Rothschild & Co
Wealth Management

QUARTERLY LETTER | JULY 2024

LongRun Equity

Advertising Communication

Investment philosophy

"It's far better to buy a wonderful company at a fair price than a fair company at a wonderful price." — Warren Buffett

We act as long-term business owners investing the wealth you have entrusted us with in a concentrated portfolio of high-quality companies.

LONG-TERM BUSINESS OWNERS

We want to own the highest-quality franchises for the long term. Little do we care about potential moves in short-term stock prices. What's crucial for us is a company's competitive position, a superior and sustainable business model and the ability to compound earnings. We want management teams that allocate capital as if it were their own. We care about valuation, but take the long-term view, avoiding excessively valued businesses but not shying away from high valuations. When you have a great business that continues to prosper, the share price tends to follow. Conversely, a narrow focus on valuation can lead one astray from truly great businesses. We are determined to avoid this mistake.

WEALTH PRESERVATION

The avoidance of permanent capital loss has been in our DNA for centuries. We avoid businesses exposed to external factors outside of their own control, which can crush attractive returns. We think long and hard about whether a business will still have a license to operate in the long term and if there are environmental or social risks. Only robust companies in control of their own destiny make the cut.

To find these, we conduct deep research to understand business models so we can take advantage of noise and temporary swings in stock prices. We would expect our portfolio companies to do the same.

COMPOUNDING

Einstein once dubbed compounding as the "eighth wonder of the world". We couldn't agree more. We look for companies with superior economics and the resulting ability to compound their earnings over the long term. Strong market positions, pricing power, high margins and asset-light business models are the key characteristics that result in high returns on capital and the ability to compound earnings. A sustainable competitive advantage resulting from high barriers to entry is crucial to maintain these high returns in the face of competition, therefore avoiding a permanent destruction of value.

DEEP RESEARCH

We spend most of our time reading annual reports, conducting and analysing expert calls and speaking with management teams and industry experts. We engage regularly with management, talk to industry insiders and conduct grass-roots research. Books on companies and their leaders, industry newsletters and trade publications as well as podcasts are hugely valuable and are often neglected sources of information.

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Values: All data as at 30 June 2024.

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 EUR, after all fees, in total return, combining income and capital growth. Returns may increase or decrease as a result of currency fluctuations. Please note the strategy's new management started on 01.08.2021.

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

The avoidance of permanent capital loss has been in our DNA for centuries. We avoid businesses exposed to external factors outside of their own control, which can crush attractive returns.

Managing our clients' money is a privilege and a role we take very seriously. It is important to us that our clients know us and understand how we operate.

CAPITAL ALLOCATION

Managing our clients' money is a privilege and a role we take very seriously. It is important to us that our clients know us and understand how we operate. In a similar vein, we want to understand how the management of our businesses thinks, acts and is incentivised. Capital allocation is the most important job of management, and the great returns of a high-quality business can be diluted via poor mergers and acquisitions or empire building. We look for management teams with incentives centered on long-term value creation and that have "skin in the game". These are critical if they are to think and act like owners, rather than managers.

QUALITY OVER QUANTITY

We prefer to analyse and own fewer companies but understand them properly. We see little value in constant screening for 'cheap' companies and it distracts us from our focus on quality. With financial information abundant, no real edge can be gained based on quantitative information in our view. On the other hand, a deep understanding of business models takes time, but this is the only way we believe it is possible to generate superior long-term performance.

FOCUS

Focus is front and center of everything we do. We like focused businesses that are easy to manage and understand. We do not need our companies to diversify; we will take care of this ourselves. Our investment universe and portfolio is equally focused, with limited turnover. This allows us to compound our knowledge of our companies in a way that is similar to how we want them to compound their earnings and cash flows.

BOTTOM LINE

The combination of the above results in a high-quality portfolio of businesses. LongRun's main financial metrics remain strong, with cross-cycle sales growth of 8%, a 28% operating margin, an operating return on invested capital of 71% and a net debt to EBITDA leverage ratio of 0.4x. On a 2.9% free-cash-flow yield, we consider valuation attractive and expect annualised forward returns in the low double digits for LongRun Equity.[1]

[1] All data as at 30 June 2024. Source: Rothschild & Co.

Notes from the manager

LongRun was up 2.9% in Q2 2024

STRATEGY PERFORMANCE

The strategy was up 2.9% (in EUR, unhedged) in the second quarter compared to its benchmark which gained 3.7%.[2] The main reason for our underperformance was a few holdings that underperformed significantly, namely Accenture, LVMH and Mastercard. Not owning the likes of Eli Lilly, Novo Nordisk and Nvidia did not help either.

Annualised returns since inception of the strategy over eight years ago stand at 11.9% compared to 11.0% for global equities, resulting in an annual outperformance of 0.9 percentage points.

PERFORMANCE DRIVERS

The main positive performance drivers in Q2 were our highly weighted technology businesses ASML, Alphabet and Microsoft (together accounting for 23% of the fund). Their strong showing was however offset by a few laggards such as Accenture, Hermès, L'Oréal, LVMH and Mastercard.

ASML gained close to 8%. Its performance was buoyed by the confirmation of the second shipment of its latest technology EUV machines later this year.

Alphabet continued to power ahead, gaining over 20% in value. The company reported another set of bumper earnings with continued strong double digit sales growth and significant operating leverage driving margins sharply higher.

Microsoft again performed well with continued double digit growth led by its cloud services which continued to grow in excess of 30%.

Accenture declined by just over 10%, its solid quarterly earnings and recovering bookings notwithstanding.

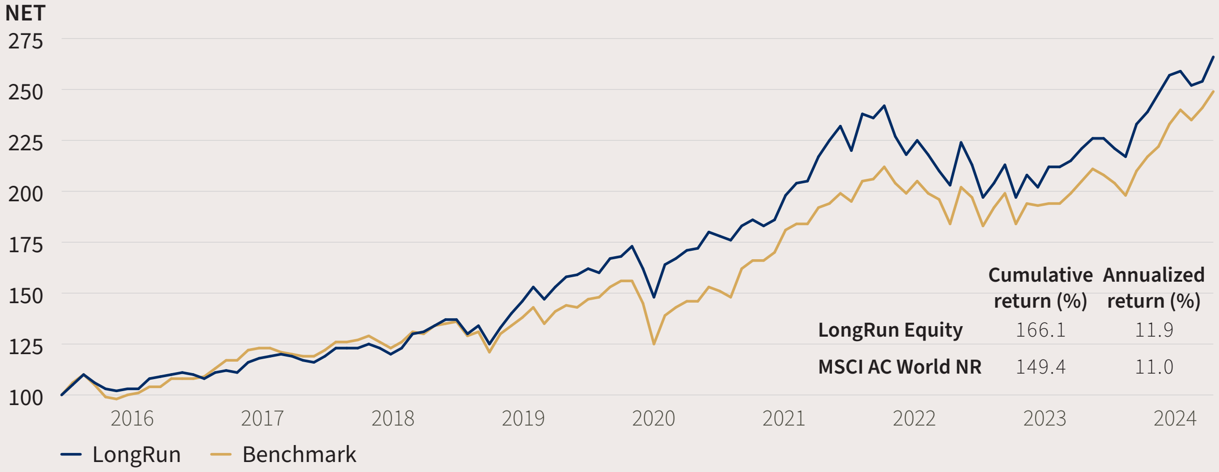
Our three French companies all fell, penalized by a rise in political uncertainty, continued lackluster consumption in China and broader worries with regards to consumer spending. That said, we expect little in terms of actual impact on their earnings power.

Mastercard also declined modestly, again largely on account of concerns with regards to consumer spending. With continued double digit sales growth, we think this is more than reflected in the company's valuation which is below historical averages.

[2] Past performance is not a reliable indicator of future performance and is not constant over time.

Sources of charts and tables: Rothschild & Co and Bloomberg, unless otherwise stated.

CUMULATIVE TRACK RECORD (EUR UNHEDGED, %)



	Cumulative return (%)	Annualized return (%)
LongRun Equity	166.1	11.9
MSCI AC World NR	149.4	11.0

ACTIVITY

In the second quarter we did not make any new investments nor divestments. While this is not the rule, it should not be the exception, either. So we want to take the opportunity to outline how the composition of the fund has continued to evolve over the last three years.

As the name of our fund implies, we invest for the long run. Moreover, our aim is to own a concentrated portfolio of high quality businesses. And we have exacting requirements in terms of the due diligence required to look at, let alone own a business. The result is that portfolio turnover should naturally be limited, and holding periods long.

Since August 2021, the number of companies in the fund has fallen by just one to 23. Portfolio turnover is at around 15% on an annualized basis since then, despite the temporary pick up in activity late last year. And over one-third of the companies in the fund have been held since inception.

The composition of the fund in terms of sectors has also continued to evolve, but not changed materially.

Taking a bigger picture view, we have increased our exposure in the semiconductor, luxury, information services and med tech sectors. In turn, we have reduced it in capital goods, fast moving consumer goods, asset management and pharmaceuticals. Software as the biggest sector at 15% and online advertising are actually little changed, our higher weightings Microsoft and Alphabet notwithstanding.

[3] Risk indicator information: The summary risk indicator is a guide to the level of risk of this product compared to other products. It shows how likely it is that the product will lose money because of movements in the markets or because we are not able to pay. We have classified this product as 4 out 7, which is a medium risk class. This rates the potential losses from future performance at a medium level, and poor market conditions could impact our capacity to pay you. The risk category is not guaranteed and may shift over time. The lowest category does not mean "risk free". Any investment is always subject to risk. Before investing, each investor must ensure the jurisdictions in which the UCI is registered. The KIID, the full prospectus as well as the net asset value (NAV)/ net inventory value (NIV) are available on our website: am.eu.rothschildandco.com.

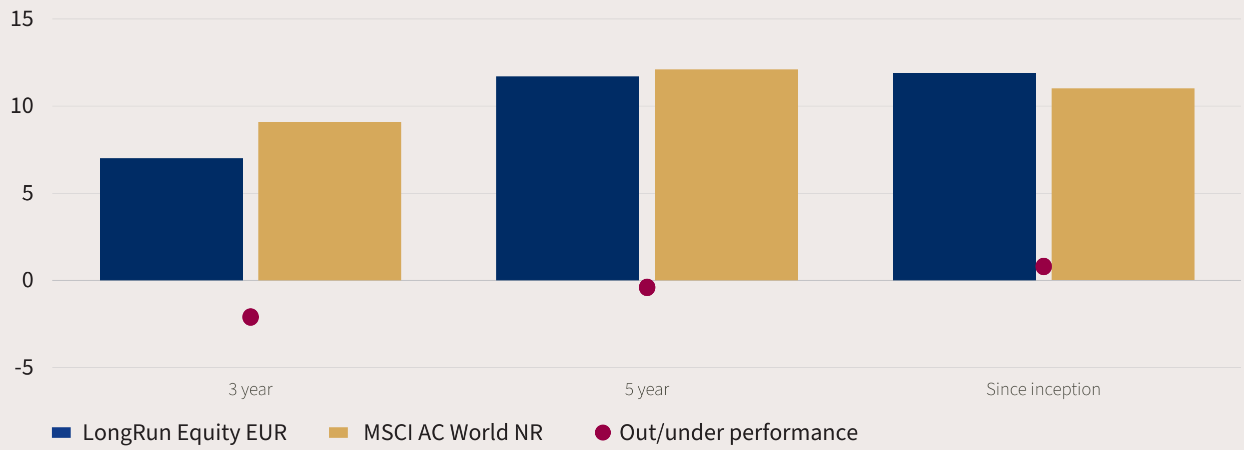
ANNUAL PERFORMANCE

	LONGRUN EQUITY (%)	MSCI AC WORLD NR (%)
2024	11.2	14.7
2023	21.2	18.1
2022	-18.5	-13.0
2021	30.4	27.5
2020	10.4	6.7
2019	34.8	28.9
2018	1.1	-4.9
2017	10.0	8.9
2016	5.8	11.1
2015	6.0	4.9

ANNUAL PERFORMANCE

	NET ASSET VALUE	QTD (%)	YTD (%)	INCEPTION TO DATE (%)
LongRun Equity EUR Unhedged	2,497	2.9	11.2	166.1
MSCI AC World NR		3.7	14.7	149.4
Out/under performance		**-0.9**	**-3.5**	**16.6**

ANNUALIZED PERFORMANCE (%)[3]



Quality, quantified

Simply the best, illuminated

The strategy of the LongRun Equity fund is a pretty simple one: be the long term owner of around 25 of the highest quality businesses worldwide. In Q4-23, we aimed to quantify the quality of the fund via five key financial metrics: i) organic growth, ii) operating margins, iii) return on invested capital, iv) cash conversion and v) financial leverage.

In this letter, we move upstream and look at key qualitative aspects that, in our opinion, define a quality business, and as such are the main ingredients driving the abovementioned financial metrics, which are in a way, the result of this. We also look at how they have developed over the past three years to see if the quality of the fund has, as is our goal, improved further.

BARRIERS TO ENTRY

If a business boasts and wants to maintain superior economics, it is of paramount importance that it be protected by high barriers to entry, in order to repel and be shielded from the onslaught of competition.

We classify barriers to entry into four levels: high, medium, low and none. The fund would never own a business with no barriers to entry, and is unlikely to own one with low barriers.

Looking at the current composition of the fund, it is reassuring for us to see that 71% of the portfolio businesses are protected by high barriers to entry, and the remaining 29% by medium ones. Our businesses are thus well entrenched and, importantly, even more difficult to be dislodged compared to three years ago when 51% of the portfolio was protected by high barriers to entry.

COMPETITIVE ADVANTAGE

The second key factor behind a businesses' ability to achieve durable superior economics is a sustainable competitive advantage. Imagine a business as a castle: the wider the economic moat (with the drawbridges firmly pulled up), the more difficult it is for competition to attack a businesses' high returns on capital.

In our investment framework, we define three levels of an economic moat: wide, narrow or none. Here, too, we would never own a business with no economic moat and our goal is for the majority of companies in the fund to boast a wide economic moat.

This is actually borne out in practice, with all but one of the companies we own featuring a wide economic moat and the remaining one with a narrow moat.

96% of the portfolio thus consists of companies with a wide moat, a further solid improvement compared to three years ago when this ratio was just under 75%. Alas, further improvements from here will be difficult to accomplish.

The strategy of the LongRun Equity fund is a pretty simple one: be the long term owner of around 25 of the highest quality businesses worldwide. ”

Our approach can be neatly described with the following three E's: "entrenched, embedded, essential."

SWITCHING COSTS

In our inaugural quarterly letter three years ago we stated that the linchpin of our investment philosophy was to "own businesses that enjoy strong and long lasting relationships with their clients and customers." Furthermore, we elaborated: "typically, our businesses' products and services are mission critical but only account for a small share of customer spend, which allows for pricing power and translates into superior economics. Perhaps the most defining feature of many of the businesses we like, and own, are loyal and lasting relationships with their customers. These are often based on business-to-business relationships with rational decision makers who focus on a variety of decision factors, and not just price. Long term relationships result in high switching costs which in turn drive greater visibility on revenues and cash flows."

As a result of the above, switching costs are by far the most important source of a sustainable competitive advantage for our businesses. Our approach can be neatly described with the following three E's: "entrenched, embedded, essential."

For switching costs, too, we have defined three levels: high, medium and none. Naturally we gravitate towards businesses with high or at least some switching costs but would not altogether rule out owning businesses with no switching costs. This is because these are rare in some more consumer driven sectors such as staples or luxury which we like for other reasons.

The current breakdown of the fund supports our ambitions with a breakdown of 69% with high switching costs, 23% with medium switching costs and 8% with no switching costs. This compares to a breakdown of 46% high, 49% medium and 5% low three years back.

RECURRING REVENUES

Recurring revenues are very much in tandem with our preference for relationship businesses and a long term investment horizon. They greatly facilitate our ability to forecast sales and earnings well into the future with reasonable confidence, rather than having to speculate. Examples in the fund would be our long standing holdings in the software (Adobe, Microsoft and Intuit) but also information services space (Gartner, Moody's and Relx).

Just under 90% of the total portfolio of businesses we own have a high or medium share of recurring revenues while just over 10% have a low or no share. This compares to just under 70% with a high or medium share of sales that were recurring back in 2021.

Hence the visibility on the future sales and earnings of our portfolio has heightened meaningfully. This is all the more relevant given many market participants' penchant for hyperbolic discounting. This, in turn, affords us the opportunity to own businesses which are attractively valued based on our investment framework given their ability for continued compounding.

MARKET SHARE

Market structure and consolidation is a key determinant of industry profitability and a business's pricing power. We like consolidated markets and prefer market leading companies.

All of the companies in our fund occupy the number one position in a majority of their markets, with the exception of three which sit just outside the number one position. Two of them (Mastercard and Moody's) actually operate in what more aptly should be called parallel monopolies given their customer's preference, or obligation, for having two providers.

In terms of market share, our holdings control just over 30% of their respective markets. This compares to around 25% three years ago. We thus have been able to further pivot the portfolio towards companies with an even tighter grip on their markets.

PRICING POWER

In terms of pricing power, an ideal business for us provides mission critical services which only account for a small share of customer spend and has a leading position in a highly consolidated market.

Two examples in the fund (again) are Mastercard in the payments and Moody's in the ratings industry, both of which are de facto duopolies. Not coincidentally, these are also the only two companies in the fund (besides Hermès) that we consider to have 'high' pricing power, the holy grail for us long term investors.

Innovation helps, too, which is why we closely monitor spending on research and development. This currently stands at 7% of revenues in aggregate. This is actually fairly similar to the ratio three years ago. This should not be too surprising given the fund's pivot away from 'big pharma' (typically a heavy spender on R&D) where ever growing investments have not been mirrored by higher returns, quite the contrary.

For LongRun as a whole, 13% of the companies have high pricing power (vs. 9% three years ago), 49% (40%) medium, 33% (47%) low, 4% (10%) none and 0% (5%) have deflationary pricing.

FOCUS

Another key tenet of the fund's investment philosophy is to own focused businesses. Examples of tremendously focused companies would be ASML, Costco or Hermès, essentially operating in one single industry or even sub industry.

For the fund as a whole, and based on our own definition, we have calculated that we own roughly 40 separate businesses currently compared to over 50 back in 2021. Ergo, the fund's focus on focused companies has continued to improve, in turn helping us to understand our portfolio of businesses ever deeper, rather than having to rely on the capital allocation capabilities of our management teams.

MANAGEMENT QUALITY

Business quality is all fine but even a great business can be, at least temporarily, harmed by bad management. What's more, strong cash flows can go to waste, or worse, if allocated imprudently. Large M&A deals carry significant risks not just in terms of value creation but also in terms of strategic direction or management distraction.

Over the past three years, we have streamlined the portfolio further in this regard, too. Today, each and every portfolio holding has what we either call strong or outstanding management while a few years ago at least a few holdings had management teams we considered fair only.

QUALITY, QUANTIFIED

We hope this exercise is useful in outlining the superior quality attributes of our portfolio (in terms of barriers to entry, economic moat, switching costs, market share, pricing power, focus and management quality).

With these we are able to draw the bridge to the superior economics of the fund (with organic growth of 8% over the cycle, a 28% operating margin, an operating return on capital of 71% and 91% free cash flow conversion).

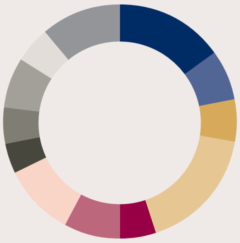
There is also some sort of interplay between the two, for example with strong returns and cash flow affording a business the wherewithal to continue investing to widen its moat further.

The result is a portfolio with a strong ability for continued compounding.

Business owner's portfolio

A deeper look into the strategy and its companies[4]

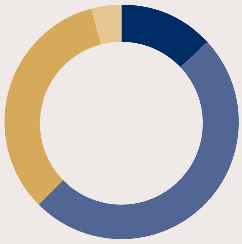
SALES BY BUSINESS (%)



Software	15
Online commerce and advertising	7
Payments	6
Professional services	17
Capital goods	5
Fast moving consumer goods	8
Medtech	10
Other healthcare	4
Luxury	5
Semi-conductors	7
Industrial gases	5
Other	11

By weight in portfolio, excluding cash

DEGREE OF PRICING POWER* (%)

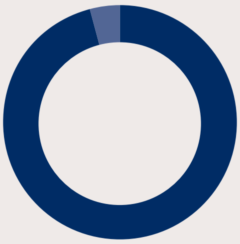


High	13
Medium	49
Low	33
None	4

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

By weight in portfolio, excluding cash

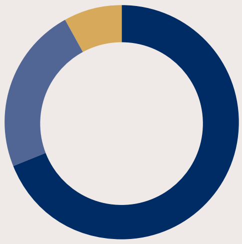
STRENGTH OF COMPETITIVE ADVANTAGE (%)



High	96
Medium	4

By weight in portfolio, excluding cash

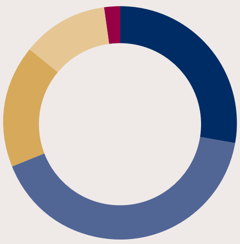
STRENGTH OF SWITCHING COSTS (%)



High	69
Medium	23
None	8

By weight in portfolio, excluding cash

ESG RATING BREAKDOWN (%)[5]



AAA	28
AA	41
A	17
BBB	12
BB	2

By weight in portfolio, excluding cash

CARBON EXPOSURE RISK BREAKDOWN (%)

1.5° Aligned	52
2.0° Aligned	24
Misaligned	24

By weight in portfolio, excluding cash

[4] Values: All data as at 30 June 2024, Source: Rothschild & Co.

[5] ESG labels only attest to the responsible and sustainable nature of management and should not be considered as a guarantee of capital security or of the fund's financial performance

Geographic and sector allocations and breakdowns are not fixed and may change over time, within the limits of the Fund's prospectus.

Notes

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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.

To follow a wide set of timely and insightful publications, podcasts and videos please visit our Wealth Insights www.rothschildandco.com/insights

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