AGT Partners

Ginko-AGT Global Growth Fund

4 Contributors to Long Term Returns for a Stock Investor

Dec 2023

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4 Contributors to Long Term Returns

Investing principles

Ginko – AGT Global Growth Fund

Long-Term Investments

Long-Term Focus & Concentrated Investment

- Businesses that possess competitive advantages can create durable earnings power over the long term; Prioritise certainty of earnings over long shots
  - *Network economics effect*
  - *High switching costs*
  - *Lowest-cost producer*
  - *Favourable location*
  - *Intangibles (Branding, Patents, Regulatory requirements, etc)*
- Ability and space to then reinvest earnings at reasonable rates of return long into the future (room to keep growing earnings at reasonable rates)
- Capital allocation ability of management – share repurchases and dividends
- Priced at reasonable valuation: Price-to-Earnings (P/E) multiple

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Long-term returns are a result of:

1. **Earnings Growth**

   (Free Cash Flow is better)

2. **Change in valuation multiple**

   (PE ratio rerating)

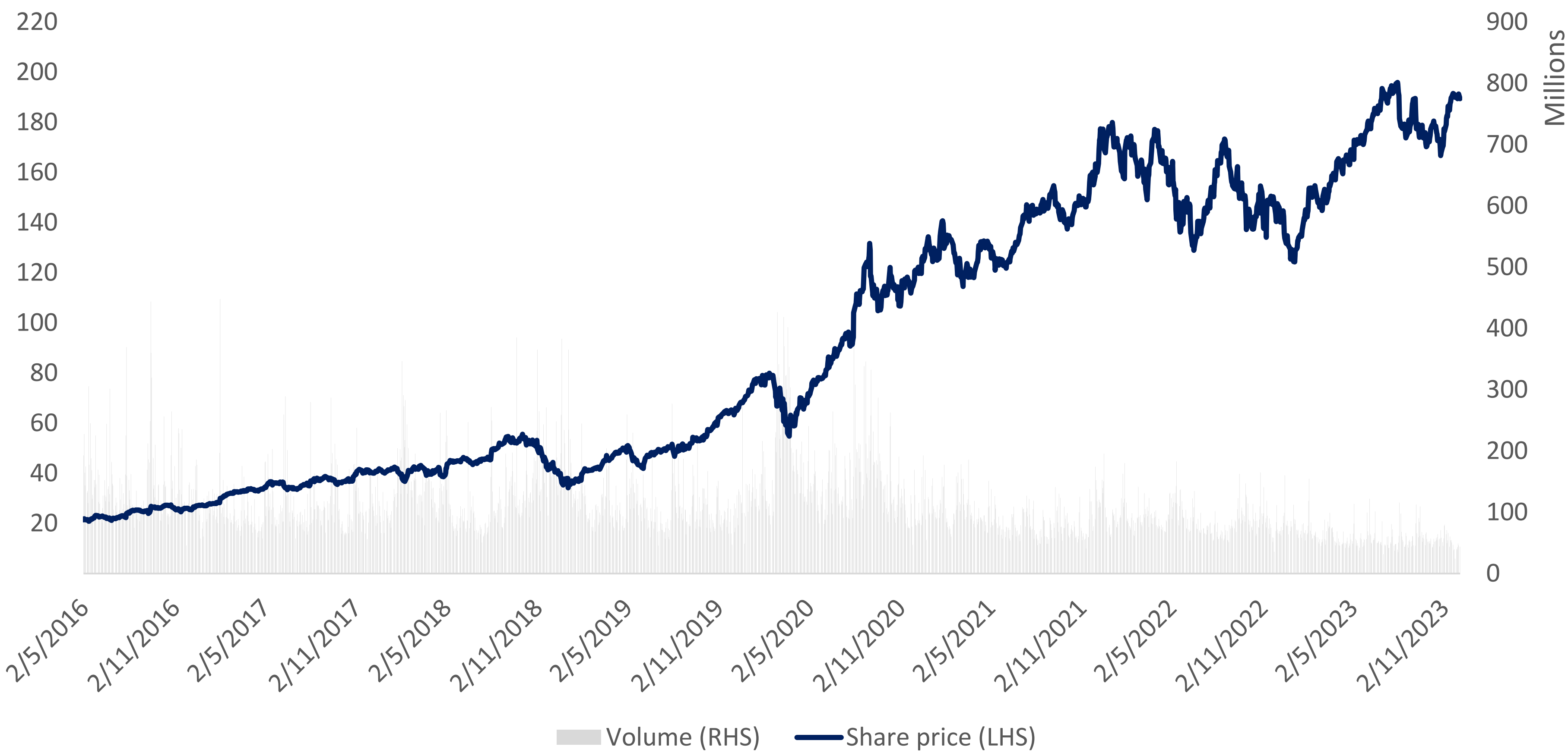
3. **Change in shares outstanding**

   (Shares repurchase / issuance)

4. **Dividends**

Case Study 1: Apple Inc.

Deconstructing Mr. Buffett's investment returns from Apple



"It's probably the best business I know in the world."
- Warren Buffett

Case Study 1: Apple Inc.

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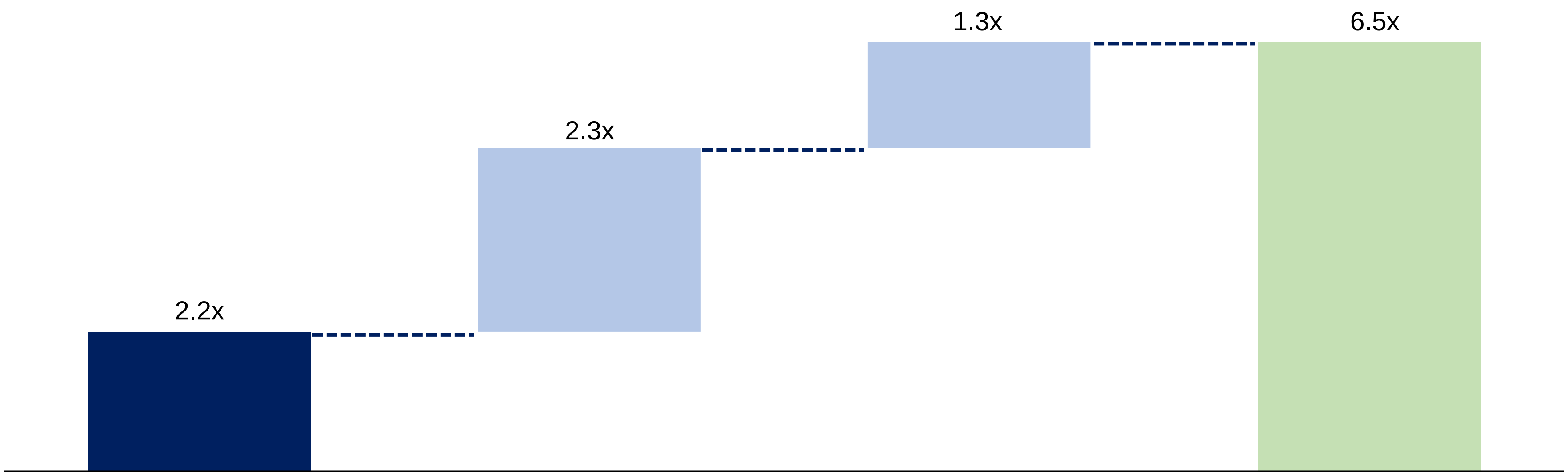


Earnings Contribution

- Earnings increased from US$45bn (2016) to US$97bn (2023)
- 2.2x increase (12% p.a., good but not outstanding)

P/E Multiple rerate

- P/E multiple increased from 13x to 30x
- 2.3x increase (13% p.a.)

Shares outstanding

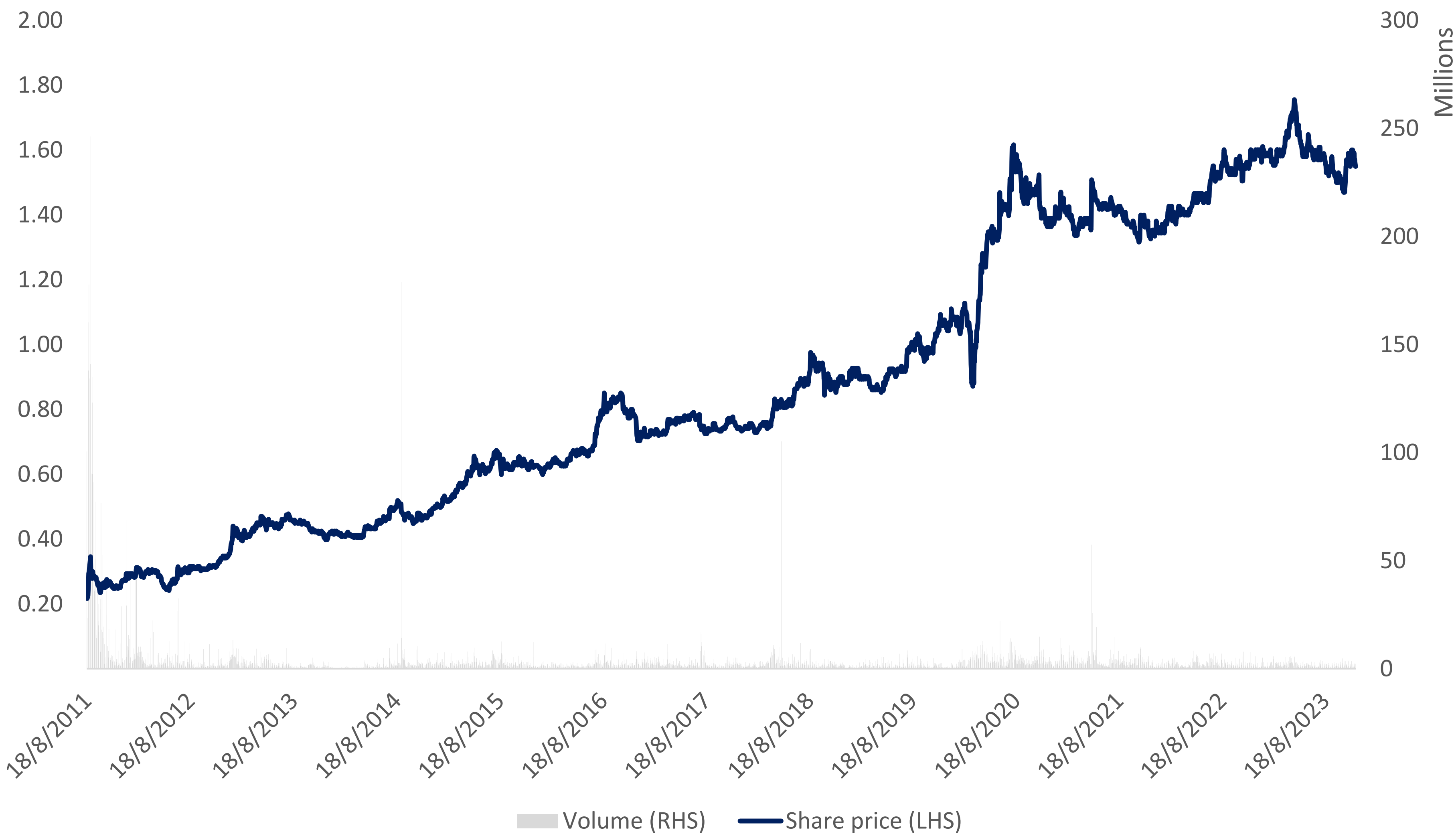
- Shares outstanding declined from 20.6bn to 15.5bn
- 1.3x

Capital gains (share price increase)

- 2.2 x 2.3 x 1.3 = 6.5x increase in share price over the 7 years period
- Share price rose from US$26 to US$170 (6.5x; 31% per year)

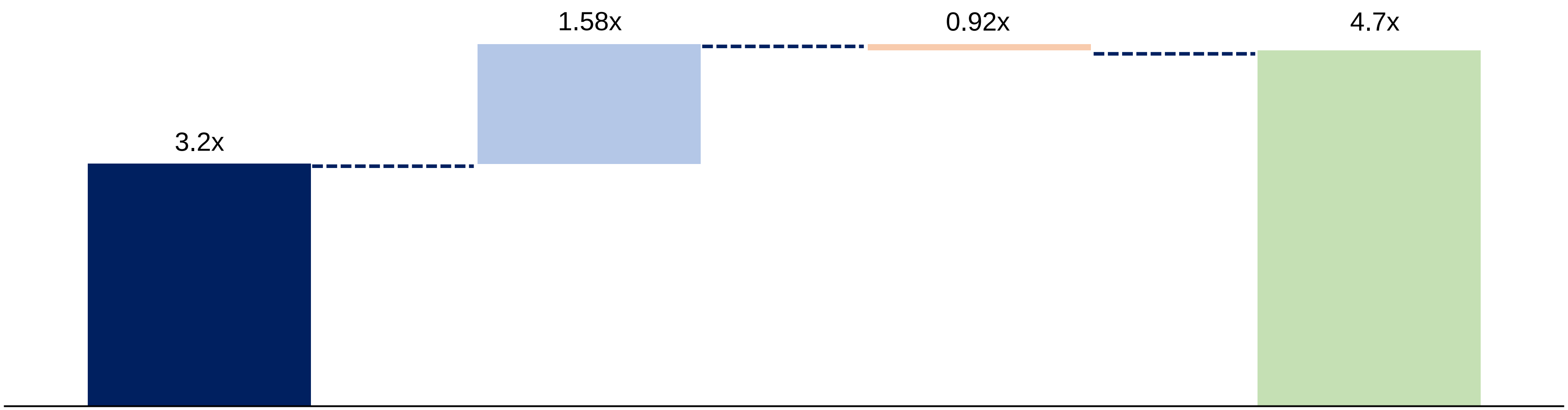
Case Study 2: Sheng Siong Group Ltd.

One of our portfolio holdings since 2019



Case Study 2: Sheng Siong Group Ltd.

Share price increased 4.7x from S$0.33 to S$1.57; 13.8% p.a.; 16.6% incl dividends



Earnings Contribution

- Earnings increased from S$42mn[1] (2011) to S$133mn (2023)
- 3.2x increase (10% p.a.)

P/E Multiple rerate

- P/E multiple increased from 11x to 18x
- 1.58x increase (4% p.a.)

Shares outstanding

- Shares outstanding increased from 1,383mn to 1,503mn
- 0.92x

Capital gains (share price increase)

- 3.2 x 1.58 x 0.92 = 4.7x increase in share price
- S$0.53 cents / share of dividends received over the 12 years period
- Share price rose from S$0.33 to S$1.57 (4.7x; 13.8% per year; 16.6% incl div)

Note:
(1) The average of 2010 and 2012 earnings. 2011's earnings consist of one-off listing-related expenses

Investing Principles

Smart capital allocation is an important driver of shareholders' value

Good capital allocation skill an important signaling effect

Long-Term Investments

- Good businesses (especially asset-light ones) generate more earnings over time that can be reinvested at existing high rates of return
- Most entrepreneurs/business executives lack ability to allocate surplus earnings well or choose to neglect minority shareholders' interest
- **What they choose not to do in effect says more than what they do**
  - *A management that ignores minority shareholders interest will naturally result in investors unwillingness to pay a high price for its stock resulting in prolonged period of low valuation*
  - *Conversely, one that is willing to repurchase shares at or below the company's intrinsic value can add tremendous value over time*
  - *Every shareholder's ownership of the company increases without having to pay for it*
  - *The perception/signalling effect that management is conscious of shareholders' interest results in prospective investors being willing to pay up for the stock; thus increasing its valuation*

Investing Principles

Important lessons for long term investors / business owners

1. **Earnings growth is important**; and often drive valuation rerating due to perception of growth potential

2. However, **longevity of growth** (due to sustainable competitive advantages) is more important than very high growth rates (which attract competition and decrease growth rates over time)

3. Seek a good business (**good ROIC >15%**) that can continue to grow and generate surplus cash to fund share repurchases

4. Important to partner with **capable and minorities-friendly management**. They add enormous value over time by smart capital allocation e.g. conducting share repurchases at or below one's intrinsic value

5. **Entry valuation** is important;
    1. A low P/E has significant room to go higher without reaching over the top valuations
    2. More shares can be repurchased by management when share price is low
    3. Establish a margin of safety

Investing principles

Construct a portfolio carefully

Identify a list of companies in which you are highly confident that ***earnings will be substantially higher*** in 10 years

Think carefully on the 4 contributors of value creation:

1 Earnings Growth

(Free Cash Flow is better)

- Approximate estimation of earnings in 10 years (Be conservative)
- Look for companies with long operating track records and operating in relatively stable, slow changing industries

2 Change in valuation multiple

(PE ratio rerating)

- Estimate P/E in 10 years time (Can be more liberal if company and earnings power truly promising)
- The lower your entry valuation point, the higher the rate of change as compared to ending multiple

3 Change in shares outstanding

(Shares repurchase / issuance)

- Estimate shares outstanding in 10 years
- (Look for facts that share repurchases is already ongoing; do not assume)

4 Dividends

- Dividends you may receive in the meantime

Moderate growth, low P/E, and good capital allocation can bring great returns over the long term; even if each one of the contributor is nothing special (Beauty of compounding)

Source: Bloomberg

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