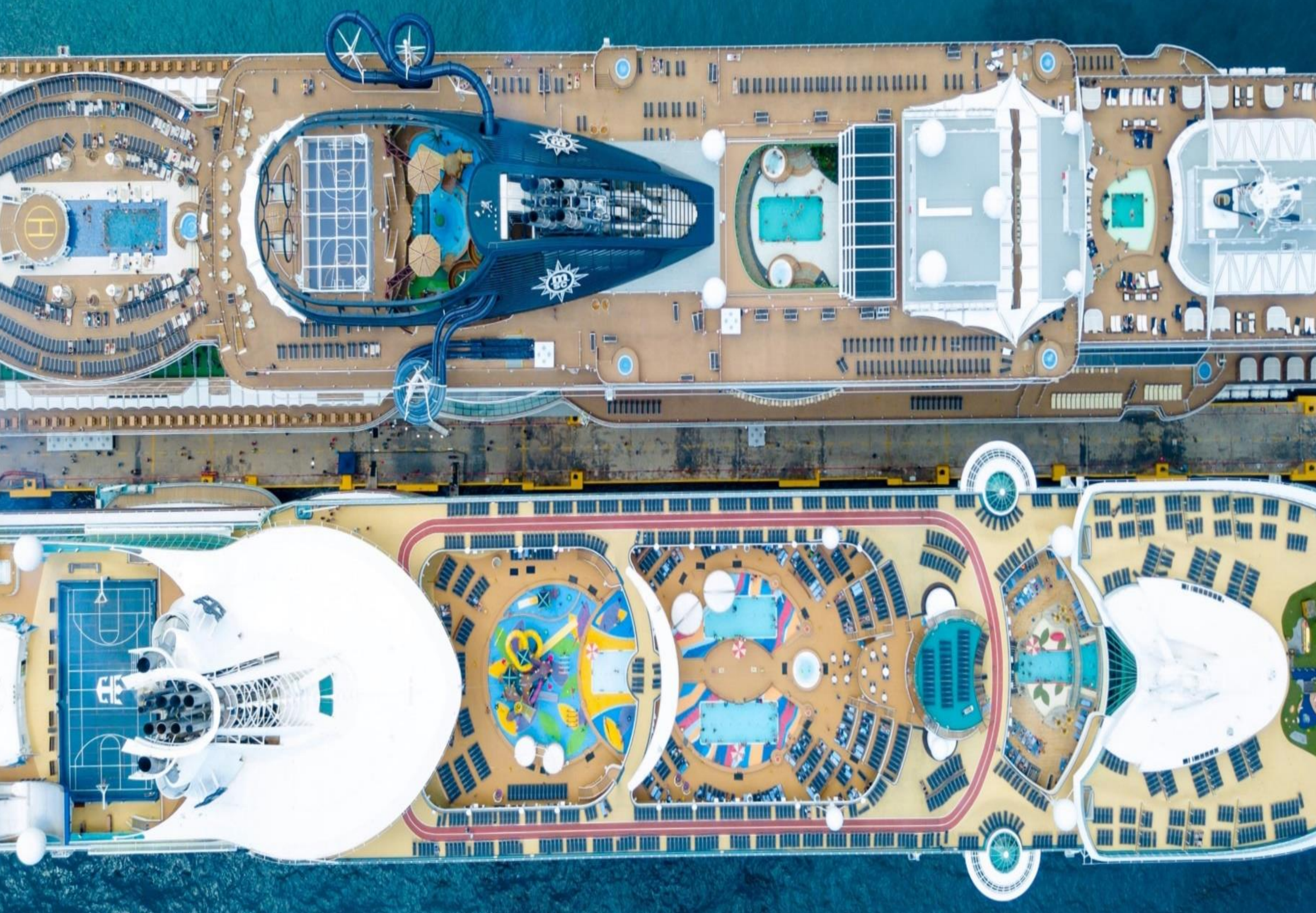
FLAGSHIP
ASSET MANAGEMENT



Quarterly Telescope Q4 2023

Flagship Asset Management · Constantia, Cape Town · +27 (0)21 794 3140 · info@flagshipsa.com

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 30 shares, diversified across geography and sector.

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The Flagship Global Investment Team

Kyle Wales CA (SA), CFA

Kyle is a fund manager of the global funds at Flagship and has been investing internationally for over 15 years. Prior to Flagship, he worked at Coronation Fund Managers for 9 years in the Global and Global Emerging Markets teams and also co-managed a global equities boutique at Old Mutual Investment Group. Kyle is a qualified chartered accountant and CFA charter holder.

Philip Short BSc (Maths), CFA

Philip is a co-fund manager of the flexible strategies at Flagship and brings specialist macroeconomic expertise to the global team. Philip has gained 19 years' experience in the industry at JP Morgan, Fairtree Capital and Old Mutual as an analyst and portfolio manager. He completed his Bachelor of Science in Mathematics at the University of Pretoria and is a CFA charter holder.

James Hayward (BEng), CFA

JD, as he prefers to be known, is a co-fund manager of the flexible strategies at Flagship, while also fulfilling an equity analyst role for the global team. Prior to Flagship he worked as an engineer and also spent 2 years at an Edu-tech startup in Cape Town. JD graduated from Stellenbosch University with a BEng (Civil) in 2016 and is a CFA charter holder.

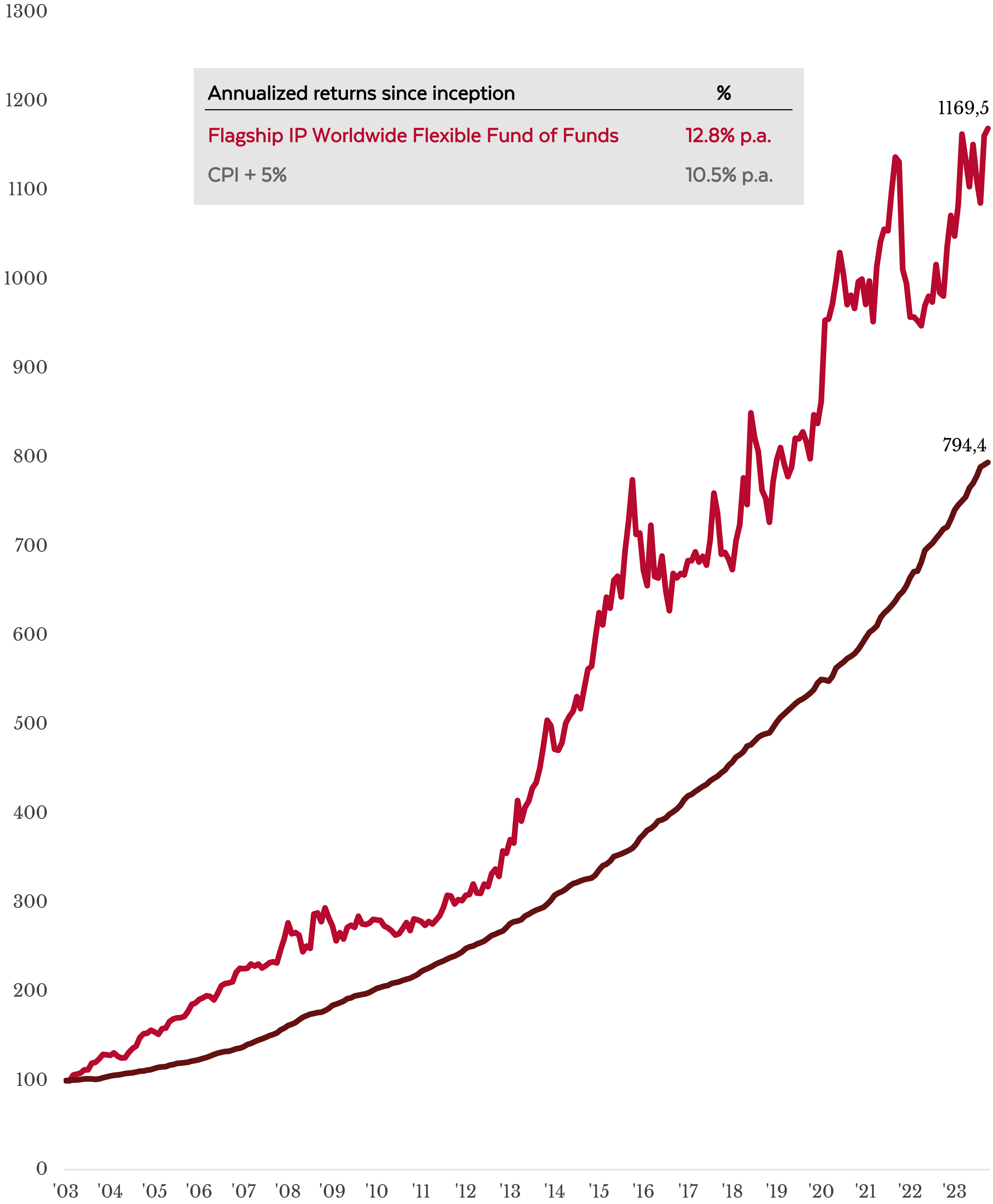
Gerhard Janse van Vuuren (BCom)

Gerhard is an equity analyst for the global team at Flagship. He completed several investment internships while concluding his degree in Investment Management at the University of Stellenbosch. Gerhard has passed Level 1 of the CFA exams and is currently furthering his studies with an Honours degree in Finance at the University of Cape Town.

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 December 2023 (20 years, 9 months)



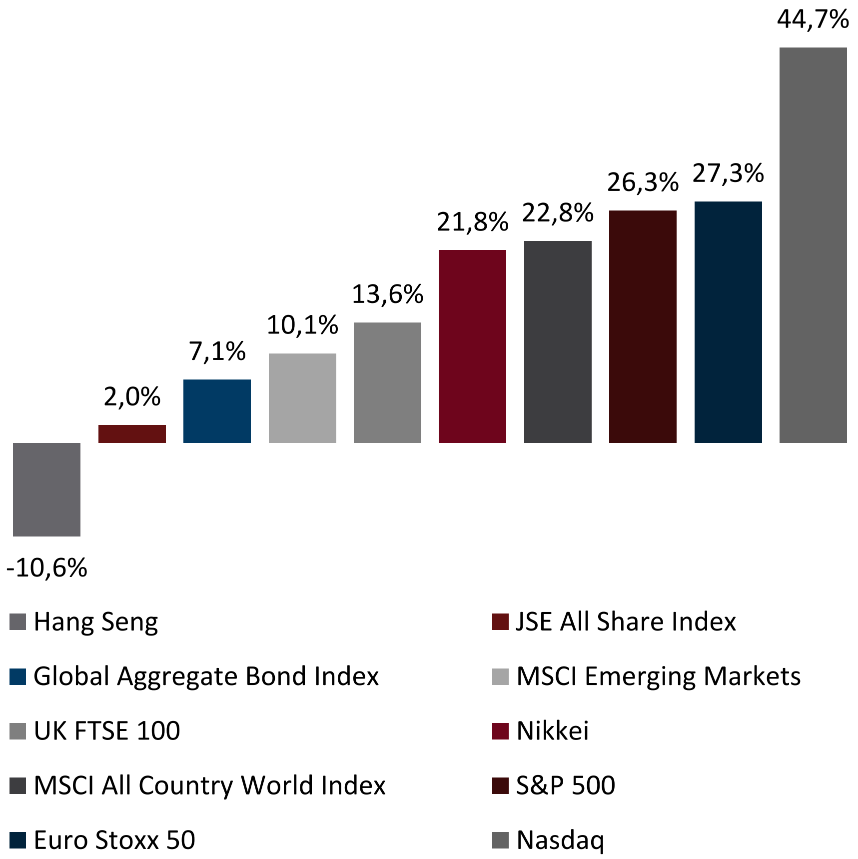
Annualized returns since inception	%
Flagship IP Worldwide Flexible Fund of Funds	12.8% p.a.
CPI + 5%	10.5% p.a.

Breaking the Piggy Bank?

"He who buys what he doesn't need steals from himself."

- Swedish proverb

Chart 1: Global Index returns in USD (Dec 31, 2022 to Dec 3, 2023)



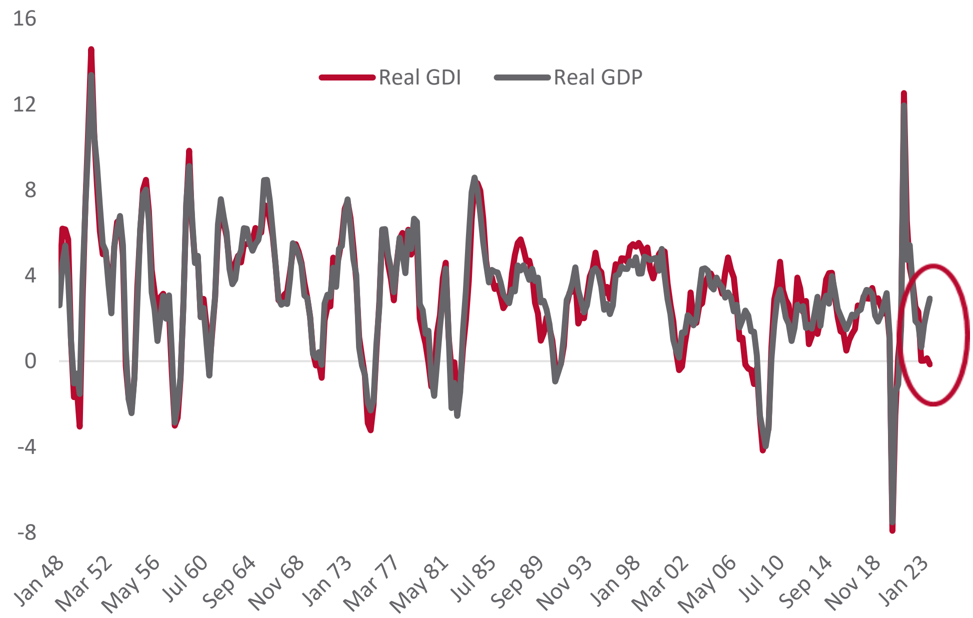
The US 10-year Treasury rate is one of the key variables investors use in their valuation of most asset classes, as it is the benchmark rate at which investors can borrow.

The year ended off with a strong fourth quarter, bringing annual returns for equities into high double-digits across most geographies. The same can't be said for South Africa which returned 2% in USD and approximately 10% in ZAR. The fourth quarter saw some stealth manoeuvring by the US Treasury as they refinanced some long-term debt that matured in November with short-term Treasury Bills which spurred the market forward. Along with the Federal Reserve signalling that the interest rate hiking cycle is at an end and that we can look forward to some rate cuts in 2024, the markets moved higher. The US 10-year Treasury rate is one of the key variables investors use in their valuation of most asset classes, as it is the benchmark rate at which investors can borrow. Starting the year at 3.5%, the US 10-year rate moved to 5% in Q4, its highest level since 2007, before closing the year off at 4%.

As many of you who read our Telescopes may know, we at Flagship have been cautious on the state of the global economy for a while. Despite the fact that many of the better known and most followed measures, like Gross Domestic Product (GDP), are indicating that the economy is in robust health, there are other factors that are beginning to flash red. One such factor is the emerging disconnect between GDP and Gross Domestic Income (GDI) shown in the following chart.

Both GDP and GDI measure an economy's activity, but do so from different perspectives. GDP measures total spend and is the more common measure. GDI measures total income (salaries, wages, corporate profits, taxes, etc.). Over time, the two measures should equal each other; if I buy something from someone, that someone is earning (income), an equal amount of what I have just spent. Interestingly, over the 3rd quarter of 2023 in the US, GDI came in slightly negative (-0.15%), while GDP was relatively strong, resulting in a meaningful difference.

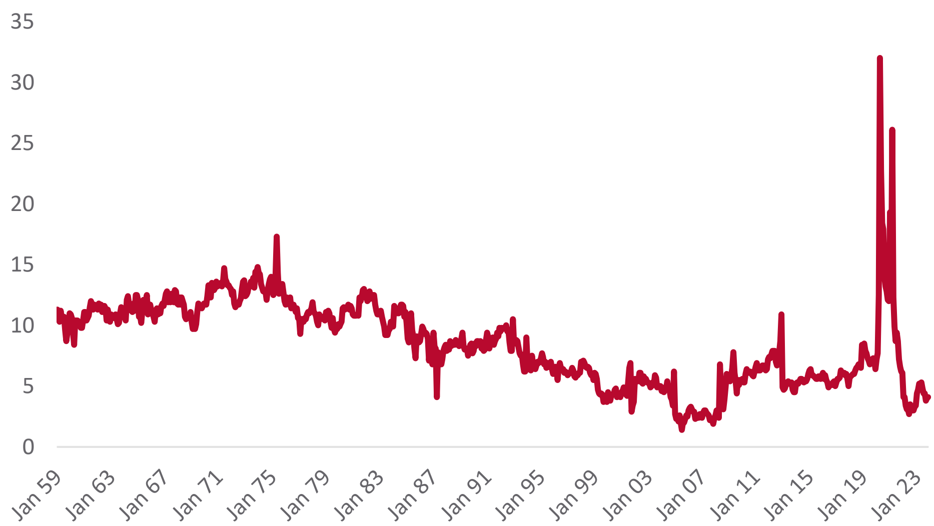
Chart 2: US Real GDI and GDP (annual % change) from Jan 1948 to July 2023



If GDP follows GDI downwards into negative territory, the US will enter a recession.

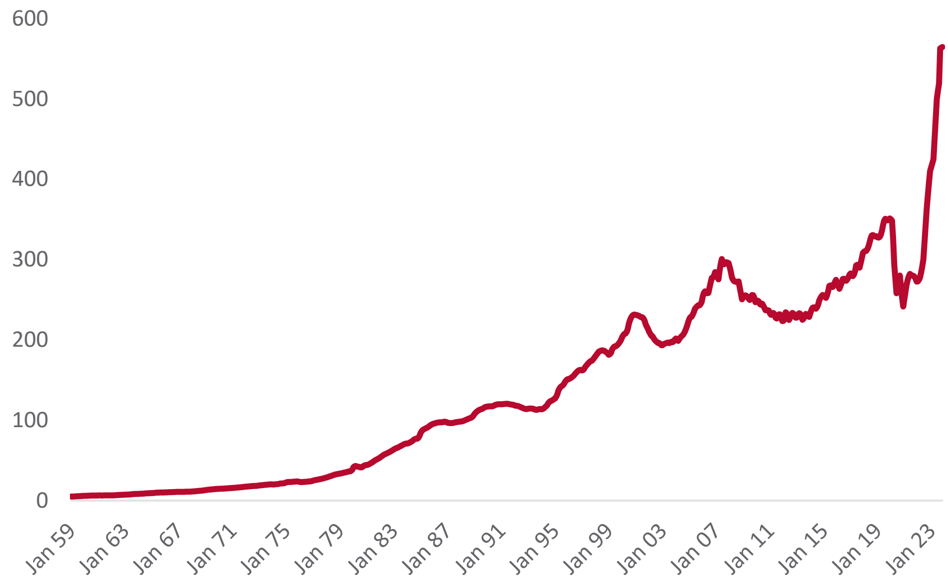
The consequence is quite noteworthy. If GDP follows GDI downwards into negative territory, the US will enter a recession. Conversely, if not, the US will avoid a recession. So, how do we solve for the difference between GDP and GDI? One reason could be that people are spending more than they're earning, dipping into their savings. The dip below trend in nominal personal savings in Q3 2023 suggests this to be the case, after the eye-watering cash handouts the government gave its citizens during Covid. How much savings do consumers have left to keep GDP ticking higher? At the current rate of savings depletion, until about mid-2024. One caveat, we do not know where the savings were spent. They could've gone into investments which could get liquidated into cash if needed. Or, as I suspect, a large portion went into good ole US consumption.

Chart 3: US Personal savings rate (%) from Jan 1959 to Nov 2023



The personal savings rate, which is relative to disposable income, is currently very low and below trend. When unemployment moves higher, which it will, given the natural business cycle and current tight labour markets, there is very little in terms of savings to act as a cushion. We also note the high levels of consumer debt and, along with higher rates, the higher personal interest payments, shown below.

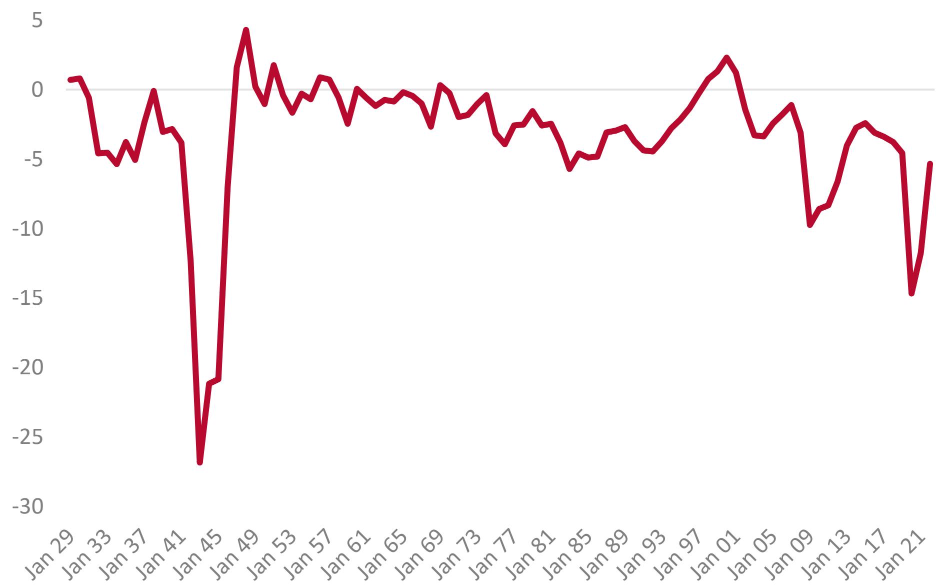
Chart 4: US Personal interest payments (USD billion) from Jan 1959 to Nov 2023



One only needs to look at the US Federal account, which has run a deficit since 1960, to see that that the US is spending more than the country's economic output.

The US as a whole, including the government and its agencies, has seen its net saving as a percentage of gross national income fall into negative territory. This has only happened during the Great Depression, the Global Financial Crisis and, briefly, in Covid. One only needs to look at the US Federal account, which has run a deficit since 1960, and significantly so since 2000, to see that that the US is spending more than the country's economic output.

Chart 5: Federal surplus or deficit (% of GDP) from Jan 1929 to Jan 2022

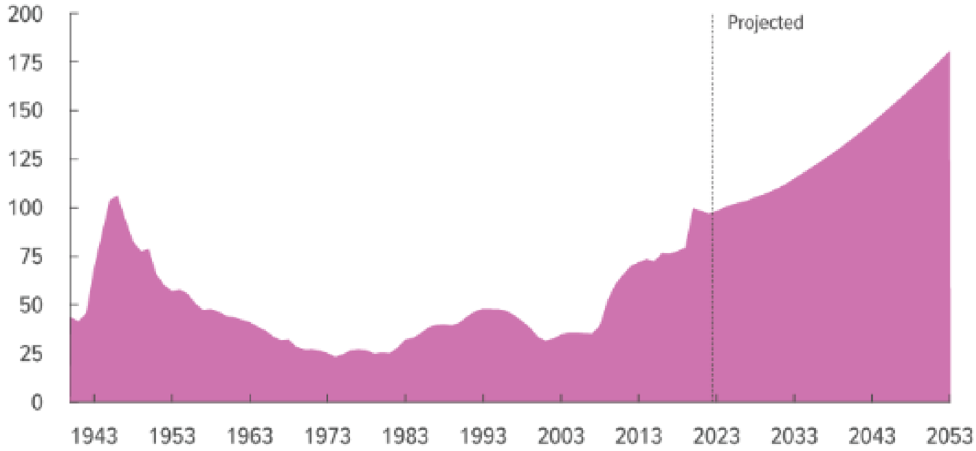


We also note that current tax receipts have gone negative year on year. So, the US is spending more every year, and significantly more so relative to the economic output of the country, and its tax receipts' growth (basically the government's income) has gone negative.

Since 1950 there have been 12 recessions. In every period that there was a recession, US government tax receipts were negative, year-on-year. The coincidence seems rational: if the economy is making less money (recession), tax receipts will be lower There were, however, two periods where tax receipts were negative and there was no recession; in 1964 and 2017. In 2017 there was a noticeable decrease in corporate tax rates, which explains that change.

So, if the country is spending more than they're earning and producing, where are they getting the money to spend as much as they are? The answer is debt, and lots of it. Currently, the US "Debt as a Percentage of GDP" is 120%, as high as it was since the end of World War 2, as the below chart illustrates. If you think the debt issue is temporary, that doesn't seem to be the case. The US' own Congressional Budget Office forecasts "Debt to GDP" to increase to c. 200% by 2053. The US debt development is something we are keeping a close eye on, as it has significant implications on a number of asset classes.

Chart 6: Federal debt held by the public (% of GDP)



If the country is spending more than they're earning and producing, where are they getting the money to spend as much as they are? The answer is debt, and lots of it.

Are the markets discounting the high levels of federal debt, deficits and negative tax receipts, along with the current 'health' of the US consumer and US economic outlook? We don't think so. Based on the current 12-month forward PE multiple of 19.7X, the US is being priced at the very high end of its 20-year valuation range (which has a median of 16X), i.e. it's currently expensive. Simultaneously, Emerging Markets and Asia Pacific are cheaper in absolute terms and relative to their own history, versus the US.

In summary, we observe the US is close to, or at, a savings deficit. Over the last 12 months, consumers have eaten into their savings and have racked up debt. The same applies to the US Government: running deficits, spending more than they earn, and taking on more debt. Interestingly, this is sustainable for a while - the US can take on more debt to fuel growth, but it will affect things like the US Treasury market and the US Dollar which need to be considered. Having said that, the longer the US drinks from the debt-fuelled punchbowl, the more "hungover" its economy will be when the inevitable recession comes.

Asset Allocation

There are other opportunities globally when deciding on asset allocation, and even within expensive geographies. If you dig deep enough, you are bound to find some compelling investment opportunities. Looking at a handful of countries, we can see that Mexico and Brazil have decent Industrial Production ("IP", another proxy for economic output) while having ample room to bring down interest rates to further spur economic growth, while inflation is at moderate levels.

Regions	CPI YoY		Central Bank Rate		IP YoY	
	Value	Date	Value	Date	Value	Date
China	-0.5%	11/23	4.35%	01/24	6.6%	11/23
Germany	3.7%	12/23	4.500%	12/23	-3.5%	10/23
France	3.7%	12/23	4.500%	12/23	1.8%	10/23
United Kingdom	3.9%	11/23	5.250%	01/24	0.4%	10/23
Italy	0.6%	12/23	4.500%	12/23	-1.1%	10/23
Japan	2.8%	11/23	-0.10%	01/24	-1.4%	11/23
United States	3.1%	11/23	5.50%	01/24	-0.39%	11/23
South Africa	5.5%	11/23	8.25%	01/24	1.8%	10/23
Brazil	4.68%	11/23	11.75%	12/23	1.30%	11/23
Mexico	4.32%	11/23	11.25%	01/24	5.52%	10/23

There are other opportunities globally when deciding on asset allocation. If you dig deep enough, you are bound to find some compelling investment opportunities.

So how does this influence our positioning at Flagship? Firstly, for the reasons mentioned above, we have kept our equity exposure in our flexible funds at around the lower level of 60%. The difference (of 25-30%) sits in offshore cash, earning an attractive yield of 4.5% in US Dollars, which is in excess of US inflation rates. An additional benefit of cash is that it gives us the option to increase equity exposure when valuations become more favourable.

Secondly, we have been more selective in our geographic exposure. We have greater exposure to Europe, Japan and emerging markets, and less exposure to the US than normal.

Finally, in our stock selection funds, we have been buying stocks with more defensive characteristics and selling those that have a greater correlation to the economy. While this caution may appear overdone, we believe that our ultimate goal is to protect your capital against severe drawdowns, even if this means sacrificing some return in the short term.

Strategy Performance

The performance of the Flagship Strategies, net of fees, over the quarter and 1 year to 31 December 2023 are shown below.

Fund of Funds Strategy	Q4 '23	%Δ 1YR
Flagship IP Worldwide Flexible Fund of Funds (ZAR)	5.2%	19.2%
Flexible Strategy	**Q4 '23**	**%Δ 1YR**
Flagship International Flexible Fund (USD)	4.9%	7.0%
Flagship IP Worldwide Flexible Fund (ZAR)	2.7%	15.6%
Global Equity Strategy	**Q4 '23**	**%Δ 1YR**
Flagship Global Icon Fund (USD)	6.2%	7.6%
Flagship IP Global Icon Feeder Fund (ZAR)	3.1%	15.4%

Our Fund of Funds strategy returned 19.2% for the year, well in excess of its benchmark of CPI + 5% (which was up 10.9%), an excellent performance considering that the fund was only 60% invested in equities. All underlying funds delivered positive returns over the year with our 3 largest contributors being Guinness Global Innovators (up 50%), MSCI World Value (up 26%) and GQG Partners Global Equity (up 29%). The largest detractor was our cash holding, which is unsurprising, given how hard markets rallied.

Our Fund of Funds strategy returned 19.2% for the year, well in excess of its benchmark, which was up 10.9%.

Our Flexible strategy, the Flagship IP Worldwide Flexible Fund, returned 15.6% for the year versus its composite benchmark, which returned 15.2%. The largest contributor was our gold ETF holding (up 23%) followed by Informa (up 45%) and Applied Materials (up 80%). The largest detractors were International Flavours & Fragrances, Tapestry and British American Tobacco.

Our Global Equity strategy performed poorly this year. The biggest reason for this was that we held only two of the “magnificent 7” stocks (consisting of Apple, Microsoft, Alphabet, Amazon, Nvidia, Tela, Meta). When it comes to high equity valuations, we are cautious by nature, which may be limiting to short term fund performance. Longer term, however, we believe a valuation discipline is good for returns. The largest contributors to the Global Icon Fund in USD were Amazon (up 80%), Applied Materials (up 68%) and Informa (up 35%). The largest detractors were International Flavours & Fragrances, Square Enix and PagSeguro.

Another active quarter, the following are the primary changes we made in our equity strategy:

UnitedHealthcare (buy)

Pharma, which forms a large part of Health care, has always been a sector we have felt reluctant to play in. The reason for this is (1) pharma companies face a patent cliff (blockbuster drugs eventually go off patent allowing generic competitors to enter the fray) and (2) it is hard to assess whether their pipelines of new drugs is enough to offset this and then some. Our healthcare universe is therefore limited to medical equipment companies, medical insurance companies and hospital operators where we believe the revenue and earnings streams are more secure. It is therefore best to think of UnitedHealthcare as a combination of a medical insurer (like Discovery Health), a medical service provider and a hospital operator, (like Netcare). It trades on a fair multiple, considering the quality of its business, and its growth rate.

Expedia (buy)

Expedia, like Booking.com, is an online travel agent. We built our position in Expedia in early November when the stock was trading at a P/E ratio of a mere 11X. We felt this was far too low for a business of Expedia's quality. This proved to be a profitable decision. The company's announcement that it was commencing a USD 5 billion share buyback, which happened when 3Q23 results were announced, has subsequently acted as a catalyst to drive its share price upwards. Expedia now trades at 16X earnings and we estimate that meaningful upside potential remains.

Goldfields (buy)

We are currently in the perfect environment for gold to perform. The gold price is a function of two variables: (1) geopolitical risk – it tends to outperforms in periods of elevated political risk, and (2) the level of interest rates – gold tends to outperform when interest rates are low as the opportunity cost of holding gold is lowest. The outlook for both of these favours the gold price: firstly, geopolitical risk is at elevated levels due to the war in Ukraine as well as the war between Hamas and Israel in the Middle East, and secondly, interest rates are forecast to decline. In addition to this, central banks are adding more gold to their forex reserve mix, to possibly avoid the situation that Russia experienced when their forex reserves were confiscated by the US authorities after initiating a war with Ukraine. Finally, there is a fourth outlier factor which may favour gold. Due to the fact that the Fed has a dual mandate of "ensuring full employment" and "ensuring price stability" (other central banks don't have the first part of the Fed's joint mandate), it may be forced to monetize US debt to prevent the US from falling off a fiscal cliff. The US is running huge primary deficits at the moment and more than 40% of its government debt has to be refinanced over the next two years, at much higher rates.

In Q4, we bought Expedia, Goldfields and Mexican bank Grupo Financiero Banorte.

Why then Goldfields? Gold shares are much more geared to a higher gold price than the metal itself and goldfields currently trades at a steep discount to the other gold miners, despite it having an expanding production profile.

Grupo Financiero Banorte (buy)

As a result of increasing geopolitical tensions between China and the US, as well as policy uncertainty within China (China's zero-Covid policy stounds out in this regard), global multinationals are diversifying their supply chains away from China. Mexico seems to be an obvious beneficiary of this trend due to its proximity to the United States and, within Mexico, banks are likely to be the sector that benefits the most should the Mexican economy perform well. In addition to this, valuations are on our side, as Grupo Financiero Banorte trades on a mere 8X earnings.

PagSeguro into StoneCo (switch)

PagSeguro has been a long-term holding of your funds. StoneCo, like PagSeguro, is a Brazilian merchant acquirer. Both shares trade on very reasonable multiples and both stand to benefit hugely from the forecasted decline in Brazilian interest rates. However, StoneCo's execution has been far better than PagSeguro's recently, so we saw this as an opportunity to "trade up".

Alibaba into MSCI China ETF (switch)

Alibaba has been a long-term holding in your fund. As you know, Alibaba is the "Amazon" of China. Similar to Amazon, it is not only China's largest ecommerce business, but is one of its largest hyperscale cloud providers as well. Chinese shares trade at a wide discount to US shares currently. Part of the reason is due to Chinese regulatory risk, to which many of them have fallen victim, including Alibaba, Tencent and New Oriental. However, while we acknowledge that regulatory risk is higher in China than the US, we believe the valuation gap between Chinese shares and US shares is too wide currently and should narrow. Although we want to have exposure to China, we believe it imprudent to experience this exposure via a single share. For this reason, we switched our Alibaba holding into a broader Chinese index.

In Q4, we switched PagSeguro into Stone Co and Alibaba into MSCI China ETF. We sold Ultra Clean Technology, Square Enix and BAT.

Ultra Clean Technology (sell)

As a reminder, Ultra Clean sells components to the Semiconductor Capital equipment manufacturers like Applied Materials and LAM. All companies within the semiconductor industry are highly cyclical, because semiconductor demand and demand for semiconductor capital equipment, is influenced by the financial health of the consumer. The 'healthier' consumers are, the more they are likely to spend on durable electronics like PCs, iPads and mobile phones. In the US, we have seen a sharp deterioration in consumer confidence and an increase in defaults on consumer loans (as a result of higher interest rates). This, combined with our cautious view on the economy, does not augur well for semiconductor demand going forward. Ultra Clean, unfortunately, would likely perform worse than most semiconductor stocks in this scenario, as its low GP margins make it very susceptible to falls in its sales. Despite offering compelling upside, we believe that the risk of holding the stock outweighs the potential rewards, at this point in the cycle.

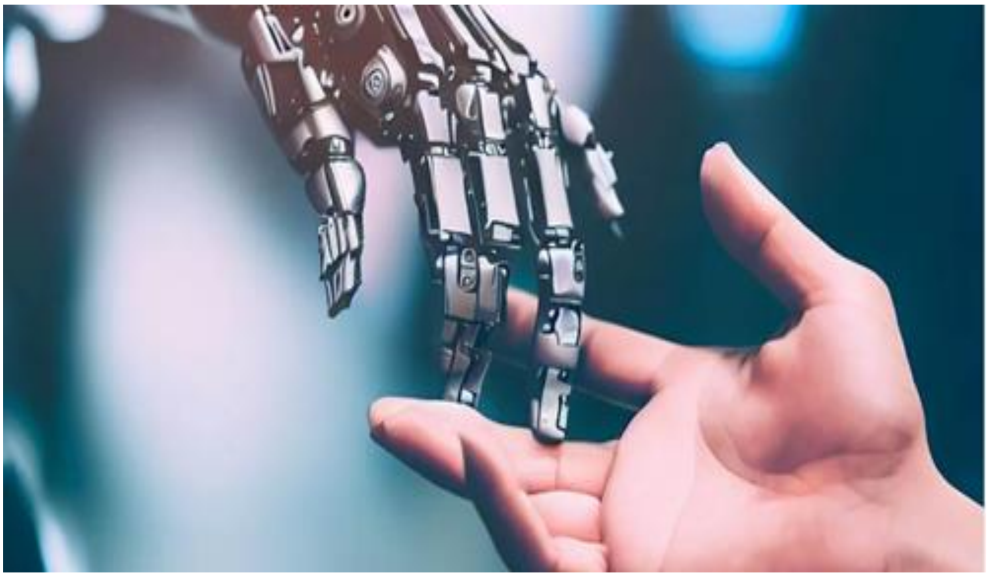
Square Enix (sell)

Square Enix is a Japanese gaming company. The reason for selling the share is because operational performance has been poor. Revenues have declined in recent years and a number of highly anticipated games (like Final Fantast XVI) have flopped. Another game, Final Fantasy VII, is expected to be launched in February, which may act as a potential catalyst for the share, but we believe its commercial success or lack of commercial success is just too difficult to call.

British American Tobacco (sell)

On a blended forward PE multiple of 6.1X (GAAP earnings) and a dividend yield of 10.4%, British American Tobacco had appeared to offer compelling value, despite the regulatory risks that are associated with holding tobacco stocks. However, another risk has emerged on the horizon, which dwarfs even regulatory risk, and which has prompted us to sell. There is preliminary evidence to suggest that GLP-1s, the active ingredients in weight loss drugs Wegovy/Ozempic, may also be effective in reducing cravings for cigarettes. These claims are being tested in a number of clinical trials but should they be true, the impact on both cigarette as well as next generation product volumes (vapes, heat-not-burn) could be substantial. Markets do not appear to be pricing this risk, so we await on sidelines for now.

The Dawn of Artificial Intelligence



By JD Hayward

Generative AI has shown that very few professions can claim to be future proof.

⇒ Generative Artificial Intelligence (GenAI) has shown, within the space of a few months, that very few professions can claim to be future proof. Professions that were once considered safe, suddenly seem to have moved into the firing line.

⇒ Issues such as ethics surrounding AI implementation, job security, data security, etc. are only now coming into focus.

⇒ Below, we take a brief overview of the changing landscape and following that, we identify a stock that we believe should outperform, despite the scary narrative surrounding it.

"Innovation is the ability to see change as an opportunity, not a threat."

-Steve Jobs

"I'm increasingly inclined to think that there should be some regulatory oversight, maybe at the national and international level, just to make sure that we don't do something very foolish. I mean, with artificial intelligence, we're summoning the demon."

-Elon Musk

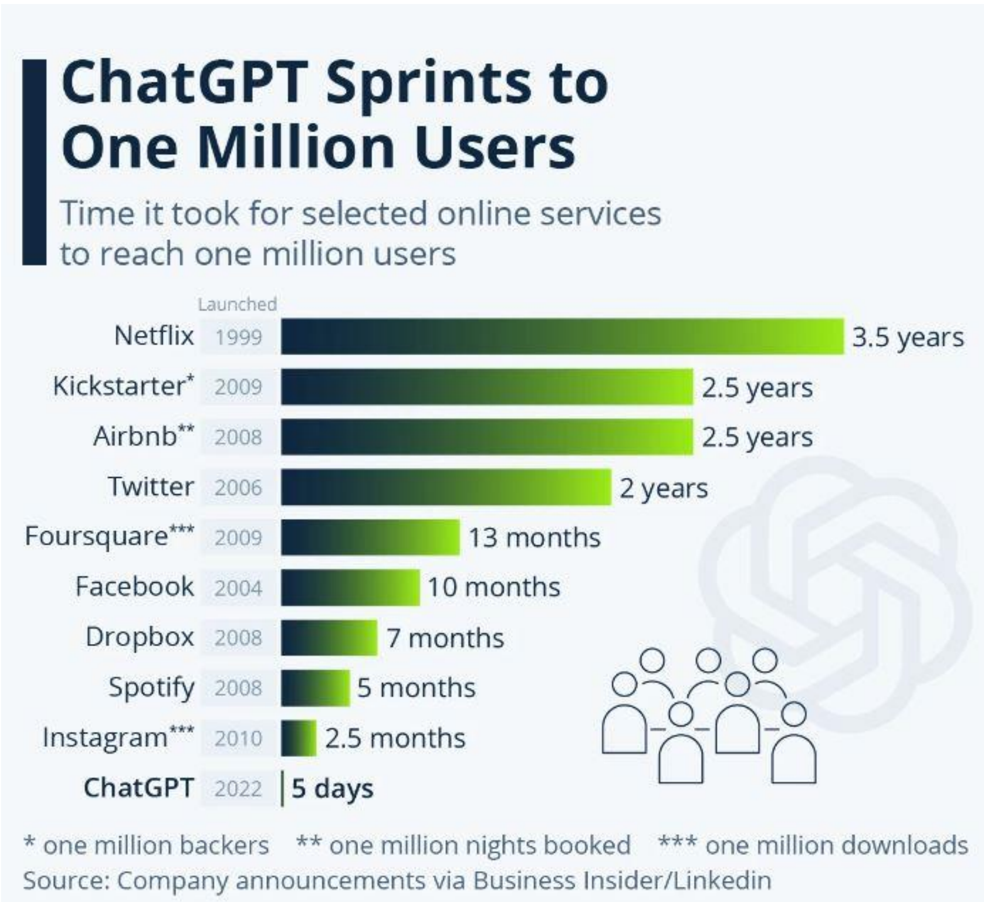
Changes and challenges – there were plenty of those for businesses to contend with over the last couple of years.

First came Covid-19, which brought equal amounts of investor fear and supply chain carnage. That served as a catalyst to the US experiencing 40-year high inflation numbers in 2022. In 2023, the focus shifted to the so-called "higher-for-longer" narrative. For the first time in more than a decade, consumers and businesses alike, had to deal with a prolonged period of significantly higher interest rates, of which the full effect on the global economy is perhaps yet to rear its head. All these events were bound to materially impact how businesses operate in the coming years. There was, however, another key event which, going forward, is bound to have a more profound impact on the lives of individuals and businesses alike...

Artificial Intelligence entered its adolescence.

While society has known about Artificial Intelligence for years, and has seen changes and new technologies being implemented constantly, it still felt like a classic case of things evolving slowly and then, suddenly, all at once. Nowhere was this more evident than in looking at the speed with which ChatGPT was adopted. While much of the initial craze might have been driven by curiosity, and some of it might have temporarily faded, one thing is for sure – we will struggle to get this genie back in the bottle. Within 5 days from launch, more than 1 million users had experimented with ChatGPT. This was clearly not a fleeting fad either: ChatGPT went on to record 100 million users in just over 2 months, something it took Tiktok more than 9 months, and Instagram more than 2 years to achieve.

While society has known about Artificial Intelligence for years, it still felt like a classic case of things evolving slowly and then, suddenly, all at once.



The potential benefits and pitfalls of this technology quickly became clear. Within weeks after launching, there were numerous confirmed cases as well as allegations of information being plagiarised, patently false information being generated and data being used without consent.

The effects didn't only have theoretical implications, nor were they limited to the job market. It also reared its head in academia. Universities had to start putting measures in place to prevent students from using ChatGPT, and its rapid-learning ability, from completing their tasks.

ChatGPT was assigned to take entry exams for professions such as law, medicine, finance, and everything in between. In many cases, it passed some of those tests with comparative ease. Even in cases where it was not passing certain tests first time round, it would learn from those mistakes, and a couple of days later it would inevitably do better when attempting the same test.

The potential benefits and pitfalls of this technology quickly became clear.

The creative industry is not immune either, and reports are already surfacing about issues such as a decline in freelancing design and creative jobs. Looking to create a logo for your new company, something that specifically contains 3 different shades of blue and has a triangular shape, for example? Simply give ChatGPT that exact prompt and you have any number of options to choose from, instantaneously.

While it was always thought that AI would first endanger repetitive, rules-based professions, it now seemed like every Elon, Bill, and Larry might be in the firing line. In the very recent past, even when it was clear that everything data, computers, software and AI related were becoming an integral part of everyday life, it was thought that software developers and coders were "future-proof" jobs. Now, even a technophobe can create lines of code, without any knowledge of the subject matter, by simply telling ChatGPT to do so. A career which was, 5 years ago, thought to be a safe choice, suddenly seems very risky.

There are, however, certain industries and companies that are deemed to be more at risk from AI disruption than others. Concentrix, a company that specialises in client services and customer care is, on the surface at least, one of these.

Investment Case: Concentrix

By JD Hayward

Concentrix -
Customer Services
in an age of AI

- ⇒ Concentrix is one of the world's largest customer experiences (CX) companies.
- ⇒ It has grown its staff compliment from 25 in 2006 to almost 300 000 today.
- ⇒ It has evolved from being an operator of call centres to being a partner and extension of the brand for top multinationals when it comes to customer experience journeys.
- ⇒ Like many of their peers, the recent craze around AI has not been good for sentiment, resulting in a number of these companies losing more than 50% of their market cap, as investors feared the worst.

"Know what your customers want most and what your company does best. Focus on where those two meet."

-Kevin Stirtz

Concentrix describes themselves as a customer experience (CX) and engagement partner. Their aim is to be the greatest customer engagement company in the world, driving customer lifecycle engagement and differentiated experiences for their clients. Concentrix think of themselves as an extension of their clients' operations. They perform functions that could potentially be insourced (and for a large part of the industry still is), but companies choose to outsource as it enables them to focus on their core competencies, while also achieving cost savings.

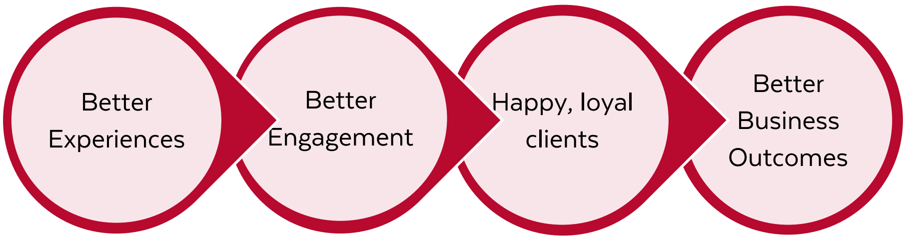
They place a focus on delivering the brand as if you are the brand. They operate on the belief that every single customer experience is critical – a simple enough idea.

In their own words:

"That moment? It's an opportunity. When a customer asks a question, sends a chat, or makes a purchase, you want to show your brand at its best—smoothly get the customer what they need, and give them a reason to come back again and again."

This approach can be boiled down to the following:

Not only are Concentrix acquiring these customers, but they are also retaining them. The average tenure of their top 25 clients is currently 16 years.



Their clients have clearly realized that this singular focus makes them a valuable partner. Although individual client names aren't disclosed, the details they do disclose makes for impressive reading. Without realizing it, most of us have probably interacted with another brand via Concentrix, as their clients include marquee companies across the globe.

Not only are Concentrix acquiring these customers, but they are also retaining them. The average tenure of their top 25 clients is currently 16 years – a testament to the integral role they play in clients' operations. This strong and expanding customer base allows Concentrix to partner with some of the largest brands in the world, while constantly increasing the complexity and the level of services offered to these clients.

The effect is that Concentrix becomes more valuable, more entrenched, and harder to replace in the lives of their customers. This has resulted in enviable operational performance, allowing profits to vastly outgrow revenues and costs.

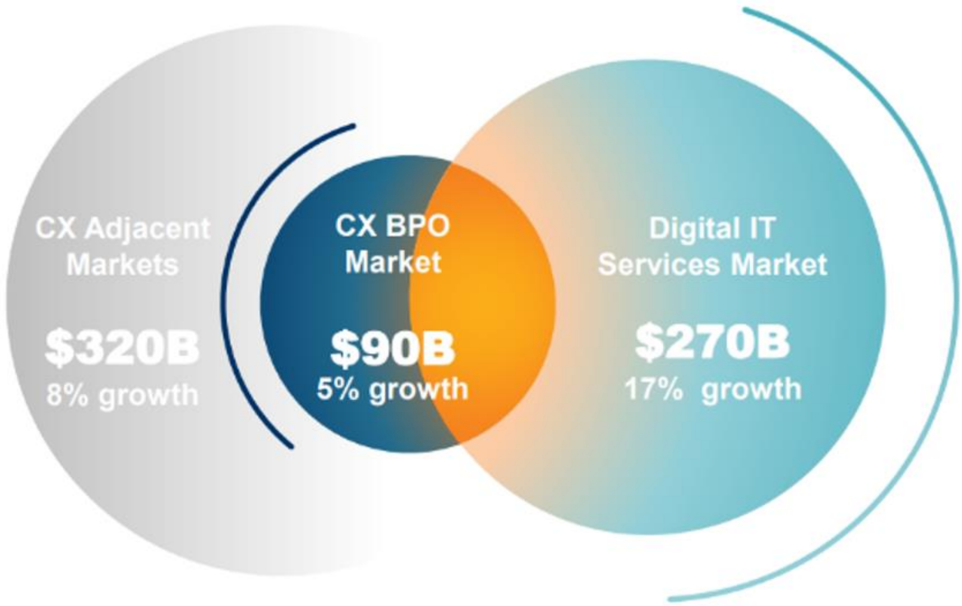
Chart 7: Concentrix compound average growth metrics (%) from 2019 to 2022

	3-year CAGR
Sales	10.3%
Gross Profit	8.9%
Operating Profit	29.6%
Net Profit	54.9%

Concentrix has largely managed to de-commoditize the traditional call centre business. They are offering more complex, more in-depth solutions while entrenching them deeper into the value chain. This ultimately leads to higher-value, higher-margin work.

2023 saw Concentrix complete another strategic acquisition. The combined entity will have revenue of at least $10 billion annually, cementing their position as one of the biggest industry players. This added capacity (along with some prior smaller acquisitions), has further enabled Concentrix to start branching into adjacent Customer Experience and Digital IT Services segments outside of their core Business Process Outsourcing market. Both adjacent markets are growing faster than their primary market.

The effect is that Concentrix becomes more valuable, more entrenched, and harder to replace in the lives of their customers.

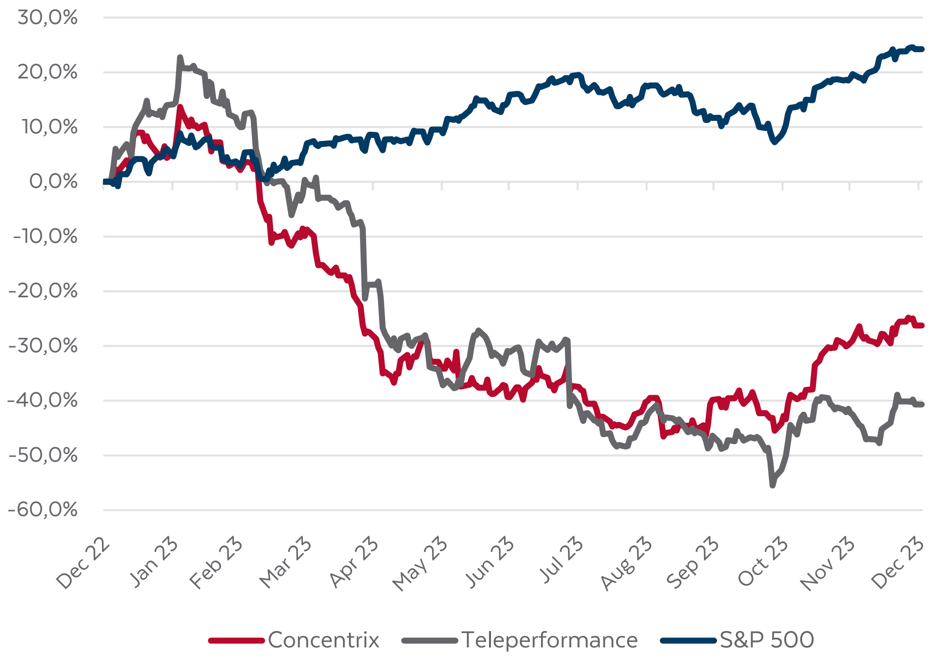


The (Artificial) Elephant in the room…

The biggest risk to the investment case is undoubtedly the effect of GenAI (like ChatGPT) and whether this could reduce the competitiveness of a large part of the business. This is clearly a threat to the industry, rather than being specific to Concentrix.

This much is evident when looking at share prices post the introduction of ChatGPT. Over the course of 12 months, both Concentrix and its largest peer, Paris-based Teleperformance, underperformed the S&P 500 by more than 50%. While an AI-overhang can be understood and even expected, 50% just seems too much.

Chart 8: Returns for Concentrix vs Teleperformance vs S&P 500 (%) during 2023



Management (predictably) states that GenAI is in fact not a threat to the business, but actually an enabler, an opportunity for them to further automate low-complexity, low-margin tasks. This may make sense.

Consider the following: Generative AI aside, technology has been an ever-present factor in this industry. This is not new.

- These businesses have consistently evolved as new tech tools became available. At the onset, the largest part of Concentrix's business was answering phones on behalf of US mobile operator, AT&T, to settle bill issues.
- Later, while doing work for e-commerce companies, they would deal with things like parcel queries. That was their role in e-commerce. Given new automated tools for all of this, their role has evolved to things like verifying legitimacy of reviews, verifying 3rd party sellers and authenticity of goods etc. This is all work that did not exist 10 years ago, but comes at a higher margin and higher value than previously generated.
- Technology further evolved to things like Interactive Voice Response (Press 1 for X, press 2 for Y) and pre-programmed chatbots. People feared it might be the end for these companies, however, it has just become tools in their arsenal.

Concentrix already deploys AI tools across roughly 70% of the business.

As far as it relates to Generative AI specifically, AI and Machine Learning have been used in the industry for years. Concentrix already deploys AI tools across roughly 70% of the business.

Another factor to consider is that, for businesses to implement AI-driven solutions (and therefore to cut out service providers like Concentrix), a host of separate issues will arise. These include:

- Data security, data ownership and data integrity. Enterprises generally don't want their data to go into the world, in an open format, for use in large language models. That means they will likely need to use their own proprietary models. They'll need partners to assist them with implementing and running these. It's not a self-operated plug and play solution.
- Solutions like this generally do not run on their own. They still require human oversight, and, from time-to-time, intervention. Concentrix plays in this space, helping customers develop and build these last mile connections. This is a crucial connection between brand and client, and enterprises aren't likely to completely sever all human interaction from the customer experience.
- Predictability and reliability issues with large language models. Global household brands need to provide a consistent experience and feel to all customers worldwide. Inaccurately generated AI responses, or inconsistently generated responses, would pose a considerable threat.

It's a far cry from saying, "hey – this is ChatGPT – let's bet our entire enterprise's customer experience on it."

Concluding thoughts on AI

Concentrix management believe the share price weakness is due to investors misunderstanding the threats and opportunities. They see AI as the logical next step in the evolution of the industry. There have been plenty of inflections before, and AI just makes their work more complex and higher value. They've always been pro-automation, as it lessens their volumes while increasing their value.

> Since being added to the portfolios, Concentrix has rallied by about 30%, handily outperforming the S&P 500 over recent months.

These statements don't appear to merely be an attempt to settle the nerves of investors. As far back as 2020, Concentrix stated the following in their Annual Report:

"We have been a leader in our industry in advancements such as conversational virtual assistants, multichannel and augmented CRM, predictive analytics, emotion analytics, cognitive learning and AI, and enjoy a first mover advantage."

While there remains a perception that customer services might be vulnerable to the coming AI boom, their situation is not that different to the world's foremost advertising firms, for example. Even though all the tools exist for large corporates to insource the entire advertising operation, they don't. They are not the experts. They outsource the work to someone that is better suited to utilize those tools.

Valuation

Since being added to the portfolios, Concentrix has been a good performer, rallying about 30% and handily outperforming the S&P 500 over recent months.

Even after this rally, Concentrix remains inexpensive, trading on a mere 10 times earnings. This is still well below levels seen in recent years, when the stock traded north of 25 times earnings.

While such lofty multiples will probably not be seen again in the near future, especially as the AI overhang remains, the assumptions used in our modelling are not at all demanding. Even after the recent rally, there remains a lot of upside to the Concentrix investment case.

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,

The Flagship Global Team

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