

Qualivian Investment Partners Q4 2024 Investment Letter

March 2025



“Waiting helps you as an investor and a lot of people just can’t stand to wait. If you didn’t get the deferred-gratification gene, you’ve got to work very hard to overcome it.”

– Charlie Munger

Overview

Qualivian Investment Partners is an **investment partnership focused on long-only public equities**. We own a concentrated portfolio of 15–25 understandable companies with **wide moats**, long **reinvestment runways**, and **outstanding capital allocation**. Since we expect them to **compound capital at a mid-teens rate**, we hold them for an extended period. **We are seeking investors who are aligned with our long-term investment time horizon**. We **do not short securities**. We **do not use leverage**. We **do not use derivatives**. We are **not macro investors**. We believe that only a relatively small number of exceptional companies are worth investing in over the long term.

Our Formula

Long-Term Orientation + Long-Term Investors + Focused Portfolio + Quality Compounders = Maximizing Chance for Outperformance

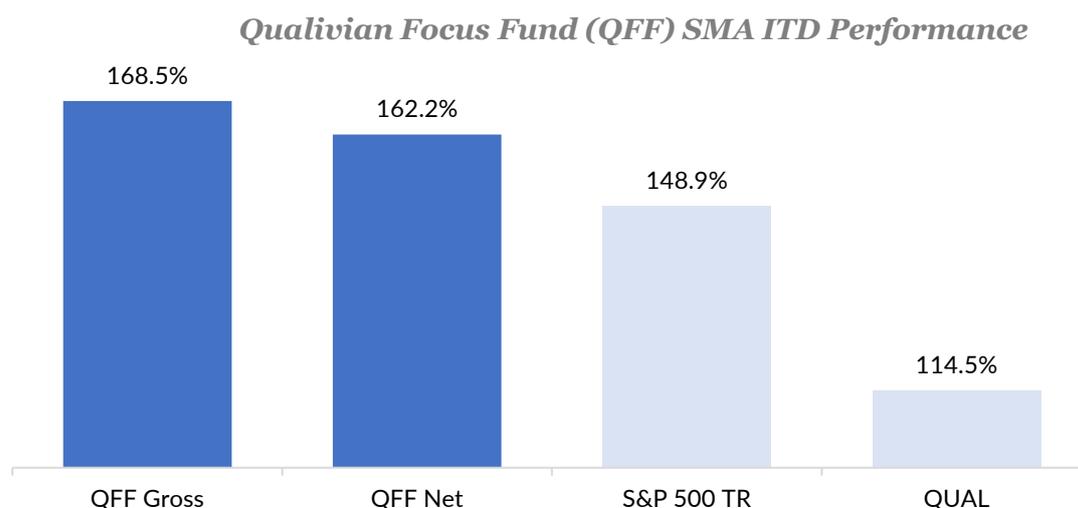
Our investors should understand how we invest so they make the right decision. We encourage investors who agree with our long-term horizon and philosophy to contact Aamer Khan (aamer.khan@qualivian.com) at 617-970-9583 or Cyril Malak (cyril.malak@qualivian.com) at 917-742-2039.

Investment Criteria

As a reminder, we use the following criteria to select businesses we own:

- Have a durable and understandable competitive advantage.
- Operate in an industry with a stable structure and rational players.
- Often sell essential products with pricing power and have a high level of recurring revenue.
- Have high and sustainable returns on invested capital often combined with high margins and low capital intensity.
- Possess investment opportunities to reinvest capital at high returns.
- Have high free cash flow generation and low levels of debt.
- Have management that has a history of value creating capital allocation.

QFF Cumulative Performance Since Inception¹ Through Dec. 31, 2024



SMA Performance

Since inception through December 31, 2024, we have **outperformed the iShares MSCI USA Quality Factor ETF (QUAL) by 54.0% and 47.6% on a gross and net basis. Similarly, we have outperformed the S&P 500 by 19.6% and 13.3% on a gross and net basis, respectively.**

Furthermore, in 2024, we outperformed QUAL by 6.0% and 5.6% on a gross and net basis. Similarly, we outperformed the S&P 500 by 2.0% and 1.6% on a gross and net basis, respectively.

Finally, in Q4 2024, we outperformed QUAL by 4.1% and 4.0% on a gross and net basis, and we outperformed the S&P 500 by 1.0% and 0.9% on a gross and net basis, respectively.

For our top 3 and bottom 3 contributors in the quarter, please refer to Appendix 2.

Portfolio Highlights

Portfolio Changes in Q4 2024

We sold out of our position in Danaher (DHR) and trimmed our positions in Amazon (AMZN), Microsoft Corp. (MSFT), and Meta Platforms (META) and used the proceeds to initiate a new position in Casey's General Stores (CASY) and to add to our position in United Rentals (URI). Both firms are Quality Compounds that we think can grow earnings in the low to mid-teens for the foreseeable future (see our Q3 2024 investor letter² for a writeup of Casey's General Stores).

In the next section we discuss how a short time horizon leads to poor investment results, and how a long-term time horizon is an advantage for investors. Following that, a Quality Compounder that we own is discussed.

¹ Qualivian Focus Fund inception date is December 14, 2017.

² Link is in Appendix 3 to the Q3 2024 letter.

A Long-Term Investing Approach and the Deferred Gratification Gene

Stock prices of individual securities are almost impossible to predict in the short term. There are too many investors who have instant access to public data and the ability to use effective pattern recognition algorithms. They cancel each other out. The odds are against short-term investors succeeding. This is why active managers with high turnover ratios tend to underperform.

However, this is less true for long-term investors.

A long-term investment horizon is a significant advantage because long-term investors do not cancel each other out. There are more investors focused on the short term than on the long term. So short-term investors compete mostly with other short-term investors and often leave long-term opportunities on the table. For example, an investor making decisions based on quarterly earnings beats and misses will ignore the long-term competitive advantage of a company.

Focusing on the short-term causes individuals to make sub-optimal decisions. For example, consider the following two options:

Option 1: Would you rather receive \$1,000 in 12 months or \$1,100 in 13 months?

Experiments reveal that most people would choose to receive \$1,100 in 13 months because they are getting an extremely high interest rate of 10% per month.

Now consider:

Option 2: Would you prefer \$1,000 today or \$1,100 in a month?

Experiments reveal that most individuals would take \$1,000 now and forgo the returns from the same high monthly interest rate of 10%.

Both offers involve delaying the reward by a month, giving you \$100 more and a monthly interest rate of 10%. Yet individuals prefer the first offer and reject the second. For the first offer, the reasoning is “I have waited for 12 months, why not wait for another month.” This reasoning breaks down for the second offer because the introduction of “now” increases the interest rate required to defer the reward. This is referred to as hyperbolic discounting.

The closer in time a reward is, the higher our internal interest rate and the more we are willing to give up for the closer reward. Investors can take advantage of this by focusing on the greater returns achieved by lengthening the time horizon. This is referred to as time-arbitrage.

The tyranny of “now” results from our animal past. Rats cannot be trained to turn down one piece of cheese now for two pieces of cheese in the future. Nor can any other animal be trained to turn down a reward now for a reward in the future. The notion of the “future” does not exist for animals. Only “now” exists. Animals can only defer gratification if it is encoded in their DNA, like squirrels burying acorns. They cannot be trained to defer gratification. The notion of deferred gratification, unless encoded in DNA, seems to be an exclusively human trait.

But not for all humans. Walter Mischel conducted a well-known experiment on delayed gratification. In the experiment a group of four-year-olds were given a marshmallow. They could either (1) eat the marshmallow immediately or (2) not eat it immediately and wait for a few minutes and then they would receive a second marshmallow, which they could then consume with the first. Most kids could not wait. A few could. The education and career

trajectories of the two groups were tracked. The kids who waited for a few minutes had better outcomes in life. These included higher academic achievement, better relationships, healthier body weight, lower substance abuse rates, and better response to stress.

The ability to defer gratification and not prioritize “now” is a cognitive advantage that only some individuals have. Many investors do not have it either. Long-term investing takes advantage of these short-term oriented investors.

We now discuss a Quality Compounder that we added to our portfolio in 2023.

Brown and Brown (BRO)

The Elevator Pitch

BRO is the 5th largest Property and Casualty (P&C) insurance broker in the US and is an understandable, competitively advantaged, cash-generative business that has a long growth runway (both organic and via acquisitions), increasing returns on invested capital, and a low risk of being disintermediated by technology or other competitive threats in the foreseeable future. It has a technology and service scale advantage over the traditional local “mom & pop” insurance broker and a business model that relies on:

- growing its product and geographic footprint organically both domestically and internationally, and
- making economically accretive acquisitions in a highly fragmented industry where it has a major product breadth, technology & service advantage over smaller competitors.

Description

Brown & Brown (BRO) is an independent insurance brokerage that offers specialized risk solutions across its three business segments, Retail, National Programs, and Wholesale Brokerage across a wide variety of clientele including businesses, corporations, governmental institutions, professional organizations, trade associations, families, and individuals. The company was founded by Adrian Brown in 1939, and is headquartered in Daytona Beach, Florida. Its Retail segment provides a broad range of insurance products and services to commercial, public and quasi-public, professional and insured customers, and non-insurance products through its automobile dealer services. National Programs, which acts as a Managing General Underwriter/Agent (MGU/A), manages over 40 programs, supported by approximately 100 carriers, that have delegated underwriting, and in many cases, claims-handling authority. The Wholesale segment markets and sells excess and surplus commercial and personal line insurance, primarily through independent agents and brokers.

Investment Thesis for BRO

1. It plays in a market with predictable and relatively stable demand.

- P&C insurance coverage for businesses of all sizes is a basic requirement for business. P&C insurance is a dependable nominal GDP plus type grower.
- Approximately 84% of its revenue is from sales commissions, which tend to be recurring (given BRO’s high customer retention rate) as policies renew every year.
- BRO is a distributor of P&C insurance, so it does not take insurance underwriting risk which requires capital, even when it is acting as MGU/MGA in its National Programs business where it effectively underwrites and often manages claims for 100 carriers.

2. It has a durable competitive advantage in the consolidating middle market.

- The middle market insurance brokerage is consolidating. Smaller players cannot keep up with the technology spending required in CRM³ systems and comprehensive risk data analytics, and many are selling out to the large players like BRO in an economically accretive manner.

3. BRO has a founder-led management that has excelled in value creation over a long period.

- The company has been led by members of the Brown family (who own 16.3% of the company) since its founding (1939) to now:
 - Hyatt Brown (age 85), the son of one of the co-founders, is Chairman of the Board.
 - His son, J. Powell (age 55), is President and CEO.
 - His other son, Barrett (age 50), leads the Retail business.
- BRO has been able to grow revenue at a higher clip than its peers consistently by 3% on average due to its superior sales execution and M&A track record over the past ten years.
- Its market share has been enhanced by the bolt-on acquisitions that it can make advantageously arbitraging its public market value (21X EV/EBITDA) vs. the private market value of smaller players (low to mid-teens EBITDA).
 - BRO typically can take out 1–2 multiple turns from their purchase price via synergies, further enhancing the value created by its acquisition programs.
 - In last 5 years, BRO has averaged 25–35 tuck-in acquisitions per year adding anywhere between 6–8% to topline growth (2024 was an exception with only 2% added to topline growth by acquisitions).
- Furthermore, BRO has consistently grown its operating margins by an average of 40 bps per year over the past ten years.
- It has grown EPS at a 17% CAGR over the last ten years due to strong execution driven by:
 - Revenue growth of 12% CAGR.
 - Operating expense growth of 11%.
 - Net income growth of 17% CAGR.
 - Free cash flow growth of 11% CAGR.

³ CRM = Customer Relationship Management.

4. It has demonstrated excellent capital allocation.

- BRO has deployed \$8.9bn in capital in the last 10 years and generated \$6.6bn in FCF over that same period.
- BRO has primarily used its excess capital toward its accretive M&A strategy (\$6.1bn of the \$8.9bn or approximately 70% of capital deployed).
- However, it has also returned excess capital to shareholders via a dividend that has increased 10% CAGR over the past ten years.
- BRO's cash return on capital invested (CROIC) over the past five years of 12.8% when compared to our estimate of the company's weighted average cost of capital (WACC) of 7.8% suggests management's capital allocation is creating value for shareholders and increasing its intrinsic value over time.
- As a result, BRO has been able to **deliver 22.9% total return to shareholders over the past ten years vs. the S&P 500's 12.4% total return.**

Valuation

- Valuation is a bit higher than its long-term average, but reasonable when compared with the S&P 500:
 - BRO currently has a P/E multiple vs. the S&P 500 of 1.37X versus its 10-year average of 1.28X but its 10-year EPS growth rate of 14% CAGR is 2X the S&P 500's long-term earnings growth of 7%, earning its premium multiple to the broader market.

Ending Thoughts

We look forward to sharing our thoughts on our investment approach and to keeping you abreast of our performance and changes to the portfolio. If you would like additional information about Qualivian, please refer to Appendix 3 for links to prior Investor Letters, our investor presentation, and an interview that Aamer did with Insider Monkey. In the meantime, if you have any questions, please feel free to reach out to us at the links below.

With best wishes,

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Appendix 1: Quarterly Performance Tables

Performance for Qualivian Focus Fund with SMA Terms

	A	B	C	D	Difference with QUAL		Difference with S&P 500 Index	
	QFF Gross Returns ⁽¹⁾	QFF Net Returns ⁽²⁾	QUAL ⁽³⁾	S&P 500 TR Index ⁽⁴⁾	A-C Gross	B-C Net	A-D Gross	B-D Net
Dec. 2017 ⁽⁵⁾	-2.8%	-2.8%	-0.1%	0.5%	-2.7%	-2.7%	-3.3%	-3.3%
Q1 2018	5.6%	5.5%	-0.2%	-0.8%	5.8%	5.7%	6.3%	6.2%
Q2 2018	4.4%	4.3%	0.9%	3.4%	3.5%	3.4%	0.9%	0.8%
Q3 2018	5.8%	5.7%	8.3%	7.7%	-2.5%	-2.6%	-2.0%	-2.0%
Q4 2018	-14.5%	-14.6%	-15.1%	-13.5%	0.5%	0.5%	-1.0%	-1.1%
2018	-0.4%	-0.7%	-7.4%	-4.4%	7.0%	6.7%	4.0%	3.7%
Q1 2019	17.8%	17.7%	15.4%	13.6%	2.5%	2.4%	4.2%	4.1%
Q2 2019	5.5%	5.4%	3.3%	4.3%	2.2%	2.1%	1.2%	1.1%
Q3 2019	2.5%	2.4%	1.0%	1.7%	1.5%	1.4%	0.8%	0.7%
Q4 2019	10.6%	10.6%	9.3%	9.1%	1.3%	1.2%	1.6%	1.5%
2019	40.9%	40.4%	31.6%	31.5%	9.3%	8.9%	9.4%	9.0%
Q1 2020	-14.7%	-14.7%	-19.8%	-19.6%	5.1%	5.0%	4.9%	4.9%
Q2 2020	30.3%	30.2%	18.4%	20.5%	12.0%	11.9%	9.8%	9.7%
Q3 2020	9.4%	9.3%	8.2%	8.9%	1.2%	1.1%	0.5%	0.4%
Q4 2020	7.7%	7.6%	12.0%	12.1%	-4.3%	-4.4%	-4.4%	-4.5%
2020	31.0%	30.6%	15.1%	18.4%	16.0%	15.5%	12.6%	12.2%
Q1 2021	2.6%	2.5%	4.8%	6.2%	-2.2%	-2.3%	-3.6%	-3.7%
Q2 2021	12.6%	12.5%	9.1%	8.5%	3.5%	3.4%	4.1%	4.0%
Q3 2021	-1.1%	-1.2%	-0.9%	0.6%	-0.3%	-0.3%	-1.7%	-1.8%
Q4 2021	4.5%	4.5%	10.5%	11.0%	-6.0%	-6.0%	-6.5%	-6.6%
2021	19.4%	19.0%	25.3%	28.7%	-5.8%	-6.2%	-9.3%	-9.7%
Q1 2022	-10.8%	-10.9%	-7.5%	-4.6%	-3.3%	-3.4%	-6.2%	-6.3%
Q2 2022	-17.5%	-17.6%	-17.0%	-16.1%	-0.5%	-0.6%	-1.4%	-1.5%
Q3 2022	-4.7%	-4.8%	-7.0%	-4.9%	2.3%	2.2%	0.2%	0.1%
Q4 2022	6.5%	6.4%	9.6%	7.6%	-3.1%	-3.2%	-1.1%	-1.1%
2022	-25.4%	-25.6%	-21.7%	-18.1%	-3.7%	-3.9%	-7.3%	-7.5%
Q1 2023	8.6%	8.5%	8.9%	7.5%	-0.3%	-0.4%	1.1%	1.0%
Q2 2023	12.0%	11.9%	8.7%	8.7%	3.3%	3.2%	3.3%	3.2%
Q3 2023	-1.5%	-1.6%	-2.3%	-3.3%	0.8%	0.7%	1.8%	1.7%
Q4 2023	10.8%	10.8%	11.7%	11.7%	-0.8%	-0.9%	-0.8%	-0.9%
2023	32.7%	32.3%	29.1%	26.3%	3.6%	3.2%	6.5%	6.0%
Q1 2024	12.6%	12.5%	11.7%	10.6%	0.9%	0.8%	2.0%	1.9%
Q2 2024	2.6%	2.5%	3.9%	4.3%	-1.3%	-1.4%	-1.6%	-1.7%
Q3 2024	6.3%	6.2%	5.0%	5.9%	1.3%	1.2%	0.5%	0.4%
Q4 2024	3.4%	3.3%	-0.7%	2.4%	4.0%	4.0%	1.0%	0.9%
2024	27.0%	26.6%	21.0%	25.0%	6.0%	5.6%	2.0%	1.6%
ITD ⁽⁶⁾	168.5%	162.2%	114.5%	148.9%	54.0%	47.6%	19.6%	13.3%

⁽¹⁾ Gross returns for SMA product exclude fund management expenses capped at 50bps annually for our commingled vehicle, Qualivian Focus Fund. These expenses typically include fund administration, audit, and similar expenses are not incurred in an SMA product.

⁽²⁾ Represents gross performance less a flat annual management fee of 35bps.

⁽³⁾ QUAL is the iShares MSCI USA Quality ETF.

⁽⁴⁾ S&P 500 Total Return Index which includes reinvested dividends.

⁽⁵⁾ Dec. 2017 period represents Dec. 14 (fund launch) through Dec. 31, 2017.

⁽⁶⁾ ITD = Inception-to-date and represents the time period from Dec. 14, 2017 through Dec. 31, 2024.

In January of 2024, we introduced a Separately Managed Account (SMA) product that replicates our core pooled vehicle product (Qualivian Focus Fund – QFF) for interested investors. The key difference is that the SMA product will not incur the typical fund management expenses, such as fund administration, tax filing and audit fees, which we cap at 50 bps in QFF. Furthermore, the SMA product will incur a lower management fee of 35 bps annually, as compared to the tiered management fee in QFF (75 bps for the first \$20 million, 65 bps for the next \$20 million, and 50 bps for anything above).

Appendix 2: Top 3 and Bottom 3 Contributors for Q4 2024

Top 3 Contributors to Performance in Q4 2024

Alphabet (GOOGL): Alphabet delivered solid results in Q4 2024. Revenue increased 12% in Q4 and 15% for the full year in constant currency terms. Operating margin in Q4 expanded 500 bps to 32% vs. year-ago levels, resulting in excellent 31% growth in EPS. The balance sheet was strong with net cash of \$84.7 billion on December 31, 2024. Alphabet's valuation is 18.2X next twelve month's consensus earnings, which is below the S&P 500's 20.3X despite having a superior 5-year growth rate and a much higher return on invested capital. Also, it has significant upside potential via its ventures in cloud computing, quantum computing, generative AI, and autonomous driving. We continue to believe that their GAAP earnings are below their economic earnings because they expense rather than capitalize many of their software investments.

Visa (V): In fiscal Q1 2025 (calendar Q4 2024), Visa grew revenue by 10% and EPS by 14%. Visa's payments volume of \$1.8 trillion grew by 7% (9% on a constant currency basis) and processed transactions increased by 11% year over year. We estimate its forward 5-year EPS growth rate be in the mid-teens. Its moat continues to be strong. What is less known about Visa is that Visa benefits not just from its own capital investments but also from those of other fintech players. Most of these use the Visa rails to process transactions. If they process more transactions, so does Visa. This is the "cuckoo bird effect." The cuckoo bird lays its eggs in the nests of other bird species. These other bird species often regard the cuckoo's egg as its own and raise the chick. The cuckoo thereby leverages the resources of other birds to reproduce. So does Visa.

Amazon (AMZN): During Q4 2024 revenue grew by 10.5% year over year but its EPS grew by 86%. The growth in EPS was evidence that the heavy investments made in its fulfillment capabilities has led to strong improvements in retail margins (up 1.9% to 8.0% from Q4 2023 levels). The company is well poised to scale its retail infrastructure further. Furthermore, AWS revenue growth reacceleration and margin recovery (+7% versus year ago levels to 36.9%) contributed significantly to the overall earnings performance in the quarter. Amazon continually demonstrates long-term thinking, customer obsession, operational excellence, and innovation.

Top 3 Detractors to Performance in Q4 2024

Microsoft (MSFT): FQ2 2025 (CQ4 2024) results showcased the company's ongoing strength across its key businesses with revenues, operating income, and EPS growing by 12%, 17%, and 10% respectively. Net income and EPS were impacted by MSFT's share of Open AI's losses (accounted for under the equity method and reflected in non-operating expenses). MSFT delivered broad-based strength as Productivity & Business Processes, Intelligent Cloud, and Personal Computing all came in ahead of expectations, with operating margins improving 200 bps vs. year-ago levels. Within Intelligent Cloud, Azure grew an impressive 31%. We continue to regard MSFT as one of the best-run, high-quality enterprise and consumer software companies with the ability to compound intrinsic value at double digits for the foreseeable future.

United Rentals (URI): URI grew revenues, operating income, and EPS by 9.8%, 2.3%, and 4.6% respectively in Q4 2024. While equipment rental revenue and EBITDA came in as expected, the company missed largely on equipment sales. Furthermore, FY2025 guidance was lackluster with the revenue guide coming in-line while EBITDA guidance at the

midpoint missed consensus expectations for the year. In addition to the company's guidance, we are monitoring the macro backdrop given rising fears of an economic slowdown.

Danaher (DHR): Danaher reported revenue and adjusted diluted EPS growth of 2.1% and 2.4% respectively in Q4 2024. The company's results were weighed down by revenue declines in its Diagnostics business, continuing the tough comparison to prior years which benefitted from higher diagnostic volumes driven by COVID. Furthermore, the turnaround in Danaher's China Bioprocessing business has taken much longer than we expected. As mentioned in the portfolio highlights section, we sold our remaining position in DHR ahead of their quarterly results, as we saw better alternatives to redeploy into other stocks in the portfolio.

Appendix 3: Links to Additional Information⁴

Investor Presentation	<u>QIP Focus Fund Final December 2024 – SMA</u>
Insider Monkey Interview	<u>https://www.insidermonkey.com/blog/exclusive-interview-with-aamer-khan-of-qualivian-investment-partners-886994/</u>
Last 4 Investor Letters	<u>QIP Q3 2024 Final.PDF</u> <u>QIP Q2 2024 Final.PDF</u> <u>QIP Q1 2024 Final.PDF</u> <u>QIP Q4 2023 Final.PDF</u>

⁴ Press the Control key and click on the link to access the reports in the Appendix.

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