a substantial certainty regarding the sustained nature of these reinvestments over the years. The calculations suggest that by amalgamating these three crucial elements, the justifiable price for a stock often surpasses initial expectations. Consequently, investing in companies that demonstrate current strength and are anticipated to fortify over the next 10-15 years becomes critical. Valuation efforts at that stage tend to diminish in significance, underscoring the vital importance of investing in companies with durable growth.



The calculations also underscore the notion that making an error in estimating the price of a business is preferable to underestimating the quality of a business. The lesson learned is clear: the decision to sell these companies should not be based solely on valuation. Investors commonly place excessive value on growth while overlooking the significance of durability. We prioritize owning businesses capable of maintaining a steady 6% annual profit growth over decades, as opposed to those experiencing rapid but potentially short-lived expansion followed by significant challenges.

We are confident that the three essential factors outlined earlier are prevalent in our current portfolios. Each of our investments boasts an extensive pipeline of growth opportunities, consistently delivering a robust aggregate return on equity of 20% or more. The deliberate diversification inherent in these business models allows us to feel at ease with holding a restricted number of companies in our portfolios.

The outstanding companies within our portfolio don't rest while we sleep; they continue to accrue earnings. While much emphasis is placed on identifying exceptional investment opportunities, an equally vital yet often overlooked aspect is the art of retaining these companies. In our view, companies with enduring competitive advantages are consistently undervalued.

A Different View on Valuing Cash Flows: Hyperbolic Discounting

Hyperbolic discounting

How We Think About Valuation

We are always surprised at the variety of special interests in which people are enthusiastic. Some are very interested in ancient Egyptian pharaohs, while others are passionate about researching tanks used in World War II. Kyoto University in Japan offers a doctoral programme in "manga," comic books that originated in Japan.

In finance, there is one topic that we find particularly interesting and that we believe explains in large part why stocks are valued the way they are. This highly interesting topic is "hyperbolic discounting." It sounds like an academic theory - but it's not.

Cash flows in the dividend discounting model are discounted using what is known as "exponential discounting". This discounting method is the standard method for discounting cash flows. We all know it by heart from our business school exams. All investors use it because most have probably only heard of this discounting model. But what does this way of discounting cash flows actually mean, and is it the right way to discount cash flows?

The traditional way of discounting, exponential discounting, is "time insensitive," meaning that the discount factor always decreases at the same rate over time. This is the rational way to look at economics. Consequently, cash flows that are far in the future are not worth much under exponential discounting.

Hyperbolic discounting

Behavioral studies of humans show that we do not behave the way traditional economic theory claims. We are not rational. Our human way of discounting is "time dependent." In other words, we use different discount rates depending on how long it takes to receive a payoff. Consider the following two examples.

1) You can choose between receiving $100 today or $110 in one year. In experiments, people have a strong tendency to choose $100 today to get the instant gratification.

2) You can choose between receiving $100 in ten years or $110 in 11 years. In this situation people tend to be willing to wait an extra year to get $110. Since the instant gratification is not there anyway, we act more rationally and think we can just wait one more year until year 11 instead of receiving the payout in year 10. It is so far into the future anyway.

The challenge in example 2, in which you decided to wait 11 years, is that when you approach year 10, you would rather get the instant gratification of $100 than wait another year. In other words, people avoid waiting the closer they get to the end of the waiting period (continued)

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A Different View on Valuing Cash Flows

Hyperbolic discounting

In the short term, people are irrational, but in the longer term, they choose the rational option.

The basis for the hyperbolic discounting model is human behavior. The pattern that emerges from the way people choose as time goes on follows what is called a "hyperbola". People do not appear to use a constant discount rate as exponential discounting purports to do. In economics, hyperbolic discounting is a time-inconsistent model of discounting. People make decisions that are more similar to hyperbolic discounting than exponential discounting.

In hyperbolic discounting, valuations fall very quickly for periods close to the present because we want instant gratification, but they then fall slowly for longer periods that are deferred. The hyperbolic model discounts more than the exponential model at the beginning and less than the exponential model for very long term events.

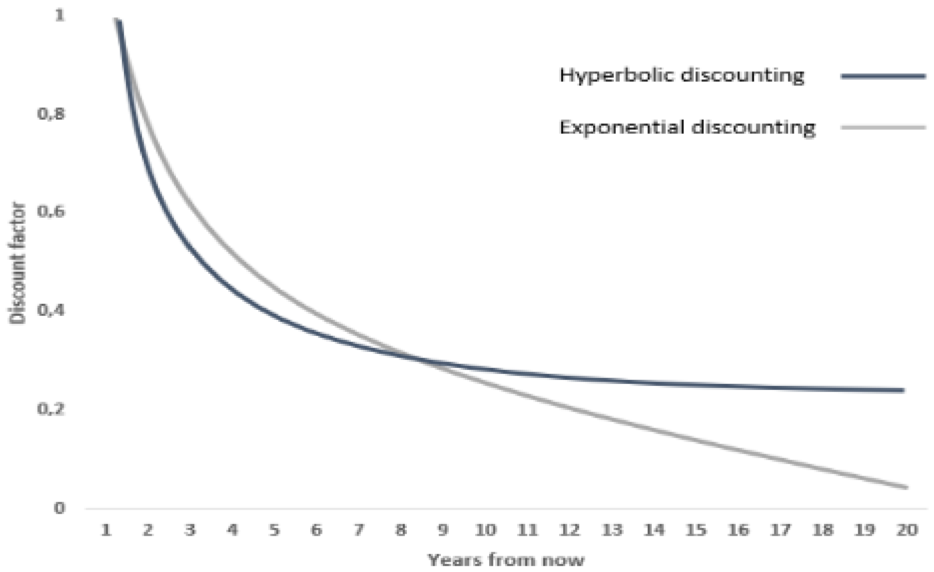
Hyperbolic discounting states that discount rates are greater in the short term than in the long term. What does all this have to do with finance and the valuation of companies?

Hyperbolic discounting in finance

In the hyperbolic formula, the present value of short-term cash flows is lower than in the exponential model, but the present value of longer-term cash flows is higher than in the exponential model. Consequently, the terminal value in hyperbolic discounting for companies with durable competitive advantages, will be higher than in the model we know from business school.

There are various kinds of mathematical expressions for the hyperbolic formula. I will not go into them, but will try to simplify the hyperbolic function using an example of a 20-year cash flow where the discount factor is decreasing over time. The falling discount factor reflects the way experiments point to how we as humans make tradeoffs, represented by the hyperbola. The resulting figure shows the discount rates using the exponential function and a hyperbolic assumption:

(continued)



A Different View on Valuing Cash Flows

Hyperbolic discounting

You will notice that by discounting the cash flows with a hyperbolic function, the present value of the firm is higher than with exponential discounting for companies with long term competitive advantages. In the example illustrated above the present value of the cash flow using the hyperbolic function is almost 40% higher than using the exponential function!

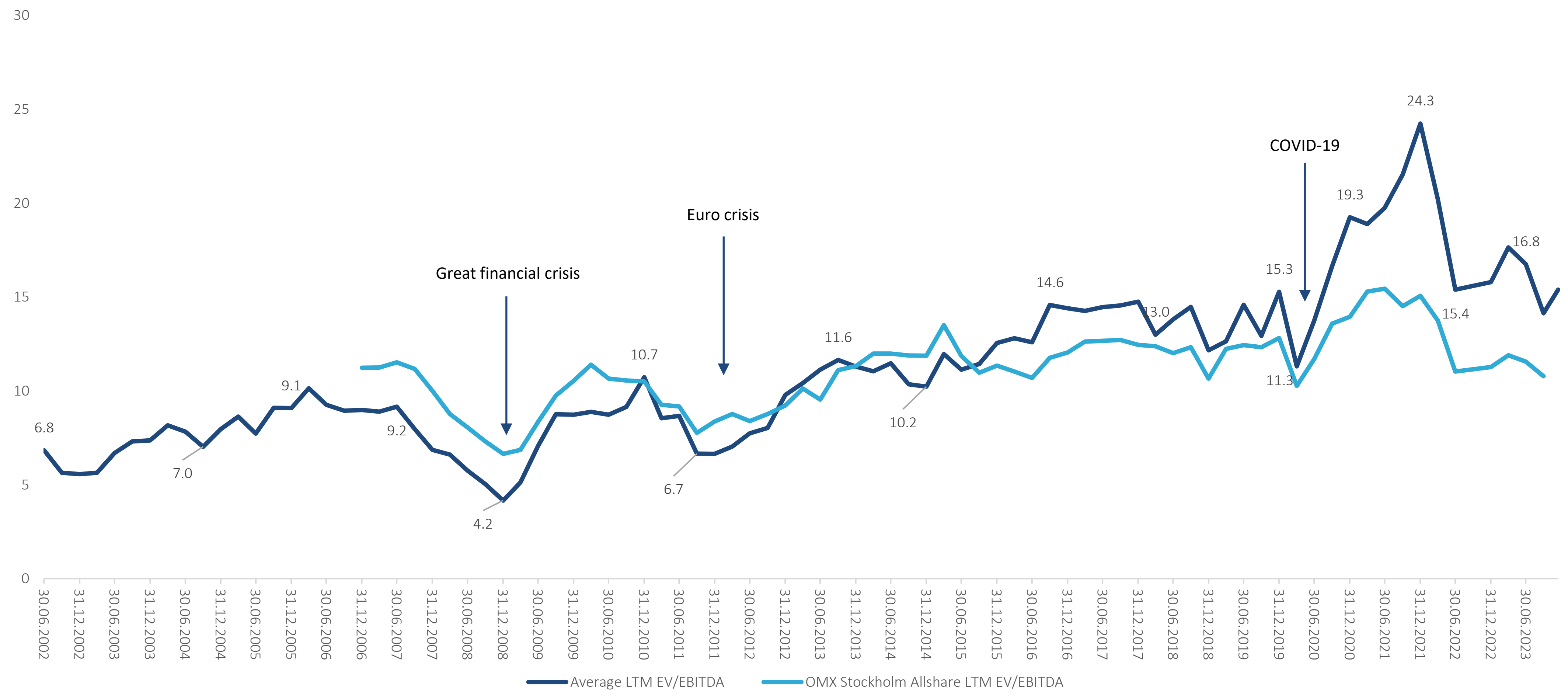
We are not advocating that you should flip all your DCF models and start using hyperbolic discounting. The reason why we find the topic very interesting is that hyperbolic discounting might be one reason why very strong companies with highly predictable cash flows long into the future deserve to be priced much higher than other companies in the stock market. We think that market participants, in aggregate, price these stocks by discounting their cash flows with a discounting mechanism that is closer to the hyperbolic discounting method than the exponential discounting method.

By using traditional exponential discounting to value very long-term cash flows you might actually undervalue these strong long-term compounders that we invest in significantly.

Pricing From a Historical Perspective

LTM EV/EBITDA - unweighted average for selected companies (2002-06-30 -> 2023-12-14)*

How We Think About Valuation

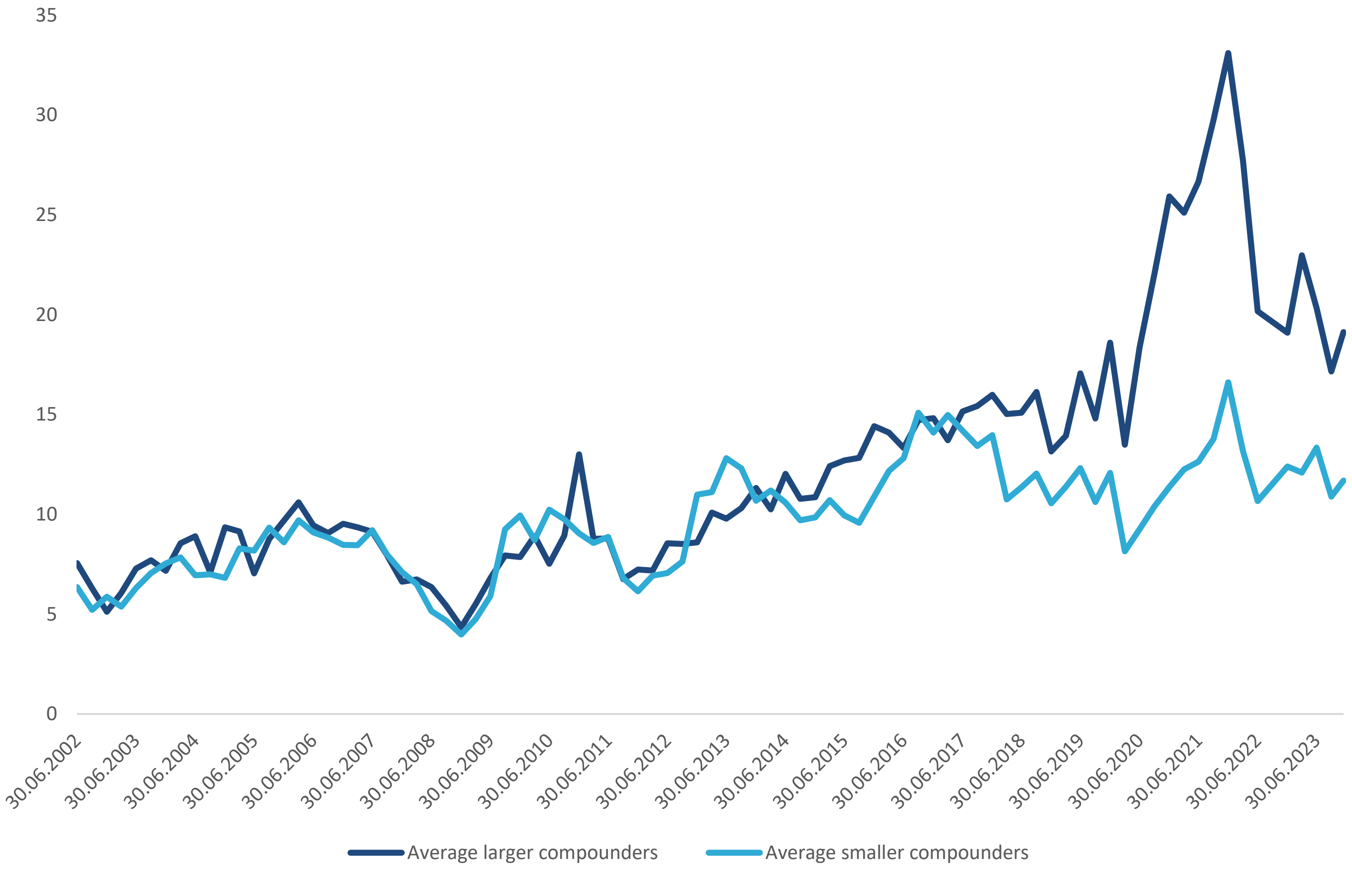


AQ Group, Beijer Alma, Ependion, Bergman&Beving, Medcap, OEM, Xano
Addnode, Addtech, Beijer Ref, Indutrade, Lagercrantz, Lifco, Vitec
Source: Factset 2023-12-14

Pricing From a Historical Perspective

Historical LTM EV/EBITDA multiples 2002-06-30 – 2023-12-14

How We Think About Valuation



As we can see from the chart the larger acquisition driven compound saw increased valuation compared to the smaller one, starting around 2017

While the valuations for the larger acquirers increased substantially in 2021, it is worth noting that their operational performance has been good during this whole period.

We believe there are two main reasons for this valuation gap between smaller and larger acquirers;
1) The larger acquirers today were historically also smaller, hence not as proven as they are today.
2) The larger acquirers have during this period displayed both higher reinvestment rates and growth as well as higher returns on capital, compared to the smaller ones.

Due to these reasons, we believe they should be valued at a premium compared to the smaller ones.

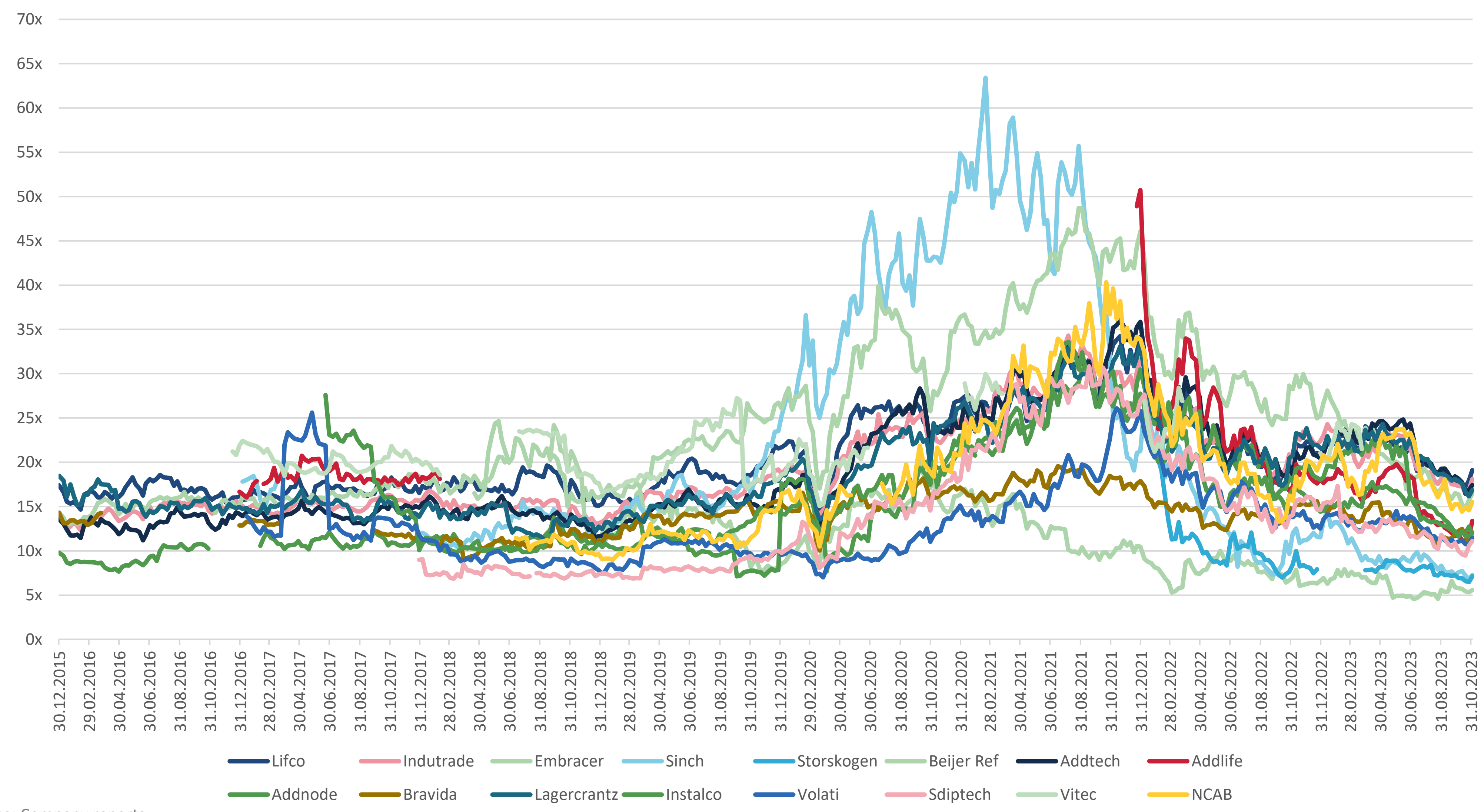
Source: Factset

Smaller : AQ Group, Beijer Alma, Ependion, Bergman&Beving, Medcap, OEM, Xano
Larger: Addnode, Addtech, Beijer Ref, Indutrade, Lagercrantz, Lifco, Vitec

Nordic Examples: Forward Looking Pricing

NTM EV/EBITA

How We Think About Valuation



Source: Company reports

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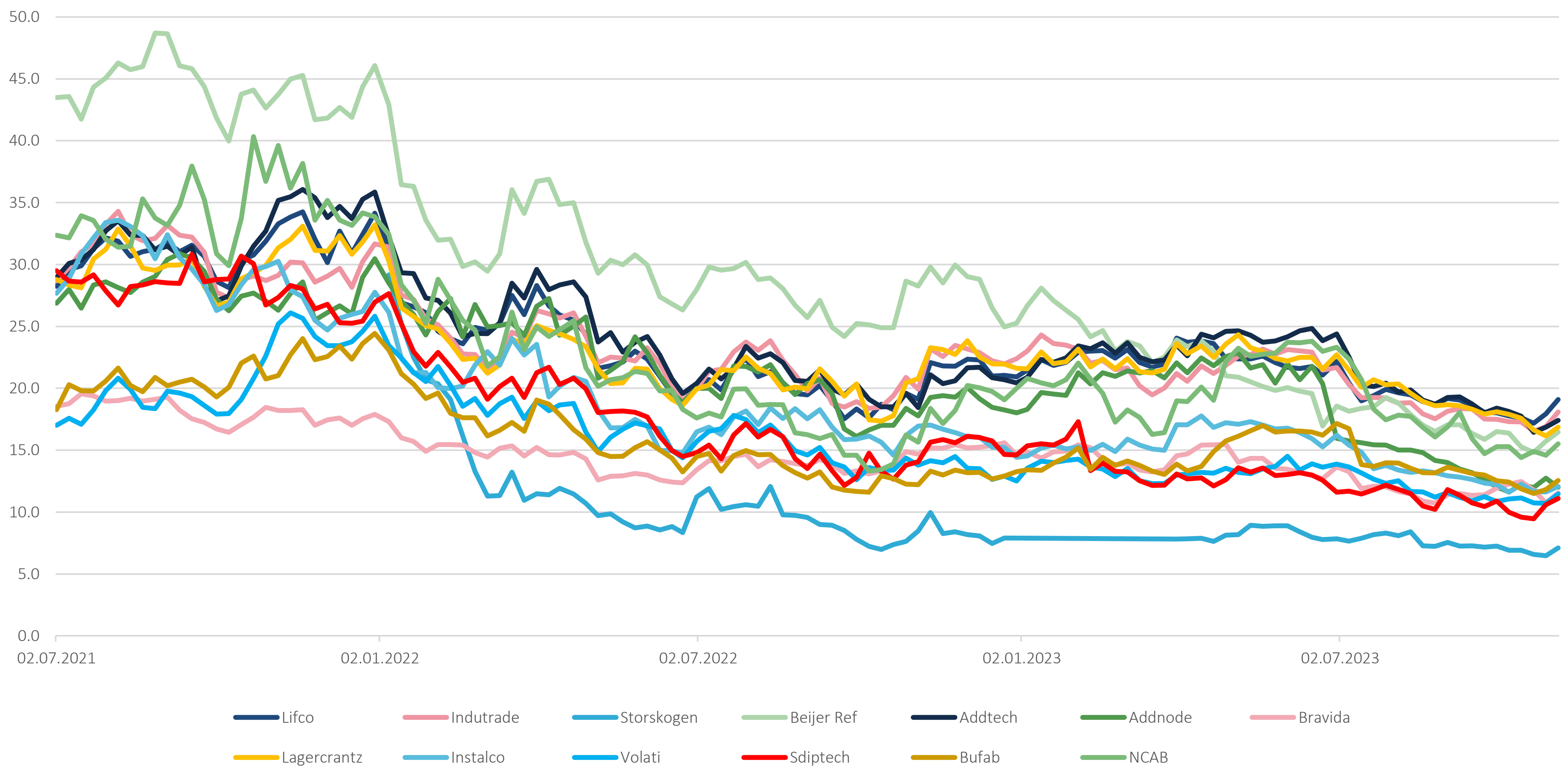
Nordic Examples: Forward Looking Pricing

Valuations have come down significantly over the last 2 years

How We Think About Valuation

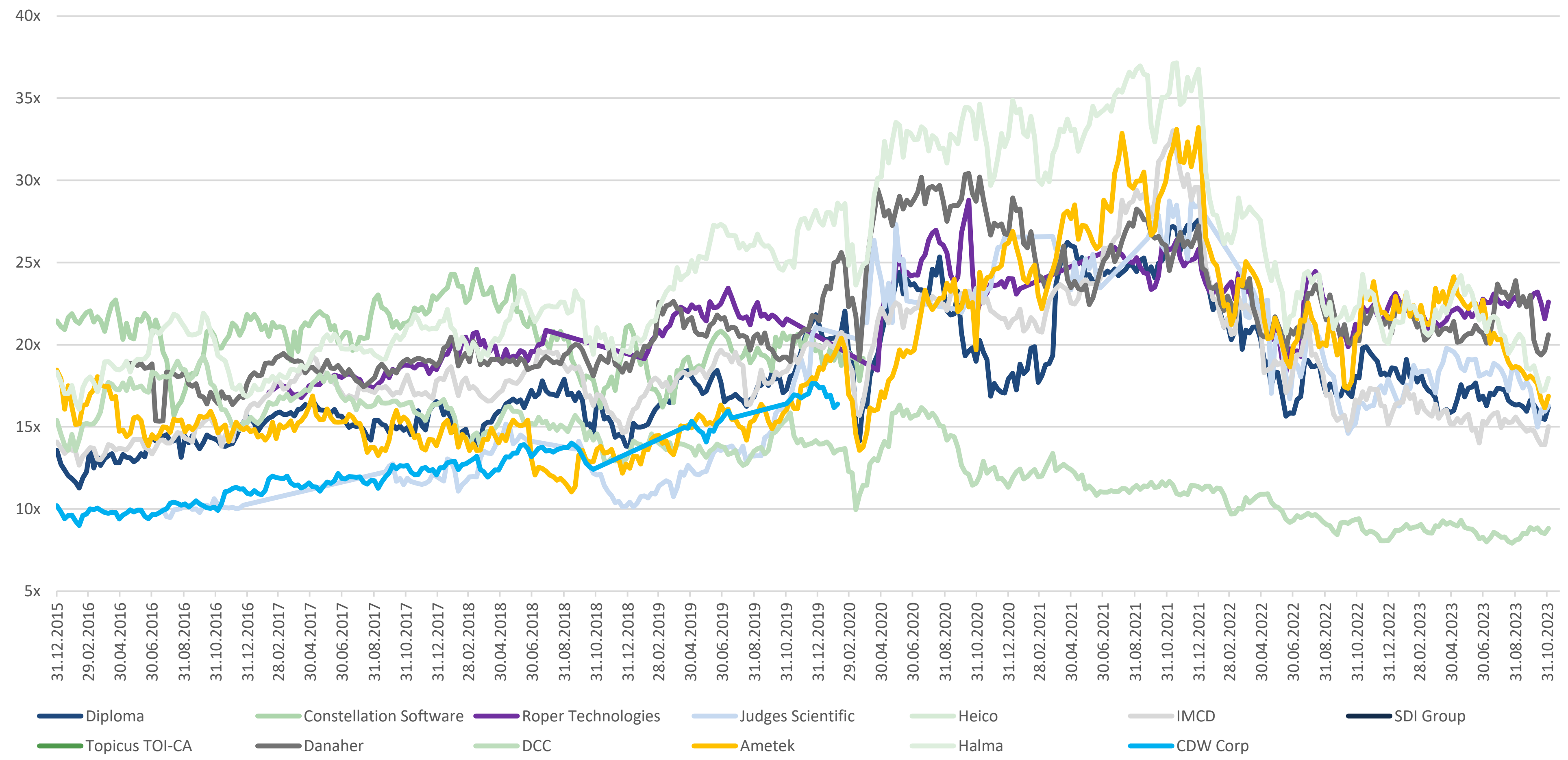


Source: Company reports

Global Examples: Forward Looking Pricing

[How We Think About Valuation](#)

NTM EV/EBITA



Source: Company reports

A Glance at Nordic Pricing

Pricing at 2023-12-05

How We Think About Valuation

	Exchange		Enterprise	EV/Sales		EV/EBITA			Sales				EBITA			P/E	Net income	Sales CAGR	EBITA-margin			
	Traded	Market cap	value	2022	2023E	2022	2023E	2024E	2021	2022	2023E	2024E	2022	2023E	2024E	2023E	2023E	21A - 23E	2021	2022	2023E	2024E
Atlas Copco	Large Cap	786,537	812,198	5.7x	4.7x	25.4x	20.4x	19.7x	110,912	141,325	171,909	178,426	31,935	39,817	41,163	27	28,737	24%	23%	23%	23%	23%
Assa Abloy	Large Cap	297,910	366,978	3.0x	2.6x	19.1x	15.9x	14.2x	95,007	120,793	141,368	153,626	19,186	23,027	25,780	22	13,810	22%	16%	16%	16%	17%
Hexagon	Large Cap	283,068	329,044	5.7x	5.3x	19.2x	18.5x	16.3x	45,120	57,332	61,685	65,353	17,137	17,781	20,141	26	10,783	17%	33%	30%	29%	31%
Lifco	Large Cap	104,061	115,161	5.3x	4.7x	24.8x	20.6x	21.1x	17,480	21,552	24,576	25,275	4,644	5,578	5,449	33	3,167	19%	21%	21.5%	22.7%	21.6%
Indutrade	Large Cap	85,179	98,132	3.6x	3.1x	23.9x	21.2x	21.0x	21,715	27,016	31,847	32,820	4,098	4,636	4,663	30	2,805	21%	15%	15.2%	14.6%	14.2%
Beijer Ref	Large Cap	58,283	69,252	3.1x	2.2x	31.2x	20.2x	18.3x	16,912	22,638	32,116	34,889	2,217	3,433	3,789	28	2,063	38%	8%	9.8%	10.7%	10.9%
Addtech	Large Cap	52,431	58,735	3.1x	2.9x	25.5x	20.7x	20.5x	14,038	18,714	20,387	21,048	2,299	2,832	2,865	33	1,608	21%	13%	12.3%	13.9%	13.6%
Embracer	Large Cap	32,723	50,493	1.3x	1.2x	7.5x	7.7x	6.1x	17,037	37,665	43,417	46,430	6,777	6,544	8,239	16	2,083	60%	25%	18.0%	15.1%	17.7%
Sinch	Large Cap	27,113	35,947	1.3x	1.2x	13.5x	11.7x	10.4x	16,177	27,722	28,851	30,843	2,665	3,069	3,452	-690	-39	34%	5%	9.6%	10.6%	11.2%
Lagercrantz	Large Cap	24,037	27,243	3.8x	3.3x	24.2x	19.4x	18.9x	5,482	7,246	8,148	8,482	1,128	1,404	1,439	28	854	22%	16%	15.6%	17.2%	17.0%
HMS Networks	Large Cap	19,885	20,641	8.2x	6.8x	30.7x	26.6x	31.7x	1,972	2,506	3,019	2,876	673	776	650	34	587	24%	25%	27%	26%	23%
Vitec	Large Cap	17,206	19,171	9.7x	6.9x	28.0x	20.8x	17.6x	1,571	1,978	2,787	3,224	684	920	1,092	47	363	33%	30%	34.6%	33.0%	33.9%
Lindab	Large Cap	14,686	18,015	1.5x	1.4x	13.2x	14.1x	12.4x	9,845	12,366	13,059	13,444	1,369	1,274	1,449	17	863	15%	13%	11%	10%	11%
Bravida	Large Cap	13,417	17,918	0.7x	0.6x	10.6x	10.1x	11.0x	21,875	26,302	29,462	28,878	1,697	1,767	1,636	10	1,297	16%	7%	6.5%	6.0%	5.7%
Storskogen	Large Cap	13,406	25,351	0.7x	0.7x	8.1x	7.5x	7.5x	17,498	34,254	36,248	35,932	3,144	3,390	3,394	14	928	44%	10%	9.2%	9.4%	9.4%
Vimian	First North	12,227	15,544	4.9x	4.2x	18.9x	16.1x	13.2x	1,843	3,168	3,697	4,244	822	963	1,174	47	262	42%	28%	26.0%	26.1%	27.7%
Bufab	Large Cap	12,000	15,832	1.9x	1.8x	16.1x	14.3x	13.9x	5,878	8,431	8,809	9,144	983	1,107	1,136	19	625	22%	12%	11.7%	12.6%	12.4%
Addlife	Large Cap	11,869	17,529	1.9x	1.8x	14.6x	15.9x	15.1x	7,993	9,084	9,736	10,448	1,204	1,104	1,162	40	296	10%	16%	13.3%	11.3%	11.1%
NCAB	Large Cap	11,452	12,074	2.7x	2.9x	19.1x	18.1x	17.4x	3,220	4,458	4,209	4,609	631	667	693	27	423	14%	12%	14.2%	15.8%	15.0%
Beijer Alma	Mid Cap	10,799	13,648	2.3x	2.0x	15.6x	13.7x	12.8x	5,389	6,028	6,882	7,255	877	998	1,064	18	585	13%	16%	14.5%	14.5%	14.7%
Ratos	Large Cap	10,625	21,290	0.7x	0.6x	10.8x	9.3x	8.5x	22,612	29,914	34,179	34,944	1,966	2,290	2,491	13	809	23%	8%	6.6%	6.7%	7.1%
Addnode	Large Cap	9,719	9,770	1.6x	1.3x	13.6x	15.5x	12.5x	4,077	6,225	7,309	8,241	720	631	781	41	236	34%	11%	11.6%	8.6%	9.5%
Swedencare	First North	9,683	11,055	6.0x	4.9x	24.5x	26.6x	19.3x	772	1,831	2,257	2,579	452	415	573	87	111	71%	15%	24.7%	18.4%	22.2%
Sdiptech	Large Cap	9,156	11,534	3.3x	2.5x	15.8x	12.4x	11.3x	2,719	3,505	4,703	5,153	728	930	1,019	19	470	32%	17%	20.8%	19.8%	19.8%
Instalco	Large Cap	8,906	13,855	1.1x	1.0x	15.1x	12.8x	13.0x	8,890	12,063	14,205	14,098	916	1,087	1,070	16	569	26%	8%	7.6%	7.6%	7.6%
Volati	Large Cap	8,084	10,265	1.3x	1.3x	13.9x	13.2x	12.3x	6,310	7,752	7,863	8,281	738	780	832	23	349	12%	11%	9.5%	9.9%	10.0%
Inwido	Mid Cap	7,629	9,293	1.0x	1.0x	8.5x	9.3x	10.0x	7,725	9,547	9,224	9,114	1,087	1,002	927	12	653	9%	12%	11.4%	10.9%	10.2%
Momentum Group	Mid Cap	6,197	6,658	3.8x	2.9x	32.4x	24.7x	21.8x	1,493	1,741	2,290	2,594	206	269	306	36	173	24%	11%	11.8%	11.7%	11.8%
Byggfakta Group	Large Cap	6,050	8,966	4.0x	3.5x	14.0x	12.1x	10.5x	1,553	2,214	2,563	2,834	639	743	853	122	49	28%	30%	28.9%	29.0%	30.1%
Karnov Group	Mid Cap	5,922	8,190	7.4x	3.3x	22.5x	16.9x	15.2x	878	1,113	2,493	2,593	364	486	537	334	18	68%	36%	32.7%	19.5%	20.7%
Stillfront	Large Cap	5,673	9,966	1.4x	1.4x	4.5x	4.9x	4.6x	5,455	7,054	6,999	7,241	2,239	2,017	2,168	57	100	13%	34%	31.7%	28.8%	29.9%
Norva 24	Mid Cap	5,660	5,628	2.3x	1.9x	22.7x	16.3x	13.7x	2,132	2,484	3,021	3,321	248	345	409	27	211	19%	12%	10.0%	11.4%	12.3%
Alligo	Mid Cap	5,265	8,437	0.9x	0.9x	11.3x	10.4x	9.4x	8,475	9,272	9,517	9,800	745	811	898	10	502	6%	8%	8.0%	8.5%	9.2%
MedCap	Mid Cap	4,568	4,708	4.2x	3.0x	22.7x	21.7x	15.8x	916	1,111	1,571	1,758	207	217	298	0	0	31%	17%	18.6%	13.8%	0.0%
Bergman & Beving	Mid Cap	4,539	6,320	1.3x	1.3x	16.3x	14.2x	13.3x	4,575	4,749	4,810	4,936	387	445	475	22	205	3%	7%	8.1%	9.2%	9.6%
Humble Group	First North	4,123	5,528	0.9x	0.8x	8.6x	9.3x	7.4x	1,548	5,974	7,141	8,032	640	597	744	-199	-21	115%	10%	10.7%	8.4%	9.3%
KnowIT	Mid Cap	4,046	5,257	0.8x	0.7x	8.6x	10.2x	9.3x	4,812	6,834	7,180	7,297	609	515	566	18	227	22%	10%	8.9%	7.2%	7.8%
Hexatronic	Large Cap	3,977	7,125	1.1x	0.9x	6.5x	5.7x	7.4x	3,503	6,593	8,103	7,815	1,090	1,247	958	5	733	52%	11%	16.5%	15.4%	12.3%
Nordic Waterproofing	Mid Cap	3,911	4,874	1.1x	1.1x	10.8x	13.7x	11.9x	3,664	4,343	4,471	4,415	453	355	409	18	219	10%	11%	10.4%	7.9%	9.3%
Green Landscaping	Mid Cap	3,508	4,738	1.0x	0.8x	11.6x	9.0x	8.8x	3,160	4,810	5,878	5,939	408	528	540	18	196	36%	7%	8.5%	9.0%	9.1%
Ependion	Mid Cap	3,311	3,952	1.9x	1.6x	19.7x	11.3x	10.5x	1,619	2,128	2,513	2,594	201	351	376	14	232	25%	0%	9.4%	14.0%	14.5%
Addvise	First North	2,804	3,411	3.7x	2.4x	16.6x	10.6x		466	928	1,398	1,771	206	323	397	20	138	73%	10%	22.2%	23.1%	0.0%
Fasadgruppen	Mid Cap	2,734	4,055	0.9x	0.8x	9.4x	9.1x	8.7x	2,676	4,548	5,110	5,196	432	445	466	13	210	38%	11%	9.5%	8.7%	9.0%
Proact	Mid Cap	2,395	2,513	0.5x	0.5x	7.9x	8.3x	7.3x	3,525	4,757	4,757	4,981	318	302	343	14	171	16%	6%	6.7%	6.3%	6.9%
BHG Group	Large Cap	2,172	4,730	0.4x	0.4x	12.6x	-14.5x	14.3x	12,666	13,434	11,888	11,595	375	-327	331	-2	-1,415	-3%	6%	2.8%	-2.8%	2.9%
Vestum	First North	1,949	4,725	0.7x	0.7x	7.1x	7.9x	7.5x	1,316	6,843	6,610	6,725	664	599	628	164	12	124%	7%	9.7%	9.1%	9.3%
Midsona	Mid Cap	1,172	1,837	0.5x	0.5x	14.8x	14.8x	8.0x	916	3,899	3,794	3,879	124	124	229	-27	-44	104%	23%	3.2%	3.3%	5.9%
Awardit	First North	639	506	0.6x	0.4x	4.9x	5.6x	3.9x	916	874	1,172	1,400	103	91	129	38	17	13%	8%	11.8%	7.8%	9.2%
Alcadon	First North	623	1,005	0.9x	0.6x	14.6x	9.6x	7.2x	737	1,110	1,565	1,770	69	105	139	18	35	46%	10%	6.2%	6.7%	7.9%
Netel	Mid Cap	619	1,471	0.5x	0.4x	7.4x	8.9x	6.4x	2,418	3,140	3,478	3,700	200	165	231	12	53	20%	7%	6.4%	4.7%	6.2%
Christian Berner	Small Cap	540	733	0.9x	0.7x	15.9x	10.0x	9.4x	743	842	999	1,039	46	73	78	12	46	16%	5%	5.5%	7.3%	7.5%
Seafire	First North	290	519	0.6x	0.5x	5.6x	6.2x	5.1x	421	898	1,018	1,055	92	84	101	-6	-48	56%	6%	10.2%	8.3%	9.6%

Source: Factset

Source: Factset

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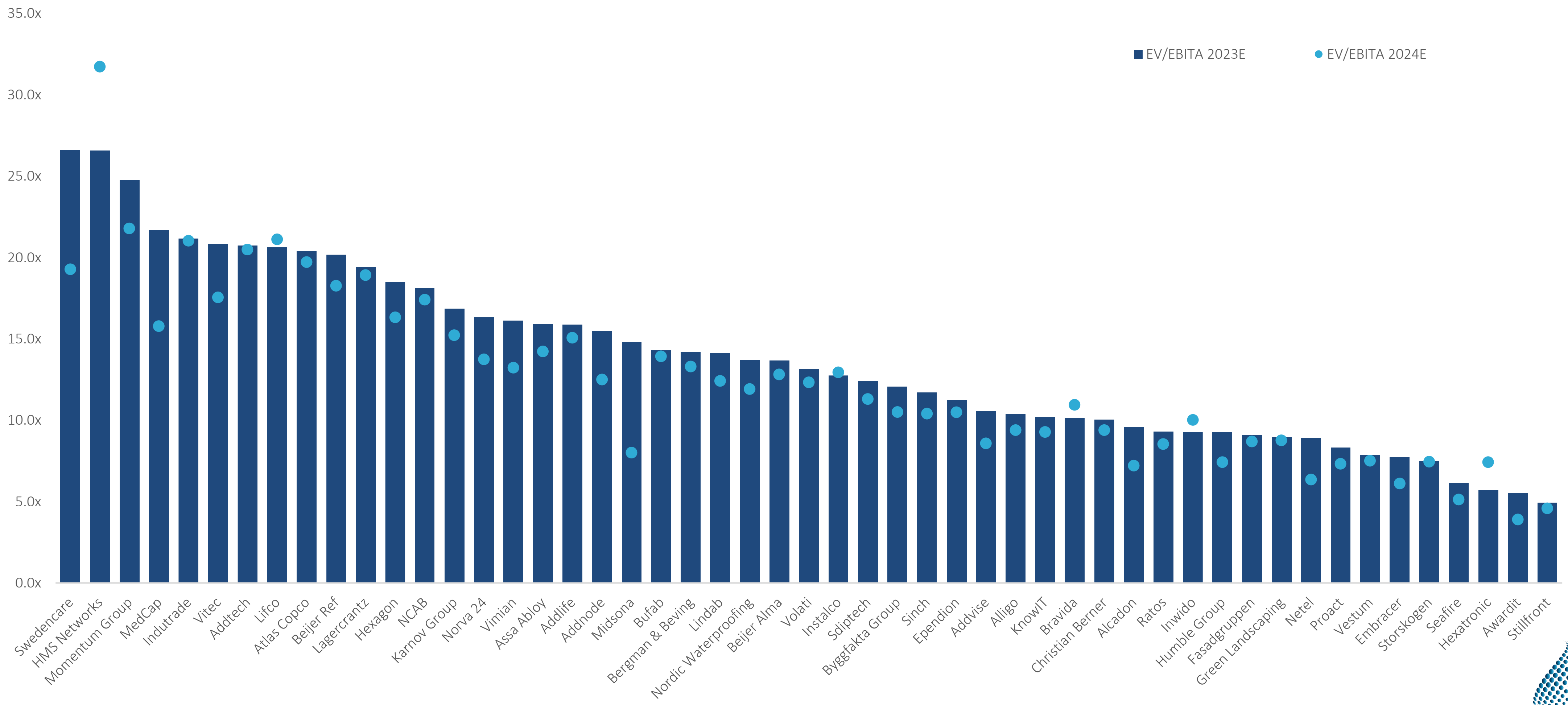
Current Pricing

Pricing per 2023-12-05

How We Think About Valuation



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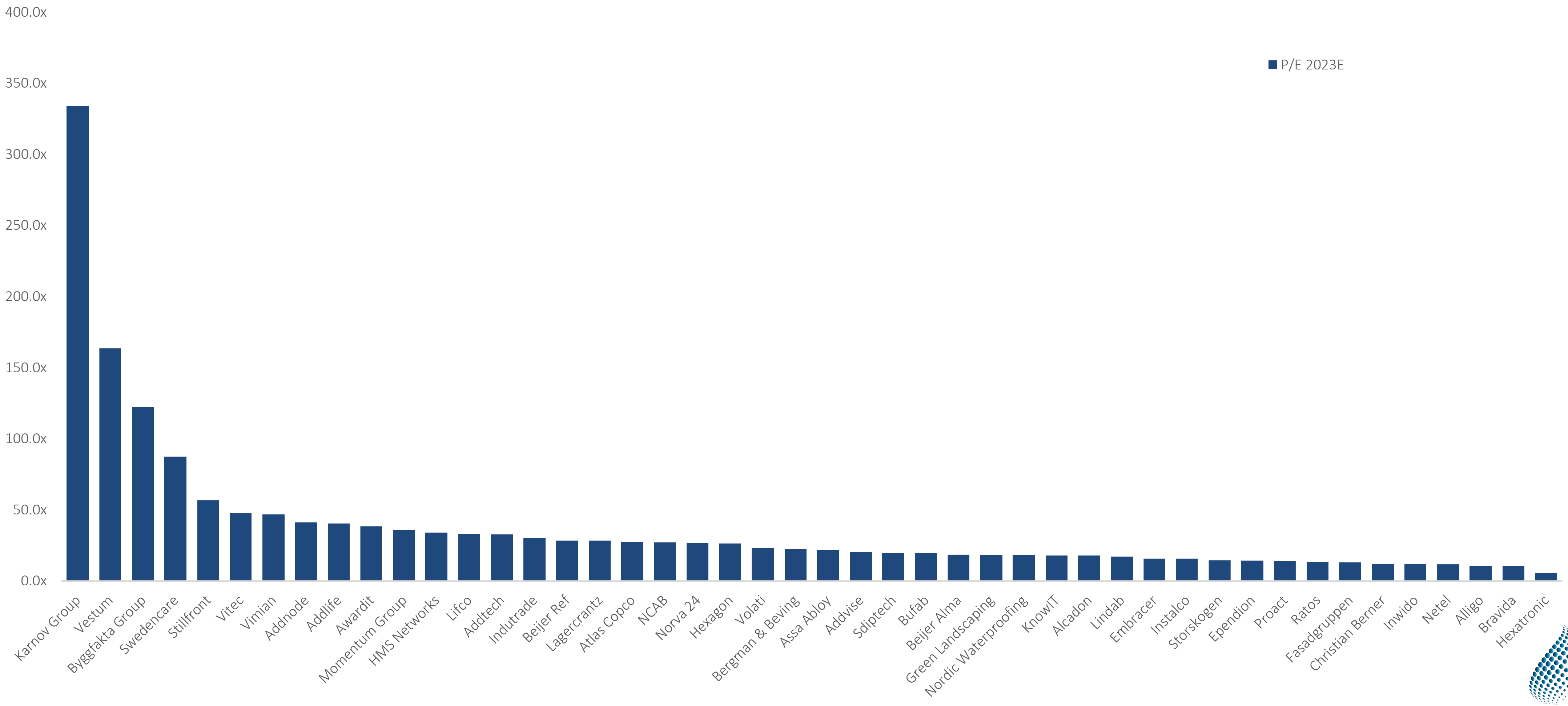
Source: Factset

Current Pricing

Pricing per 2023-12-05

How We Think About Valuation



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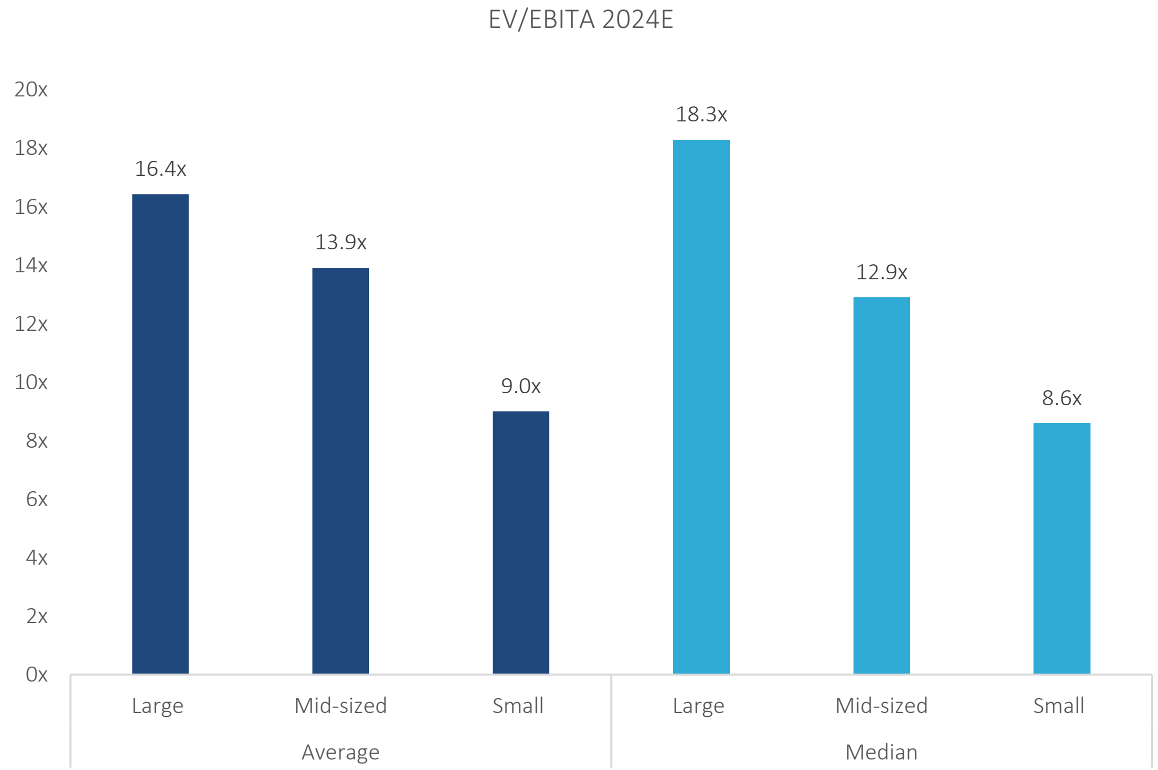
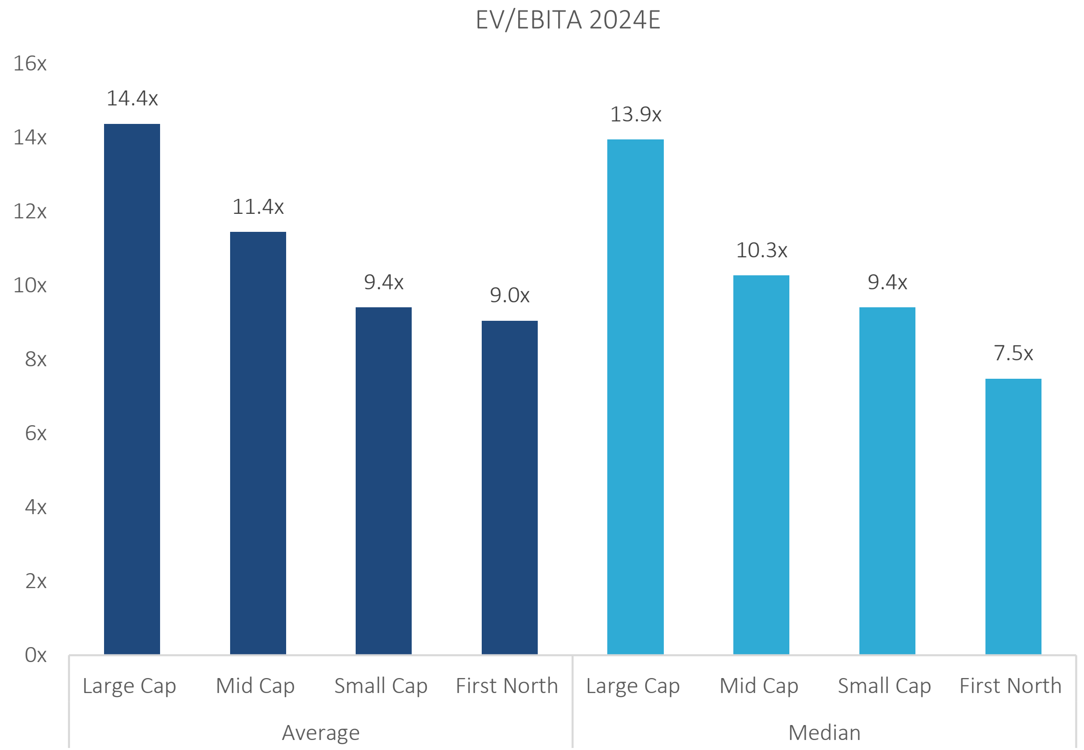
Source: Factset

Market Size & Exchange List vs Pricing

Our findings show that market cap size impact valuations

How We Think About Valuation





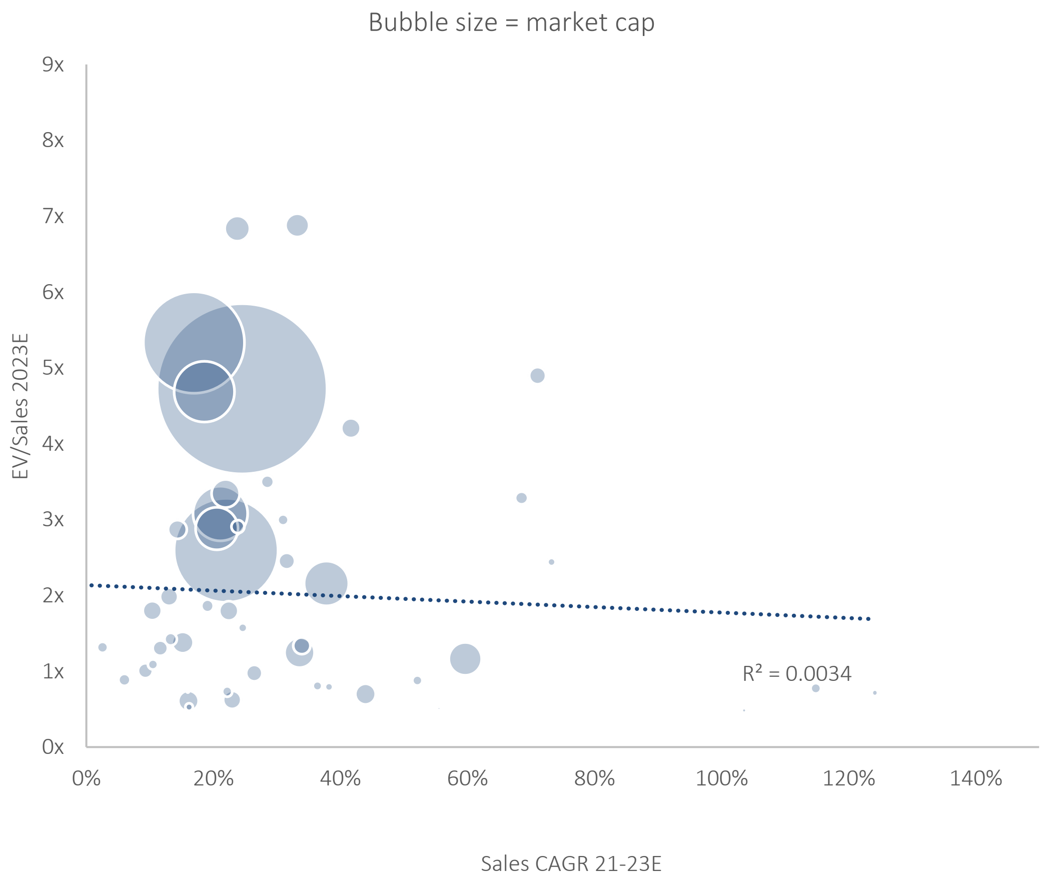
Size of market cap	
Large	> SEK 25bn
Mid-sized	SEK 5bn – SEK 25bn
Small	<SEK 5bn

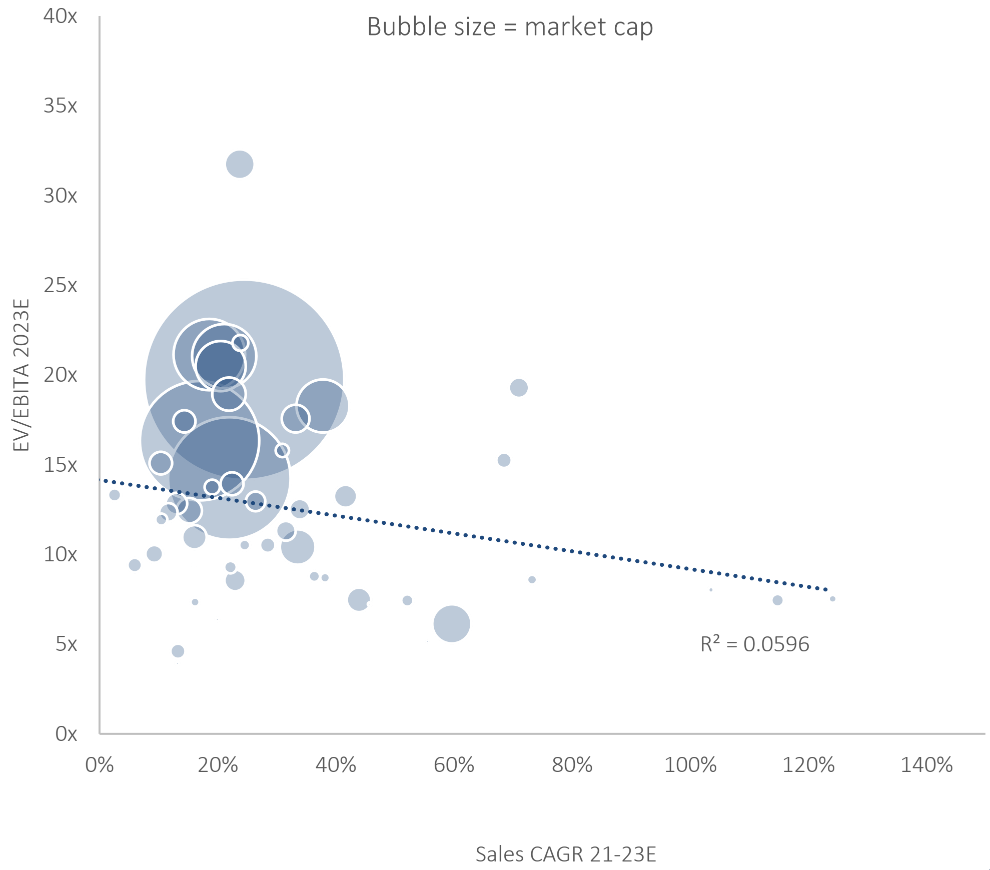
Source: Factset

Durable Growth More Important Than Hyper Growth

In current environment, companies with hyper growth are not valued higher but rather durable growth

How We Think About Valuation



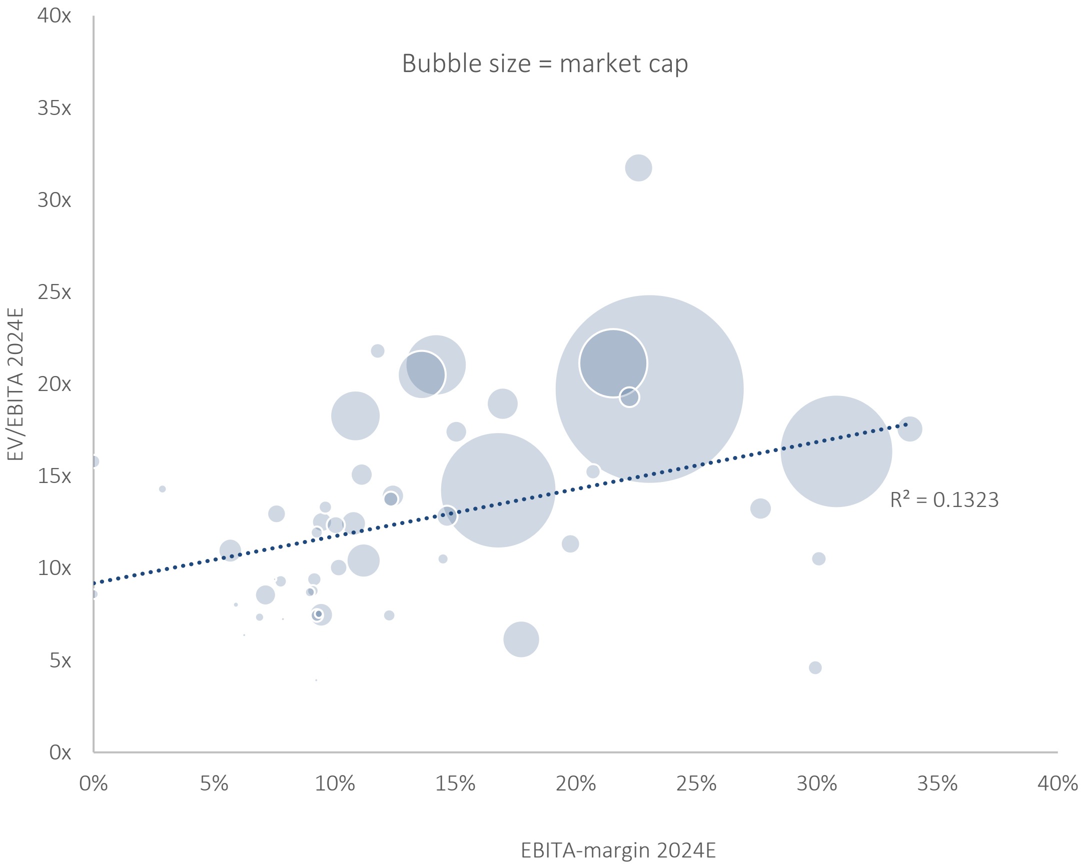


Source: Factset 2023-12-05

Margin vs Pricing

Margins themselves does not necessarily explain valuation levels

How We Think About Valuation



- For our selection of companies, EBITA margin itself does not explain higher EV/EBTIA multiples as we can see (R2=0,13)
- Higher margins can however be important from a cash flow perspective as they provide companies with higher head room to generate cash flow in poor economic times, but high margins also produces cash flow that is important to support to the equity story and M&A agenda.
- Gaming companies with high margin profiles are not necessarily rewarded by the market (which we believe is possibly reflected by the underlying predictability of the business and sales/profitability duration/volatility) – and maybe as well due to the proportion of capitalized own work on the P&L.
- Size matters: Even though EBITA-margin itself does not entail higher valuation multiples, we can from the charts see that larger companies (in terms of sales) with higher EBITA-margins tend have higher multiples. The chart below displays the relation between size and EV/EBITA 2023e (hence support our conclusions).
- What we have noted in recent years is that companies with higher valuation today are valued higher, compared to 2020/2021 where we did not see this effect so clearly.

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Source: Company reports & Factset 2023-12-05

Acquisition Multiples Paid

How We Think About Valuation

Company name	Multiple	2015	2016	2017	2018	2019	2020	2021	2022
Judges Scientific plc	EV/EBITA	6x	4x	7x		4x	7x		7x
Diploma PLC	EV/EBITA	9x	9x	5x	7x	7x	6x	8x	9x
SDI Group plc	EV/EBITA	3x	5x	13x	7x	8x	16x	9x	12x
Addtech AB Class B	EV/EBITA	24x	10x	11x	12x	12x	16x	9x	9x
Lifco AB Class B	EV/EBITA		9x	8x	8x	8x	9x	7x	7x
NIBE Industrier AB Class B	EV/EBIT	13x	16x	15x	15x	17x	17x	31x	17x
Lagercrantz Group AB Class B	EV/EBITA	6x	6x	7x	6x	5x	8x	6x	
Indutrade AB	EV/EBITA	7x	7x	6x	8x	10x	9x	7x	8x
Addnode Group AB Class B	EV/EBITA	10x	18x	15x	11x	13x	19x	9x	
AddLife AB Class B	EV/EBITA	10x	5x	7x	7x	5x	5x	13x	7x
NCAB Group AB	EV/EBITA					5x	7x	8x	16x
Teqnion AB	EV/EBIT			2x	4x	5x	5x	6x	8x
HMS Networks AB	EV/EBIT		8x		22x	n/a	6x	11x	8x
Instalco AB	EV/EBITA	4x	9x	4x	7x	6x	6x	7x	13x
XANO Industri AB Class B	EV/EBITA	4x	7x	8x	4x	n/a	8x	13x	
Beijer Ref AB Class B	EV/EBIT	5x	2x	4x	13x	2x	5x	7x	8x
Bufab AB	EV/EBIT	7x	10x	9x	3x	4x		10x	9x
OEM International AB Class B	EV/EBIT	8x	12x	n/a	4x	6x	14x	2x	5x
Sdiptech AB Class B	EV/EBITA	10x		14x	6x	10x	9x	11x	11x
Fasadgruppen Group AB	EV/EBITA				4x	4x	8x	7x	7x
Average		**8x**	**9x**	**8x**	**8x**	**7x**	**9x**	**9x**	**9x**
Median		**7x**	**8x**	**7x**	**7x**	**6x**	**8x**	**8x**	**8x**

Source: Company press releases. A subset of companies from both Global Compounders and Nordic Compounders where data on all transactions are available

Perspective on Multiples: The Value of Profitable Growth

Return on capital, growth and pricing

How We Think About Valuation

We invest in companies that grow profitably over time. We are often asked what we think is the fair price for exceptional companies that can reinvest cash flow and grow with high incremental returns on capital.

Value is created when a company grows with a return on capital that exceeds its cost of capital. No value is created in companies whose growth is 0%, or in companies that are unable to generate a return on capital above their cost of capital.

Let us look at what you can pay for different companies that are able to deploy incremental capital (growth) at different rates of return equal to or above their cost of capital. The table below shows what premium you could be willing to pay for a company with different returns on capital and growth prospects, compared to a company with no growth opportunities or a company earning exactly its cost of capital which we have set at 9.5% and is "the market" for all practical purposes.

If a company grows with an incremental return on capital equal to its cost of capital (9.5%), the growth is not creating value, as shown in the first column. In this case, you should not be willing to pay a premium to the market multiple. However, if the incremental return on capital is 16% and the company is growing at 5%, you could justify paying 46% more than for a company with no growth. At the extreme, a company with an incremental return on capital of 22% and growth of 8% is worth three times as much as a company with no growth.

What is striking is how valuable growth is when the return on capital is high. An increase in growth from 5% to 8% increases the value of a company with a high return on capital many times over. The CEO of a company generating 18% return on capital should spend his or her time finding growth opportunities instead of trying to further increase profitability (continued)..

		Return on Capital				
		9,5 %	**12 %**	**16 %**	**18 %**	**22 %**
Growth	**5 %**	0 %	24 %	46 %	52 %	64 %
	6 %	0 %	36 %	70 %	81 %	98 %
	8 %	0 %	111 %	217 %	252 %	304 %

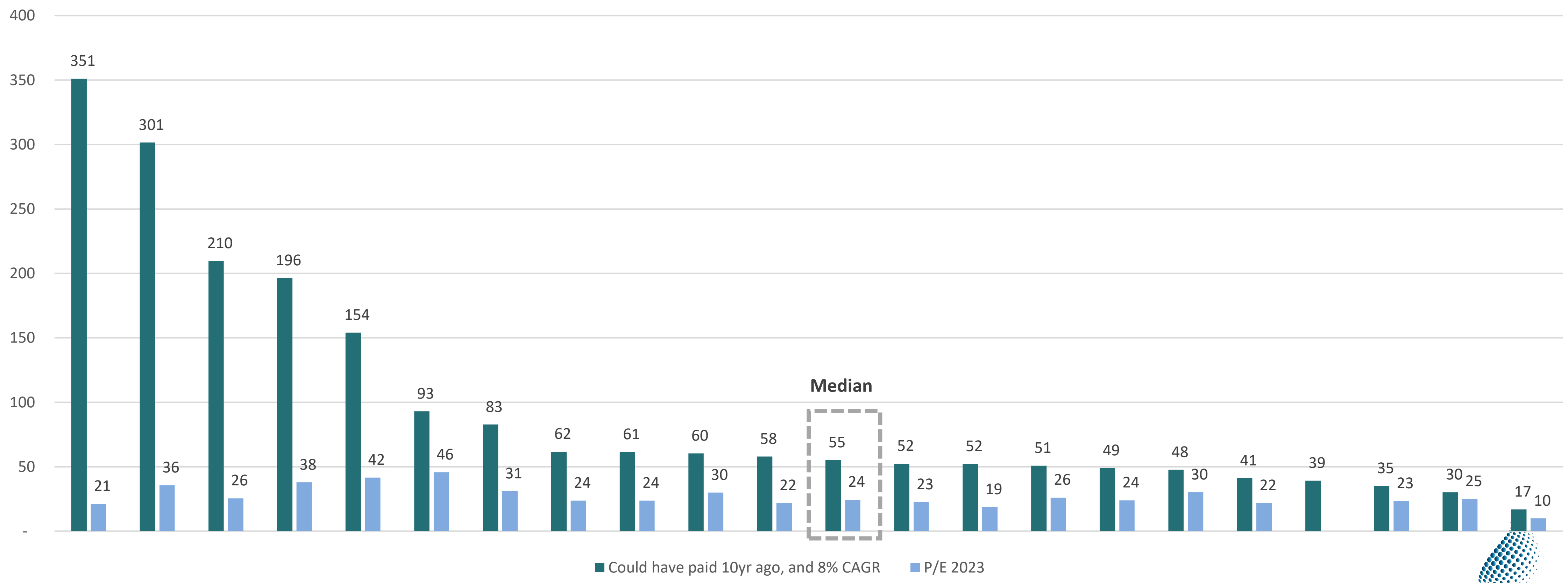
High Growth Rates Have Justified High Pricing Historically

REQ Global Compounders: «P/E justified» and P/E today

How We Think About Valuation

«Justified P/E 10years ago»:

What P/E ratio you could have paid 10 years ago and still got 8% CAGR on the stock until today



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Source: Factset: REQ Global Compounders

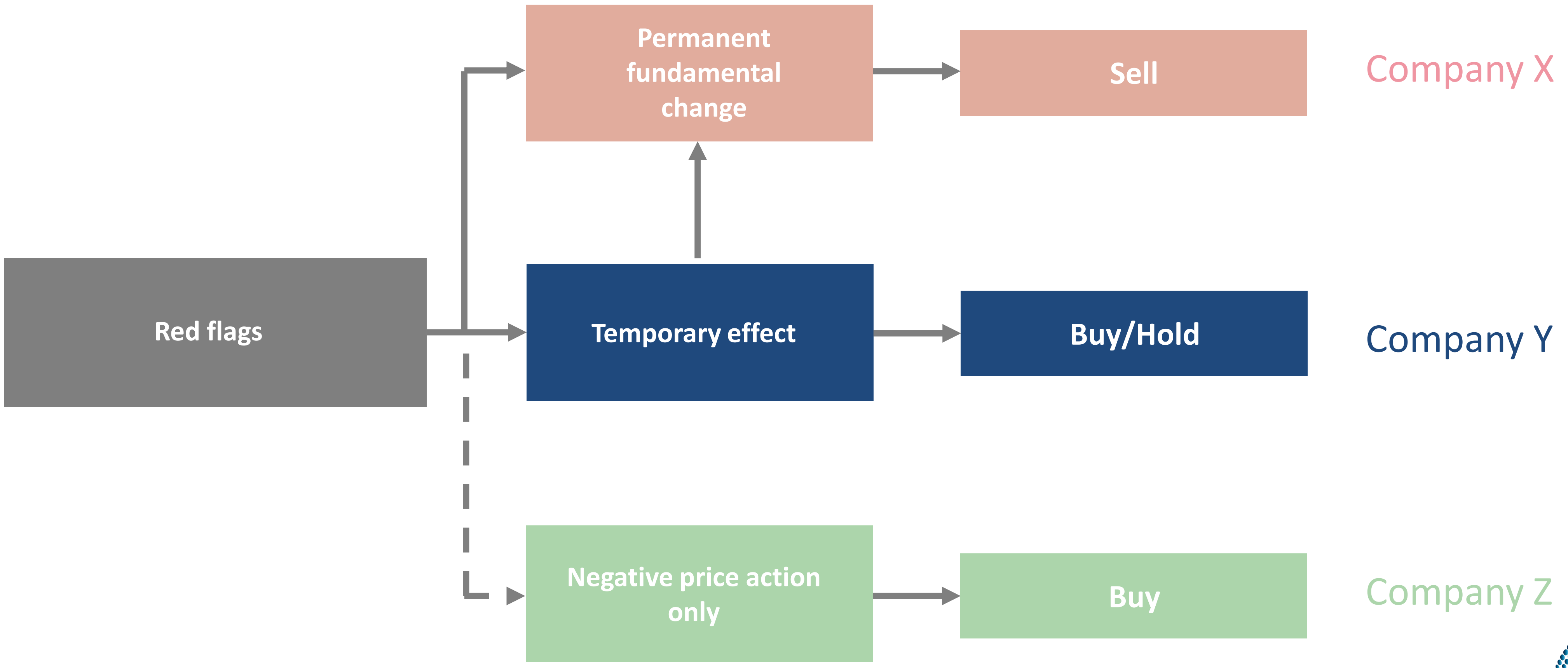
Potential Risk & Red Flags

Common Red Flags

In our framework: Often related to M&A strategy and management

- Change in M&A strategy
- Change in financing
- Cultural change
- Change in communication style
- Change in compounding trajectory

Red Flags: Permanent & Temporary Effects



Potential Red Flags

Potential Risk & Red Flags

When we analyze acquisition-driven compounders, we are selective about the type of companies we invest in. We have identified several characteristics that we believe create value and some that we believe destroy value:

Capital allocation

Acquisition-driven business models, which we generally consider unattractive, make extensive use of equity or debt to fund acquisitions. Some very early-stage companies use equity as a means of financing, but we generally prefer the use of free cash flow. We want growth with high incremental return on capital. Declining return on capital is a sign that the company is paying too much for acquisitions. The companies we own buy companies with high returns on capital. Turnarounds rarely succeed.

Synergies

Our companies generally do not expect synergies from acquisitions. Acquisition decisions are based on stand-alone valuations and should be accretive to earnings without restructuring or synergies. We avoid investing in companies that justify acquisitions by realizing revenue or cost synergies.

Ownership

We prefer family-owned or management-owned companies to those that are purely institutionally owned. The CEO should hold a significant stake in the company to align interests with those of shareholders. Companies that are purely institutionally owned are often run at the sole discretion of management, who in many cases do not even own shares. We avoid investing in such companies because the interests are not aligned.

Management

Management in the companies we are invested in tend not to guide the market on short term earnings expectations. We do not like the earnings expectations game where companies play with sell side analysts and “beat” consensus expectations with a cent every quarter due to earnings (mis)management. We also avoid investing in companies where the CEOs spends too much time attending financial conferences and investor events, as we believe the CEO should prioritize his or her time on running the company and focusing on his employees, customers, and suppliers. If these stakeholders are happy, shareholders will benefit.

Acquisition targets

Since we prefer “programmatic” acquisition-driven compounders the acquisition candidates are small private companies. We do not like companies that undertake few and large deals. Larger deals are more complex to carry out, and the due diligence process and integration takes longer. These deals typically carry higher risk. Larger deals also come with higher valuations. Our companies focus on “active sourcing” of deals. Active is when our companies contact private companies directly themselves. Passive is when companies work mainly through M&A advisors who have a mandate to sell a company. Active sourcing leads to better prices for buyers.

(continued)

Potential Red Flags

[Potential Risk & Red Flags]

Use of M&A consultants

Companies that specialize in programmatic acquisitions develop an in-house skillset for acquisitions. Very few of these companies utilize external advisors when sourcing and acquiring new companies. Not only does this lower transaction costs, but it also speeds up and improves the strategic sourcing of new deals, deal execution, and integration of the acquired companies. We prefer companies that do the financial due diligence of private companies themselves instead of outsourcing the activity to "The Big 4".

One reason to do the sourcing ourselves has of course to do with price levels, but that is not the primary driver. By doing it ourselves, we have control of the whole process, and we can look for whichever company we want instead of waiting for the plat du jour.

We can discuss directly with the entrepreneur about the partnership, and it is much easier to get closer to each other when it is only us. I believe one can look at the process a little bit like a dating ritual. Would one really like a situation where one can only choose a partner based on what a matchmaker sends you and then go on a date with the matchmaker sitting on the side of the table?

Daniel Zhang, CXO Teqnion, acquirers.com interview

Decentralized business models

We prefer investing in acquisition-driven compounders that have decentralized business models. This enables the portfolio companies to focus on running the businesses, rather than on integration processes post acquisition. Within the companies we invest in, senior management delegates responsibilities to local managers who possess an in-depth understanding of the business, customers, and employees of their respective portfolio companies. Embracing decentralized models enhances the agility and responsiveness of our companies to navigate and adapt to change effectively.

We try to focus on what matters. Therefore, we generally do limited due diligence processes and focus on main matters.

We believe it is crucial that our internal champion and the deal team involved are the same persons that will work with the company post-acquisition. For these reasons, we very rarely use external consultants.

Bergman&Beving, company website

Attractive	Unattractive
Free cash flow to fund acquisitions	Heavy use of equity to fund acquisitions
Strong incremental return on capital	Weak incremental return on capital
No synergies expected	Expects synergies
Avoids guidance to the market	Guiding market
Buys demonstrated track records	Buys turnarounds
Prefers to buy private companies	Tend to buy listed companies
Small, frequent tactical acquisitions	Few, large deals
Inhouse M&A team	Frequent use of "M&A consultants"
Founder operators or family owned	Purely institutionally owned

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Potential Red Flags

Which «yellow flags» we have seen in the markets

- Different ways to define/measure organic growth as well as changes in same.
  - Proforma, last years' performance.

- Companies stops disclosing organic growth on quarterly basis.

- Aggressive definitions of net debt & net debt/EBITDA:
  - Using "4 quarters average net debt",
  - adjusting net debt for lease but not EBITDA,
  - not counting for certain type of debts (property holdings),
  - not adjusting EBITDA for non-cash components like revaluation of contingent considerations,
  - using tax-credits to pay down net debt but exclude tax-credits from net debt,
  - adding proforma P&L to net debt/EBITDA calculation but not proforma balance sheet.

- Interest costs under financing activities in the "CF Statement" as well as incorporating interest rates into "delta net debt" in quarterly reports.

- Aggressive financial targets as well as continuously increasing targets.

- Proforma figures more commonly used.

- Increasing P&L adjustments for all kinds of costs.

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Potential Red Flags

Which «yellow flags» we have seen in the markets

- Aggressive accounting.
- Large insider selling in conjunction with capital raises.
- Companies press-releasing several acquisitions at the same time (and repeatedly).
- CEOs' leaving shortly after very large acquisitions.
- Managements / large owners receiving bonuses based on acquired volume or on sales / ARR growth.
- Earn-out structures that do not seem to benefit shareholders (example of 1x EBITDA p.a. for 5-7 years.)
- Press-releasing LOI's (in some cases before share issues and in other cases LOI's were withdrawn).
- Press releases with no substantial shareholder information.
- Low transparency in M&A in both press releases but also in PPA's.
- Low transparency around contingent considerations/earn-outs.
- Substantially increased capitalisation of own work in relative terms (hence boosting EPS).

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Shareholder Communication

Some thoughts around shareholder communication

Potential Risk & Red Flags

The best shareholder letters should give you, the investor, a good insight into the company's culture. Unfortunately, most shareholder letters do not provide insight into the company or management's thinking. But the best shareholder letters share many similar characteristics. We will try to summarize the most interesting ones below which is a summary of both our own experiences as investors and some takeaways from a great book on the subject; "Dear Shareholder" by Lawrence A. Cunningham.

Trust

The best shareholder letters instill confidence. They are not written by the investor relations department, but by the CEO. The best shareholder letters establish management accountability. The best CEOs talk openly about underperforming investments and failed product launches. They seem almost proud to describe failures. They are personal. They do not try to cover up challenges. They are honest and convey a message based on trust.

One of the analysts who covers Constellation recently changed his perennial "sell" recommendation to a "buy". We lost one of our few critics. Analysts who worry about the quality of earnings and reversion to the mean and the impossibility of trees growing to the sky are valuable.

CEO Mark Leonard, Constellation Software, Shareholder Letter 2017

Culture

The best shareholder letters provide a deep insight into a company's culture. Over time, employees self-select into or out of a culture. So, it is with investors. Companies often get the shareholders they deserve. A company that takes a long-term view and does not focus on quarterly numbers will attract investors who value those aspects. If the company spends a lot of time talking about short-term results and quarterly numbers, it will attract speculators. Long-term communication attracts long-term investors, which is a great competitive advantage for any company.

Conservatism and frugality

The best shareholder letters convey a story of conservatism, but also of rationality and boldness. The best shareholder letters convey a culture of frugality. The message sends a strong signal to the company about how best to spend its hard-earned money. CEOs themselves lead by example and do not spend money on expensive hotels or airline tickets in front of the curtain. Employees are adapting to the frugal mentality.

Ownership and compensation

The best shareholder letters are written by CEOs who act like owners. They treat the company as if it were their own. These companies often have a dual stock structure where the original founders or CEO control the voting stock of the company. These companies are big fans of internal stock ownership among all employees and often supplement employee 401(k) plans with company stock. In cases where the company grants stock to employees, the vesting period lasts for many years.

(continued)

Shareholder Communication

Some thoughts around shareholder communication

Potential Risk & Red Flags

Long termism
The best shareholder letters provide a long-term vision. The CEOs who write these letters do not provide earnings forecasts and use the shareholder letter as their primary medium to communicate information about the company. Many of these CEOs aim for low share turnover, which is a sign that many long-term shareholders are on board. They use the shareholder letter to explain the company's strategy and often take the time to explain the company's history and how it got to where it is today. The best letters address the importance of long-term shareholders.

Our approach to ownership is perpetual.

Per Waldemarson, CEO Lifco, 2020 Annual Report

Principles
The best shareholder letters contain ideas that relate to the business and management principles on which the company is built. These principles serve both to build the company's culture and to manage investor expectations. Management principles are often about how people in the company treat each other, and they focus on processes rather than goals. These CEOs know what they are influencing. By making the culture process-oriented, they increase the chances of achieving their goals.

Succession planning
The best shareholder letters clearly set out the company's succession plan. Therefore, there are no surprises for employees or shareholders when the CEO decides to leave the company. Often, internal candidates are promoted to CEO, which reduces the risk of changes in corporate culture and strategy.

Capital allocation
The best shareholder letters emphasize the important aspect of capital allocation. The letters explain how the company will allocate its capital and what its priorities will be in terms of dividends, share buybacks, investments, acquisitions, and leverage. Some of the CEOs have very clear ideas about dividends and share buybacks. Most CEOs who write good shareholder letters are aware of the need to reinvest in the company at high returns on capital to create shareholder value.

Performance measurement
The best shareholder letters describe how shareholders should evaluate the company's performance. The best letters include different types of performance metrics, but the common denominator is some type of economic value creation (EVA). The performance metrics that the CEO presents do not alter from year to year. The CEO does not cherry-pick the metrics based on what looks good in the current year. The best letters often explain and argue why the metric is used.

Accounting
The best shareholder letters frequently discuss accounting and the limitations of accounting in measuring true economic profit. They explain to investors the subjective nature of accounting and its drawbacks. These letters take time to explain to investors what they should look for in financial statements.

(continued)

Shareholder Communication

Some thoughts around shareholder communication

Potential Risk & Red Flags

We won't 'smooth' quarterly or annual results: If earnings figures are lumpy when they reach headquarters, they will be lumpy when they reach you.

Larry Page and Sergey Brin in their first investor letter on Google's IPO

Conclusion

The best shareholder letters stand out from the rest. These letters are based on trust and go to great lengths to attract the right shareholders. They have a long-term focus and often cover the same topics such as ownership, principles, capital allocation, and how best to value the company. When you invest in companies that can clearly articulate the fundamentals of their corporate culture, you increase your chances of excellent long-term returns.

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Investment Process

Assessing Durability and Returns

Field Research Insights

Durability filter #1	Durability filter #2	Compounding
Business resilience	People and capital allocation	Expected returns
Seven categories, each comprising both qualitative and quantitative checklist items	Six categories, each comprising both qualitative and quantitative checklist items	Assessing compounding trajectory: reinvestment rates, returns on incremental capital, and duration

Score weighted for durability and IRR

Informs our discussions around:

- Initial weighting and underwriting
- Re-underwriting
- Evaluation of changes in thesis

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Input from our discussions with sellers

"I like small steps"

"CEO buddies"

"Monthly reporting"

"Documentation is good"

«Price by far not the most important aspect»

«Current leadership needs conviction on new owner»

«The acquirer promised that employees would keep their jobs»

«Also approached by PE-funds but no cultural match»

Examples from Field Research Insights

Insights from talking to entrepreneurs who sell

Imagine you founded and built a business through a lot of hard work and effort over the last 20 years. At some point, you may seek to offload some of the responsibility for various reasons.

In the following, we share some perspectives of entrepreneurs who have decided to sell their businesses and their life's work to the acquisition-driven compounders within our portfolios. We enjoy talking to these sellers as we gain new cultural insights*. Behind the critical decision to sell are several considerations for the founder.

"CEO-buddies"

We recently spoke to a founder who decided to sell to one of our acquisition-driven compounders last year, who started his specialty tool business more than 20 years ago. After selling his company two years ago, he continues to run it. It was a personal match with the buyer. Both parties "*liked small steps*." The founder told us that he appreciates the fact that he now has the opportunity to talk and share ideas with other company CEOs in the group, even though the companies in the group are in different sectors and niches. He referred to the other company CEOs as "*CEO buddies*" because they share experiences, challenges, and ways to improve. After the transaction, the founder continued to run the company without interference from headquarters. He told us that the only change is "monthly reporting" to headquarters. "Documentation is good," the founder said, as it "*leads to more reflection.*"

Price is not the most important aspect

Another founder we recently spoke to decided to give all the responsibility of the sell decision to the current management team, which owned 20% of the company. The management team needed to determine whom to work with on the ownership side. The company contacted an accounting firm and asked for a valuation of the company and advice on whom to talk to regarding an acquisition. The company was introduced to the buyer through the accounting firm, and there was a cultural fit. According to the founder, the price was far from the most important criterion in the decision-making process.

Caring for employees

A third founder we spoke with recently had built a profitable business over many years and had been approached by one of our portfolio companies many years ago. Private equity firms were also knocking on his door at the same time. He said (loosely translated) that "*the deal offered by private equity would have been better for me financially, but I had no control over what would happen to my employees. They had built the company with me, and I could not bring myself to let them go into an unknown future*." The founder said he did not want to "*dramatically scale the business over the next five years and sell,*" which was proposed by a couple of buyers.

(continued)

Examples from Field Research Insights

Insights from talking to entrepreneurs who sell

Field Research Insights

The above insights from founders who chose to sell part of their life's work to our acquisition-driven compounders point in the same direction. When you build a business over decades, you develop an emotional attachment. Price is important, but soft factors and cultural fit are critical. The primary motivation of these founders is not to "cash in" and get out on the golf course.

Capitalism does not always work by the textbook, which we believe benefits many of our portfolio companies in the acquisition process since they have an eternal perspective on acquired companies. The companies we own have a founder's mentality that enables them to negotiate and close attractive acquisitions for us as shareholders. As public investors, we enjoy the value creation in this process.

*We have chosen to keep the company name and the founders who sold anonymous.

Investment Process and Analysis

What kind of analysis do we do?

Field Research Insights

- One important part of our investment process is to look how group companies (subsidiaries) develop pre-acquisition but most importantly post-acquisition.

- We analyse the development in terms of sales, profits and margin.

- Also, we look at the CEO changes happening in the subsidiaries, trying to understand the culture and current state in the organizations.

- Another important process in our analysis is talking to people involved earlier or currently in the companies we own; ex-CEO's, group managers, subsidiary CEOs, previous sellers etc.

On the coming slides, we will present some of the research/analysis we do internally.

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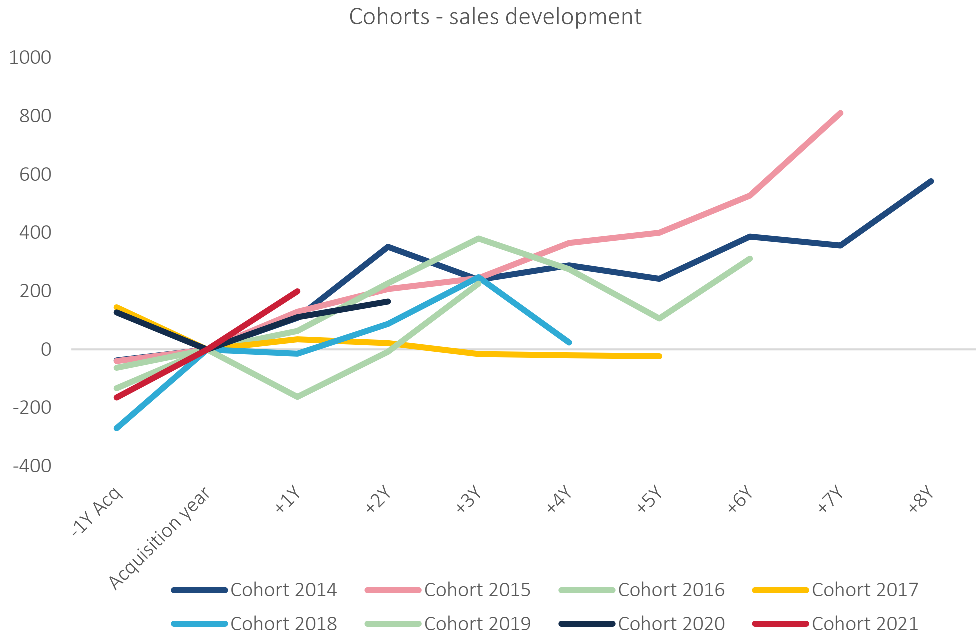
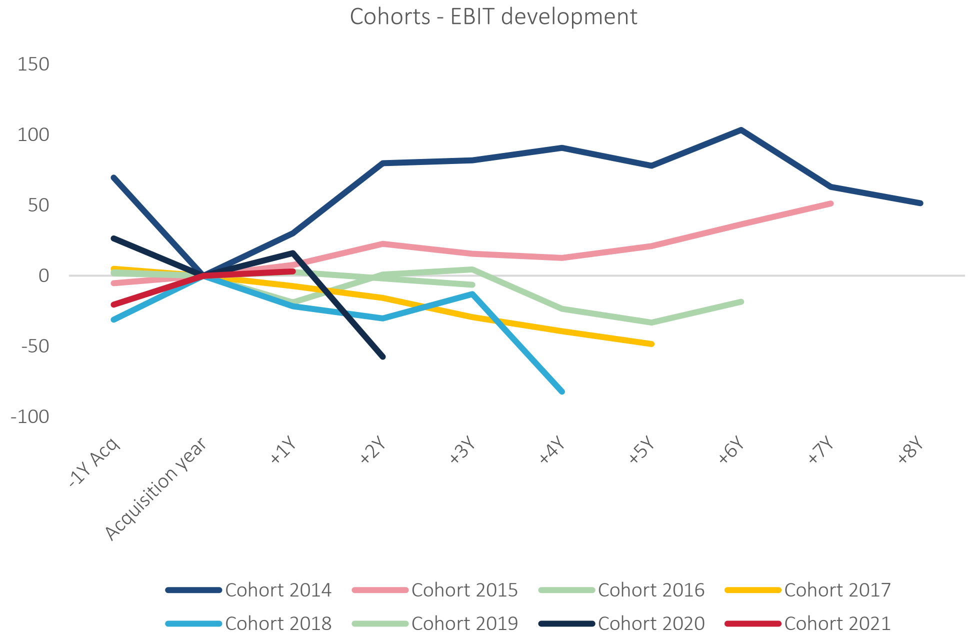
Case Study: Process and Analysis

Analysis of company X

Field Research Insights

- Company X is a Nordic acquisition-driven compounder with >SEK 10bn in sales and margin of around 7.5%.
- It has grown quickly in recent years and we did a deep dive into its subsidiaries to try to understand the real value creation happening within the group and its decentralised setup.
- For company X, we have studied the development of 120 subsidiaries, both pre-acquisition and post-acquisition.
- Primarily, we have looked at the development of sales, EBIT and margins.
- Our findings show that subsidiaries of Company X increase sales post-acquisition but not EBIT.
- Out of eight cohorts from 2014-2021, only two have increased EBIT in absolute numbers.





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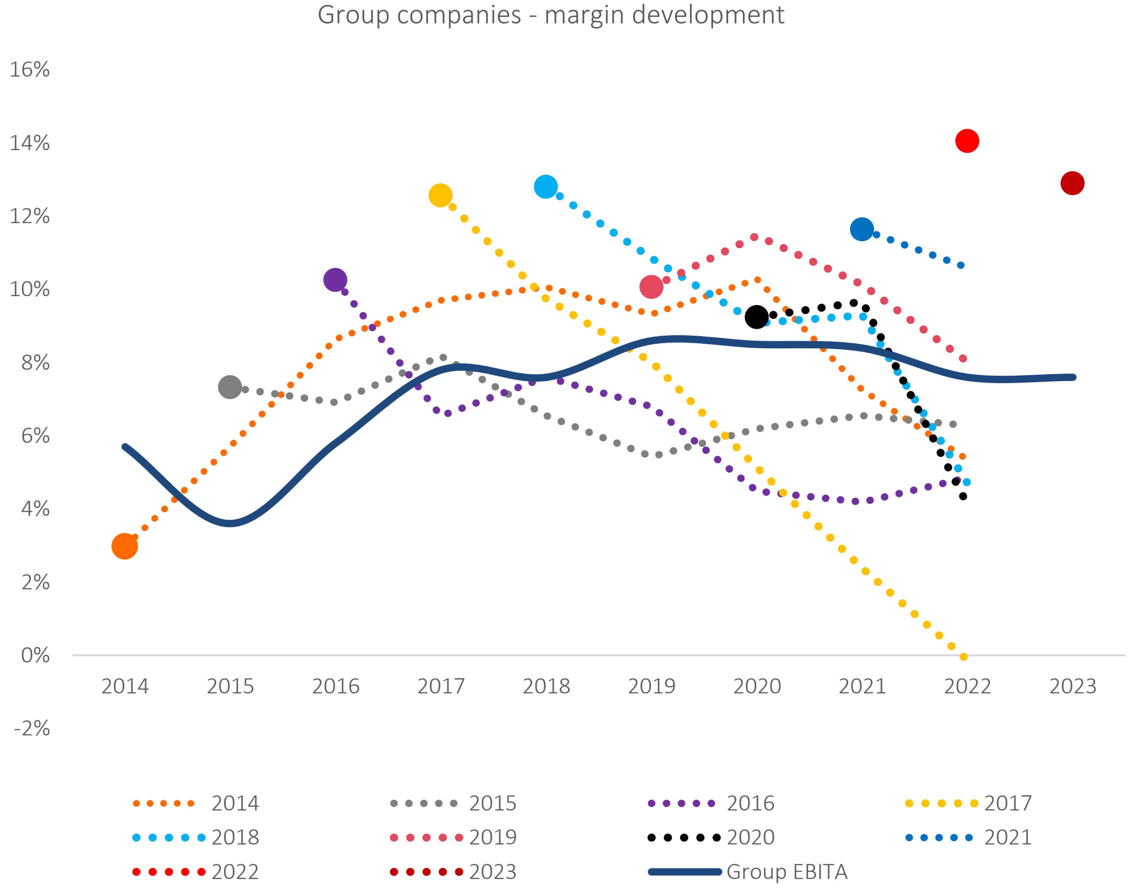
Source: Slides are based upon company data but only used for illustrative purposes as we do not disclose the company name

Case Study: Process and Analysis

Analysis of company X

Field Research Insights

- As we stated on the previous slide, the subsidiaries of Company X tend to increase sales in the acquired companies post-acquisition, but not margins.
- On the chart to the right, we display the margin development of 120 subsidiaries (>90% of the companies owned).
- Our findings shows us that margins post-acquisition for most of the cohorts tend to decrease.
- Also, we can also clearly see that the company each year acquire companies with higher EBIT-margins than the group margin, keeping the overall group margin stable.



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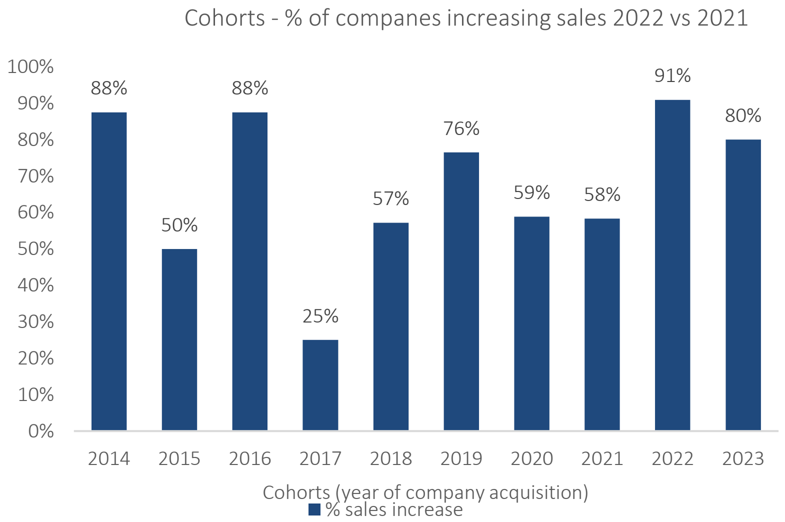
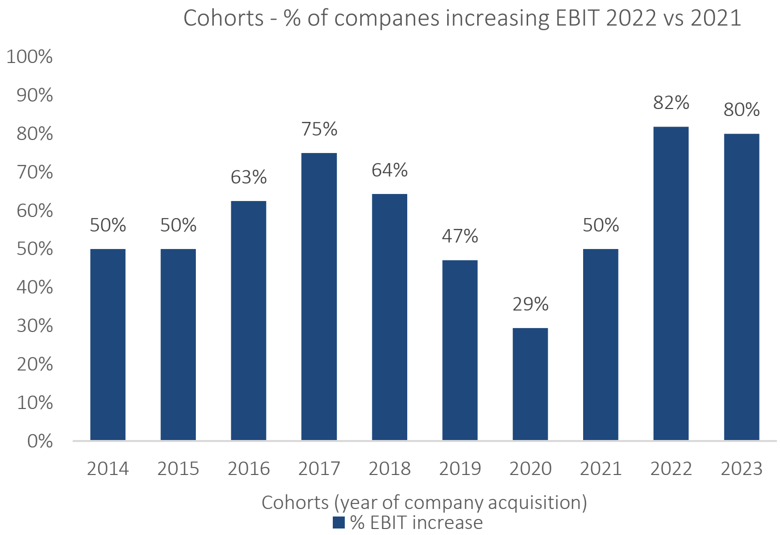
Case Study: Process and Analysis

Analysis of company X

Field Research Insights

- We can through our extensive analysis on how different cohorts (year of acquisition) develop in 2022 compared to 2021.
- Our findings show that in 2022, there is a big variation between the cohorts in terms of increasing sales and margins.
- While most of the companies within the cohorts display increasing sales in 2022, many them do not increase EBIT.





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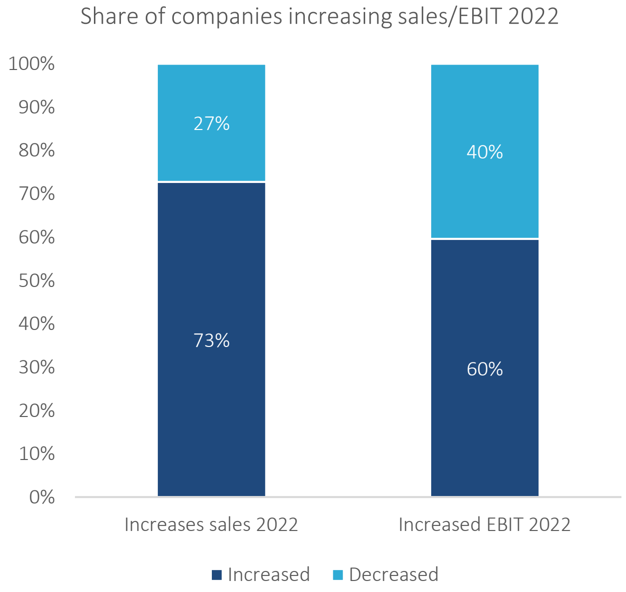
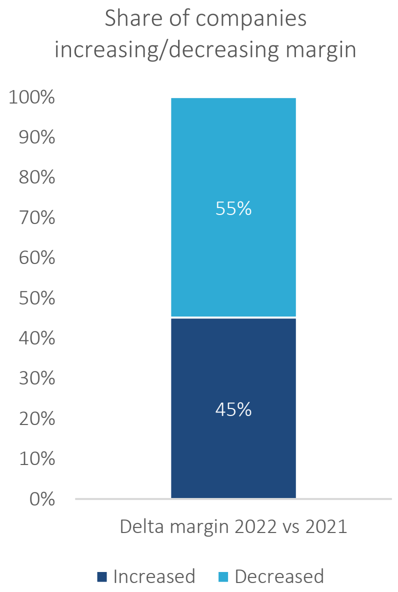
Case Study: Process and Analysis

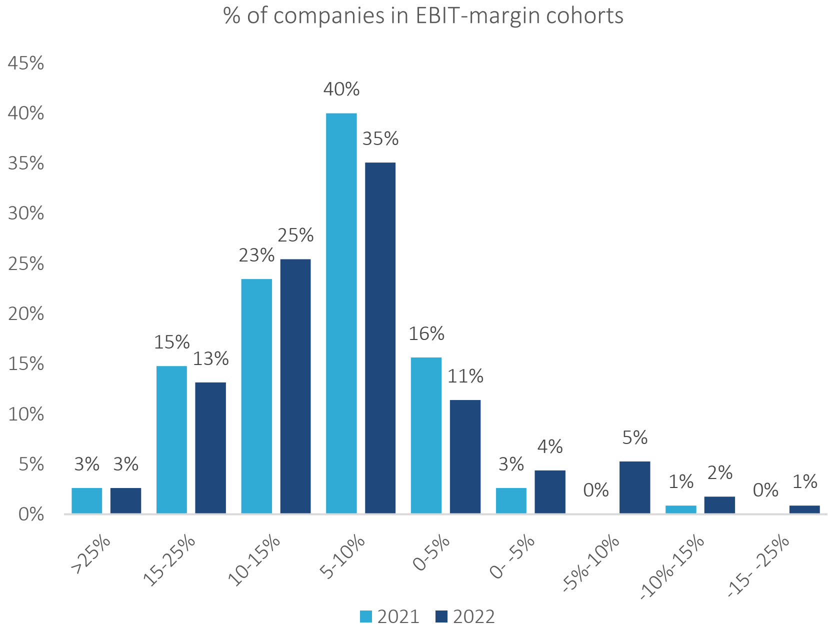
Analysis of company X

Field Research Insights

- Summing up the previous slide, we show that in total, 73% of the companies increased sales in 2022, whereas 60% increased EBIT.
- That sumps up to 45% of the companies increasing margins while 55% display decreasing margins.







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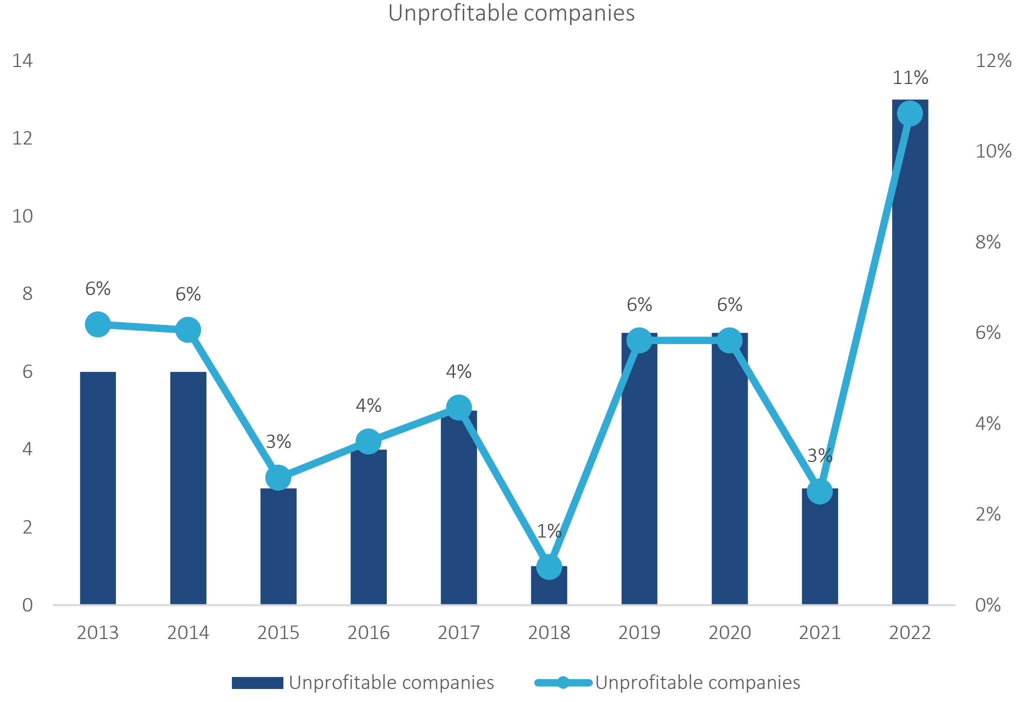
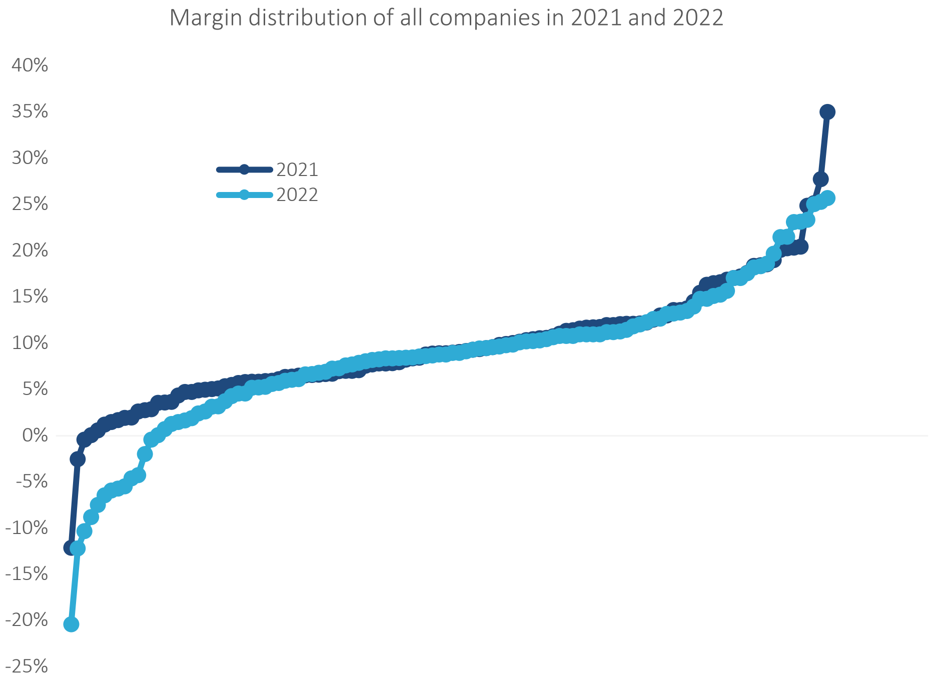
Case Study: Process and Analysis

Analysis of company X

Field Research Insights

- Through our analysis, we can also see that how many of the companies are unprofitable each year (including the period prior to Company X's ownership.
- We find that 11%, equivalent to 13 companies were unprofitable in 2022, compared to only 3% in 2021.





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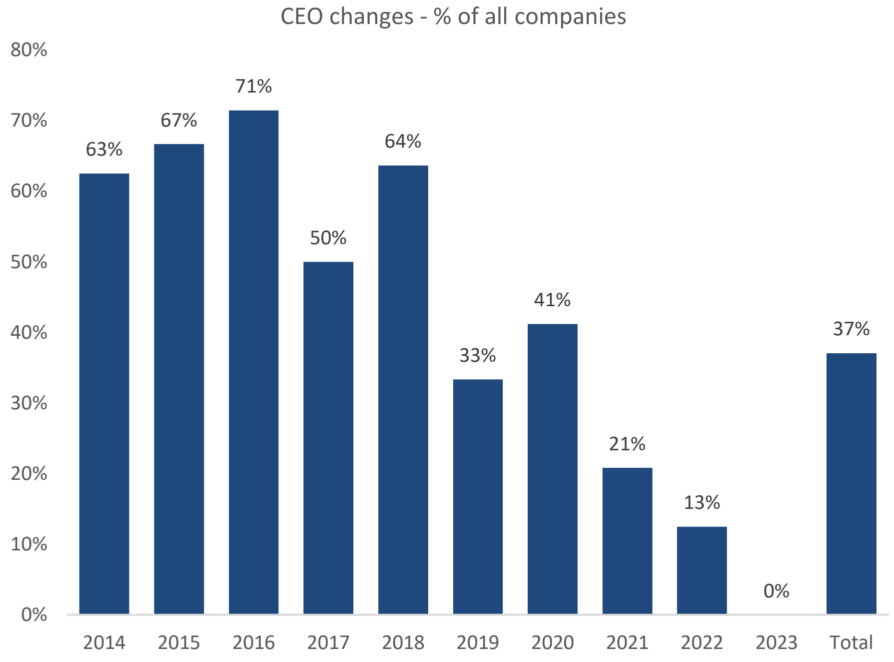
Case Study: Process and Analysis

Analysis of company X

Field Research Insights

- In addition to analysing underlying subsidiaries' financial performance, we also look at the CEO changes in the underlying companies.
- As CEO changes does not need to be a bad thing necessarily, we like to discuss this with our companies to get a better understanding about why subsidiary CEOs are leaving.
- We also compare different companies to each other (where we have access to data).



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Case Study: Process and Analysis

Analysis of company X

Field Research Insights

Acquisition year	Company		2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
		Sales							89.9	81.2	123.9	158.2	147.7	161.5	226.3	203.0	220.8	230.8	200.5	230.4	256.2
2014	Subsidiary 1	EBIT							2.7	1.9	6.3	12.6	6.4	13.0	23.4	19.3	20.3	13.9	22.7	27.7	29.1
		EBIT %							**3.0%**	**2.3%**	**5.1%**	**8.0%**	**4.3%**	**8.0%**	**10.3%**	**9.5%**	**9.2%**	**6.0%**	**11.3%**	**12.0%**	**11.4%**
		Sales	15.0	15.4	17.8	18.6	20.7	23.4	23.0	24.6	23.4	25.7	29.1	27.1	30.7	32.2	35.0	39.2	40.0	43.6	45.2
2015	Subsidiary 2	EBIT	2.4	2.4	2.7	3.4	3.5	5.2	5.0	4.6	5.0	4.7	5.2	5.3	6.8	7.1	6.8	7.2	9.6	9.8	10.8
		EBIT %	**16.0%**	**15.8%**	**15.1%**	**18.2%**	**16.8%**	**22.4%**	**21.5%**	**18.8%**	**21.6%**	**18.4%**	**18.0%**	**19.7%**	**22.0%**	**22.1%**	**19.4%**	**18.3%**	**24.0%**	**22.5%**	**23.9%**
		Sales	33.7	40.2	44.6	52.8	47.5	46.3	51.8	58.4	55.2	55.3	66.6	62.7	75.2	83.5	89.3	101.1	97.9	121.7	152.8
2016	Subsidiary 3	EBIT	1.9	2.8	3.5	5.4	4.3	3.8	3.0	4.6	4.2	4.1	5.8	6.7	7.3	7.0	9.2	8.0	8.4	15.5	21.0
		EBIT %	**5.5%**	**6.9%**	**7.9%**	**10.2%**	**9.1%**	**8.2%**	**5.8%**	**8.0%**	**7.7%**	**7.4%**	**8.7%**	**10.6%**	**9.7%**	**8.4%**	**10.3%**	**8.0%**	**8.5%**	**12.8%**	**13.7%**
		Sales		5.0	5.4	5.3	6.7	9.5	13.7	17.7	20.9	25.9	28.1	30.3	32.6	36.7	37.5	36.4	30.9	32.9	30.1
2016	Subsidiary 4	EBIT		0.4	0.5	0.8	0.7	1.6	2.9	4.1	4.1	7.1	6.9	6.3	6.4	3.9	1.8	-0.4	-0.4	1.3	0.3
		EBIT %		**8.3%**	**8.4%**	**15.2%**	**10.9%**	**17.2%**	**20.9%**	**23.3%**	**19.5%**	**27.4%**	**24.4%**	**20.8%**	**19.6%**	**10.6%**	**4.8%**	**-1.1%**	**-1.2%**	**4.0%**	**0.9%**
		Sales	30.4	28.4	29.3	30.6	43.1	43.8	41.3	42.1	43.1	42.9	45.1	46.0	44.3	35.4	49.8	48.8	59.5	69.2	79.0
2017	Subsidiary 5	EBIT	5.6	3.9	5.5	4.5	11.9	9.4	7.8	8.7	10.3	6.6	4.6	3.9	6.5	2.8	5.2	4.1	8.5	10.8	9.1
		EBIT %	**18.6%**	**13.7%**	**18.9%**	**14.7%**	**27.5%**	**21.5%**	**18.9%**	**20.7%**	**23.8%**	**15.3%**	**10.2%**	**8.4%**	**14.7%**	**7.9%**	**10.4%**	**8.4%**	**14.3%**	**15.6%**	**11.5%**
		Sales													25.8	27.3	30.0	28.7	26.2	31.2	33.7
2017	Subsidiary 6	EBIT													5.3	3.2	3.5	3.4	1.5	3.1	3.9
		EBIT %													**20.5%**	**11.7%**	**11.7%**	**11.8%**	**5.7%**	**9.9%**	**11.6%**
		Sales	17.5	22.0	23.8	26.0	28.3	30.9	31.3	31.6	35.5	36.6	40.6	37.9	37.5	43.4	42.3	35.6	28.6	34.5	42.4
2017	Subsidiary 7	EBIT	2.4	2.3	2.6	1.4	2.3	3.1	2.6	0.9	1.4	1.4	3.0	1.8	2.5	4.2	1.7	-1.6	-0.3	1.6	2.3
		EBIT %	**13.6%**	**10.7%**	**11.0%**	**5.4%**	**8.1%**	**9.9%**	**8.2%**	**2.9%**	**4.1%**	**3.8%**	**7.4%**	**4.8%**	**6.8%**	**9.7%**	**4.1%**	**-4.6%**	**-1.1%**	**4.6%**	**5.4%**
		Sales			60.3	50.0	66.8	70.6	59.6	56.5	40.5	55.3	60.1	66.4	87.0	101.6	123.3	122.6	94.7	133.5	96.8
2017	Subsidiary 8	EBIT			0.2	1.6	2.3	3.8	3.7	2.3	-0.6	0.6	-1.4	2.4	6.6	8.6	11.6	7.6	4.8	6.2	5.5
		EBIT %			**0.3%**	**3.3%**	**3.4%**	**5.4%**	**6.1%**	**4.1%**	**-1.4%**	**1.1%**	**-2.4%**	**3.6%**	**7.5%**	**8.5%**	**9.4%**	**6.2%**	**5.0%**	**4.7%**	**5.7%**
		Sales	11.0	13.1	14.9	18.7	20.8	20.9	21.8	23.1	24.9	26.4	28.2	29.8	33.7	36.8	38.4	38.4	42.5	38.7	41.4
2018	Subsidiary 9	EBIT	1.2	1.4	1.4	2.5	2.9	2.5	2.3	2.7	2.4	2.3	2.9	-2.6	2.7	2.8	2.0	0.8	0.7	-1.4	-1.6
		EBIT %	**10.6%**	**10.9%**	**9.5%**	**13.5%**	**14.2%**	**11.8%**	**10.6%**	**11.8%**	**9.7%**	**8.8%**	**10.1%**	**-8.8%**	**8.0%**	**7.6%**	**5.2%**	**2.1%**	**1.7%**	**-3.7%**	**-3.8%**
		Sales	26.7	26.6	26.0	30.3	26.1	30.3	26.2	26.7	29.8	30.6	35.3	44.4	47.8	50.5	51.2	55.8	69.6	91.1	80.5
2018	Subsidiary 10	EBIT	-1.0	-1.2	0.9	3.2	2.7	3.0	2.0	2.1	3.2	1.9	6.3	9.1	10.0	10.2	7.7	8.1	13.3	22.1	15.1
		EBIT %	**-3.6%**	**-4.6%**	**3.4%**	**10.6%**	**10.3%**	**9.8%**	**7.6%**	**7.7%**	**10.7%**	**6.1%**	**17.9%**	**20.6%**	**20.9%**	**20.3%**	**15.1%**	**14.6%**	**19.1%**	**24.3%**	**18.7%**
		Sales	25.8	33.8	38.2	46.5	45.5	56.8	47.8	62.0	61.5	67.5	76.4	69.2	75.0	42.9	39.5	40.8	47.7	48.2	50.2
2018	Subsidiary 11	EBIT	4.4	5.5	6.0	12.1	5.8	5.2	12.1	20.7	14.6	14.0	15.6	15.5	17.2	1.4	3.8	3.4	5.4	3.4	2.6
		EBIT %	**17.2%**	**16.4%**	**15.6%**	**26.1%**	**12.8%**	**9.2%**	**25.4%**	**33.4%**	**23.8%**	**20.8%**	**20.5%**	**22.3%**	**22.9%**	**3.3%**	**9.7%**	**8.4%**	**11.4%**	**7.1%**	**5.2%**
		Sales			41.0	47.1	51.7	43.8	52.9	60.3	57.6	58.1	63.9	69.9	68.1	70.4	67.1	60.3	39.4	47.3	61.7
2019	Subsidiary 12	EBIT			4.8	4.7	6.0	1.8	5.7	6.5	5.6	5.3	6.1	8.2	5.2	6.3	5.0	2.9	-1.4	2.1	6.7
		EBIT %			**11.7%**	**9.9%**	**11.6%**	**4.0%**	**10.8%**	**10.8%**	**9.8%**	**9.1%**	**9.5%**	**11.8%**	**7.7%**	**8.9%**	**7.5%**	**4.9%**	**-3.6%**	**4.4%**	**10.8%**
		Sales	16.7	21.5	46.1	31.2	27.8	24.8	34.9	34.4	23.2	24.8	24.9	24.6	29.8	29.2	29.2	26.3	25.1	27.8	30.6
2019	Subsidiary 13	EBIT	3.1	4.7	6.9	6.3	4.1	11.1	8.8	11.6	6.5	7.5	7.8	7.6	9.2	10.4	11.7	10.5	9.8	9.9	7.5
		EBIT %	**18.5%**	**22.0%**	**14.9%**	**20.2%**	**14.9%**	**44.5%**	**25.2%**	**33.7%**	**27.9%**	**30.0%**	**31.2%**	**31.0%**	**30.9%**	**35.8%**	**39.9%**	**40.1%**	**38.9%**	**35.7%**	**24.5%**
		Sales							4.4	5.8	6.2	7.6	8.2	8.7	10.8	11.9	15.6	17.0	21.5	23.9	26.7
2019	Subsidiary 14	EBIT							0.8	1.5	1.5	1.9	1.8	2.6	4.3	4.3	6.3	6.2	7.4	8.1	8.0
		EBIT %							**18.2%**	**26.1%**	**24.6%**	**25.0%**	**21.9%**	**29.4%**	**39.6%**	**36.0%**	**40.7%**	**36.6%**	**34.5%**	**33.7%**	**30.1%**
		Sales	15.9	20.7	20.7	20.8	21.3	19.1	20.4	22.4	21.9	22.3	25.0	29.1	32.1	33.4	34.3	33.6	32.7	39.9	42.6
2019	Subsidiary 15	EBIT	1.8	4.0	2.9	3.0	3.0	4.2	2.8	3.5	2.3	2.4	3.0	4.5	4.7	5.8	5.7	5.1	7.3	6.1	5.6
		EBIT %	**11.4%**	**19.4%**	**13.8%**	**14.3%**	**14.2%**	**22.1%**	**13.7%**	**15.6%**	**10.7%**	**10.9%**	**12.2%**	**15.3%**	**14.7%**	**17.3%**	**16.6%**	**15.2%**	**22.3%**	**15.3%**	**13.1%**
		Sales	27.6	30.5	29.1	34.2	40.4	30.0	34.3	51.0	58.8	64.6	63.1	70.2	74.6	100.0	124.0	148.3	134.6	175.6	227.5
2021	Subsidiary 16	EBIT	2.3	1.8	0.1	3.1	3.7	1.5	1.6	6.2	6.1	6.3	4.6	5.2	6.9	7.3	12.3	15.5	18.0	23.1	43.4
		EBIT %	**8.2%**	**5.9%**	**0.3%**	**9.2%**	**9.0%**	**5.1%**	**4.5%**	**12.2%**	**10.5%**	**9.7%**	**7.3%**	**7.4%**	**9.2%**	**7.3%**	**9.9%**	**10.5%**	**13.4%**	**13.1%**	**19.1%**
		Sales	40.2	44.0	50.8	56.4	57.8	46.0	56.5	64.2	62.0	60.9	65.1	65.4	70.8	74.6	80.7	81.4	74.2	90.8	100.1
2021	Subsidiary 17	EBIT	2.9	2.9	4.2	5.4	5.1	2.2	6.4	8.9	7.4	7.6	7.4	7.2	8.6	8.3	8.3	7.3	6.4	16.5	17.4
		EBIT %	**7.1%**	**6.6%**	**8.2%**	**9.6%**	**8.8%**	**4.8%**	**11.3%**	**13.9%**	**11.9%**	**12.4%**	**11.4%**	**11.0%**	**12.1%**	**11.2%**	**10.3%**	**8.9%**	**8.6%**	**18.1%**	**17.4%**
		Sales					31.3	48.9	48.0	51.4	47.0	45.5	45.2	60.3	61.5	69.5	75.3	84.9	101.6	114.4	131.6
2021	Subsidiary 18	EBIT					4.0	6.8	5.0	9.0	5.4	6.8	6.1	8.0	11.0	12.4	12.9	13.3	19.2	23.4	23.8
		EBIT %					**12.8%**	**13.9%**	**10.5%**	**17.6%**	**11.4%**	**14.9%**	**13.5%**	**13.3%**	**17.8%**	**17.9%**	**17.1%**	**15.7%**	**18.9%**	**20.5%**	**18.1%**
		Sales			3.6	6.7	8.4	14.1	16.3	13.6	11.4	12.0	14.6	16.1	15.3	16.1	19.8	23.9	25.9	29.9	30.4
2021	Subsidiary 19	EBIT			0.1	0.2	0.4	1.4	1.7	0.3	0.0	0.7	1.3	0.4	1.2	0.6	1.4	1.5	4.3	5.3	4.7
		EBIT %			**1.6%**	**3.3%**	**4.3%**	**10.2%**	**10.2%**	**2.4%**	**0.2%**	**5.7%**	**8.6%**	**2.7%**	**8.0%**	**3.9%**	**7.1%**	**6.1%**	**16.7%**	**17.9%**	**15.4%**
		Sales					0.6	0.8	0.7	0.8	0.7	0.5	0.3	0.5	0.5	0.5	0.5	0.9	1.1	1.1	1.5
2021	Subsidiary 20	EBIT					0.6	0.8	0.7	0.7	0.6	0.5	0.3	0.5	0.5	0.5	0.5	0.9	1.0	1.1	1.5
		EBIT %					**96.5%**	**96.8%**	**95.9%**	**96.4%**	**95.3%**	**95.8%**	**91.1%**	**95.3%**	**95.8%**	**96.1%**	**95.8%**	**96.3%**	**97.7%**	**97.2%**	**98.3%**
		Sales	16.7	15.6	30.3	32.3	35.7	29.4	24.8	27.1	29.5	26.8	29.4	32.7	39.4	36.5	35.9	37.3	44.9	55.0	51.4
2021	Subsidiary 21	EBIT	1.4	0.8	4.3	6.5	7.5	5.5	3.7	5.7	6.3	4.8	6.2	9.9	13.1	12.7	10.8	8.8	15.9	19.2	19.2
		EBIT %	**8.4%**	**4.9%**	**14.2%**	**20.0%**	**21.1%**	**18.6%**	**14.8%**	**21.2%**	**21.2%**	**17.9%**	**21.1%**	**30.2%**	**33.2%**	**34.7%**	**30.1%**	**23.5%**	**35.3%**	**35.0%**	**37.4%**
		Sales				23.0	37.3	33.7	41.1	51.3	64.5	64.4	69.9	90.7	98.2	104.5	119.2	123.0	122.8	133.2	175.1
2021	Subsidiary 22	EBIT				3.0	4.0	4.3	5.0	7.0	8.6	7.8	6.5	10.3	12.1	10.8	13.8	13.2	15.0	17.2	24.7
		EBIT %				**13.1%**	**10.8%**	**12.7%**	**12.1%**	**13.7%**	**13.4%**	**12.1%**	**9.3%**	**11.3%**	**12.3%**	**10.3%**	**11.6%**	**10.7%**	**12.2%**	**12.9%**	**14.1%**
		Sales					11.0	13.7	15.2	14.9	15.1	16.3	15.1	17.0	21.0	21.3	24.1	28.2	28.2	32.8	36.5
2022	Subsidiary 23	EBIT					1.5	4.0	5.7	3.7	5.0	4.7	1.8	2.3	4.6	3.5	5.7	8.1	8.3	8.8	9.8
		EBIT %					**13.4%**	**29.3%**	**37.6%**	**24.6%**	**33.1%**	**28.9%**	**11.9%**	**13.3%**	**22.0%**	**16.5%**	**23.8%**	**28.7%**	**29.3%**	**26.8%**	**26.9%**
		Sales	4.3	5.3	7.3	10.7	11.8	11.4	14.4	19.0	23.7	25.8	29.3	34.1	37.3	42.9	45.2	47.7	57.7	59.0	70.6
2022	Subsidiary 24	EBIT	0.5	0.3	0.7	2.3	1.6	0.9	2.0	2.2	2.6	3.3	4.1	4.0	5.7	7.0	5.3	5.0	5.2	8.1	3.2
		EBIT %	**12.7%**	**5.5%**	**9.0%**	**21.4%**	**13.6%**	**8.1%**	**13.6%**	**11.8%**	**10.8%**	**12.6%**	**14.2%**	**11.7%**	**15.2%**	**16.2%**	**11.8%**	**10.6%**	**9.0%**	**13.7%**	**4.6%**
		Sales	22.3	23.9	30.0	36.5	40.3	41.6	37.9	38.1	42.4	41.6	39.4	43.4	36.2	39.7	39.5	38.4	35.6	38.4	42.8
2023	Subsidiary 25	EBIT	3.3	2.1	4.1	5.5	7.1	4.4	1.7	2.9	4.5	6.0	4.4	5.3	2.1	3.4	3.0	3.9	4.8	4.4	2.6
		EBIT %	**14.7%**	**9.0%**	**13.7%**	**15.2%**	**17.6%**	**10.5%**	**4.4%**	**7.7%**	**10.6%**	**14.4%**	**11.2%**	**12.3%**	**5.7%**	**8.5%**	**7.7%**	**10.1%**	**13.4%**	**11.5%**	**6.1%**
		Sales	185.0	198.4	205.1	216.9	228.5	250.2	252.4	256.4	264.7	273.0	271.7	274.1	272.1	276.1	284.5	281.3	295.5	305.0	335.6
2023	Subsidiary 26	EBIT	8.5	15.4	15.9	14.2	3.2	23.2	24.8	24.4	27.0	28.4	25.6	21.8	21.6	23.9	25.4	23.9	40.7	35.9	28.2
		EBIT %	**4.6%**	**7.8%**	**7.8%**	**6.6%**	**1.4%**	**9.3%**	**9.8%**	**9.5%**	**10.2%**	**10.4%**	**9.4%**	**8.0%**	**7.9%**	**8.6%**	**8.9%**	**8.5%**	**13.8%**	**11.8%**	**8.4%**

- An important part of our analysis is also to study underlying subsidiaries from a historical perspective – both pre- and post-acquisition.
- We prefer to analyse companies' performance "through-the-cycle".
- Additionally, we gather information about historical NWC movements and returns on capital for the group subsidiaries.

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Source: Slides are based upon company data but only used for illustrative purposes as we do not disclose the company name

Appendix

More Deep Dives in Collaboration With the Norwegian School of Economics

Appendix

Norwegian School of Economics

NHH

Bergen, Autumn, 2022

The Performance of Acquiring Firms in the Nordic Market

Return Characteristics of Single, Traditional, and Programmatic Acquirers

Thomas Lie and Markus Martinsen

Supervisor: Darya Yuferova

Master Thesis, Economics and Business Administration

Major: Financial Economics

NORWEGIAN SCHOOL OF ECONOMICS

Abstract

In the long term, programmatic acquirers consistently outperform other acquirers and the market by 0.88 to 1.32 percentage points per month. Our findings suggest that this outperformance is associated with a well-defined M&A strategy, aligning with the observations of practitioners.

REQ Capital provides support to Master's degree students at the Norwegian School of Economics (NHH) by offering inspiration for thesis definitions that sheds light on REQ's investment strategy. Additionally, we assist with data gathering.

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More Deep Dives in Collaboration With the Norwegian School of Economics

Appendix

Norwegian School of Economics

Bergen, Autumn 2020

NHH

Founder-CEOs and Stock Market Performance in the Nordic Region

An empirical study conducted on publicly listed companies in the Nordic region during the period from 2008 to 2020

Ole-Petter Sjøvold

Supervisor: Darya Yuferova

Master thesis, Economics and Business Administration,

Financial Economics

NORWEGIAN SCHOOL OF ECONOMICS

Abstract

About nine per cent of the publicly listed companies in the Nordic region are managed by one of its founders. These companies are different from others in terms of firm valuation and to some extent, 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 well during the generally challenging period from 2008-2013. These findings become somewhat mixed when looking at a value-weighted portfolio, and when controlling for a variety of equity characteristics, leaving a mixed conclusion for these firms' stock market performance. Nonetheless, these firms have a higher firm valuation despite no systematic differences in investment levels.

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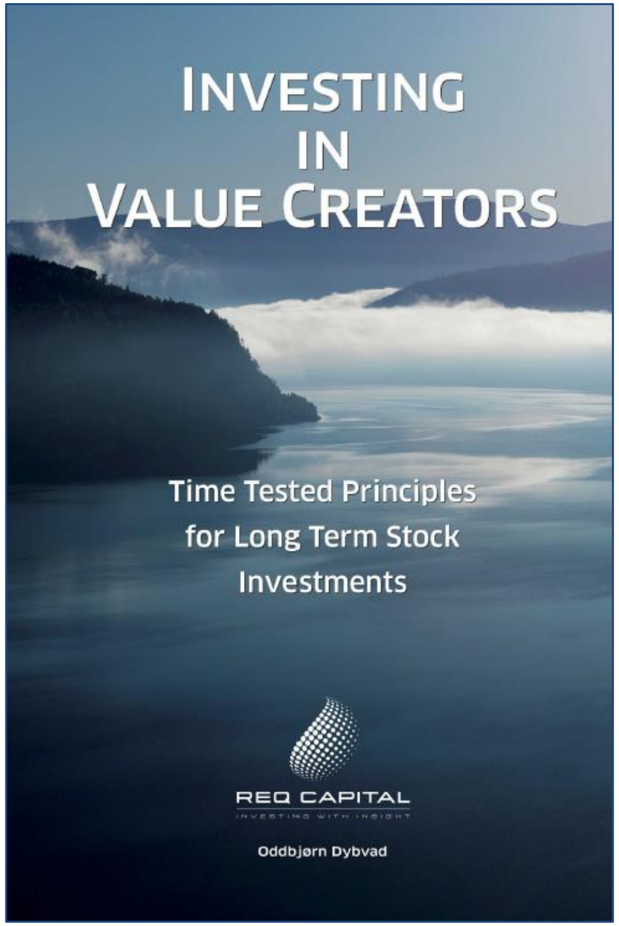

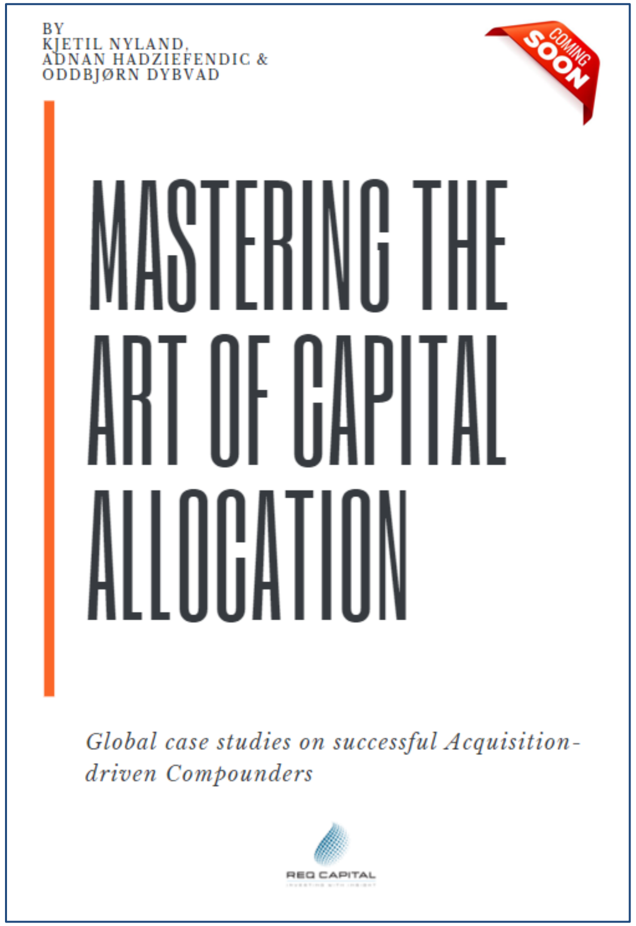

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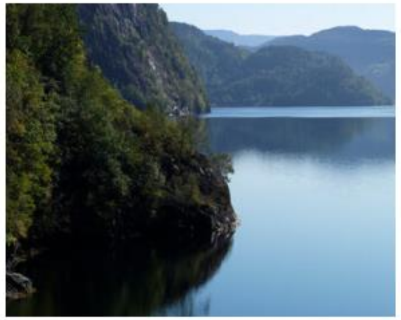

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Reach Out to Us

Oddbjørn Dybvad
CIO / Portfolio manager
od@req.no | +47 98 84 17 01

Location: Norway

Kjetil Nyland
Portfolio manager
kn@req.no | +47 47 20 23 57

Location: Norway

Adnan Hadziefendic
Portfolio manager
ah@req.no | +46 76 235 25 83

Location: Sweden

Visit our web site: www.req.no

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