The Club Glue Platform Framework:
How We Assess Competitive Moats at Rondure

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Our mission at Rondure Global Advisors is to serve our clients as trusted partners in guarding and augmenting their assets over many years. The best way we know how to do that is by investing in companies we think can patiently compound capital in steady, low-risk ways. These are companies with a competitive moat—a well defended market position that has kept competitors at bay and has helped generate outsized returns on capital over time.

The tough part is deciphering which companies have a lasting moat and which do not.

At Rondure, we have devised a conceptual framework to help answer that question. We call it the Club Glue Platform Framework, or CGP Framework for short.

The CGP Framework is built around a simple observation:

Every truly great company, at its core, is a Club, a Glue, or a Platform. In other words, every company with the potential to generate consistently high returns on capital over many years:

> *1) Is part of an exclusive Club (it enjoys high barriers to entry in its core market)*
> *2) Has products or services with the stickiness of Glue (it benefits from unusually loyal or captive customers), or*
> *3) Controls a valuable network (it has a synergistic asset portfolio or membership base).*

There are no exceptions to this rule, in our experience. We believe it holds true across varying industries and countries. Every company with a competitive moat has Club, Glue, and Platform attributes.

We've found that our CGP Framework is a powerful tool in figuring out whether a company may have a lasting competitive advantage.

What are Club, Glue, and Platform Companies?

Let's explain what we mean by a "Club," "Glue," or "Platform" company.

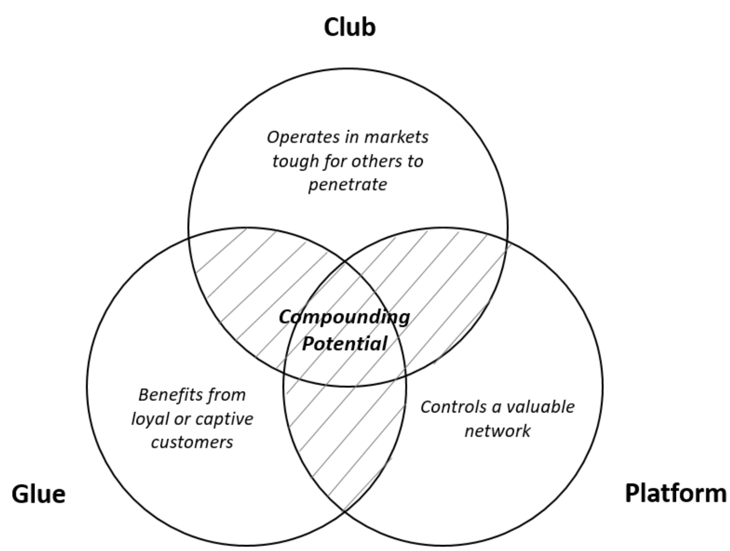
Club companies have an entrenched position in markets where it is difficult for new entrants to gain traction. These companies are marked by their exclusivity. They enjoy barriers to entry that constrain competition in their core markets.

Glue companies provide a product or service that benefit from unusually loyal or captive customers. Glue companies offer something with exceptionally sticky demand. Their products or services a strong bid even when the broader economy may be weak.

Platform companies are those that own or control a valuable network or asset portfolio whose value grows as its membership or scale does. These networks tie together people, places, and organizations in ways that can be difficult to dislodge and are valuable to their customers.

We believe that only when a company has at least two of these CGP elements can it generate economic value added over many years (see Figure 1). We define economic value added as returns of invested capital net of capital costs. Economic value, consistently generated by a company, forms the basis of excess compound returns.

Figure 1: Club, Glue, and Platform Companies: The Basis for Long-Term Compounding



How to Identify CGP Companies

Having studied thousands of CGP companies as investors, we've observed that each of these three types of companies tends to share certain traits. Once you become familiar with these patterns, it becomes easier to recognize when a company has the special attributes that may allow it to compound capital. In other words, you can discern if the company has a lasting moat.

So how can you identify a CGP company? The best way is to identify the unique *forms* that these companies take (see Figure 2).

Figure 2. Types of Club, Glue, and Platform Businesses

CLUB

Operates in markets tough for others to penetrate

What forms can Club businesses take?

A. Low-Cost Leaders
- Economies of Scale Beneficiary
- Economies of Integration Beneficiary
- Proprietary Process, Inputs, or Tools

B. Asset Monopolists
- Proprietary Intellectual Property Owner
- Government License Holder
- Scarce Physical Asset Owners

C. Incumbents in Capital-Intensive Industries
- High Brand Establishment Costs
- High Platform Build Out Costs
- High Product Development Costs

D. Incumbents in Relationship-Intensive Industries
- Difficult to Win Customer Trust

E. Efficient Scale Players

GLUE

Benefits from loyal or captive customers

What forms can Glue businesses take?

A. Providers of Must-Have Products Without Good Substitutes

B. Providers of Products Where Brand Loyalty is High

C. Providers of Products Where a Customer Can't Easily Switch to a Competitor

PLATFORM

Controls a valuable network

What forms can Platform businesses take?

A. Communications Networks

B. Marketplaces

C. Custom Manufacturers

D. Distribution and Logistics Networks

E. Brand, Product and Intellectual Property Portfolios

<u>Clubs</u>

Club businesses take at least one of five forms:

1. *Low-cost leaders*: They provide products or services at a lower price point than their competitors. Although their offerings may be relatively undifferentiated from others, they sustain a special level of demand given their better price. Low-cost leaders derive their advantage from some combination of economies of scale, economies of scope or integration, or cost-related trade secrets.

2. *Asset monopolists*: These businesses own or control a scarce asset that is highly valued by the market. It can be physical in nature (e.g. prime real estate), a unique license to operate (infrastructure or a regulated utility), or a legal claim (intellectual property, like a patent or copyright).

3. *Incumbents in capital-intensive industries*: These businesses operate in industries that require extraordinary upfront capital investments to enter. Those who seek to break into these industries are often stymied due to the cost of developing a competitive product, establishing a credible brand, and building out a scaled distribution platform.

4. *Incumbents in relationship-intensive industries*: They provide products or services whose quality is often difficult to judge ex ante and can be hard to ascertain even after purchasing, such as medical treatment or financial advice). A company's track record and pedigree play a decisive role in a customer's purchasing decision.

5. *Efficient scale players*: These businesses benefit from being established players in markets that are best served by a limited number of players, discouraging would-be competitors who know that entering the market could push returns to unacceptably low levels give the limited market size. Hotels, railroads, logistics firms, and rural retailers are examples of businesses that often enjoy this advantage.

Profiles of Club Businesses

Oriental Land Co. Ltd. (4661 JP)

Oriental Land owns and operates Tokyo Disneyland and other adjacent Disney properties. It began in 1960 with a land reclamation project in Chiba, Japan—a suburb of Tokyo between the international airport and the massive city center. The park opened in 1983. A second one, DisneySea, opened in 2001.

While Disney owns the underlying intellectual property, Oriental Land, as the local license holder, controls unique recreational assets that face no real challenger nearby. Disney properties in Japan are one of a kind and enjoy a devoted group of loyal fans. Like many of our best CGP businesses, Tokyo Disney and Tokyo DisneySea have the high-quality problem of having visitor count dip in some years due to incredible congestion, hosting over 30 million people a year.

China Resources Beer Holdings Co. Ltd. (291 HK)

In beverages, brand is everything. And if you're in the business of producing low-cost beverages, brand, scale, and growth are an incredible combination. That's what gives China Resources Beer such phenomenal compounding potential. Owner of the world's best-selling beer brand, China Resources sold 101 million hectoliters of its leading Snow brand last year, while the #2 brand, Budweiser, sold less than half that.

Ten years ago, China had a fragmented beer market with multiple provincial players vying for drinkers. Now 70-80% of the market is in the hands of the top five players. The sheer size and cost competitiveness of Snow beer should squeeze out even more players over time, making this a great club industry with the country's best distribution network. The Chinese drink less per capita than Americans (even though China as a country is the biggest drinker in terms of total consumption). According to Statista, beer consumption stands at 30 liters per capita as of 2019 versus a frothy 73 liters per capita in the United States. There is room for Snow to expand on its dominance.

Glues

Glue businesses fit at least one of three descriptions. They provide products or services that:

1. *Customers consider "must-have" and lack good substitutes*. We all have certain purchases that we consider it impossible (or perhaps just unpleasant) to go without. When we see a favorite product as a must-have, we are likely to come back to it again and again.

2. *Enjoy high brand loyalty*. Some businesses benefit from unusually loyal customers, even when peers may offer things that are substantially similar. Buyers may have a deeply ingrained trust in the product quality or identify with the company or its products on a personal level.

3. *Customers cannot easily opt out of*. When it is costly to opt out of a business' product or service (whether in terms of time or money), the provider can often raise prices and still enjoy solid customer retention, even if it underinvests in its offerings relative to peers.

Profiles of Glue Businesses

WH Smith PLC (SMWH LN)

WH Smith is a reminder that brick-and-mortar retail can still work today. Its secret is selling small-ticket consumable products in settings like train stations where online shopping just isn't possible. This company was the world's first retail chain, founded by Henry Walton Smith and his wife Anna in 1792 as a news vendor. Today, the British retailer operates a chain of travel, hospital, and High Street stores selling books, stationery, magazines, newspapers, drinks and candy.

We've all been told that e-books will take over the world, yet all of our airport journeys tell us this hasn't happened. Most travelers are stuck in waiting areas where boredom nudges them into the nearby WH Smith travel store for a diversion.

People traveling often impulse shop. As a research team who spends a lot of time on the road, we've collected a lifetime of books, gum, Dramamine, bottled water, and all the other impulse-driven sundries that WH Smith sells. This is a captive customer at its best.

Philippine Seven Corp. (SEVN PM)

Philippine Seven is the master franchisee of the 7-Eleven convenience store chain in the Philippines. This is one of the best distribution platforms in the world, in our view. The company sells affordable products that consumers want in good times and bad. It's a cash flow monopoly on convenience in a country where its competitors are all burning cash at present.

The cash flow characteristics of the business are superb. The consumer pays cash on visiting. The supplier, which needs the shelf space, provides 7-Eleven the working capital to sell the good. This results in a negative working capital cycle for the company, which it uses to build new stores. Unlike Japan, where sizeable competitors like Lawsons and FamilyMart exist, 7-Eleven is in the pole position in the Philippines. As the store count grows, so does the companies power relative to its suppliers. In that sense the company's market power is self-reinforcing as it grows.

Platforms

Platform businesses facilitate exchanges by other people or businesses, who tap into their network to pursue their own interests. Platform businesses own or operate:

1. *Communications networks*: These businesses provide social infrastructure, enabling everyday activities like placing a phone call, sending an email, or advertising a product. High-profile communication and social media businesses form the basis of some of the world's most familiar and iconic companies.

2. *Marketplaces*: These businesses bring together buyers and sellers. Financial exchanges and online classifieds are two examples. The value they provide to customers grows as a function of their liquidity and scope. Like other platforms, they can be physical in nature (e.g. an outlet mall or auction house) and online.

3. *Custom manufacturers*: They provide a digital and physical platform that customers can tap into to create products of their own. Customer manufacturers are, in essence, infrastructure providers. They allow third parties to utilize their services to invent products that will shape the future.

4. *Distribution and logistics networks*: These companies control the physical and virtual infrastructure that facilitates supply chains. These platforms grease the wheels of the global industrial economy by allowing them to move products along the value chain.

5. *Brand, product and intellectual property portfolios*: Assets portfolios can be synergistic. For a company like Disney or Nestle, owning a suite of complementary products allows for revenue generation and cost savings to occur in a way they could not if the assets were sold off and separately controlled.

Profiles of Platform Businesses

GrameenPhone Ltd. (GRAM BD)

GrameenPhone (which translates to "rural phone"), is Bangladesh's leading telecommunications operator. Before it came along, the cell phone was a luxury, a gadget of the privileged. The mass could not fathom owning mobile phones. GrameenPhone started its journey with the Village Phone program, a pioneering initiative to empower the country's rural women. Starting operations in March 26, 1997, Bangladesh's national Independence Day, the company pioneered the then-breakthrough initiative of mobile-to-mobile telephony, lowering the cost of services and eventually spreading access to 99% of the country's population. It is the country's biggest tax payer and largest-ever IPO when it was floated in 2009.

Euronext NV (ENX FP)

The financial and commodities exchanges that today comprise Euronext NV have been at the center of European capital markets for centuries. Although Amsterdam is the company's hub, technically the Antwerp and London exchanges, both essentially commodities exchanges, came first. Amsterdam started by trading shares in the Dutch East Indies Company, bringing to the 17th century futures, short selling, and good, old-fashioned stock trading along the boat-laden canals of the old city.

Euronext is a merger of several national European markets. The conglomerate is one of Europe's oldest and most well-known trading platforms. The physical structure of the exchange is no longer very sizeable, as trading activity becomes increasingly electronic, but the exchange in Amsterdam still stands among modern buildings in a historical city.

Clubs, Glues, and Platforms: The Basis of Long-Term Earnings Power

We believe truly great businesses, which have the power to generate potential market-beating returns on capital and sustain them over economic cycles, share certain attributes that unite them as a class and distinguish them from their peers. The aim of our Club Glue Platform Framework is to identify these companies and ascertain the source of their competitive advantage. Our investment process at Rondure Global Advisors utilizes the CGP Framework in an effort to find these companies, wherever they exist in the world. Then we can own them with confidence, knowing they have the potential to compound their earnings over economic cycles.