Rothschild & Co
Wealth Management

QUARTERLY LETTER | JANUARY 2024

LongRun Swiss Small & Mid Cap Fund

Investment philosophy

“Make things as simple as possible, but not simpler.” — Albert Einstein

Welcome to the inaugural letter of the LongRun Swiss Small & Mid Cap Fund. Some may recognise the name, at least in parts, as we also manage the LongRun Equity Fund. Both strategies share the same investment philosophy. Their chief distinction is the investment universe: Swiss small and mid cap companies or global mid and large cap companies. More on why we like Switzerland and its companies is outlined in later pages.

As stewards of our clients’ wealth, we invest the monies entrusted to us in a selective and concentrated portfolio of high quality Swiss small and mid cap businesses. Put differently, we simply want the best.

LONG-TERM BUSINESS OWNERS

We want to own high-quality businesses which will be around and prospering for decades. Hence, we pay little attention to short-term price moves and rather focus on a business’s sustainable competitive position. This means we search for companies with enduring superior business models that can compound their earnings. Consequently, we avoid companies in commoditized industries where price is the main differentiator. We seek solid companies in control of their own destiny, immune to external prices swings. A key metric is often management’s allocation of capital as if it were their own, with a dedicated emphasis on achieving sustainable superior returns.

We care about valuation but are not dogmatic about it. If a great business continues to prosper, we are convinced that its share price will eventually follow. Furthermore, an obsessive focus on valuation often fails to identify truly exceptional businesses. We are determined to avoid this mistake.

Warren Buffett’s advice “It’s far better to buy a wonderful business at a fair price than a fair business at a wonderful price” is gospel to us. We are long-term business owners, which, in essence, implies that we envision acquiring a business and happily owning it for decades, if not longer.

DEEP RESEARCH ON A FEW COMPANIES ONLY

As follows from the previous section, we do not continuously screen our investment universe for “cheap” companies nor do we buy and sell based on short-term price changes. Instead, we leave this to machines which go through publicly available data to identify and exploit perceived arbitrage opportunities.

Our research process is thorough. Once we consider buying a company, we spend time reading its annual reports, conducting expert calls, talking to management and constructing our own financial models. We also read books on companies and their leaders, industry newsletters and listen to podcasts. In short, we leave no stone unturned to better understand a business.

Rothschild & Co Bank AG
Zollikerstrasse 1818034
Zurich Switzerland

+41 44 384 71 11

rothschildandco.com

Values: All data as at 31 December 2023.

Sources of charts and tables: Rothschild & Co and Bloomberg, unless otherwise stated. Past performance is not indicative of future performance and investments and the income from them can fall as well as rise. Strategy performance is shown in CHF, after all fees, in total return, combining income and capital growth.

Please ensure you read the Important Information section at the end of this document.

We do not continuously screen our full investment universe for “cheap” companies and buy and sell based on short-term price changes.

Avoiding permanent capital loss is essential to long-term investment success. Deep research on a few companies only should facilitate that.

[1] The SPI Extra defines the strategy's investment universe and is used as the benchmark. Up to a total of 15% can be invested outside of this universe for two reasons: To maintain an existing investment despite benchmark composition changes or to make an investment complementary to the overall portfolio.

We prefer to analyse and own fewer companies, ensuring a deeper understanding. To us, this deep understanding of business models is absolutely necessary even if it is no guarantee for superior long-term performance.

WEALTH PRESERVING PORTFOLIO

Avoiding permanent capital loss is essential to long-term investment success. Consequently, we conduct deeper research on fewer companies. Also, it's an ongoing process, never truly finalized. We always strive to learn more and assess whether a business will be around and prospering decades from now, considering environmental, social or governance risks. Only companies of high quality, firmly in control of their own destiny, make the cut.

Our approach stands in stark contrast to benchmark-relative investing, where the allocation to each company is determined by the benchmark. In this method, any particular company then receives a higher or lower or even no allocation depending on a portfolio manger's view. This frequently results in a portfolio with – we would claim – too many positions. To us, the benchmark serves as a yardstick only, and when looking at its constituents, we select simply the best.[1] That is why our portfolio's deviation from the benchmark as measured by the active share commonly exceed 65%.

On a portfolio level, our selection of businesses is complementary, as they serve different end markets across various geographies, generating revenues in multiple currencies. To us, this represents true diversification. We are cautious about merely adding more businesses to achieve diversification by quantity. This results in a robust portfolio.

A robust portfolio is also what then allows us to compound returns over the long term. Just like we expect our businesses to compound their earnings, we also want to compound our clients' wealth.

Portfolio performance and changes

PERFORMANCE

The fund performed stongly, with a return of +9.2% over the fourth quarter and +21.9% for the full year 2023. In comparison, the SPI Extra, serving as the fund's yardstick, increased by +2.8% and +6.5% for the same periods, respectively. Annualised returns since the strategy's inception some four years ago stand at +6.7% for the strategy and +2.8% for the benchmark. This results in an annualised outperformance of +3.9%.

Positive contribution over the quarter came from VAT Group (+28% share price change over the quarter), Comet (+36%) and Straumann (+16%). Detractors included Burkhalter (-2%), SGS (-6%) and SIG Group (-15%).

ACTIVITY

The third and fourth quarter saw an unusually high number of portfolio changes, primarily due to the launch of the fund on June 11, 2023. Initially the strategy was launched on November 6, 2019 as a certificate. Adjustments were necessary due to the fund's regulatory requirements concerning portfolio concentration and maximum position sizes.

Overall we increased the quality of the portfolio by adding investments in the liquid handling specialist Tecan, the pharmaceutical equipment company SKAN, the electronic component manufacturer LEM, the private equity manager Partners Group and the semiconductor equipment manufacturer Comet. Amongst others, we sold our investment in the hearing aid company Sonova and building technology company Burkhalter.

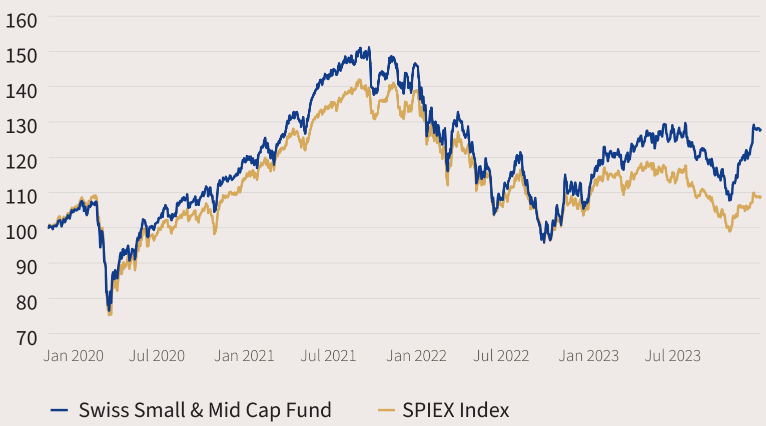
RESULT

Our portfolio comprises high quality businesses as evident from the financial metrics: Cross-cycle sales growth of 7%, a 18% operating margin, an operating return on invested capital of 26%, a net debt to EBITDA leverage ratio of 0.3x and a strong cash conversion of 70%.[3] We consider current valuation attractive as current free cash flow yield of the portfolio is 2.7% versus 2.3% for its yardstick.

[2] Performance based on a certificate from its inception on 2019-11-06 until the fund's inception on 2023-06-11 and the fund's performance thereafter.

[3] Based on internal calculations using ca. eight historical and two future years.

PERFORMANCE (%)[2]



	FUND	BENCHMARK	DIFFERENCE
2023	21.9	6.5	15.3
2022	-26.6	-24.0	-2.5
2021	22.9	22.2	0.7
2020	14.1	8.1	6.0
2019	4.4	4.9	-0.5
CUMULATIVE RETURN	31.0	12.1	18.9
ANNUALISED RETURN	6.7	2.8	3.9

Case study

Swiss small and mid cap businesses

Contrary to what you can expect from this section in future letters, namely a pure focus on specific investments, the inaugural letter also outlines why we like Switzerland. Since we select businesses purely based on a fundamental approach, we recognize that discussing the geography of choice involves macro considerations. This apparent contradiction is acknowledged, yet, for the introduction of the strategy, we allow ourselves this one exception. Also, we live here!

WHY SWITZERLAND

Switzerland, with its approximately nine million inhabitants, boasts a high standard of living, robust infrastructure, and an excellent education system. The business-friendly environment has helped companies thrive. Since the domestic market is small, Swiss companies have historically sought expansion opportunities in the EU, the world's second-largest unified economic zone. To succeed in foreign markets, these companies strive to become the best in their fields through quality, innovation, high productivity, and unwavering perseverance. Remarkably, they have achieved this against the backdrop of a strong Swiss currency often increasing companies' domestic cost bases and reducing profits from foreign currency revenues once repatriated.

BELIMO, A RELATIONSHIP BUSINESS

There are many outstanding businesses in Switzerland which are often global technology and market leaders. At first sight, this seems surprising considering that research, development and manufacturing in Switzerland is comparatively expensive. However, this has forced companies to operate with exceptional efficiency to secure and maintain a prominent position on the world stage. Yet, efficiency alone is not the sole criterion for inclusion in our portfolio. We have a distinct preference for what we term "relationship businesses."

Relationship businesses have strong and lasting ties with their customers. Their services are typically mission critical but account for a small fraction of customer spend which grants the business pricing power. Used correctly, these elements lead to superior economic returns. An excellent discussion of pricing power can be found in the LongRun Equity Fund's Quarterly Letter of Q4-22.

Think about long-lasting customer relationships in a business-to-business context, where rational decision makers focus on the overall value proposition and not just price. Over time, these relationships result in higher switching costs and more captive customers. This gives the company good revenue visibility. We like such companies.

We prefer relationship businesses in the business-to-business domain where rational decision makers form long-lasting ties.

The polar opposite of relationship businesses are transactional ones, frequently found in the business-to-consumer domain, where customers show little loyalty and focus mainly on price. Therefore, every sale needs to be won again which limits visibility. We try to avoid such commoditised companies.

An exemplar of these desired qualities in our portfolio is Belimo. As a maker of field devices for building climate systems, the business focuses on a niche in terms of product offering and target customers. Its actuators, valves and sensors are integral to commercial buildings' HVAC (heating, ventilation and air-conditioning) systems. The important nature of Belimo's products becomes evident when considering the potential consequences of a malfunctioning climate system in a building – unoccupiable spaces, discomfort due to inadequate heating or cooling, or even compromised indoor air quality throughout the year. Clearly, Belimo's products are mission critical. Also, they represent a tiny fraction of the cost of a new construction (<0.5%) or renovation project (<5%), with its offering particularly suited to upgrading an existing system whilst it remains in use. Commonly, renovation projects achieve improved indoor climate whilst reducing a building's energy consumption, thus saving running cost.[4]

Belimo is the global market and technology leader and maintains this position by remaining focussed and not getting side tracked. Spending on average 7% of sales on R&D every year enabled Belimo to obtain an outstanding reputation and dominant market share by geography and by product line.

Anecdotally, some customers proudly refer to some installed field devices as "a Belimo". In select geographies, Belimo's overall market share exceeds 50%. Globally, by product category, the company controls 40% of damper actuators, 20% of control valves and 3% of sensors. Interestingly, out of roughly 100m actuators sold to date, around 90% remain in use, which speaks to its high product quality.

Belimo boasts a repeat customer rate of more than 95%. Whilst its sales are not recurring in a classic sense, the high repeat customer rate make them quasi-recurring, thus giving Belimo incumbent advantages. Customers only switch suppliers on the rare occasion when devices are not available. However, even during the supply chain disruptions caused by Covid-19, the company gained market share as it was, unlike its competitors, able to deliver. Today, Belimo is the only competitor able to service and provide spare parts or replacements for virtually all existing HVAC systems. Customers highly appreciate such expertise. Also, Belimo has transformed itself from a pure device supplier and today selectively advises on building climate system projects and provides training for contractors, to name but two initiatives. We believe this will make customers even more captive overtime.

In summary, Belimo's products and services are mission critical, command only a small fraction of overall customer spending, and price increases are rarely disputed. Opportunities to grow remain vast, and Belimo is well positioned to command its fair share and then some. Hence, in its niche Belimo is simply the best.

[5] As outlined during Belimo's Capital Markets Day (2023-09-06), ca. 40% of worldwide energy consumption is attributable to buildings of which ca. 40% is used for HVAC. Many HVAC systems are dated and inefficient, providing vast retro-fit opportunities. For instance, installing a BACS (building automation and control system) may save ca. 50% of energy.

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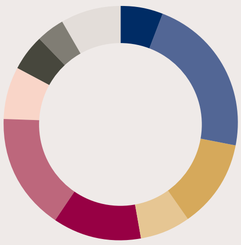
Business owner's portfolio

A deeper look into the strategy and its companies

SALES BY BUSINESS (%)

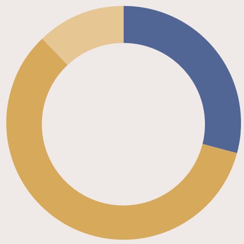


Materials	6
Machinery	22
Other cap goods	12
Transportation	7
Semiconductors	12
Health care	16
Food	7
Real Estate	5
AM	4
Other	8

Based on internal analysis.

By weight in portfolio, excluding cash.

DEGREE OF PRICING POWER* (%)



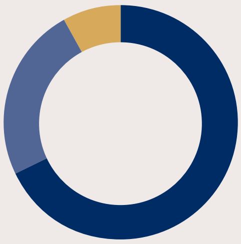
High	0
Medium	29
Low	58
None	12

*In the investable universe, approximately 5% of companies have medium or high pricing power.

Based on internal analysis.

By weight in portfolio, excluding cash

STRENGTH OF COMPETITIVE ADVANTAGE (%)

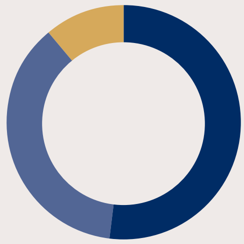


High	68
Medium	24
Low	8

Based on internal analysis.

By weight in portfolio, excluding cash.

STRENGTH OF SWITCHING COSTS (%)

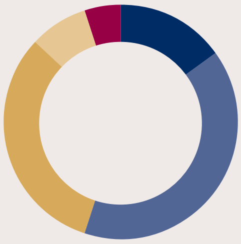


High	52
Medium	37
None	11

Based on internal analysis.

By weight in portfolio, excluding cash.

ESG RATING BREAKDOWN (%)



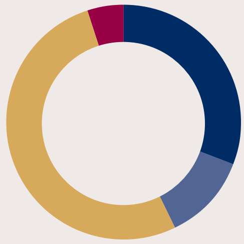
AAA	15
AA	40
A	32
BBB	8
Not rated	5

The ESG rating summarizes the ESG performance of a company across environmental, social and governance topics compared to its industry peers.

Data retrieved from MSCI ESG Research LLC.

By weight in portfolio, excluding cash.

IMPLIED TEMPERATURE RISE BREAKDOWN (%)



1.5°C aligned	31
2.0°C aligned	12
Misaligned	52
Strongly misaligned	0
Not rated	5

Implied Temperature Rise (ITR) shows the alignment of companies with global temperature goals. This represents the global warming amount if everyone replicated the measured company's practices. Categories range from less than or equal to 1.5°C Aligned to more than 3.2°C Strongly Misaligned.

Data retrieved from MSCI ESG Research LLC.

By weight in portfolio, excluding cash.

Notes

At Rothschild & Co Wealth Management we offer an objective long-term perspective on investing, structuring and safeguarding assets, to preserve and grow our clients' wealth.

We provide a comprehensive range of services to some of the world's wealthiest and most successful families, entrepreneurs, foundations and charities.

In an environment where short-term thinking often dominates, our long-term perspective sets us apart. We believe preservation first is the right approach to managing wealth.

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