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PARTNERS

Q2 2024 INVESTOR UPDATE

Langdon Global Smaller Companies Portfolio

Performance	Q2-2024	YTD	1 Year	3 Year	Since Inception[2]
Langdon Global Smaller Companies Portfolio[1]	1.9%	7.1%	14.4%	N/A	17.0%

1 LEP210 (Class F) - performance is net of fees.

2 Since date of August 26, 2022.

Returns greater than one year are annualized

Past performance is not indicative of future performance. Please see the important information in the endnote below

Overview

The second quarter saw the fund perform resiliently in what continues to be a delicate economic situation. **This resilience reflects the quality of our portfolio companies and their conservative balance sheets**.

The push-pull debate on interest rates is playing games with an investor's ability to price companies in both public and private markets. This is most evident in the lack of private market transactions. For patient, long-term investors like Langdon, it is nice to see what appears to be the end of the multiple expansion era. Many companies were being sold from one private investor to another, aka 'pass the parcel', at increasingly higher multiples, driven by financial engineering that created short-term value through the use of more and more cheap debt. The regime shift towards a long-term sustainable value creation environment aligns well with our investment approach. This transition positions our portfolio to benefit significantly from the quality businesses we own, which are run by talented and experienced management teams with proven track records of value creation.

We want to spend the remainder of this quarterly commentary exploring the impact of stock-based compensation in our approach and its impact on our ability to source investments.

Stock-Based Compensation around the Globe

One of our most important jobs as Global Investors is to create a level playing field across many countries, languages, and disclosure regimes to ensure we are investing in the best risk adjusted investment opportunities. How do we effectively compare different region's accounting measures? By creating a single Langdon global standard, including the all-important definitions of earnings and free cash flow. This process allows us to properly compare an investment opportunity in a German industrial, to a U.S. software company, or that same U.S. software company to a French software company.

At Langdon, our job for each business we evaluate is to:

1. Calculate our expected revenues,
2. Subtract all true costs of running the company
3. Determine the cash flow/owner earnings, and
4. Discount the sum to a present-day per share value.

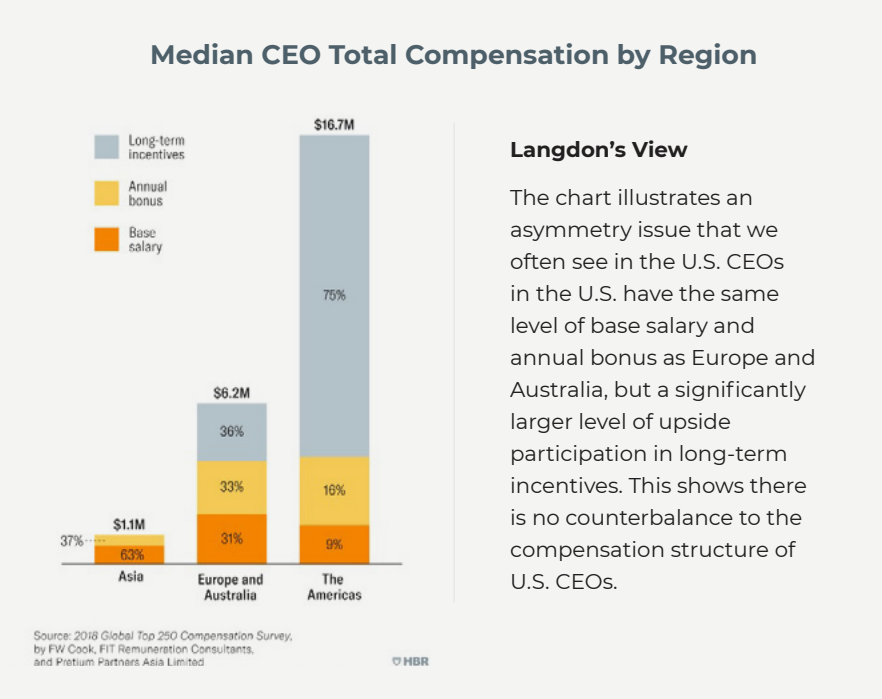
This informs us whether the business is attractively priced.

A quick peruse of our portfolio characteristics show a significant overweight to Europe compared to our peers and the Global Small Cap benchmark. This is not due to a common macro belief, such as the political environment (which arguably is in disarray everywhere anyway), interest rates, currencies, or any other 'top down' view. It certainly does not stem from any bias or desire to take longer flights for a living. This largely **relates to capital being mobile, allowing us to deploy capital into 23 developed countries, and our steadfast belief that stock-based compensation is an expense** that cannot be simply 'pro-forma'd' away from 'adjusted earnings'.

The idea of stock-based compensation being a real expense is an important concept for long-term investors like us, and one that we feel needs more attention.

Since a picture is worth a thousand words, we have included a great chart from a Harvard Business Review (HBR) study[1] on executive compensation. The chart shows how the components and magnitude of compensation can vary depending on your location in the world.

You can see that the amounts for base salaries and annual bonuses are similar for CEOs in the Americas, Europe, and Australia. Yet, the **total CEO compensation in the Americas is more than 2.5 times greater than in Europe and Australia, with pay in the form of long-term incentives making up the difference**.



This is not a blanket statement implying that U.S. executives are overpaid, nor do we disagree with aligning management incentives with those of shareholders. Quite the opposite. The key takeaway is that significant stock incentive awards must be tied to value creation for shareholders, and the alignment of those incentives cannot be one-sided. If you want more upside, you should also be willing to accept less certainty via cash compensation.

1 https://hbr.org/2021/01/compensation-packages-that-actually-drive-performance

Here is a simple 'Langdon' example to demonstrate our belief that stock-based compensation is a real expense:

Financial Metrics	Company A	Company B
3-year Revenue Growth	12.0%	12.0%
3-year Profit Growth	17.0%	17.0%
Share Count Increase	3.5%	0.5%
3-year Cumulative Per Share Profit Growth	**46.2%[2]**	**58.1%[3]**
Langdon Hurdle[4]	**52.1%[5]**	**52.1%**
Pass/Fail	**FAIL**	**PASS**

If Company A is going to pay similar cash compensation to Company B and then issue 3% additional shares from treasury each year for compensation it will be harder for that company to meet our 15% IRR hurdle.

It is our belief that dilution created by equity grants should be offset by lower cash compensation paid to executives, but this has typically not been the case in our experience.

The pain of paying

A study by Dan Ariely[6] highlights the impact of paying for something versus getting it for free and how it affects how much people value and consume the 'product'. When people pay, they experience the "pain of paying," which increases their likelihood of using the 'product' to avoid feeling wasteful. Conversely, when the 'product' is free, there is no emotional or financial investment. We believe Dan's insights relate well to the issue of stock-based compensation. The structure of compensation for U.S. executives is such that, compared to Australian and European executives, they face little downside and significant upside potential, thereby excusing them from the "pain of paying."

The U.S. has the largest collection of world class companies and represents 40% of the several hundred companies we follow closely. We would like to see an increased subset of these businesses thinking more like long-term owners and less like well-paid managers.

Langdon Investment Team

Written by
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2 Calculation: $\{(1+(0.17-0.035))^{3-1}\}$
3 Calculation: $\{(1+(0.17-0.005))^{3-1}\}$
4 15% annualized Per Share Profit Growth over 3 years
5 Calculation: $\{(1+(15\%))^{3-1}\}$
6 **The Pain of Paying - Dan Ariely**

F Class. These net performance figures covers the period from August 26, 2022 to June 30, 2024, and has been provided to Langdon Equity Partners Ltd. by State Street Trust Company Canda for the Global Portfolio ("LGSCP"). Commissions, trailing commissions, management fees and expenses all may be associated with mutual fund investments. Please read the prospectus before investing. The indicated rates of return are the historical annual compounded total returns including changes in unit value and reinvestment of all distributions and do not take into account sales, redemption, distribution or optional charges or income taxes payable by any securityholder that would have reduced returns. Mutual funds are not guaranteed, their values change frequently and past performance may not be repeated.

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The Product Disclosure Statement ('PDS') and Target Market Determination ('TMD') of the Fund are available via the links below. Any potential investor should consider the PDS and TMD before deciding whether to acquire, or continue to hold units in, the Fund.

Link to the Product Disclosure Statement: **here**
Link to the Target Market Determination: **here**

For historic TMD's please contact Pinnacle Client Service Phone 1300 010 311 or Email **service@pinnacleinvestment.com**

FOR CANADIAN CLIENTS:
Important information about each Langdon mutual fund is contained in its prospectus, AIF, fund facts document and in its management report on fund performance. Any potential investor should review these documents prior to making any investment decision relating to such fund. You can view copies of these documents by following the links below:

Link to the Langdon Global Smaller Companies Portfolio Disclosure Documents: **here**
Link to the Langdon Canadian Smaller Companies Portfolio Disclosure Documents: **here**

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