FLAGSHIP
ASSET MANAGEMENT

Quarterly Telescope Q1 2023

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01

We are a global specialist investment boutique

Flagship is a specialist global asset manager founded in 2001.

We are 100% independent and fully owned by staff and directors.

Our mission is to be the navigators and global authority of your complete investment future, wherever it may lead.

02

We manage global portfolios in three distinct strategies

Global Equity | Global Flexible | Global Fund of Funds

We believe in a focused approach to fund management

Our longest running Funds have track records spanning over two decades

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03

We are long term investors who manage concentrated portfolios

Our investment approach is process-driven and rigorous, and our definition of quality is demanding and exclusive.

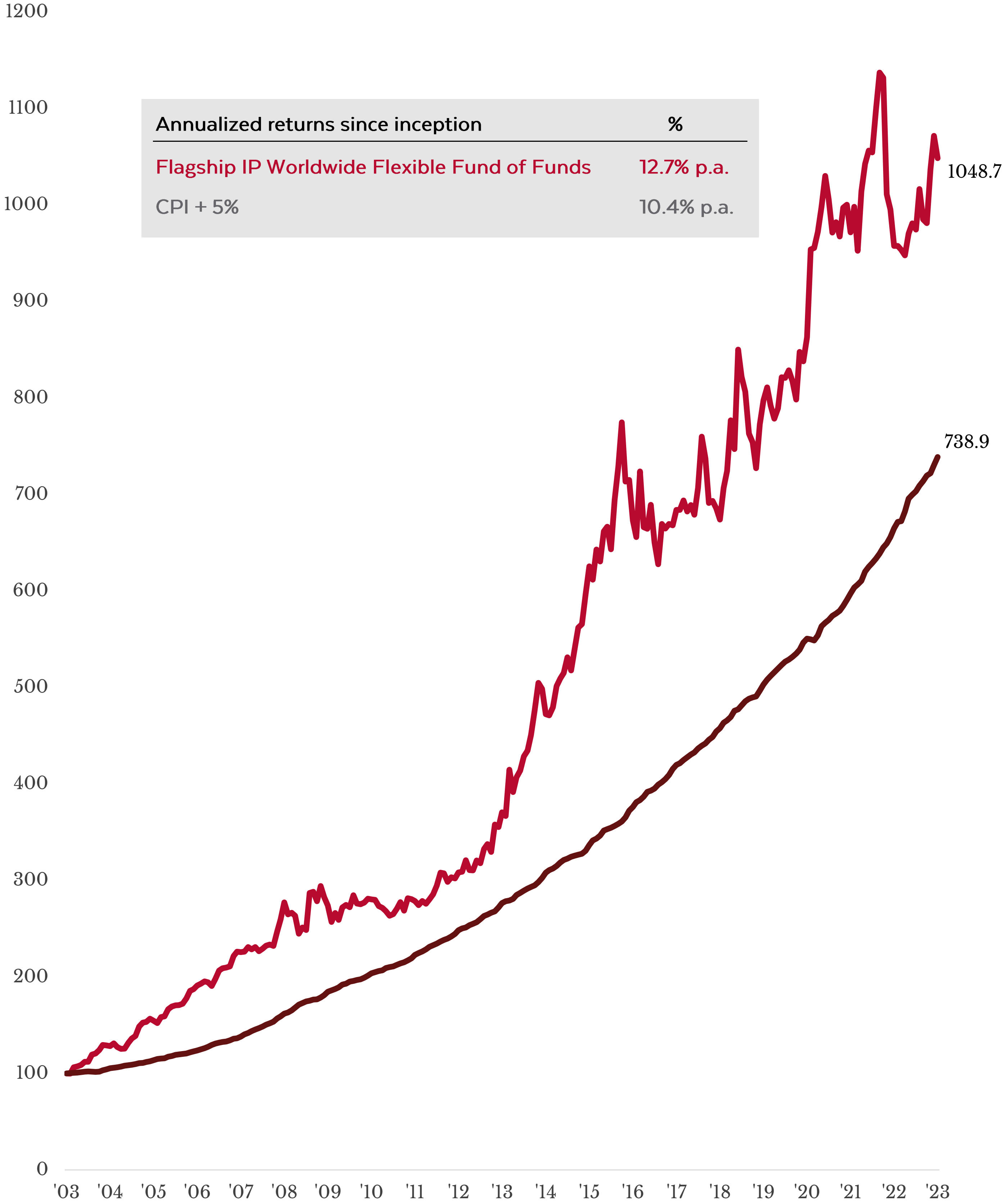
Our equity portfolios are focused. We own a maximum of 25 shares, diversified across geography and sector.

Contents

The Power of Long-term Compounding

The **Flagship IP Worldwide Flexible Fund of Funds** (net of all fees) vs. SA CPI +5%

from 3 April 2003 to 31 March 2023 (20 years)

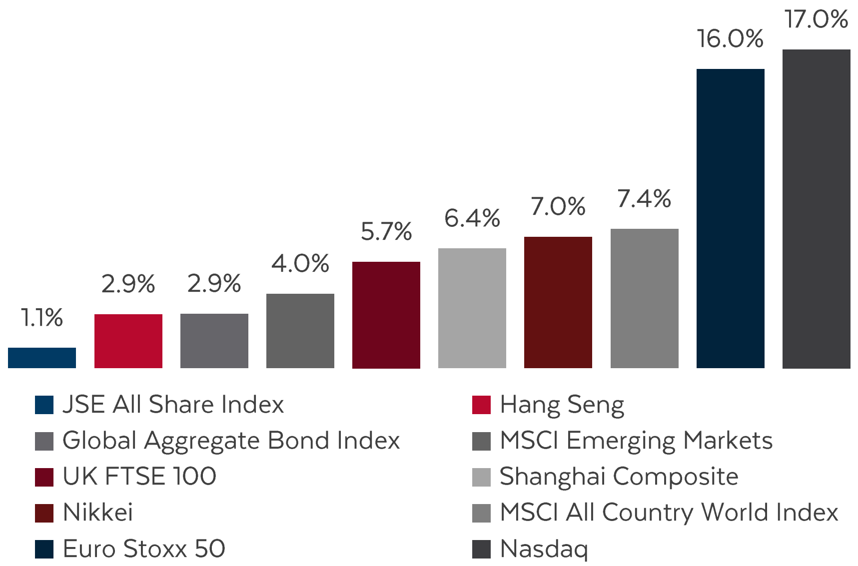


Risks are building

"There's a time for daring and there's a time for caution, and a wise man understands which is called for."

- Robin Williams

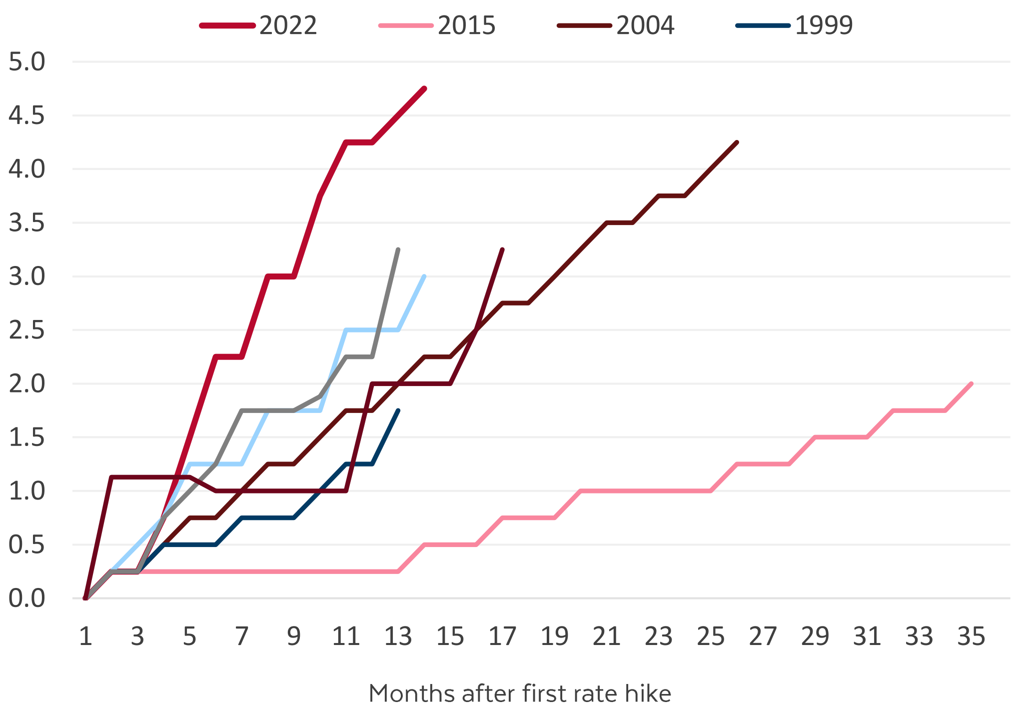
Chart 1: Global Index returns in USD (Dec 31, 2022 to March 31, 2023)



The current rising interest rate cycle has been the sharpest for many decades.

The current rising interest rate cycle has been the sharpest for many decades. From a very low starting point, in the aftermath of the Covid-19 crisis, the Fed Funds Target Rate has been steadily increased to 5% today. Similarly, interest rates have risen in both Europe and the UK, with Japan being the only hold-out. This was in response to surging inflation caused by supply chain disruptions post-pandemic as well as Russia's invasion of Ukraine which played havoc with commodity prices.

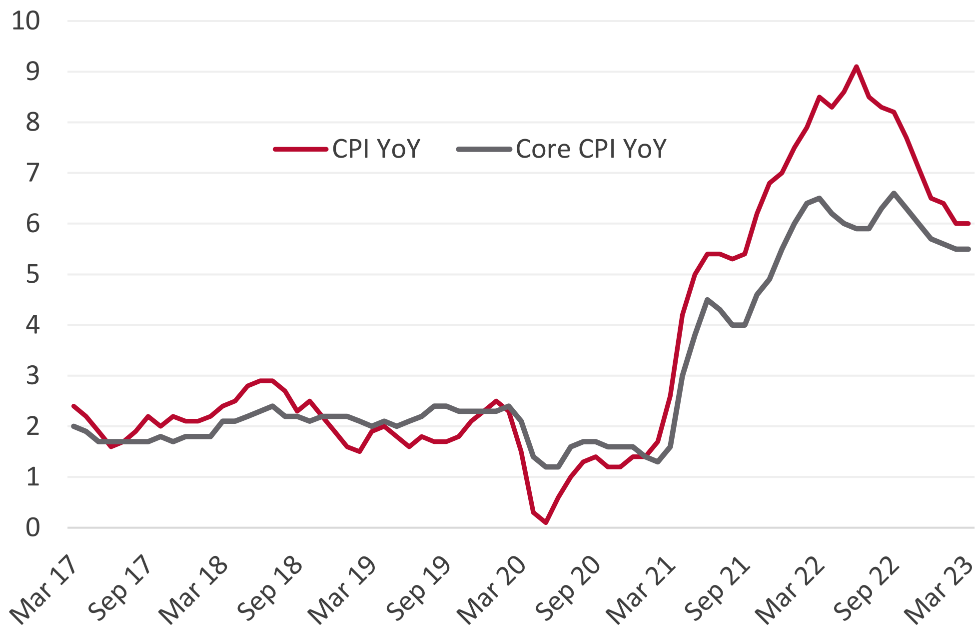
Chart 2: Fed Tightening Cycles (in percentage points)



Unfortunately, these increases do not appear to be having the desired results. Headline CPI in the US has fallen considerably, from highs north of 9% to 6% at last print. However, "core" CPI – the measure which excludes volatile items such as food and fuel – has barely budged.

Hikes in interest rates are meant to tame inflation by reducing economic activity and they appear to be failing at this, raising the spectre of higher inflation for longer.

Chart 3: CPI vs Core CPI



In particular, the labour market has been exceptionally strong. Unemployment remains close to all-time lows, and while there have been some headline grabbing retrenchments in the tech sector, these pale in comparison to the hiring spree they followed. If one uses Facebook (Meta) as an example, its number of employees increased at a compound annual growth rate of 144% in the five years preceding 2023, with the result that their number of employees went from 36k to 87k. In addition to this, if one looks at the unemployment level in conjunction with job openings, there are currently only 50 unemployed job seekers for every 100 job openings.

Chart 4: Unemployment level / Job Openings: Total Nonfarm

In fact, one of the few indicators that shows hiking interest rates may be slowing down the economy is the "Conference Board US Leading Economic Indicators Index" which showed a 6.5% y-o-y decline in February, up from a 5.9% decline in January. No measure can be viewed in isolation, but this one should provide the optimist with some assurances that the Fed is succeeding at its aims, because it has never dipped below 1% without there being a recession in the next couple of months.

Ominously, a slowing economy does not appear to be the only consequence of the current cycle of interest rate hikes. The recent failure of a number of US regional banks, most notably Silicon Valley Bank (SVB), indicates there may be lurking fragilities in the financial system and interest rates have had no small role to play.

SVB's story is instructive. SVB was a bank which targeted a very select group of customers, specifically entrepreneurs in Silicon Valley, who needed a place to temporarily "park" the money that they had raised from Venture Capitalists (VCs). These entrepreneurs would then spend this money, with varying degrees of success, to fund their business operations.

Before the current interest rate hiking cycle commenced, start-ups were raising record sums from VCs and this money, in turn, flowed to SVB in the form of deposits. At that time, SVB was literally not able to lend out money fast enough, so it invested any excess (of deposits over loans) into government bonds. This did not seem like an imprudent thing to do because US government bonds are perceived as being one of the safest forms of investments out there. In academic research, US government bonds are even used as a proxy for a "risk-free" asset.

A slowing economy does not appear to be the only consequence of the current cycle of interest rate hikes. The recent failure of several US regional banks indicates there may be lurking fragilities in the financial system.

Government bonds, however, are only "risk-free" with respect to "default" risk. The government cannot default on domestic bonds because when it runs out of money it can always print more. In essence, it will always return the $100 you lent it even if that $100 is worth less, measured in real asset terms (because money-printing leads to inflation).

Government bonds are not "risk-free" when it applies to "interest rate" risk, because when interest rates rise, **all** asset holders find themselves in the same boat - worse off. All treasuries were trading at lower yields a year ago than they do today. No rational player would accept a lower yield above a higher yield. Therefore, because treasury coupons are fixed, it is the fair value that must fall.

Unfortunately, as we now know, the good times, with respect to low interest rates and record VC funding, were not destined to last forever. As interest rates drifted upward and VC funding dried up, SVB's deposit clients were forced to withdraw their money to keep their businesses afloat. SVB had to liquidate $21bn of government bonds in order meet their withdrawals, forcing SVB to recognize $1.8bn of losses. These losses had hitherto not been recognized because it accounted for them using "held to maturity" accounting, which did not require them to recognise losses until it sold those bonds. If one extrapolated the loss of $1.8bn to the bank's entire government bond portfolio, the bank was technically insolvent. For SVB's deposit clients this had the potential to be disastrous. More than 90% of them had deposits which were larger than the $250k FDIC limit for guaranteeing deposits in the event of a bank failure.

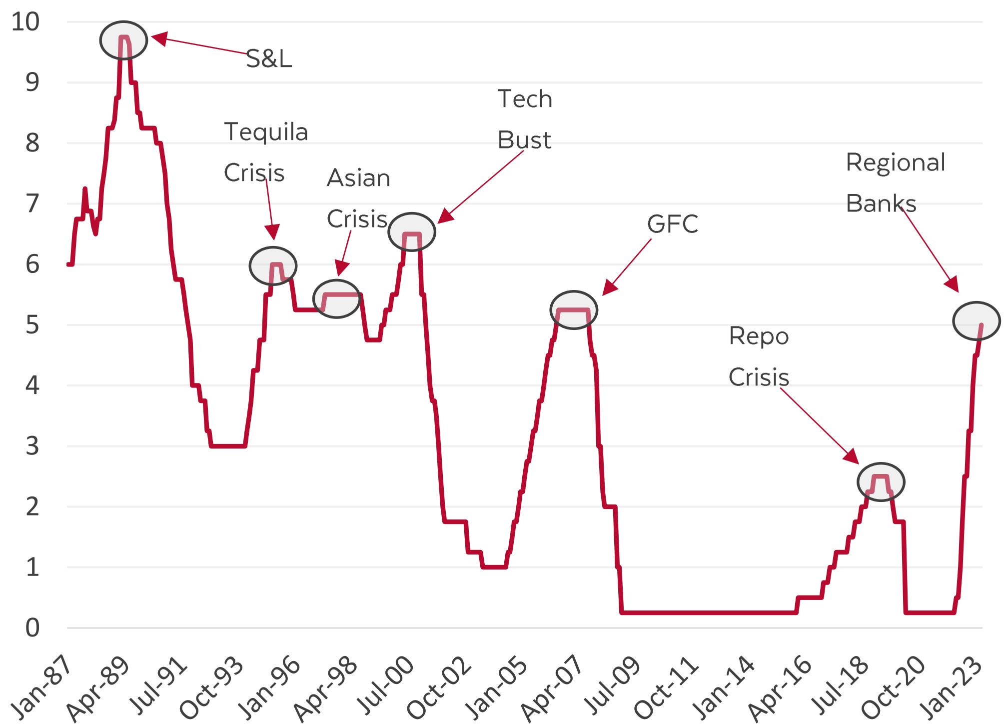
One venture capitalist had placed a deposit of $50mn with them. The combination of mark to market losses on a government bond portfolio, plus a deposit base skewed towards larger deposits, proved fatal.

SVB is not the only bank which sits with unrecognized losses on its bond portfolio. One estimate placed the number of unrecognized losses in the US banking system at $620bn. Thus far, the failure of SVB has even spread to Credit Suisse, the second largest bank in Switzerland, as confidence has drained from the financial system. Its take-over by UBS, which was orchestrated by regulators in Switzerland, wiped out all of its subordinated debt holders and most of the value of its equity holders (with the exception of CHF 3.3bn). Only its deposit holders and senior debt holders were left "whole."

This wouldn't be the first time that rising interest rates had unintended negative consequences.

This wouldn't be the first time that rising interest rates had unintended negative consequences. Past interest rate hiking cycles have led to crises as diverse as the S&L crisis, the Asian Crisis and the Tech bust, amongst others. In fact, it is only the size of the unintended consequences which are up for discussion and hopefully we have seen the worst. However, this is not a given.

Chart 5: The Fed always breaks something



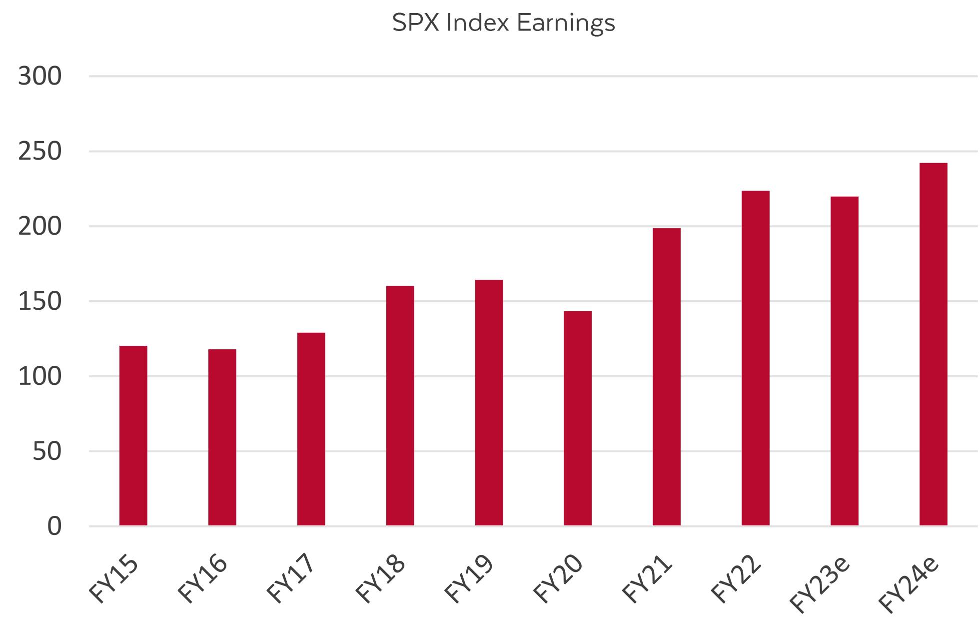
So where does this leave us? Albeit, with a better understanding of the tail risks that may be lurking out there, but no more constructive on equity valuations, which are still above their long run averages, despite very high interest rates and potential dark clouds on the horizon.

Asset Allocation

When our last Telescope was published, we gave reasons as to why we were moving underweight equities. In summary: valuations.

In December the S&P traded at a blended forward P/E ratio of 17X which was in line with the long run average of 16X. However, the "E" was based on highly optimistic forecasts given the likelihood of a recession. Since then, equities have become even more expensive.

Currently, the market forecast is for S&P earnings to shrink by only 1% this year and for earnings to grow by 10.1% the year after that.



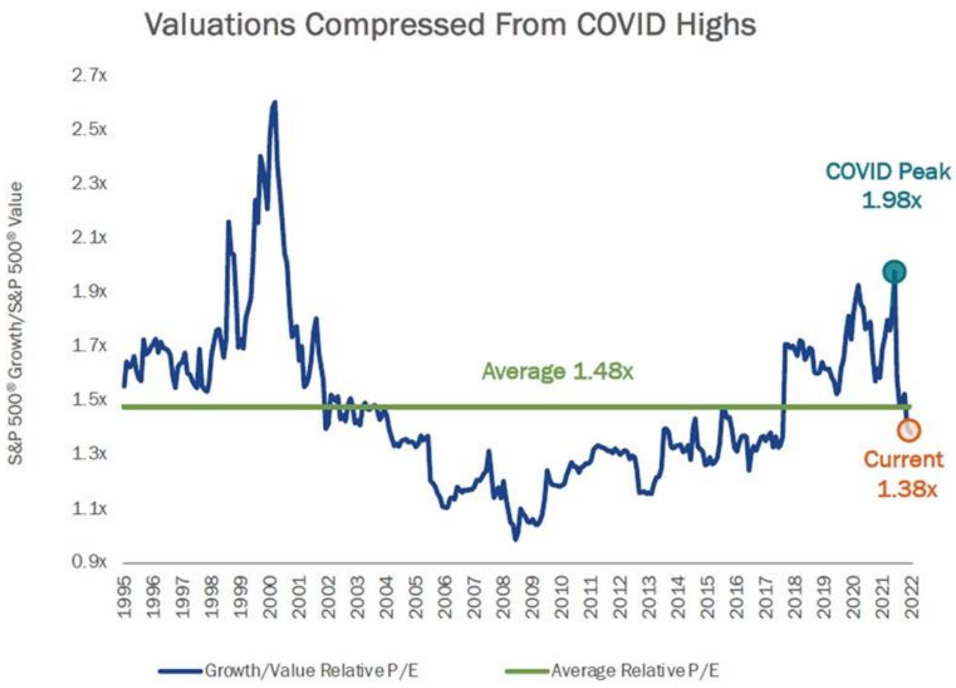
As a result, we have further reduced our equity exposure to below 50%.

Many economic indicators also appear to be moving against us. There are signs that inflation may be more persistent than we originally expected and interest rate hikes do not appear to be having the desired result of slowing down the economy in order to bring inflation down. A new nightmare scenario (although one which we would currently attach a low probability to) is beginning to unfold where inflation remains high, but the Fed is prevented from using the policy tools (raising rates, quantitative tapering) at its disposal to reign inflation in, for fear of exacerbating frailties in the financial system. This might result in prolonged stagflation of the type we last saw in the 1970's.

As a result, we have further reduced equity exposure in our flexible mandates. Our equity position of 54.7% at the end of last year had originally drifted upwards, as equity prices rose, to a peak of 58% in February. However, in March we took the decision to cut aggressively, to well below December's levels. Today, our flexible mandates sit with 48% equity exposure with the balance in cash and small positions (around 5% each) in gold and property. While incrementally more positive on bonds, we remain on the sidelines for now.

In the Q4 2022 Telescope, we noted that a number of sectors – including the technology sector – which sold-off heavily in the recent downturn were beginning to look attractive again. In fact, all growth sectors (of which technology was one), were trading below their mean discount to value sectors, as demonstrated in the chart below. That rebound has started to materialize with the Nasdaq rising 12.2% during the quarter.

Growth Multiples Have Significantly Compressed



As of 6/30/22.
Source: FactSet. See Notes in the Appendix for term and index definitions. Past performance does not guarantee future results.

While we remain cautious for now, we are forever on the look-out for new investment opportunities and we look forward to deploying the excess cash we have when valuations become more favourable.

Strategy Performance

The performance of the Flagship Strategies over 1 year to 31 March 2023 are shown below.

Fund of Funds Strategy		%Δ 1YR
Flagship IP Worldwide Flexible Fund of Funds	ZAR	9.5%
Flexible Strategy		**%Δ 1YR**
Flagship International Flexible Fund	USD	-14.7%
Flagship IP Worldwide Flexible Fund	ZAR	6.7%
Global Equity Strategy		**%Δ 1YR**
Flagship Global Icon Fund	USD	-17.1%
Flagship IP Global Icon Feeder Fund	ZAR	-1.1%

The difference in performance of both our Flexible strategy and Equity strategy when measured in US dollars and Rands is also noticeable and shows the extent to which the Rand depreciated during the quarter.

Beginning with our Fund of Funds strategy, we saw the funds with a more growth bent outperform during the quarter. These include Sands Capital (+16.5%), Guinness Global (16%) and Artisan Global Discovery (11.5%) which were buoyed by the performance of the Nasdaq. This was in stark contrast with last year, when our growth managers were the worst performers, indicating the cyclical nature of fund performance and underscores why we hold a portfolio of funds, each with a different style. The only equity funds which delivered a negative return for the quarter were GQG Partners Global Equity and GQG Emerging Market Equity Funds (both down single digits). GQG Global Equity Fund was last year's best performing fund. Our South African bond ETF performed poorly during the quarter and was the largest detractor from performance due to the depreciation in the Rand, but we continue to believe in the investment case for SA government bonds given the inflation adjusted yields they trade on.

In our Flexible strategy, the largest contributors were Zalando, Applied Materials and NewGold. The largest detractors were Capri, Endava and Schlumberger. All three of the latter have been substantial contributors to longer term performance and we believe the causes of the recent poor performance are temporary. In some instances, the reasons of the recent sell-off will even ultimately benefit their businesses. In Capri's case, the market responded negatively to a revenue number which disappointed, but this was due to it withdrawing inventory from its wholesale channel. The wholesale channel refers to it supplying department stores with handbags who, in turn, sell to the end customer as opposed to it selling handbags to the end customer itself. However, the wholesale channel has always been a poisoned chalice for the company because, while it can be lucrative in the short-term, department stores can damage the brand's equity value when they sell excess inventory at sharp discounts at the end of a season.

Finally, in our Equity strategy, many of the contributors and detractors were the same as our Flexible strategy. There were two exceptions. Firstly, Microsoft took the place of Newgold amongst our top contributors. Secondly, International Flavours and Fragrances (IFF) took the place of Schlumberger amongst the detractors. In IFF'S case the market responded poorly to a revised Q1 guide that was substantially below the guidance they gave in December. However, they retain substantial pricing power and any short-term volume declines they experience will be temporary. Ultimately, IFF trades at a sharp discount to its peers, even though we believe it has rosier longer-term growth prospects.

The difference in performance of both our Flexible strategy and Equity strategy when measured in US dollars and Rands is also noticeable and shows the extent to which the Rand depreciated during the quarter. This once again demonstrates the wisdom of having a globally diversified investment portfolio.

Activity in the first quarter of 2023 was moderate, with two buys and two sells for the equity strategy.

In Q1 we added Endava and Becle to the funds.

Endava (buy)

Endava is an IT services company that advises other corporates on their digital transformations. It uses a near-shoring delivery model, with most of its engineers based in Romania, while its clients are based in the UK, US and developed Europe.

Endava is a stock we have held before. Recessionary fears have given us the opportunity to hold it again and we recently began rebuilding a position. The market expects its revenues to fall as a result of cuts to corporate IT budgets. We believe Endava's revenues will be more resilient because digital transformation budgets are increasingly viewed as a "stay-in-business" line item in corporate income statements as opposed to a "nice-to-have."

Longer-term, Endava is very well-positioned in the most attractive niche of IT services and we expect its revenues and earnings will continue to compound at very high rates, well north of 20%. Today, Endava trades on 20X blended forward earnings.

Becle (buy)

Becle will likely be an unfamiliar name to most investors, who might be better acquainted with the company's flagship brand – Jose Cuervo Tequila.

With its roots in Mexico dating back more than 250 years, Becle has a stronghold in the global tequila market, controlling roughly 30% of sales volume – more than double that of its nearest competitor. Like Champagne, Tequila can only be produced and bottled in a region known as the Appellation of Origin. Becle is the largest producer of Agave Azul, tequila's raw ingredient, within the Appellation of Origin.

The company has also diversified into other spirits, and via its acquisitions of Bushmills, Proper Twelve and Sexton, it is now the 3rd largest producer of Irish whiskey in the world. Apart from its tequila and whiskey operations, Becle also owns numerous other spirit brands such as Kraken Rum, Boogles Gin, Three Olives Vodka and Stranahan's American whiskey.

The opportunity for Becle is twofold: penetration and premiumization. Tequila as a percentage of worldwide volume is still low, but outgrowing the overall industry substantially. In the US, tequila's largest market, it has moved from the 4th largest spirits category in 2020, to the 2nd largest by 2022, overtaking American and Canadian Whiskey in the process. It is set to overtake Vodka by the end of 2024. There has also been a strong trend toward premiumization, and while Becle has products in premium segments, they are actively attempting to move larger parts of their portfolio into this segment.

In Q1 we sold Adobe and Hyprop from the funds.

Adobe (sell)

Adobe is one of the highest quality businesses out there. Its products are indispensable to its clients and its software-as-a-service model generates high margins which it converts into free cashflow at very high rates. Management's reputation took a knock after its controversial purchase of Figma but even this cannot detract from the positive fundamentals of the business.

Adobe is a business we would love to own, but our valuation discipline does not permit us to own a business – even a great business – at any price. At a 30X blended forward earnings multiple on a GAAP basis (many analysts, incorrectly in our view, base their earnings multiples on "adjusted" earnings which makes the earnings multiples appear lower), Adobe is simply too expensive.

Given the uncertainty around the ongoing Figma acquisition and current high valuation levels, we prefer to sit on the sidelines for now.

Hyprop (sell)

Hyprop is one of the largest shopping mall owners in South Africa. Its portfolio includes Canal Walk, Hyde Park and Rosebank malls amongst others.

We had held Hyprop for a while, primarily because we felt that the discount it traded on relative to the value of its property portfolio was too steep.

We continue to believe this, however, the time horizon for any discount unwind has lengthened and there are better opportunities in the interim. Many of the positive catalysts for the share are behind it (such as the unwinding of its complex Eastern Europe structure) and the future looks increasingly murky. This is due to a combination of a challenged consumer in South Africa as well as load-shedding, which is bad for its costs of operations.

Three equity investing metrics to watch

By Kyle Wales

We live in tumultuous times. Since one of the steepest interest rate increases commenced last year, and with a recession on the horizon, the focus of the prudent investor needs to shift away from solely focusing on potential upside towards mitigating downside risk as well. The importance of capital preservation is perhaps best captured in Warren Buffet's quote: "Rule No. 1 (of investing): Never lose money. Rule No. 2: Never forget rule No. 1." The following are the three key metrics which I believe investors should monitor to mitigate downside risks.

Price/Earnings ratio

Most investors would have heard about the price-earnings (P/E) ratio because it is the most commonly used metric to assess valuation. The P/E ratio measures the price you would pay for a share in the company at any point in time versus the earnings it is generating.

The measure gives an indication of whether a company is expensive or cheap relative to its peers or history. Thus, when it comes to managing risk, it should inform whether to invest in the asset or not because, regardless of the business specifics, the price you pay for the asset will determine the returns you receive from it in the future.

Even a very good business can make a poor investment at the wrong price, while a poor business can be a good investment at the right price.

The focus of the prudent investor needs to shift away from solely focusing on potential upside towards mitigating downside risk as well.

At current levels, overall equity valuations are not particularly cheap if one considers the weak economic outlook and considerable uncertainty weighing on financial markets. The S&P 500 trades on a forward P/E of 17.2X versus a historical average (from 1997) of 16.5X. The forward P/E is based on forecast rather than historical company earnings.

Compounding the risks attached to this indicator is that the forward earnings estimates are based on rosy expectations. While most investors think that a recession is likely in the next 12 months, the market expects earnings for the S&P to decrease by only 1.2% in calendar 2023 and increase by 10% in calendar 2024 (as at 14 March 2023).

Revenue growth

Most fundamental investors (whether they invest based on a value or a growth mindset) try to invest in high quality businesses, even though they may differ with respect to the price they are prepared to pay or the growth rate in revenue and earnings they target. Characteristics of a high-quality business include a moat, which is the company's ability to maintain its competitive advantage, high returns on its invested capital and high free cashflow conversion, which is the business's efficiency in turning sales into cash. Most importantly, it includes pricing power, because the company's capacity to sell its products and services at a profit will determine its revenue growth.

Certain types of businesses have very little pricing power. Miners and other commodity producers are examples of these. In a "stagflation" type scenario, where high inflation is paired with low economic growth, it is not inconceivable that miners of commodities that are sensitive to economic cycles might experience declining prices at the same time as their costs increase, squeezing their profit margins.

That said, investors should also not have unrealistic expectations about a business's ability to pass on price increases because even the best quality businesses may find it difficult in challenging times, such as those we are currently experiencing.

Unilever, a very high-quality business, reported consolidated underlying pricing growth of 11.3% for its financial year ended December 2022, but this was still not sufficient to offset raw material inflation and came at the expense of volumes, which shrank by 2%. However, we expect Unilever to claw back profits by raising prices when raw material inflation slows.

Net debt/EBITDA

Another key metric to watch is net debt/Earnings Before Interest, Tax, Depreciation, and Amortisation (EBITDA), which is a useful measure because it highlights the extent of debt taken on by a company relative to its operational earnings.

A good example of a company to reference here, and one with which the South African investor will be familiar, is Anheuser Busch Inbev (ABI). Post its takeover of SABMiller, ABI was saddled with an enormous amount of debt. Its net debt/EBITDA rose to almost 5X after the transaction, which far exceeded the normally acceptable threshold of 2.5-3X. Even today, more than five years later, its net debt/EBITDA is still a substantial 3.7X.

High levels of debt are concerning, especially in the current environment when interest rates are rising steeply to rein in inflation, because debt must be refinanced at higher yields if the company does not have sufficient cash on hand to settle debt as it matures.

According to ABI, however, "the bond portfolio has a very manageable pre-tax coupon of approximately 4% with 95% of the portfolio at a fixed rate, a weighted average maturity of greater than 15 years and no relevant medium-term refinancing needs". We believe this debt profile reduces the risk of a large debt burden becoming substantially unsustainable.

In good times, investors are almost always rewarded for taking additional risks. In bad times, taking on additional risk can be detrimental to investment performance. Investors need to be aware of the risks they are taking and protect themselves as far as they can if they want to achieve superior long-term returns – and these three measures give you crucial insight into the potential performance of assets you are considering adding to your portfolio.

In good times, investors are almost always rewarded for taking additional risks. In bad times, taking on additional risk can be detrimental to investment performance.

Investment Case: Amazon

By Gerhard Janse Van Vuuren

At current valuations you are getting Amazon Web Services at a fair price and the Amazon.com platform for free.

⇒ Amazon started as an online bookstore and has since become one of the largest e-commerce platforms in the world. The company is also active in the streaming, advertising, and web hosting service industries.

⇒ Amazon is well placed to benefit from the technological trends around the world. We also believe that the market underestimates Amazon's pricing power and assumes that Amazon Web Services growth will slow down substantially.

⇒ We believe Amazon is currently mispriced as the market is using a high risk-free rate to discount its future earnings, leading to a smaller value per share.

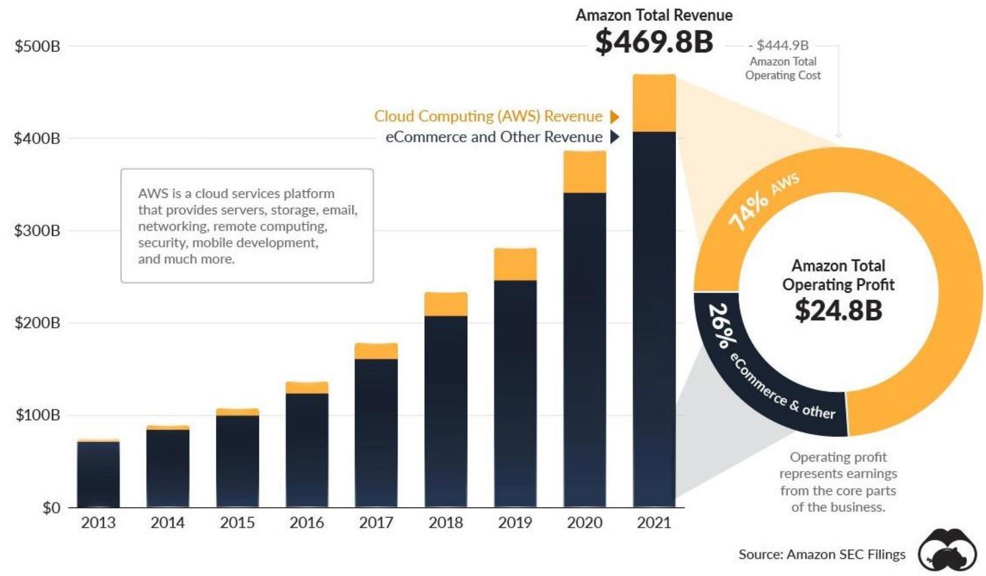
⇒ At current valuations you are getting Amazon Web Services at a fair price and the Amazon.com platform for free.

"We have had three big ideas at Amazon that we've stuck with for 18 years, and they're the reason we're successful: Put the customer first. Invent. And be patient."

-Jeff Bezos

Amazon started out as an online bookstore but has since evolved into a much more dynamic and multi-faceted business. The company has subsequently expanded into online retail, streaming and advertising. The most notable of their businesses, however, is cloud storage – Amazon Web Services (AWS).

As at the end of 2021, AWS contributed around 13% of revenues but a massive 74% of the group's operating profit. eCommerce consists of 69% of revenues but contributed less than 25% of operating profits. Amazon also owns several other businesses including subscription services which don't contribute meaningfully to revenue/profit today, but have the potential to be large in the future.



AWS (13% of revenue, 74% of operating profit)

Amazon Web Services is an integral part of the valuation of the company and an area where significant future value should accrue. AWS is the world's most comprehensive and broadly adopted cloud platform, offering over 200 services from data centres around the globe.

As at the end of 2021, AWS contributed around 13% of revenues but a massive 74% of the group's operating profit.

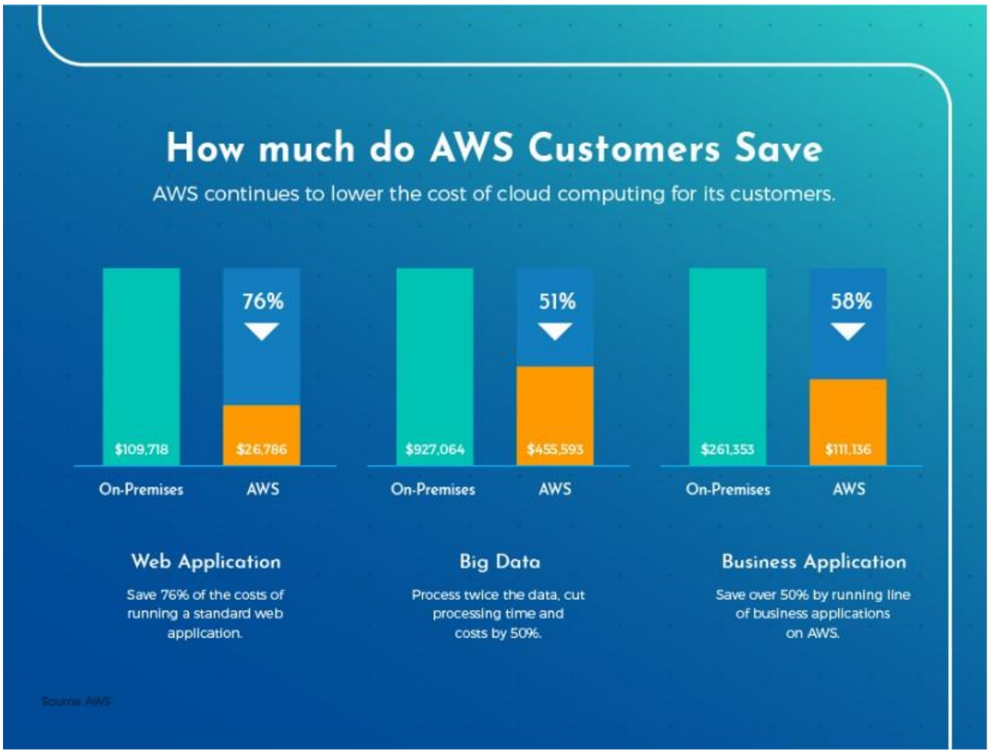
Cloud businesses can be split into different categories based on the services they provide such as IaaS (Infrastructure-as-a-Service), PaaS (Platform-as-a-Service), SaaS (Software-as-a-Service) and On-Premise. Amazon mostly competes in the IaaS and PaaS space, which make up around 50% of the entire cloud market. Within this, AWS is expected to have captured 47% of this market. This means AWS has captured 25% of the global cloud market!

If a company provides its client with servers, virtualisation, as well as computing resources, then the company would be classified as an IaaS business. IaaS means that a company such as AWS installs and maintains the servers, storage, and physical aspects of the IT infrastructure. The client therefore gains the advantage of not spending a huge amount on up-front capital to install and maintain these systems, but rather out-sources it to Amazon.

One of the major selling points of using such a service, from a client point of view, is that this provides them with flexibility. Cloud services are not just a once-off purchase; therefore, the company can scale the level of services they would like from AWS up and down as needed. If a client wants to scale up their system to do some heavy computing, they can scale it up in a matter of seconds and scale down as soon as they are done.

It is easy to see why businesses prefer this model compared to the traditional way of doing things where you have your own servers and no scaling is possible (at least not in a reasonable timeframe). The advantage from AWS's perspective is that as soon as a customer has fully migrated to the cloud platform and trained their staff on using it, it is very costly and time consuming to move to another provider, resulting in a low churn rate. This helps to maintain existing clients and, given that Amazon is already the biggest IaaS provider, it helps to defend their competitive position.

The 2nd step in the story for AWS is that as soon as a customer has fully migrated to the cloud platform and trained their staff on using it, it is very costly and time consuming to move to another provider.



eCommerce Platform (69% of revenue, ~25% of operating profit)

Another aspect of the Amazon investment case is the e-commerce platform. It can be split into 2 segments:

- 1st Party (or 1P)
- 3rd Party (or 3P)

1P is where Amazon lists, sells, and ships goods on Amazon.com using their own suppliers, warehouses and, mostly, their own couriers.

3P is where Amazon allows other companies to list and sell goods on the Amazon platform for a fee. In addition to this, the companies can opt to let Amazon fulfil the order for them by shipping their products to the Amazon warehouses and Amazon will then take care of the rest, such as payment processing and specifically the shipping to the customer. Amazon has substantial bargaining power in this segment, as evidenced by charging the 3rd Party fulfilment clients both a fuel and holiday surcharge last year.

Subscription service (6% of revenue, 0% of operating profit)

Amazon subscriptions work differently from Amazon's other businesses because rather than being a profit centre on its own, it is meant to entrench the loyalty of their customers. Amazon offers Amazon Prime as a monthly subscription which grants customers access to a variety of Prime Member benefits. These include perks such as free or reduced shipping, exclusive access to sales, free movie streaming and access to other services. As of late, Prime Members also have free access to Amazon's full music catalogue which has around 100 million songs. Members consist mostly of wealthier clients for whom it is a no-brainer given the shipping benefits. Prime currently has more than 200 million members worldwide.

With Amazon's new launch of Buy with Prime (BWP), this allows websites (merchants) to add a BWP payment option on their own websites. Prime subscribers can then buy products on websites that offer this with minimum effort. Amazon can then process payment, fulfilment and returns on behalf of the seller. For companies who don't operate at a very large scale and do not have their own fulfilment networks, this is a very enticing offer.

Valuation

The final part is valuation. If I use the following assumptions for AWS only (i.e., excluding the retail business):

- Revenue growth rate of 15% to 2027 (last year 28%, last 5 years 35% CAGR)
- Normal margin is in line with the current margins for AWS of 28%
- P/E multiple of 20

Amazon currently trades at the fair value of the AWS business only. Buyers of the share are getting Amazon.com (1P + 3P), one of the largest ecommerce businesses in the world, as well as its internal ad platform, entirely for free.

Conclusion

Amazon's cloud business is hugely profitable compared to their other segments. The increasing adoption of cloud computing will lead to continued growth of the AWS segment, providing margin uplift to the entire business. The e-commerce and subscription businesses should, however, not be under-estimated, as they are right up there with the leaders in their industries and margins are currently depressed. Amazon is a high-quality business and we believe it offers compelling long-term value at the current share price.

Amazon's cloud business is hugely profitable compared to their other segments. The increasing adoption of cloud computing will lead to continued growth of the AWS segment, providing margin uplift to the entire business.

In conclusion

We write these Telescopes so that our investors know what it is we are doing, and why we are doing it. For many of you, we are the caretakers of your global investments, and we would like to use this opportunity to thank you for the trust you place in us, and emphasize how deeply committed we are to the responsibility you have placed in our hands.

We believe it is of the utmost importance that all clients feel a true sense of the word "Partnership" in how we are aligned. Our portfolio management team reflects this with significant personal investments in the Flagship strategies.

Flagship funds own a selection of businesses that we believe to be of unusually high quality, and will prove to be financially resilient whatever the prospects of the global economy.

We expect the value of these businesses to rise at an attractive rate over the coming years, and that owning these businesses at a discount to what they are worth will make an additional contribution to your returns.

While we believe that Flagship funds will continue to outperform over longer-term periods, there will inevitably be shorter-term periods over which our funds will not outperform. This is the nature of markets – one's alpha (or excess performance relative to one's benchmark) is lumpy and doesn't accrue in a straight line.

Warm Regards,

Kyle and the Flagship Global Team

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