

Quality Shareholders #9

Dear Valued Shareholder,

“It’s better to hang out with people better than you. Pick out associates whose behaviour is better than yours and you’ll drift in that direction.” – Warren Buffett

During 2021, we had the tremendous fortune to have Lawrence Cunningham reach out to us via email on 17th of April through one of our shareholders.

Lawrence is very well known for his works, some of which are listed below:

1. The Essays of Warren Buffet: Lessons for Corporate America
2. How to Think Like Benjamin Graham and Invest Like Warren Buffett
3. Berkshire Beyond Buffett: The Enduring Value of Values
4. The Warren Buffett Shareholder: Stories from Inside the Berkshire Hathaway Annual Meeting
5. Quality Investing: Owning the Best Companies for the Long Term
6. Quality Shareholders: How the Best Managers Attract and Keep Them

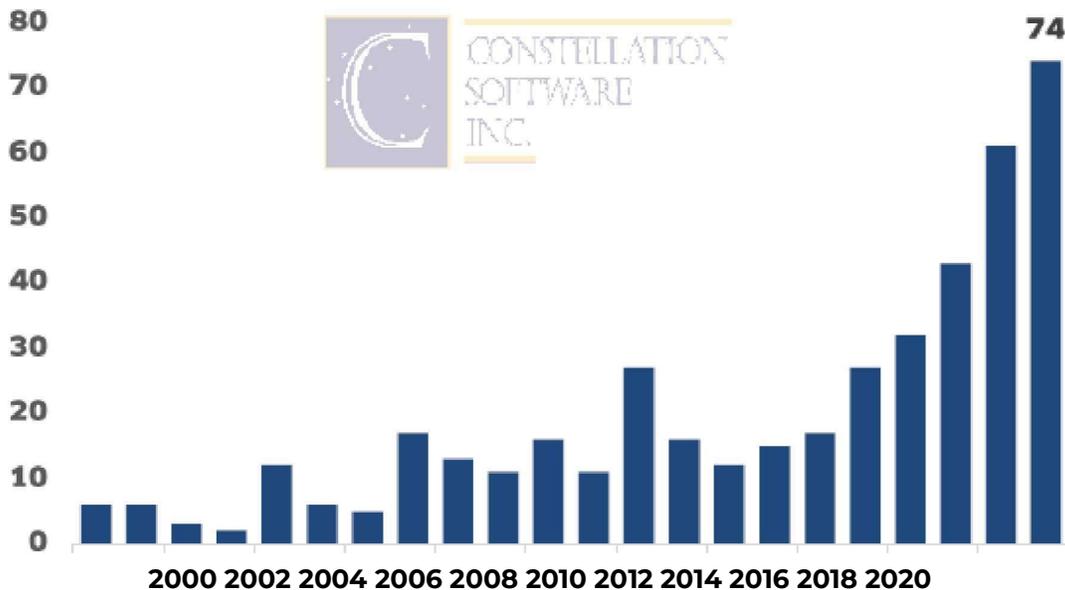
Most notably, he was the authorised author of the book collating Warren Buffett’s annual shareholder letters that was the first major exposure to Warren’s thoughts and philosophies. Warren himself provided a personal testimonial for the book, saying that “Larry Cunningham has done a great job at collating our philosophy. His book is far better than any of the biographies written to date. If I were to pick one book to read this would be the one.”

However, while Lawrence’s work on Warren Buffett is life changing (in particular his work on quality shareholders that prompted me to commence writing these letters to you as our valued shareholder and partner), it was primarily his role as Deputy Chairman of Constellation Software (CSI:TSE) that caught my eye.

Constellation Software

Constellation Software Inc is a programmatic acquirer of Vertical Market Software businesses and have acquired more than 600 such businesses across 100 countries since it was founded in 1995. They listed in 2006 raising \$80m and have since grown their market capitalisation from \$320m to \$44b, a staggering 138x.

Number of deals completed by Constellation Software

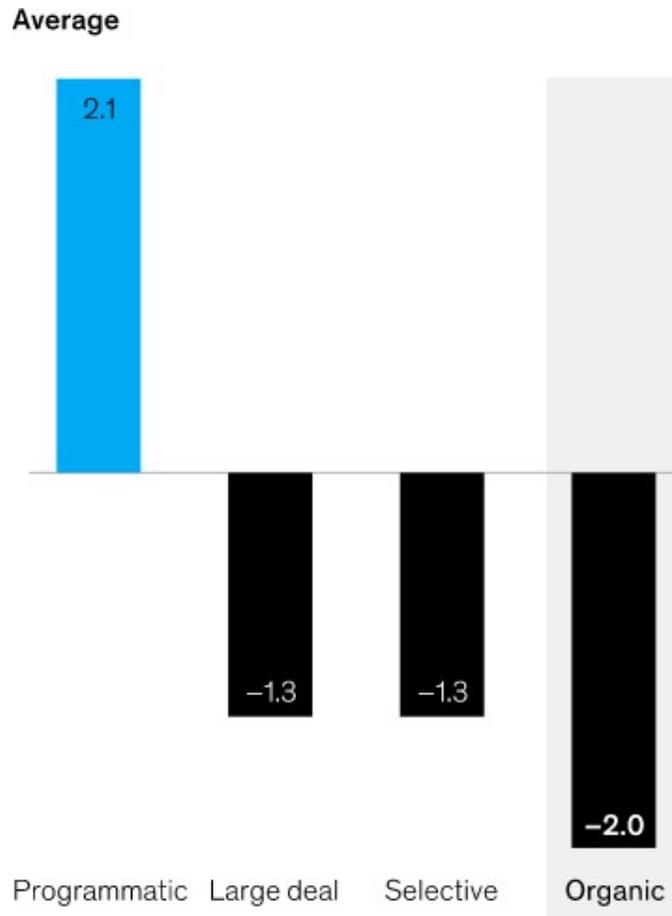


Source: REQ Capital "REQ Global Compounders – Investing with Insight" Presentation

Lawrence, through his role at Constellation Software, understood our systematic advantage as a sophisticated programmatic acquirer of accounting firms and why we do not need to do bigger deals, a question we are often asked by investors. Lawrence is the first person who recognised this since I began this journey in 2006.

The success of the programmatic M&A strategy is best supported by McKinsey & Company's research into the topic. McKinsey & Company's empirical research confirms that "programmatic M&A is the strategy that is mostly likely to create the most value for companies. That is, carefully choreographing a series of deals... rather than relying on episodic 'big bang' transactions... lead to stronger performance and less risk." For more information on this M&A strategy, You can read McKinsey & Company's research by clicking [here](#).

Global 2,000 excess total returns to shareholders by program type, Jan 2010 – Dec 2019, %



Source: McKinsey & Company, "How one approach to M&A is more likely to create value than all others", October 13, 2021

We recommend all our shareholders to read Mark Leonard's shareholder letters. Mark is the Founder and President of Constellation Software and his shareholder letters can be found on the Constellation Software website.

Mark's letters have had a profound impact on me with his clear and insightful writing. Our businesses share a similar strategy and our values so aligned that it feels like hearing from a fellow traveller, though older and wiser.

REQ Capital – Norway

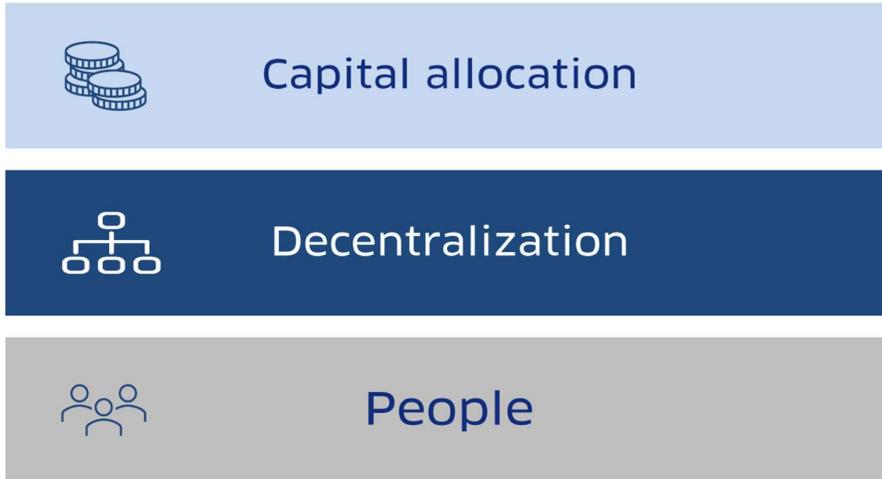
In December, we met with REQ's Chief Investment Officer, Oddbjorn Dybvad, who had found us through screening serial acquirers, the primary theme and basis on which their funds invest.

Oddbjorn shared with us his presentation which clearly distils the thesis of investing in serial acquirers that were excellent capital allocators and operated with a high decentralised structure.

We share with you a number of slides from his presentation which we found particularly interesting:

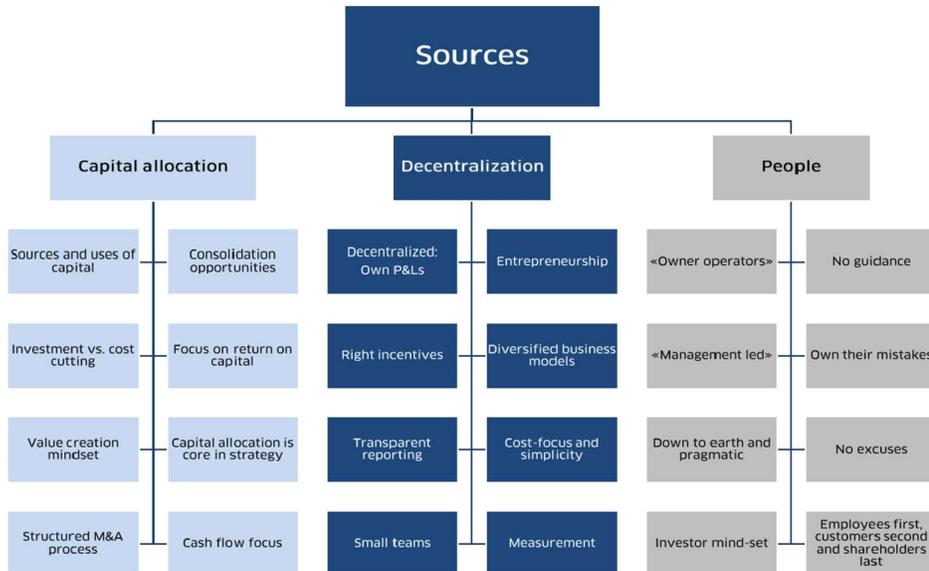
Sources of extraordinary performance

3 key ingredients



Sources of extraordinary performance

Details



KP+GH

KELLY PARTNERS GROUP HOLDINGS LIMITED

Targets

- Private niche market leaders.
- Strong track record of profitability.
- Initial founder still managing the business

M&A Process

- Simplicity and speed.
- High transaction certainty for sellers.
- Typically buys 70-80%. Founders stay on as management.

Post transaction

- Perpetual holding period.
- Decentralized - minimized bureaucracy.
- Board representation: Clear incentives (cash generation, growth & ROIC)



What are we looking for when we analyze business models?



- Free cash flow to fund acquisitions
- Strong incremental return on capital
- No synergies expected
- No guidance to the market
- Buys demonstrated track records
- Prefers to buy private companies
- Small, frequent tactical acquisitions
- Inhouse M&A team
- Founder operators or family owned

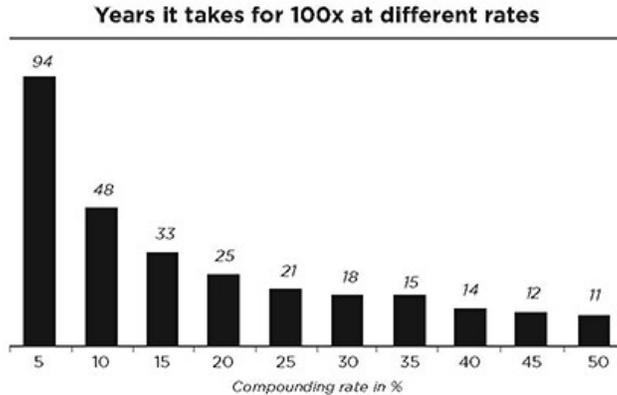


- Heavy use of equity to fund acquisitions
- Weak incremental return on capital
- Expects synergies
- Short term guidance
- Buys turnarounds
- Buys listed companies
- Few, large deals
- Use of M&A consultants
- Purely institutionally owned

Source: REQ Capital "REQ Global Compounders – Investing with Insight" Presentation

100 Baggers

Finally, a shout out to Christopher Mayer for his book *100 Baggers* which we have added to our shareholders' recommended reading list. Any shareholders who take the time to read it will surely benefit. It will help you increase your understanding in our business.



We include our assessment of KPG against the criteria for a 100-bagger below (slide is from our 1H22 results presentation):

100 BAGGERS Checklist



#	100 Baggers Criteria	KPG
1	Extended high growth is essential	✓ 30% CAGR since inception, 15% CAGR since IPO
2	P/E ratio expansion is key	✓ P/E 10.8x at IPO
3	There is always room for more growth	✓ 24.5% revenue growth and 18.3% NPATA growth in 1H22
4	Look beyond earnings	✓ 0.4% share of \$12.5b SME accounting market
5	Buy right and hold on	✓ IPO shareholders would have 4x their investment over 5 years
6	High consistent returns on equity is key	✓ ~40% ROE consistently achieved
7	Owner-operator companies	✓ Founder CEO owns 50%+ , Partners and management owns 9%
8	Gross Profit Margin	✓ GP margin at 60% , leading in industry
9	100 baggers don't favour a particular industry	✓ KPG operates in an unpopular and fragmented industry
10	Share buybacks accelerate returns	✓ ~1.0% shares bought back since IPO at significant discount ~65%

Conclusion

We will continue to execute our programmatic acquisition strategy relentlessly. In the last financial year (FY21), we completed 7 acquisitions, the highest number of acquisitions we have ever completed in a single year. This year we are on track to complete 6 transactions, 2 of which have already been completed in 1H22 and another 4 which is scheduled to complete in 2H22.

We extend our thanks to our wonderful group of partners and team members, as well as you, our valued quality shareholders. We know that the addressable market remains huge, the runway very long, and we continue to be tremendously passionate about the business. We hope that you will enjoy the journey and the ride ahead of us.

Thank you

Thank you for your trust in our company and we look forward to meeting you on zoom again soon!

Yours sincerely,

A handwritten signature in black ink, appearing to read "Brett Kelly", with a horizontal line underneath.

Brett Kelly

Founder & CEO, Kelly Partners Group Holdings Limited