



# Melville Douglas

## Quarterly Commentary

### Global Equity Fund

/ Q4 2024

## When to sell

Selling is often assumed to be the other side of the coin to buying. The presumption is that the decision-making process should be the same. But empirical evidence<sup>1</sup> finds that, for the average fund manager, sell decisions perform less well than (and detract from) buy decisions. Also, those with superior selling skills are also good buyers, but not necessarily vice versa.

## Why is selling so hard?

In essence, there are more mental obstacles to overcome. These include:

### 1/ **Regret (loss aversion)**

The Cambridge dictionary definition of “regret” is a feeling of sadness about a mistake you have made, and a wish that it could have been different and better. Investors typically anchor to the original price paid or to recent peaks. This results in hanging on to losing investments for far too long on the hope of a rebound to the level they wished they had sold with hindsight.

Regret is only made permanent when a stock is sold at a loss. While it is still held there is always the chance (in one’s mind) for the investment to recover. Regret also leads to selling winners too early - presumably to avoid the potential discomfort of seeing your gains going up in smoke if the share price rolls over.

### 2/ **Changing your mind**

John Maynard Keynes famously quipped “when the facts change, I change my mind”. As well being one of the most influential economists of the 20th century, he was a hugely successful manager of the King’s College, Cambridge endowment fund.

However, most people, especially the clever and educated, are afraid to change their minds and admit they were wrong. This is likely exacerbated in a professional context where frequently flagging your mistakes is not an obvious way to self-promote your skillsets. This is true in many fields where a sense of certainty and infallibility provides reassurance (e.g. doctors or airline pilots). It is not, however, the right trait for successful investment analysis, which involves making forecasts over an ever-evolving future.



### 3/ Inertia

For directly held client portfolios, capital gains tax planning (e.g. waiting to sell until the next tax year) can prevent selling. It is not a foregone conclusion that a sale will be successful. By contrast, to quote Benjamin Franklin, “nothing is certain except death and taxes”. The problem is that not selling may well cost more in terms of foregone investment returns compared to stumping up a little more to the taxman.

In addition, there are less proactive forms of inertia. The “endowment effect” finds people are more likely to retain an object they own than acquire the same object when they do not own it. The most famous example is a study<sup>2</sup> in which undergraduates were given a mug and then offered the chance to sell it for pens, an equally valued alternative. Once ownership was established the students required twice the mug’s value to part with it. This behavioural bias is problem for investment portfolios as it would stymie switching existing investments into better alternatives.

Inertia is also a result of the uncertainty and the lack of well-defined precision associated with equity investing. An investment thesis will often become less attractive at a glacial pace. This is either because the valuation has become too expensive or because there is a gradual deterioration in the long-term outlook. However, there is rarely an exact tipping point when the investment view switches from buy to a sell. No-one is waving a red flag. The perfect time to sell will only be obvious in hindsight. By that time, it will be too late.

<sup>1</sup> Taffler & Jin, 2016    <sup>2</sup> Kahneman, Knetsch & Thaler, 1990

## How do we approach selling?

Our investment philosophy is based around holding a range of high-quality investments over the long-term to best capture the power of compounding. We see ourselves as business owners rather short-term traders of the share price.

As with buying, a clear and repeatable process is also necessary for selling. Our sell decisions need to overcome the behavioural biases described earlier.

Reasons for selling fall into three categories:

### 1/ The facts have changed

This is when the original reasons for holding the position have deteriorated. To avoid mission-creep, i.e. changing the original thesis to justify continuing to hold the position, when we first add a stock to the portfolio we document “red flags” that would make us change our mind.

These “red flags” are regularly monitored and provide an objective sell signal. Examples include:

- / Loss of pricing power.
- / M&A outside the core business.
- / Addressable market is ex-growth and reaching saturation.
- / We have lost faith in management.

### 2/ Competition for portfolio capital

We purposely limit the holdings in the global equity strategy to a maximum of 35 names. The primary reason is to ensure only the highest conviction ideas on our monitored list of 60-80 high quality compounders make it into the portfolio. We want to avoid holding a long tail of less convincing ideas.



Furthermore, because buying is easier than selling (as explained earlier), why not play to this behavioural bias. Our team regular reviews monitored list ideas and new ideas for this list. We are very choosy, so not many make the grade. But when they do that provides an opportunity to think different about an existing position as it now holds us back from owning a potentially better idea. We consciously seek to overcome the “endowment effect”.

### 3/ Valuation becomes egregiously expensive

A mistake for quality-growth investors is to sell your winners too early. We are aligned Warren Buffett's shrewd advice that “it's far better to buy a wonderful company at a fair price, than a fair company at a wonderful price”. Quality compounders will grow through their valuations. For example, five-years ago Microsoft was trading on a seemingly elevated 30x price-to-earnings ratio. If the share price hadn't advanced since then it would have now been valued at a rock bottom 13x earnings. What had happened was that the valuation stayed at around 30x but the share price tripled, matched by the earnings growth.

However, there is a price for everything (even Microsoft). We do not seek to overtrade on valuation, but we pay a lot of attention and generally take action when they become stretched (two standard deviations away from the mean is a flag for us).

## Experience helps

An important selling (and buying) tool is to codify our shared knowledge and experience. To quote George Soros, “To others, being wrong is a source of shame; to me, recognising my mistakes is a source of pride. Once we realise that imperfect understanding is the human condition there is no shame in being wrong, only in failing to correct our mistakes”.

Over the years, we have documented our lessons learnt – successes as well as mistakes. We add to this every expanding internal booklet annually. Examples of our selling lessons include:

- / Your first loss on a stock is often the best loss.
- / Management teams are economical with the truth and will hope for the best.
- / Think like a short-trader when considering the bear case.
- / Trim at two standard deviations expensive.
- / Start over with a blank piece of paper.
- / Maintain a wide bench of ideas vying for a place in the portfolio.
- / Large acquisitions = dead money.
- / Big ships are hard to turn.
- / And so on...

This collective wisdom is regularly noted at our investment discussions, is shared with the next generation to accelerate their learning curve, and helps to avoid repeating the same old mistakes.

## To conclude

Our investment philosophy and process are predicated on selecting only the best compounders and allowing sufficient time for their investment theses to play out. But there will be times when we need to move on. Being humble, understanding our own biases and having the guardrails and processes in place ensures selling is given equal billing to buying.



# From our **Fund Manager's Desk**

Author: Justin Maloney / Global Equity Fund Manager

## Experian

We regularly explore the investment rationale of one of the companies held in the Melville Douglas Global Equity fund to articulate what we find compelling. This time round we have chosen Experian.

If information is power and power is money, Experian has a lucrative edge.

The firm has quietly amassed a data empire that underpins a wide range of critical functions in the modern economy. From lending decisions to fraud prevention, Experian's data-driven insights are increasingly vital as the digital age accelerates. This note will examine Experian's business model and why it deserves a place in the fund as a "Melville Douglas Compounder".

# What is Experian?

The credit information industry traces back to 1803 when a group of London tailors began swapping information on customers who failed to pay their debts. Experian originated out of the operations of Great Universal Stores (GUS), a retail conglomerate in the UK. GUS had millions of small customers who purchased goods on credit through its mail order business and home furnishing stores. In the 1960s, approximately a quarter of British families were customers of GUS. Therefore, GUS was probably the largest lender in the UK at the time. The company built its own credit databases, which were originally only for in-house use until IBM persuaded them to sell the information externally. The commercial conduit for GUS' credit information services was formalized in 1980 as CCN Group. The business grew in part through acquisitions, including the 1996 purchase of US-based Experian, formerly known as TRW Information Systems and Services. Experian, as it was renamed, was spun off from GUS in 2006. The IPO was in October 2006 at £5.60 per share. In 2007 it added another geographical leg beyond its key US and UK franchises by acquiring Serasa, Brazil's leading credit bureau.

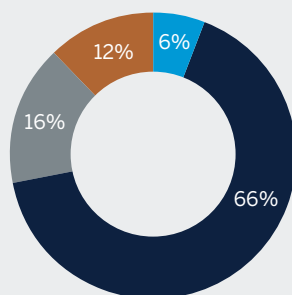
The company reports its financial results according to three segments: Data, Decisioning and Consumer Services. Data and Decisioning includes its credit bureaux and provides businesses with a suite of data driven tools and services, enabling better decisions about credit risk, fraud prevention, and marketing. Consumer Services provides credit reports and scores to consumers, empowering them to make informed financial decisions. While the competitive advantages for Experian's other businesses are not quite as deep as the core credit bureau business, they are natural add-ons that have significantly expanded its growth opportunities.

## Building on its credit database – a balanced business mix

### Global revenue split as at 31st March 2024

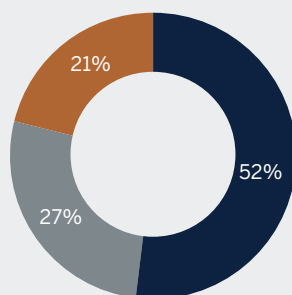
#### BY REGION

- North America
- Latin America
- UK and Ireland
- EMEA and Asia Pacific



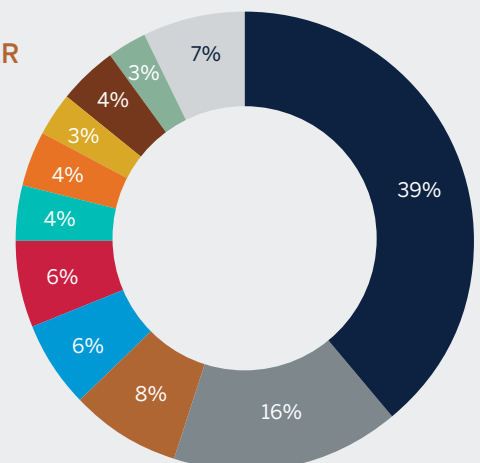
#### BY BUSINESS ACTIVITY

- Data
- Consumer Services
- Decisioning
- Business-to-Business 73%



#### BY CUSTOMER

- Financial Services
- Direct-to-consumer
- Health
- Retail
- Software and Professional services
- Automotive
- Insurance
- Telecoms and Utilities
- Media and Technology
- Government and Public Sector
- Other



### Diverse portfolio by region, business activity and customer

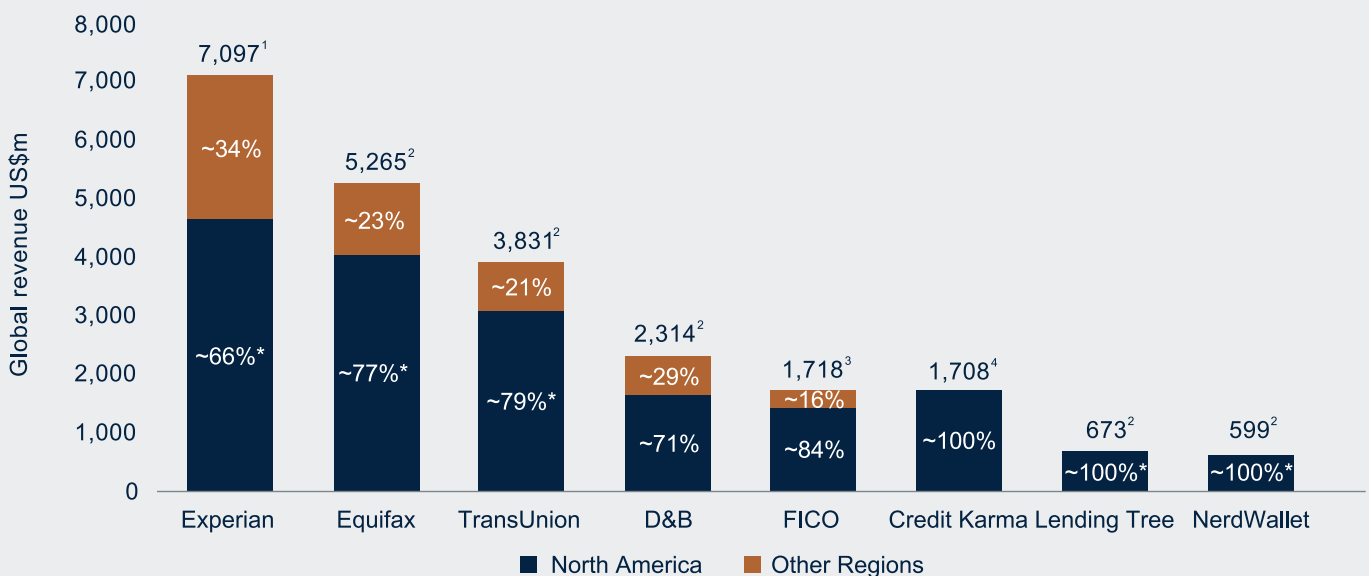
# Why is a credit bureau an attractive business model?

A credit bureau (or “consumer reporting agency” in the US) searches and collects individual credit information. The information includes credit applied for, whether or not their applications were successful, bill-paying habits and how they repaid loans. Experian acquires data from thousands of sources, including from creditors, debtors, debt collection agencies or offices with public records (e.g. court records) as well as incorporating demographic information on consumer purchasing activity. The data it collects are the foundation for credit scores used by lenders to assess the creditworthiness of a consumer.

This data is sold for a fee that is typically tiered (i.e. \$0.80 per credit report for the first 10,000, then \$0.75 and ultimately \$0.60 for a very large number of reports). Customers include large multinationals, financial institutions (i.e. banks, mortgage lenders, credit card companies and other financing companies) and governments as well as small mom-and-pop businesses. About 39% of Experian’s revenue still comes from the financial-services industry. That proportion might sound high but is down from about 70% in 2000.

The US credit reporting agency (CRA) industry is concentrated given it is dominated by a top tier of three players. There are other much smaller CRAs, but they do not pose much of a competitive threat. The other two major players are Equifax and TransUnion, which are less global and more US-centred compared to Experian. Another significant competitor is Dun & Bradstreet, which is just focused on business lending, where it is the market leader in the US (Experian is #2). Experian is split 80% consumer credit information and 20% business credit information. Outside the US, the industry structure and competitive landscape varies. For example, credit bureaux tend to be state owned in Germany. In Brazil there is only one significant credit bureau, which is Serasa (owned by Experian). Experian is also the dominant player in the UK.

## EXPERIAN IS THE LARGEST AND MOST INTERNATIONAL OF THE MAJOR CREDIT BUREAUX



1 Year ended 31 March 2024.

2 Year ended 31 December 2023.

3 Year ended 30 September 2023. FICO’s North America includes Latin America, which is ~5% of total revenue.

4 Year ended 31 July 2024. Credit Karma revenue are primarily US. Intuit/CK does not disclose international revenues.

\*US only  
Source: Annual results & latest SEC filings.

This analysis covers traditional competitors that are publicly listed. It does not include companies where a single division competes against Experian.

Given the concentrated industry structure, credit bureaux/CRA competition tends to be oligopolistic. Although a credit report is often a tiny fraction of a lender's total costs, it is a crucial piece of information to assess the risk of default. Hence, the credit report industry does not need to compete on price. The market leaders tend to provide a joint service as banks and lenders usually pull credit data from more than one firm when determining the creditworthiness of consumers. The result is a highly profitable and cash generative credit reporting industry.

## Given its lucrative dynamics, why doesn't this industry attract more competition?

**There are three main reasons:**

**/ First**, there is the difficulty and expense of replicating a database of similar depth and quality. Experian has a powerful network effect, whereby businesses want to use its information, and are happy to supply it with their own, as it has the best data. This has fuelled multi-decade growth of an unrivalled database of millions of records that have been tirelessly matched and enhanced.

**/ Second**, there is no incentive for most banks to go to the expense of setting up data distribution to new entrants, unless there is a major pricing issue, which there isn't. As credit bureaux data is based on the voluntary reporting of thousands of financial institutions, it is unlikely a startup, particularly amid heightened data security concerns, would be able to convince banks to share consumer information.

**/ Third** and finally, regulators have imposed high barriers to new entrants to ensure consumer protection. For example, the US regulator requires credit bureaux to have the infrastructure and processes in place to deal with any consumer disputes over the accuracy of their credit score within 30 days.



## Steady Eddie growth

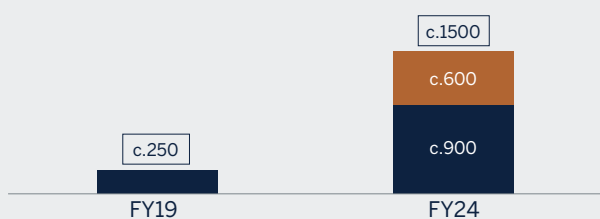
Experian's three largest markets for its data are the US, the UK and Brazil. The first two geographic regions are expected to grow steadily. A key driver is the sale of data analytics software platforms to enable its clients to enhance lending decisions. For example, Experian's software automates and drives the process when a person applies online for a bank loan. This includes checking the borrower's credit status and their ability to repay the loan, applying the bank's lending criteria, checking that applicants are who they say they are and replying with an answer within seconds for a process that previously took days. Another example is the PowerCurve suite, which helps clients deal with delinquencies (e.g. determines whether it is worthwhile renegotiating debt) and is anticyclical in nature.

There is also growth from new market segments such as healthcare, automotive and fraud detection. For example, Experian services more than 60% of all US hospitals with revenue cycle and identity management. Furthermore, Experian's direct-to-consumer offering is an attractive business in its own right.

Brazil, where Experian is the largest credit bureau, is the fastest growing region. In Brazil, limited financial data means lenders charge borrowers significantly higher rates of interest as they are unable to determine good or bad credits. Inefficient capital allocation is detrimental for economic growth, and therefore the government has been keen to address this issue through regulatory change to make credit bureau data collection easier. Experian has been ideally positioned to benefit, as well as expanding its product and services offering in this more nascent market.

### Experian continues to find new growth opportunities

#### REVENUE FROM NEW AND SCALING PRODUCTS (US\$ MILLIONS)



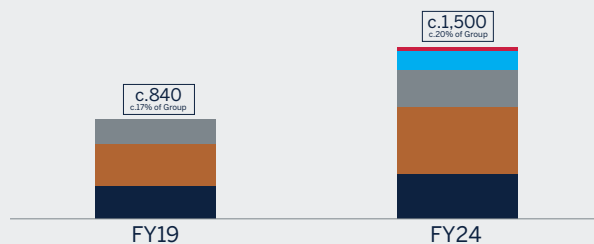
#### Scaling products:

- Software (e.g. Ascend, PowerCurve)
- Identity and Fraud
- Consumer Services (e.g. North America and UK & Ireland Marketplaces)

#### Recently Introduced products:

- New products launched since FY21

#### NEW VERTICALS REVENUE PERFORMANCE (US\$ MILLIONS)



#### Brazil Agrifinance

- North America Employer Services and Verifications
- North America Automotive
- North America Health
- Targeting

Source: Experian

These new growth avenues and the mission-critical nature of the credit data business (i.e. lenders cannot operate without Experian's data) all add up to a robust business model.

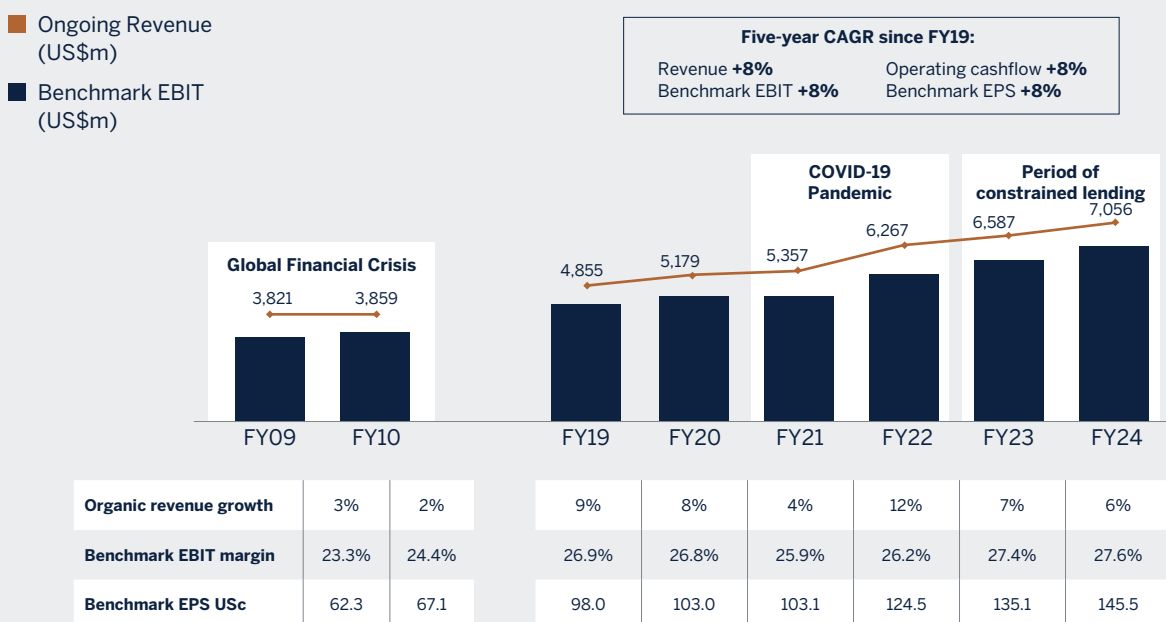


The business has proven to be resilient through the ups and down of business cycles. Although credit application volumes slow in a recession, the core bureaux in the US, the UK and Brazil only account for around a third of group revenue. Experian has counter-cyclical protection through its risk management and asset protection offerings as well as products in healthcare and other segments.

The proof is in the pudding. As shown in the chart, Experian saw positive organic revenue growth during the Global Financial Crisis, despite many of its financial sector clients running in difficulties, because there was a pick-up in demand for its credit monitoring, risk management and collections offerings.

## A bullet-proof business model

### RESILIENCE AND STRATEGY EXECUTION THROUGH CYCLES STRONG CAGR SINCE FY19



Revenue, EBIT and margins at actual rates, organic revenue growth at constant rates. Global ongoing activities revenue and Benchmark EBIT only. Excluding growth rates, FY09 to FY24 revenue, Benchmark EBIT may have been adjusted to exclude various exited business activities and discontinued operations. Growth rates are not restated.

Source: Experian's Annual Reports from FY09 to FY24 (see <https://www.experianplc.com/investors/results-reports-presentations/results-presentations>)

When investor sentiment normalised the shares quickly recovered and then went to be a ten-bagger. There was a similar disconnect, albeit less extreme through the pandemic and during a period of constrained lending when rates were hiked up in 2022 and 2023.

## FOLLOWING THE MONEY

### EXPERIAN SHARE PRICE AND EARNINGS PER SHARE



Source: FactSet

## Elementary, my dear...

**“It is a capital mistake to theorise before one has data”.** So said Sherlock Holmes (A Study in Scarlet by Arthur Conan Doyle). It is equally critical in business.

Experian provides the information and the tools for its clients to make the right decisions. In an increasingly complex, disruptive and digitised world, the company is finding ever more opportunities to optimise its proprietary data. With a rock-solid competitive edge, multiple growth avenues, and resilience through business cycles, Experian has been (and will likely continue to be) a core compounder in the portfolio.





# Market outlook

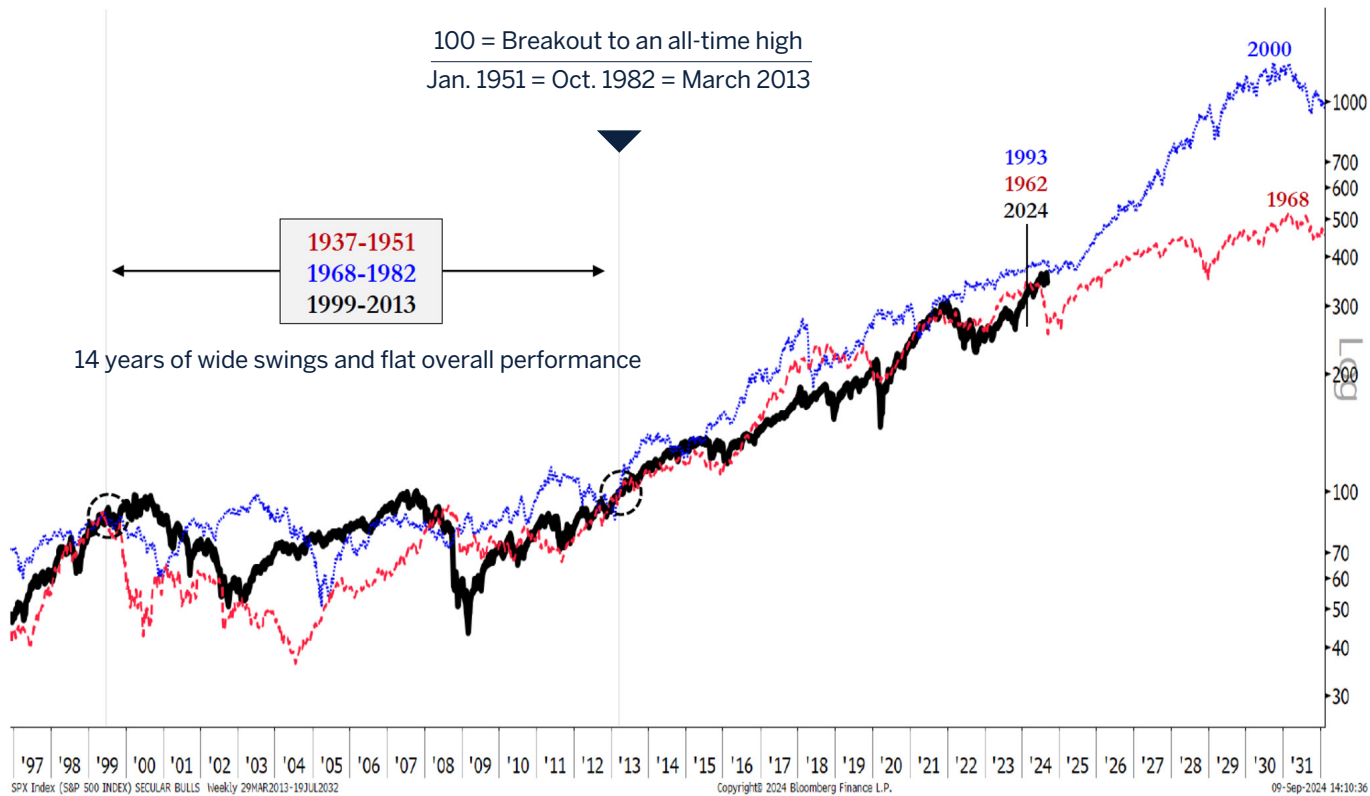
Global stocks markets, led by Big Tech, have been on an impressive run over the past two years. The MSCI All Country World index is up over +50% since the late 2022 nadir when out-of-control inflation and recession fears dominated the narrative. Nonetheless, the investor mood music is far from celebratory.

There is a lot in this world that could go wrong – wars, recessions, inflation, disruption, climate change, etc. And investors usually tend to latch onto the potential downside, particularly those focused on the daily swings in the markets. It often leads to an aura of pessimism. This is part of the human condition - studies<sup>3</sup> find people are twice as sensitive to “losses” rather than “gains”.

But there is plenty of scope for optimism if one steps back, takes a big picture perspective, and considers the current market regime. In a secular bull market, there are underlying forces that support asset prices, such as low interest rates and an upward trend in corporate earnings over many years. The opposite applies for a secular bear market, where trend growth has stagnated. In secular bull markets, investors will be looking for excuses to buy on dips. There is a sense of optimism about the future. In bear markets, investors will shun equities as pessimism rules.

As shown in the chart from Oppenheimer & Co, the makings of a secular bull market is a long stretch of preceding indifferent performance as seen in the forties, seventies and naughties (coincidentally every 30 years). The two earlier regimes set the stage for 17-18 years of strong market returns.

## BLUE SKY THINKING – A FEW YEARS LEFT IN THIS BULL MARKET S&P 500



Source: Oppenheimer & Co. and Bloomberg. Note: These results cannot and should not be viewed as an indicator of future performance.

The case for catch-up is an untapped driver for the second half of the secular bull

<sup>3</sup> Kahneman & Tversky, 1979



We are coming up to the 12th anniversary of the current bull market regime. The starting point was in March 2013 when there was breakout to an all-time high. Of course, there were big sell offs along the way. The most recent were the 2020 pandemic crash and 2022 inflation-scare decline. They felt uncomfortable at the time but, in hindsight, they were merely bumps in the road. If history rhymes, we have at least five years left before this structural bull market reaches a similar end point to the 1950/60s and 1980/90s versions.

This opinion about the current market regime is based on pattern recognition, and admittedly the starting and end points are subjective. To have conviction we also need a fundamental argument for why markets can go higher over the next several years. As with prior secular bull rallies, it is often a technology step-change. Think electrification in the 1920s, the space race in the 1960s and the internet in the 1990s.

We and other market participants tend to focus on macroeconomic drivers such as interest rate policy, inflation and jobs. Although these factors are important for the short to medium term outlook, what drives sustained economic progress is technological innovation. Innovation leads to productivity gains, i.e. doing more from less, as well as creating new avenues for growth. The combination is critical for higher corporate earnings growth, and by extension, higher stock markets.

The past century has seen one game changing innovation after another. The earlier innovations involved enhancing **physical power**, making the most of land, infrastructure, resources and human capital. These included widespread adoption of electrification and more efficient modes of transport (road, rails, shipping and the air) as well as advances in healthcare (e.g. antibiotics and vaccines). The 20th century and early 21st century have seen revolutions, world wars and the capacity to end humanity through nuclear weapons or climate change, but also amazing advances in the standard of living.

## The world changes in the blink of the eye

**EASTER MORNING 1900: 5<sup>TH</sup> AVE, NEW YORK CITY. SPOT THE AUTOMOBILE.**



Source: US National Archives

**EASTER MORNING 1913: 5<sup>TH</sup> AVE, NEW YORK CITY. SPOT THE HORSE.**



Source: George Grantham Bain Collection.



What is new and exciting today is what many see as a second machine age, which is all about harnessing **mental power**. The use of data, digitisation and artificial intelligence has the potential to change the world at least as much over the next century as it did over the past one. If not more. Unlike physical objects, digital tools are much scalable and can beget even more technological innovations and accelerate productivity further.

If one was to believe only a smidgin of AI's possibilities, the technology will completely upend almost every walk of life in a brave new world (hopefully less dystopian than Aldous Huxley's vision). At present AI-boostered productivity has taken the guise of automating tasks and generating content. However, from where we stand today, it is difficult to imagine how exactly the use cases for AI will evolve over time. What is more certain is that there will be big winners (such as Nvidia in 2023 and 2024) and losers (education stocks were early casualties). But, in aggregate, the net benefits will meaningfully boost productivity and create new revenue-generating opportunities for most companies.

However, we are wary of AI-hype going too far as it will take time for AI applications to boost productivity for knowledge workers. This may lead to near term disappointment. What is reassuring is that there is a lot more scepticism compared to the 1990s dotcom bubble. As such, most companies do not have any AI premium assigned to their share price valuations. In addition, unlike the dotcom bubble, the large IT companies benefiting from delivering AI infrastructure and solutions are highly profitable.

There are plenty of geopolitical and macroeconomic worries and uncertainties to fuel the pessimist in 2025. It is why we seek diversification across investment themes (AI is one of many in the portfolio), industries and geographies. On the plus-side there is the prospect of lower rates and solid earnings growth to sate the optimist. Our glass is half full for 2025, albeit expect lower and more volatile market returns compared to 2024.

---

#### Important Information

##### Melville Douglas

This document has been issued by Standard Bank Jersey Limited. Melville Douglas is a registered business name of the Investment Services Division of Standard Bank Jersey Limited which is regulated by the Jersey Financial Services Commission and is a member of the London Stock Exchange. Standard Bank Jersey Limited is registered in Jersey No. 12999 and is a wholly owned subsidiary of Standard Bank Offshore Group Limited whose registered office is Standard Bank House, 47-49 La Motte Street, St Helier, Jersey, JE2 4SZ. Tel +44 1534 881188, Fax +44 1534 881399, e-mail: [sbsam@standardbank.com](mailto:sbsam@standardbank.com). Standard Bank Offshore Group Limited is, in turn, a wholly owned subsidiary of Standard Bank Group Limited which has its registered office at 9th Floor, Standard Bank Centre, 5 Simmonds Street, Johannesburg 2001, Republic of South Africa. Melville Douglas is a subsidiary of Standard Bank Group Limited. Melville Douglas Investment Management (Pty) Ltd. (Reg. No.1987/005041/07) is an authorised Financial Services Provider. (FSP number 595). Telephone calls may be recorded. Please refer to the Standard Bank Offshore Group Client Privacy Statement available from: <https://international.standardbank.com/>

##### Disclaimer

This summary brochure has been prepared for information purposes only and is not an offer (or solicitation of an offer) to buy or sell the product. This document and the information in it may not be reproduced in whole or in part for any purpose without the express consent of Melville Douglas.

All information in this document is subject to change after publication without notice. While every care has been taken in preparing this document, no representation, warranty or undertaking, express or implied, is given and no responsibility or liability is accepted by Melville Douglas as to the accuracy or completeness of the information or representations in this document. Melville Douglas is not liable for any claims, liability, damages (whether direct or indirect, actual or consequential), loss, penalty, expense or cost of any nature, which you may incur as a result of your entering into any proposed transaction/s or acting on any information set out in this document.

Some transactions described in this document may give rise to substantial risk and are not suitable for all investors and may not be suitable in jurisdictions outside the Republic of South Africa. You should contact Melville Douglas before acting on any information in this document, as Melville Douglas makes no representation or warranty about the suitability of a product for a particular client or circumstance. You should take particular care to consider the implications of entering into any transaction, including tax implications, either on your own or with the assistance of an investment professional and should consider having a financial needs analysis done to assess the appropriateness of the product, investment or structure to your particular circumstances. Past performance is not an indicator of future performance.

*It's Personal.*