GCI | Globescan Capital Inc

GCI Select Equity

August 2020

Firm Overview

GCI was founded on the principle that investing in high-quality companies at attractive prices is the most consistent strategy to achieve long-run risk-adjusted performance.

- Registered Investment Advisory firm
- Independent
- Established 1996
- Minority and employee owned
- Headquartered in Houston, Texas
- c$85m AUM

GCI Select Equity: Strategy Overview

- Active: benchmark agnostic
- Concentrated: 20-30 positions
- US Equity
- Long only
- Low turnover, long term focus
- All cap
- Fundamentals focused
- Experienced management team
- Disciplined and repeatable investment process
- Inception 01/02/17
- Strategy AUM $50m (>60% of firm assets)
- Available via SMAs through a number of investment platforms

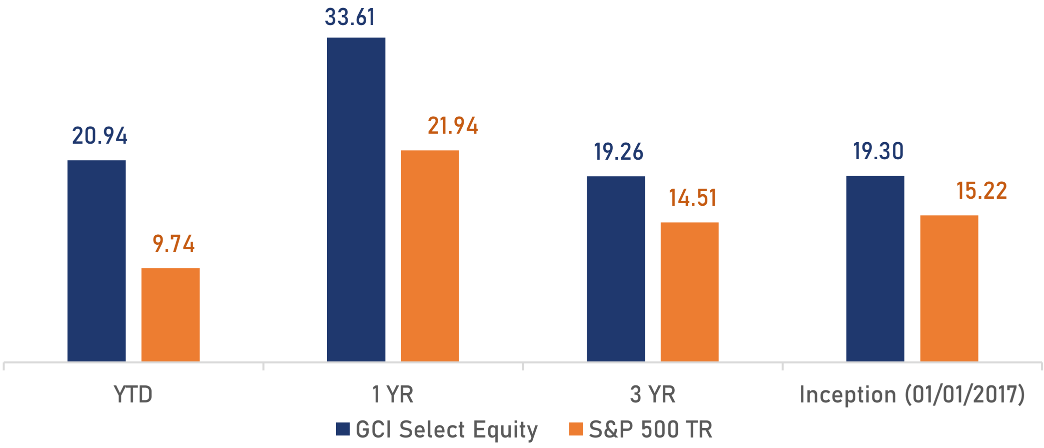
Performance

Returns (GIPS®)							
Year	Gross Return	Net Return	S&P 500 Return	3 Yrs Composite Standard Deviation	3 Yrs S&P 500 Standard Deviation	Composite Assets ($M)	Firm Assets ($M)
2020	20.94	20.00	9.74	17.79	17.51	32.45	92.59
2019	37.00	35.53	31.49	12.03	12.1	25.14	78.48
2018	-4.47	-5.44	-4.38	-	10.95	17.57	63.73
2017	20.65	19.46	21.83	-	10.07	18.32	65.66

Returns (Trailing)

	YTD	1-year	3-year	Since Inception (01/01/17)
GCI Select Equity	20.94	33.61	19.26	**19.30**
S&P 500 TR	9.74	21.94	14.51	**15.22**
+/-	**11.20**	**11.67**	**4.75**	**4.08**

Returns (GIPS®)



Performance data quoted represents past performance; past performance does not guarantee future results. The investment return and principal value of an investment will fluctuate. Current performance of the portfolio may be lower or higher than the performance quoted. Performance data current to the most recent month end may be obtained by calling (713) 401-9048. Performance data does not reflect the management fee. If it had, returns would be reduced. Globescan Capital Inc claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS standards.

Up/Down Capture

	2018 Drawdown 10/03/2018 - 12/24/2018	2019 Bull Market 12/24/2018 - 02/19/2020	2020 Covid19 Crash 02/19/2020 - 03/23/2020	2020 Recovery 03/23/2020 - 07/16/2020
GCI Select Equity	(18.57%)	43.39%	(32.74%)	49.33%
S&P 500 TR	(19.19%)	36.51%	(33.47%)	40.36%
Relative	**0.62%**	**6.88%**	**0.73%**	**8.97%**

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Investment Philosophy

Our guiding philosophy is built on four principles:

1. Invest in Businesses, Don't Trade Stocks

Investing is about allocating capital to businesses, not just buying pieces of paper. As such we take on an owner's mindset with each of our investments, asking ourselves which management teams we want to partner with in order to grow a business.

2. Think Long Term, Don't Try to Time Markets

Short term market movements are impossible to predict, not only because of the vast number of variables one would need to get right, but because even if we could predict all those variables with certainty, we would still have no idea how markets would react to them.

3. Be Concentrated, Don't Overdiversify

Great ideas and opportunities are rare and should not be diluted by average ones. As such, we concentrate our portfolio in our best ideas with the understanding that such an approach runs the risk of deviating significantly from the overall market in any given three-year period.

4. Use the Market, Don't Rely on It

Market prices only reflect an opinion about underlying business value and those opinions are prone to substantial errors in the short term. As such, we always reach our own opinion about a company's value in isolation of what the market might think, and then we wait for the market to provide us with an opportunity to initiate or exit a position.

Investment Process: Real Intrinsic Value Recognition (RIVR)

What is Real Intrinsic Value Recognition (RIVR)?

RIVR is our disciplined, repeatable, and proprietary investment process. At a headline level, RIVR involves evaluating businesses as long- term owners would – we establish an underlying real value for the business itself, based on our expectations of its long-term future.

RIVR requires us to answer two crucial questions before including a business in our portfolio:

1. **Is this a high-quality business?** and
2. **Is it trading at an attractive price relative to its real value?**

To answer these questions, we must fully understand a company's industry, business model, economics, management, culture and financials. This process can take anywhere from two to six months in which we are analyzing relevant data – some of which is qualitative in nature and some of which is quantitative.

DATA SOURCES	
QUALITATIVE	**QUANTITATIVE**
Company history	Revenue model
Strategy	Financial structure
Management	Capital requirements
Culture	Addressable market
Competitors	Liquidity Requirements
Competitive advantage/ Moat	Reinvestment opportunities
Customer relationships	Profitability
Industry dynamics	
Regulations	

Investment Process: Real Intrinsic Value Recognition (RIVR)

1. Is this a high-quality business?

The term ‘quality’, as typically used by financial market participants tends to be backward looking – i.e. has company X generated high returns in the past? RIVR takes the concept one step further, understanding that what really makes a high-quality business is not only its past returns but its ability to continue generating those returns into the future.

As such, a high-quality company must have an identifiable *moat or competitive advantage* – something structural that prevents competition from eroding profits and returns over time.

The best quantitative signs that a business currently has a wide moat are market share stability, high margins, and high returns on invested capital. However no amount of historical financial data can determine the future defensibility of a moat. That can only be understood through qualitative analysis of the moat itself. To do this, we need to understand the source of the moat in order to assess its strength. Moats come in many forms such as:

- Network Effects – the value of a service grows as more people use it.
- Economies of Scale – being the largest player creates better economics.
- Switching Costs – customers stay with a company because switching would be too expensive.
- Cost Advantage – being the low-cost producer in a commoditized space.
- Brand – having the most desirable product on the market.
- Regulations – regulatory imposed barriers on competing in a market.

2. Is the business trading at an attractive price?

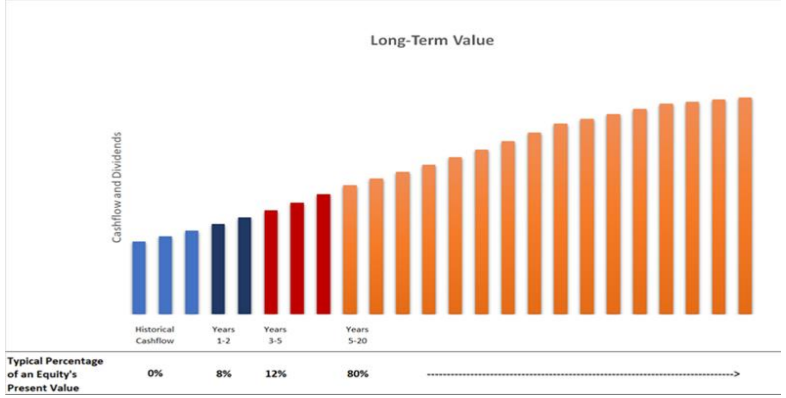
Once we have determined that a business is high quality, the next step in our RIVR process is to establish what the business itself is worth to us as long term, owner-oriented investors. It is important that we come to this valuation in isolation of wherever the market is currently valuing the business– a concept foreign to much of the investment industry who typically base their estimation of value based on current share prices and market information. In reality current share prices rarely reflect real intrinsic value.

It is only our estimation of the value of a business that enables us to determine if the current share price presents an attractive investment opportunity or not. To do this, we focus on the long-term economic profits (cash flows) we stand to receive as shareholders, based on our assessment of the quality of the business. We model these returns with a detailed discounted cash flow analysis using explicit forecasts at least ten years out.

Establishing Intrinsic Value

We focus on the long-term economic profits (in cash terms) we stand to receive as shareholders. To model this we primarily rely on a detailed discounted cash flow model with explicit forecasts at least ten years out. This is built only after we have thoroughly established an understanding of the business model, economics, competitive advantage and management's strategy. Once we have established our estimate for intrinsic business value, we can then think in terms of an estimated internal rate of return for each investment, off-set by our conviction level in our forecasts. We avoid thinking in terms of multiples as these typically are backwards looking and short-term in nature.

Since we are long term investors, we understand that business prospects rarely change in a matter of days, months, or quarters. As such we take a pragmatic approach to updating our valuation models, focusing on when events or changes to the story warrant further consideration. Aside from substantial events or thesis changes, we would still expect to update our valuation models at least annually.



Sell Discipline

Sell discipline is an area that is as, if not more important than buy discipline. We apply the following criteria to determine appropriate exit points from positions:

1) Change in investment case: if our original buy thesis has either played out or been altered by events/ news flow or has proved to be incorrect (intellectual honesty and humility is vital in investing).

2) The share price approaches or exceeds our assessment of fair value (any assessment of a security's fair value is subjective and therefore should be thought of as more of a 'range' than an absolute share price level).

3) Portfolio risk/ return profile: if the stock is no longer appropriate given the overall portfolio risk profile/ desired positioning. OR prices approach a level where our expected returns are lower than we would like, or lower than other opportunities of similar risk.

Risk Management

We believe that traditional risk metrics such as historic volatility, active money limits, VAR (value at risk), etc. are typically backward looking and have proved themselves to be ineffective at the very times they are needed most; times of crisis.

We maintain that the best risk control is to understand what we own, and what it is worth. As such, our focus is on understanding each of our portfolio companies in great detail- giving us confidence in underlying earnings regardless of short-term share price movements. If we are confident that a company's future earnings growth is secure, a share price sell- off is a great buying opportunity for us, rather than a reason to sell. It is only when an investor understands what they own that they will have the conviction to add to their position during such a selloff.

This is combined with the intellectual honesty and humility to adjust both our forecasts and portfolio positions (selling as necessary) as and when the original thesis is no longer applicable, or the market has bid the stock up to a level where our expected IRR is no longer attractive.

The Fallacy of Diversification:

Is it safer to own hundreds of companies that you know nothing about, or a small number that you know in great detail?

Portfolio Construction

- 20-30 Positions
- Entirely benchmark agnostic: no requirement to take exposure to any sector
- Position size 2%-8%: based on our confidence in earnings projections, the implied Internal Rate of Return (IRR) (based on our forecasts), overall portfolio risk and portfolio concentrations.
- Holding period: typically multi- year

Portfolio Characteristics

Portfolio Characteristics (06/30/20)	
Number of Holdings	23
Total Net Assets	$27.47M
Total Firm Assets	$80.38M
EV/EBITDA (ex fincls/reits)	17.41x
P/E FY1 (ex fincls/reits)	28.2
EPS Growth (ex fincls/reits)	11.8%
ROIC (ex fincls/reits)	15.7%
Standard Deviation (3-year)	17.0%
% of assets in top 5 holdings	30.7%
% of assets in top 10 holdings	55.8%
Dividend Yield	1.20%

Top 10 Holdings (06/30/20)	%
Microsoft Corp	6.48%
United Parcel Service Inc Class B	6.22%
Facebook Inc A	6.01%
Equinix Inc	6.01%
American Tower Corp	6.00%
Mastercard Inc A	5.44%
Air Products & Chemicals Inc	5.07%
First American Financial Corp	4.90%
Wyndham Hotels Resorts Inc	4.87%
Booking Holdings Inc	4.75%

Microsoft (MSFT)

Investment Thesis

Microsoft is probably best known for its Windows operating system – the dominant computing platform back when everyone still used desktop computers. Windows is a small portion of Microsoft's business today, massively overshadowed by their Cloud (Azure) and Productivity Software suite of services (Office).

In the cloud, Azure is well-positioned to gain share in a fast-growing, massive market opportunity where they are a more natural partner for enterprise customers compared to the current market leader, Amazon's AWS. In productivity, Office remains one of the best businesses of all time on a stand-alone basis and looks even better when we realize Microsoft can leverage their massive installed base as a touchpoint for an Azure move.

Putting everything together, and we are looking at a $1T mission-critical company that is growing faster than many smaller companies and doing so with tremendous operating leverage. While Microsoft may look expensive relative to it's past, their market opportunity and growth rates far outpace historical comps and the company should be able to deliver at least mid-to-high teens EPS growth going forward with upside from deploying its $137B cash balance.

UPS (UPS)

Investment Thesis

The market is overstating the competitive risks UPS faces. In order to understand why we believe that to be the case, one must look 'under the hood' of the main players in this market- UPS, FedEx and now recently- Amazon.

Both FedEx and Amazon have grown their delivery businesses very quickly, but they crucially have done so using a fundamentally different business model to UPS. UPS is a fully integrated model- they own everything: ground, air, express, trucks, planes, etc. Both FedEx and Amazon are franchised- they have agreements with franchisees, and as such are restricted in how they can optimize their own routes and services. UPS have total freedom to optimize and structure their operations in whatever way is most efficient- that translates into a structural advantage that cannot be replicated. UPS has consistently earned returns on capital above 20%, Fedex cannot even reach 10%.

Amazon's 'threat' to UPS is also greatly over- stated, not only based on the efficiency issue above, but also on the basis that Amazon is going to find it very hard to deliver for any retailers other than itself, given for most retailers Amazon is their biggest competitor.

For UPS, we have a stock trading at significantly beneath it's real intrinsic business value. Plus a substantial long- term growth runway (ecommerce etc), significant efficiency gains in the next five years from continued investment and continued huge cash generation (the stock pays a well covered 3%+ dividend yield).

Facebook (FB)

Investment Thesis

Facebook is one of the most influential companies over the last decade. They have created the largest social network the world has ever seen. And not only is it the largest, but it is probably also the most detailed the world has ever seen as far as their capacity for data collection. Never has one company known so much about so many people. That network as an entity is incredibly valuable- even if conceptually it is very hard to ascribe an actual dollar value to it.

Despite the incredible breadth and depth of their network, Facebook shares were heavily punished during 2018, over a lot of negative press and political pressure. There were substantial concerns that the company would be regulated, split up, or otherwise restricted from being able to monetize their data. But we must remember that Facebook has only just scratched the surface of what they will be able to do with this network over the next decade. Take WhatsApp as an example- it has over 1billion daily active users, and so far, Facebook generates almost no revenue from it. Opportunities such as this are abundant across the Facebook ecosystem.

Facebook has been compounding earnings growth in excess of 35% for the last 5 years. Even if you assume that rate halves going forward (as a result of more regulation) the stock is still very much underpriced. Such a substantial amount of negative news flow has a powerful sentiment effect on stocks, such that valuable companies can trade beneath their underlying value for considerable periods of time if they are deemed out of favor.

Equinix (EQIX)

Investment Thesis

Equinix is a data center operator, structured as a real estate investment trust (REIT). Unlike other wholesale data center operators which provide large amounts of low-tiered commoditized capacity to select customers, Equinix's key service is offering co-location and interconnection services in which customers pay for traffic exchanged within the data center among carriers, enterprise customers, the public cloud, etc.

The interconnected data center market is fundamentally different from the simple data storage data center marketplace. In interconnections, the most important thing is scale- who are the customers present at each site; the more customers present, the more attractive that site is to other customers. Equinix's position in this market is very well protected due to powerful structural advantages: they have the most interconnections and key cloud partners, so their data centers gain value as more customers co-locate thus increasing the density of the network. In addition, their data centers are positioned in key, scarce metropolitan areas which provide lower latency for latency-sensitive customers. Furthermore, customers face high switching costs since moving a server could disrupt their business, resulting in longer-term contracts that are often renewed. Equinix's churn rate is sub 3%.

We believe that Equinix's data center business is still in its early growth stages, driven forward by secular trends in global internet access, e-commerce, IoT, high definition streaming video, and enterprises moving to the cloud, which the market has yet to fully appreciate.

American Tower (AMT)

Investment Thesis

American Tower is a wonderful example of a company that lies squarely in the middle of a huge, multi-decade trend. This trend is the exponential growth of mobile data consumption driven by increasing smartphone penetration, faster available mobile internet speeds, a huge growth in content (particularly video such as Netflix, Disney+, etc) being consumed on mobile devices, as well as huge growth in the number of internet-enabled devices.

American Tower is one of the largest owners of cell towers in the US. These are incredibly valuable assets, as they are arguably the bottleneck when it comes to us all needing more and more mobile data. It is very hard to build any new towers as zoning is so difficult to achieve, so the ones that exist are increasingly valuable assets. American Tower owns the tower and rents space to telco companies to fix their equipment on – a very efficient business model. These towers typically have 10-20-year inflation-linked contracts. The cash flow predictability is exceptional and American Tower is taking this business and reinvesting it in exactly the same business model, but it more nascent and faster-growing markets like Brazil and India, providing tremendous growth runway.

This is the sort of trend that is very unlikely to be disrupted- no political party, individual company or country is likely to disrupt the huge growth in mobile data consumption. Valuation permitting, we could conceivably own American Tower for decades to come.

Mastercard (MA)

Investment Thesis

Mastercard is a tollbooth business – collecting a fee on electronic payments regardless of whether those payments are credit, debit, online, mobile, etc. Their position in the market is extremely well protected due to a very difficult chicken and egg problem that would-be competitors would need to solve – issuers want to issue cards that consumers want to use, consumers want to use cards that merchants accept, and merchants want to accept cards that issuers issue. This creates a powerful network effect as the more of each party on the network, the more convenience, the more data, the more secure, the better the overall network is for everyone, which explains why only a handful of networks have come to dominate the market over time.

Going forward, Mastercard's earnings growth will be driven by the continued secular trend away from cash-based payments – a trend magnified by the inexorable shift towards e-commerce (growing 4-5x the rate of face-to-face transactions), and the increasing ease with which merchants can access Mastercard's network (mobile payments, browser payments, smart speaker payments, IoT payments, etc). We believe that the market is failing to price in the likely step up in growth these trends will bring Mastercard, probably due to continued worries relating to disruption risks (Bitcoin, FinTech, Regulatory) which we do not believe are justified over the medium-term.

The GCI Team

Guy Davis, CFA **Portfolio Manager and Managing Director**

Guy Davis is a proven mutual fund manager with over a decade of experience managing assets for financial institutions. In London, he was portfolio manager for a $2bn institutional global equity mutual fund and a $1.5bn multi-asset charity endowment fund. Guy was voted 'Asset Management Top 40 under 40' in 2015 and was finalist for 'Equity Income Fund Manager of the year 2017'. He is a CFA Charterholder, has completed a Masters in Wealth Management and received his BS from the University of Bath (First class with Honors).

Neil Sadhukhan **President**

Neil has 15 years of hedge fund management experience and has also served as special advisor to both Corporate Management Teams and Portfolio Managers. He was a Managing Director at the Meritage Group and Managing Partner at Lotus Group prior to joining Globescan Capital. He received his BS from Stanford University.

David Shahrestani, CFA **Senior Equity Analyst**

David focuses on fundamental deep dive equity research for Globescan and also writes extensively on investing, the markets. He is a CFA Charterholder and received his B.A. in Economics from California State University - Long Beach.

Roberto Sanchez **Director**

Roberto has over 20 years of investment and banking experience. He previously worked for the World Bank in both Washington D.C. as well as Latin America. Roberto has also provided investment advisory services to institutional, family offices and High Net Worth US and Latin American investors. He received an Honors degree in Economics from Monterrey Technological Institute in Mexico, as well as an MBA from Monterrey Tech and The University of Texas. He also attended the University of Pennsylvania's completing PhD work on managerial economics.

Pas Sadhukhan, PhD **Founder, CIO**

Pas holds 11 patents and has over 30 years of investment management experience. He founded Globescan Capital in 1996.