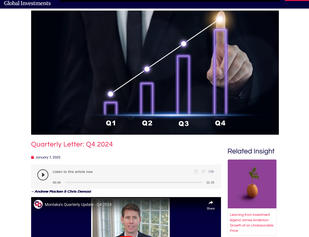

Quarterly Letter: Q4 2024

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Owning business advantages, not technology, in AI

One of the major themes of today, obviously, is AI, and it provides a good example of how we can companies with clear business advantages.

As our landmark white paper shows, we were comparatively early to identify AI as an important investment theme and have been benefiting from it for some time. We have been able to do so by focusing on the business models and technological developments within the AI space we deem compelling, not chasing buzzwords and speculating on hot technologies, per se.

Business advantages are valuable attributes that cannot be easily replicated by competitors. There aren't many. And breakthroughs in new technologies are typically not advantages because they can be quickly copied by competitors. Indeed, new technologies, including AI, often represent disruption risks for many businesses - that we strictly seek to avoid.

Business advantages in AI include:

- Economies of scale in the delivery of compute required to train and deploy AI-infused applications. This favors the incumbent hyperscalers, Microsoft, Amazon, Alphabet, Meta, Oracle, and Tencent.
- Embedded distribution channels to captive customers through which new value-adding AI services can be delivered. In the enterprise space, for example, this favors Samsaraforce and Salesforce, and in the consumer space Spotify and Meta.

Despite only just scratching the surface of its potential, today's AI models are already rapidly driving down the effective cost of many tasks, including those that have historically been very expensive to perform, such as coding, across the broader economy. But only those businesses with sustainable advantages, including those highlighted above, stand to benefit disproportionately from this transformation.

Concentrated and patient

Montaka's investing formula doesn't mesh with what's in vogue, and why. It is clear about how we view these businesses that, to us, have design and manage Montaka's portfolio.

2024 will mark the five year anniversary of Montaka's assisted portfolio construction philosophy, where, as mentioned, we moved to the concept of owning relatively few, outsized, long-duration investments. Based on our performance, this framework has generally enhanced Montaka's investment capability.

When we repositioned five years ago, we did it knowing that when we took big capital allocations to our best ideas, and then nurtured them with extraordinary patience, compounding that of good investments drove deep returns. We actually every first year, on average*, is our best high probability of delivering outstanding long-term returns.

Our investing formula is backed by empirical and academic evidence - which shows that the highest risk-adjusted returns and patient investment strategies tend to substantially outperform over the long-term.

And yet, remarkably few investors actually do it. Why? Perhaps, in part, because this formula will almost certainly underperform in the short-term, and, in the extreme, for years. With such a high degree of focus placed on month-to-month, relative performance by our industry, most investment management firms have become risk averse from the market - even if it is the expense of better long-term returns.

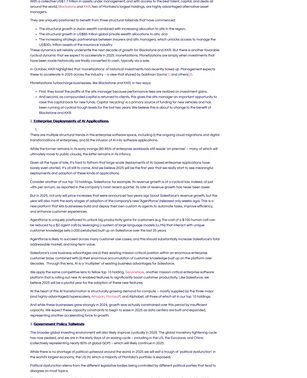
Personally, we are grateful for this structural quirk of the investment management industry. Indeed, it is likely due to the dearth of managers pursuing our 'concentrated and patient' formula that we've found that long-term investment opportunities outlasts period to begin with.

Our top 10 investments comprise around 70-75% of Montaka's total portfolio. And our annual portfolio turnover is approximately 20% (representing 4-year holding period, on average).

The contradiction in a stark contrast to the average of US large cap mutual funds, for example, which have 70% of a portfolio allocated to the top 10, and an average holding period of ~8 months.

You can see this in the chart below, along with the significant advert to which Montaka has repositioned from nearly five years ago.

Montaka's Repositioning — Concentrated & Patient



Note: Based on the average of 5, diversified large cap retail funds. Positions weighted based on aggregate magnitude. US portfolio Morningstar Portfolio Manager Global Equity Funds.
Source: Montaka Global Investments, Morningstar Portfolio Manager, Bloomberg.

Montaka's long-term investing success depends on the successful execution of the investing formula described above. We believe Montaka has an edge, MPT, at executing the formula with a high probability of success.

MPT fire-up strengthens our ingredients of success

One of our most important learnings over the last decade is that long-term investing success requires more than just the right investing formula. It also requires the right conditions for that formula to be executed.

Ultimately, long-term investment returns are the result of four ingredients:

1. Formula (described above);
2. Culture (required to execute the formula);
3. Structure (required to enable the Culture); and
4. Capital (required to execute the Structure).

Our MPT fire-up has strengthened our Structure and Capital, specifically, which represents a significant over-long time period. Over the last five years, enabled by the evolutionary patience of our unitholders, Montaka has successfully strengthened these ingredients. And our strong results over this period reflect these changes.

It is within this context that Montaka's investment capability should continue to grow stronger under these new arrangements.

Outlook For 2025 And Beyond: Four Cyclical Upwelings

Montaka's long-term success will ultimately stem from the identification and ownership of businesses with advantages that allow them to grow relatively faster than their competitors over the medium-term.

What's interesting about 2025 specifically - and we suspect quite underappreciated by many - is that, in addition to our focused structural trends continuing, there is a cyclical upsurge that we expect to Montaka's portfolio are likely to emerge:

- Alternative asset manifestations,
- Enterprise deployments of AI applications,
- Government spending,
- Monetary policy.

We outline these in more detail below.

1. Alternative Asset CMA's Manifestations

With a collective c.$8T+ in assets under management, and with access to the best talent, capital, and deals all around the world, Alternative asset firms are Montaka's biggest holdings, are highly advantaged alternative asset managers.

They are uniquely positioned to benefit from three structural tailwinds that have commenced:

- The structural growth in Asian wealth combined with increasing allocation to alts in the region;
- The structural growth in US$8T+ Million global private wealth allocations to alts; and
- The increasing strategic partnerships between insurers and alts managers, which unlock access to manage the ~$30T+ of insurance industry assets globally.

Insurers are still widely underweight to private markets, and, as we have discussed, we believe that there is another favorable cyclical dynamic that we expect to accelerate in 2025: insurance manifestations. We are already seeing early investments that have been made historically are finally connected to cash, typically via a sale.

In October, KKR highlighted their 'manifestations' of historical investments had recently ticked up. Management expects these to accelerate in 2025 across the industry - a view that Blackstone's management team shares.

Manifestations further leverage Blackstone, like Blackstone and KKR, in two ways:

- First, they boost the profits of the alts manager because performance fees are realized on investment gains.
- And second, as compounded capital is returned to clients, this gives the alts manager an important opportunity to reset the compounding growth engine. This is particularly important in a world of looming tax rate headwinds, where been running at cyclical highs toward the last two years. We believe this is about to change to the benefit of Blackstone and KKR.

2. Enterprise Deployments of AI Applications

There are multiple structural trends in the enterprise software space, including (i) the ongoing cloud migrations and digital transformations of enterprises, and (ii) the infusion of AI into software applications.

While the former remains in its early innings (80-85% of enterprise workloads still reside 'on premise' - many of which will ultimately move to public clouds), the latter remains in its infancy.

Given all the hype of late, it's hard to fathom that large-scale deployments of AI-based enterprise applications have yet to occur. However, they have. Indeed, Salesforce's Einstein 1 AI platform will be the first peer that we really start to see meaningful deployments and adoption of these kinds of applications.

Consider another of our top 10 holdings, Salesforce, for example. Its revenue growth is at a cyclical low. Indeed, at just ~8% per annum, as reported in the company's most recent 'Analyst Day', this is the lowest growth rate in over a decade.

But in 2025, not only will year-increases that were announced two years ago (about Salesforce's revenue growth, but the year will also mark the early stages of adoption of the company's new 'Agentforce' released only weeks ago. This is a new platform that sells businesses build and deploy their own custom AI agents to automate tasks, improve efficiency, and enhance customer experiences.

Agentforce is uniquely positioned to unlock high productivity gains for customers (e.g. the cost of a $1 human call can be reduced to 10c with an AI agent, for example). Management has noted that Agentforce has driven material revenue customer knowledge sets (CRM) underpinned by an Salesforce over the last 25 years.

Agentforce is likely to succeed across many customer use cases, and this should substantially increase Salesforce's total addressable market, and long-term value.

Salesforce's core business enterprise CRM software remains critical position within an enormous enterprise customer base, combined with the tremendous accumulation of customer knowledge built up on the platform over decades. Through this lens, AI is 'multiplier' of existing business advantages for Salesforce.

We apply the same competitive frame to Salesforce's 10 holdings. Microsoft's Azure remains critical enterprise software platform that is rolling out new AI-enabled features to significantly boost customer productivity. Like Salesforce, we believe 2025 will be a pivotal year for the adoption of these new features.

At the heart of this AI transformation is structurally growing demand for compute - mostly supplied by the three major hyperscalers (Amazon, Microsoft, and Alphabet). We expect all three of them will be top 10 holdings.

And while these businesses grew strongly in 2024, growth rates are expected accelerate over the period by insufficient capacity. Any slowdown in capacity bottlenecks is longer to ease in 2025 as data centers are built and expanded, thereby accelerating revenue growth.

3. Government Policy Tailwinds

The broader global investing environment will also likely improve cyclically in 2025. The global monetary tightening cycle commenced in 2022 and, as we have discussed, it has been very aggressive. The US, for example, and Europe, collectively representing nearly 40% of global GDP, - which will likely continue in 2025.

While there is no analogue of political upheaval around the world, in 2025 we will end a trough of 'political disruption' in the world's largest economy, the US, which is important for Montaka's portfolio companies.

Political disruption stemming from the different legislative bodies being controlled by different political parties had tend to disrupt or mute topics.

The surprise clean sweep in the November general election, however, means that Republicans will control the White House, the House of Representatives, and the Senate, and can pass new laws with relative ease.

We expect to see a lot of new government policies enacted, including among the dimensions of tax reduction and deregulation, of relevance to Montaka's portfolio companies.

These collective conditions will benefit the shareholders of many businesses.

One of our major holdings, TMX Global, for example, which has already commenced a cyclical recovery in its Credit Business, will likely see a new recovery in its Market Intelligence business as buy-side and sell-side mandate activity recovers.

Similarly, luxury giant, LVMH, which also sits in our portfolio, will benefit from increasing wealth levels (noting that it heard record-very earlier in the year in the US) as well as any improvement in the Chinese economy - which is being increasingly supported by policymakers and growing from a very depressed low base.

To be clear, while we have been present in consumer retail 2020 might long, we are ultimately driven by what the longer-term future holds for these businesses. And the answers to this question remains firmly grounded by the strength of their respective franchises, and their ability to compound value per share over a decade or longer. For example, to attract representative, Samsara, LVMH's best brands are rarely marked down and can never be revoked. These attributes place these businesses in a naturally good stead over the long term.

US Housing Rebound

We also expect a recovery in the all important US housing market to accelerate in 2025. It's worth highlighting that high mortgage rates combined with recessed levels over recent years, disorder in a collapse of existing home sales.

Even today, they remain at the lows of the 2008 GFC, as shown below.

US Existing Home Sales

Millions of homes

Source: National Assn. of Realtors, via Bloomberg.

But under the hood, households are in far better financial health, on average. Indeed, most homeowners have large equity customers in their home. Mortgage debt in the US, as a percentage of GDP, is 80%, down from a peak of 73% during the housing bust following the GFC(1).

A recovery in the US housing market would be helpful for US consumption, and the health of the broader economy. And it would be particularly potent for big-box specialist home surface flooring vendors, Floor & Decor (FND), a top 10 holding in our portfolio. Its home sales increase, so has demand for home renovation equity, including hard surface flooring.

During the cyclical downturn of the last few years, FND has continued to build momentum in its 'Pointed' that builds and strengthens its scale advantages, while reducing price and increasing value to customers. Over the period many competitors have exited and ceded market share to FND.

As the US housing market recovers, we believe FND is positioned for accelerated growth. Not only will existing stores sell better, but new stores will be rolled out more quickly. And at just 240 today, there is ample room for FND to roll out new stores, with management targeting more than 300 stores over time. Importantly, the unit economics of each store are extremely favorable.

Portfolio Positioning: Our Advantaged Top10 + MongoDB Add

Below we provide the composition of Montaka's top 10 investee companies of year end.

Consistent with our investment philosophy all these are businesses have strong - and strengthening - business advantages, are run by high-quality, long-term-oriented management teams, and have strong balance sheets and balances. And, even with strong recent stock price performance, they remain materially underrated.

Said another way, we continue to see substantial long-term upside in Montaka's portfolio.

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Note: Montaka is invested in: Amazon, MongoDB, Salesforce, SAP Global, LVMH, Blackstone and KKR.

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