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 by 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 grassroots 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 September 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.

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 29% operating margin, an operating return on invested capital of 71% and a net debt to EBITDA leverage ratio of 0.5x. On a 3.0% free-cash-flow yield, we consider valuation attractive and expect annualized forward returns in the low double digits for LongRun Equity.

Notes from the manager

LongRun fell 0.8% in Q3 2024

STRATEGY PERFORMANCE

The strategy fell 0.8% (in EUR, unhedged terms) in the third quarter compared with its benchmark, which gained 2.4%.[2] The main contributors to the underperformance were the three largest holdings – Alphabet, ASML and Microsoft (which were our three largest contributors to outperformance in Q1).

Annualized returns since inception of the strategy almost nine years ago stand at 11.4% compared with 11.0% for global equities, resulting in an annualized outperformance of 0.4 percentage points.

PERFORMANCE DRIVERS

The main positive performance drivers in Q3 were most of our medtech and professional services businesses, while most of our technology businesses suffered.

In medtech, our two healthcare equipment suppliers Danaher and Thermo Fisher rose by double digits, as did healthcare provider UnitedHealth. All three were buoyed by solid Q2 results. Danaher and Thermo Fisher also benefited from reiterating their attractive long-term growth outlooks during recent investor events.

Our professional services business performed well. They all boast strong market positions as suppliers of mission critical information, data and services. Accenture, Gartner, Mastercard and Moody's increased by over 10% with Relx the only laggard among this group, which fell slightly.

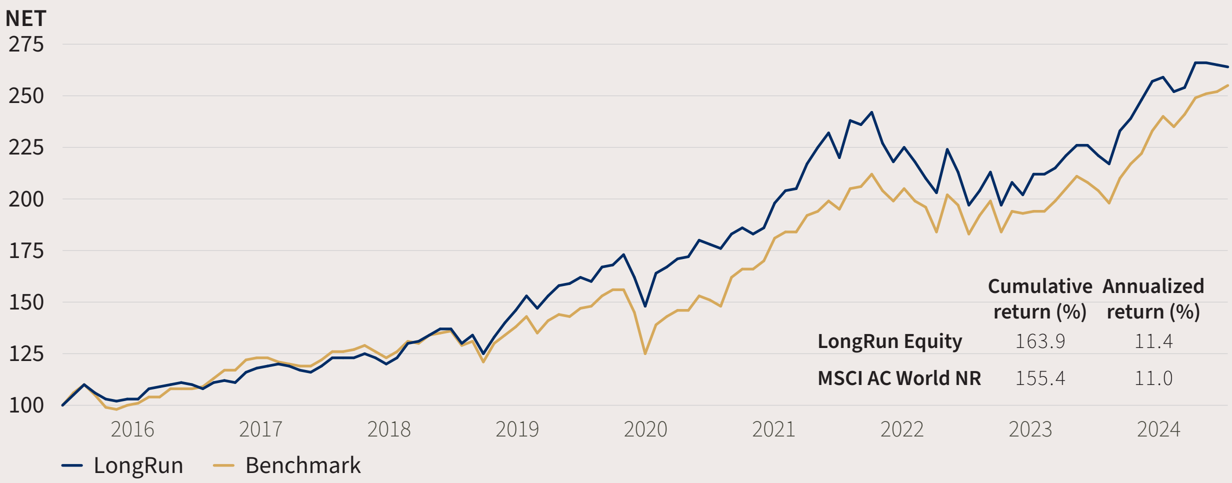
In the technology space, our software businesses Adobe, Intuit and Microsoft fell in the single digits. All three reported mixed quarterly results and suffered from more tempered expectations with regards to software spending.

The worst-performing holding was lithography equipment monolith ASML, which fell by over 20%. The share price was impacted negatively by rising political tensions and worries about new export restrictions, as well as concerns about a (cyclical) slowdown in demand. Given the sharp, almost 30% correction in the share price, we consider these concerns more than fully reflected and retain our positive view, not least because of the sharp derating the stock had to endure (earnings estimates have actually not really moved since Q1).

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

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

CUMULATIVE TRACK RECORD (EUR UNHEDGED, %)



	Cumulative return (%)	Annualized return (%)
LongRun Equity	163.9	11.4
MSCI AC World NR	155.4	11.0

ACTIVITY

We did not make any new investments in the third quarter but sold our entire holding in Kone, which had been part of the fund since its inception.

Kone (as well as the broader elevator and escalator industry) is a business whose fundamentals we continue to like. The firm occupies a strong market position in a consolidated industry with strong sales and earnings visibility thanks to its highly profitable aftermarket operations. For the first time, Kone publicly quantified this position during its recent capital markets day by stating that “this year we expect around 90% of our profits to come from Service and Modernization”. So far, so good.

Yet a key tenet of our investment philosophy is that “only robust companies in control of their own destiny make the cut”. We still see Kone as a robust, high-quality business. But we have become more concerned about its large exposure to the Chinese market, which accounts for 25% of sales.

Our concerns with China are threefold. First, China is a country where the government still wields an outsized influence on many markets, including the property sector. Second, new construction has likely peaked, resulting in the risk of overcapacities, exacerbated by a more fragmented market structure. Third, we think China may remain a “product” market over the long term, thus blunting to potential for attractive profits from more profitable aftermarket operations. Therefore, we sold our investment in July on the back of a rerating of the share price.

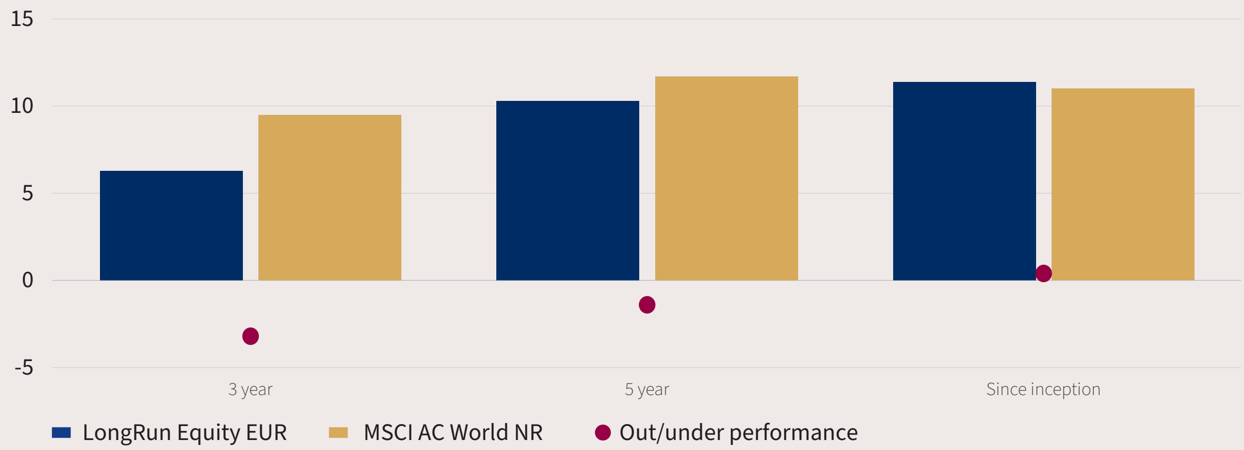
ANNUAL PERFORMANCE

	LONGRUN EQUITY (%)	MSCI AC WORLD NR (%)
2024	10.3	17.5
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	2,477	-0.8	10.3	163.9
MSCI AC World NR	—	2.4	17.5	155.4
Out/under performance	**—**	**-3.2**	**-7.1**	**8.6**

ANNUALIZED PERFORMANCE (%)[3]



[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

Case study: L’Oréal

A high-quality business with financial metrics to match

In this section, we outline our investment case on a long-standing holding in the fund – beauty behemoth L’Oréal. While there are many good and some excellent businesses in the fast-moving consumer goods sector, we believe there are only a few great ones, and we consider L’Oréal one of those.

We put forward our rationale by linking the key quality characteristics of a business we outlined in the last quarterly letter to L’Oréal. We also explore L’Oréal’s key quantitative characteristics following the financial framework we outlined in our Q4 23 letter.

THE BUSINESS

L’Oréal is the clear leader in the global beauty industry, and generated sales of more than €40bn last year. These sales have compounded organically at a rate of 6% annually since early 2000. The company is organised across four operating segments – Professional Products, Consumer Products, L’Oréal Luxe and Dermatological Beauty – and five geographical regions.

Among the world’s largest consumer goods companies, L’Oréal stands out in terms of its strategic focus on just one industry – beauty.

BARRIERS TO ENTRY

We think the advent of online commerce and marketing has lowered barriers to entry in the beauty space, which were already not particularly high to begin with. Historically, access to retailer shelf space was much more difficult for newcomers but online commerce has, at least partially, levelled the playing field. In addition, most parts of the beauty value chain can be readily outsourced these days with new entrants typically focusing on marketing and trying to leverage their personal brands.

We believe L’Oréal remains well positioned to compete with increasing competition. The firm is well known for being agile. It also has a broad presence and culture of innovation not just in terms of products but also consumer access – with more than a 25% share of sales from digital, L’Oréal is well ahead of most of its competitors.

COMPETITIVE ADVANTAGE

We consider brand equity to be the key source of L’Oréal’s competitive advantage. Since its founding more than 100 years ago, the company has amassed many strong brands thanks to decades of significant investments into research, creation and marketing in order to create differentiated products with scientific benefits.

To put some numbers around this, last year advertising and promotion spend was over €13bn, or 32% of sales, with another €1.3bn spent on research and development, equal to 3% of sales. While these figures are not capitalised as per standard accounting practice, they nevertheless generate large intangible assets of licenses, patents and

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Just 11 brands generate over €1bn in annual sales, such as L'Oréal Paris, Garnier and Maybelline in the mass segment, Lancôme and YSL in luxe, Cerave and La Roche Posay in dermatological and Kérastase in hair care.

brands worth much more than the group's physical assets.

L'Oréal has been able to build brands of tremendous scale. Just 11 brands generate over €1bn in annual sales, such as L'Oréal Paris, Garnier and Maybelline in the mass segment, Lancôme and YSL in luxe, Cerave and La Roche Posay in dermatological and Kérastase in hair care.

SWITCHING COSTS

Typically, switching costs can be found in business-to-business companies, and more rarely in business-to-consumer companies like L'Oréal. However, the term business-to-business-to-consumer is probably more fitting for L'Oréal, and even at the consumer level there are various factors supporting some switching costs.

At the retailer level, L'Oréal has built strong and loyal partnerships over many decades. It is worth noting that a physical presence remains paramount even in today's digital age, given consumer desire for discovering and trying out beauty products and the importance of look, feel and taste. L'Oréal's strong and broad portfolio of brands makes it a must have, or mission-critical, partner for retailers both large and small. For the largest accounts in particular, these relationships are further tightened through close integration on the supply side, combined in-store promotions and advertising campaigns, product exclusivity and the sharing of consumer purchase data.

Another factor driving switching costs can be found in the professional products and dermatological beauty segments. Here, hair care professionals and dermatologists act as trusted advisers on whom consumers heavily rely given the need for specific products. L'Oréal services them through an expert sales force, which understands product features and scientific benefits.

At the consumer level, beauty routines and (perceived) product efficacy also support loyalty and trust, thus countering a typical consumer's quest for value and fresh products. It's no surprise that repurchase rates are among the highest in the beauty sector, and can exceed 50% for some of the most premium brands.

MARKET SHARE

Consumer goods market fragmentation varies greatly by category, and the beauty market is one of the more fragmented ones. Given this, and the strong importance we place on good disclosure, understanding a company's fundamentals and leading market positions is all the more important. In contrast to many of its peers, L'Oréal fulfils these criteria well.

In terms of market share, L'Oréal occupies the clear number one position with a (growing) share of around 15% globally. The same holds true for most geographies (for example, a market share of 20% in Europe) and categories (skincare at 15%). Even in the premium segment (around 50% of sales) – where the main closest competitor Estée Lauder focuses – L'Oréal holds the top spot by controlling around a fifth of the market, which is well above Lauder.

PRICING POWER

As we have said many times, for us the magic ingredients that drive pricing power are i) mission-critical products, ii) which account for only a small share of customer spend, and iii) industry concentration.

Whether beauty products, or any consumer goods category, is 'mission-critical' is something on which there are many different views. But given the importance of efficacy, whether scientifically proven or just in a consumer's head, we would argue the beauty industry is among the best positioned within its sector.

Looking at customer spending patterns, the verdict is clearer with the typical price point in the low to mid single-digit euro range. Put differently, L'Oréal sells billions of products, but most of its customers spend well below the €100 threshold. Lastly, market concentration, as we have argued previously, is rather low in beauty.

Taking all this together, we think L'Oréal is a business with 'low' pricing power in line with our classification, meaning it should be able to increase prices broadly in line with inflation. Looking at its performance since 2019, we think pricing has averaged more than 3% annually, which we believe is broadly consistent with our classification.

FOCUS

Despite its size, scale and growth, L'Oréal continues to focus on one end market – beauty. There is no diversification by being present in different end markets (as portfolio managers, we want to take care of that ourselves). Nevertheless, L'Oréal is well diversified, or balanced, in terms of: i) business segments (Consumer Products and L'Oréal Luxe both account for just over 35% of sales), ii) categories (skincare is the largest at 40% of sales), iii) brands, iv) geographies, v) currencies, vi) price points and vii) distribution channels.

MANAGEMENT QUALITY

L'Oréal is a model for management quality and consistency, with only three chief executives over the past 35 years (and only six since its founding in 1909). What all of three have in common is that they were L'Oréal lifers with a strong focus on the long term.

The long-term focus is further strengthened through their significant shareholdings, giving them skin and (given their lifelong loyalty to L'Oréal) soul in the game.

This stability and long-term perspective is mirrored in the group's shareholder register, with the main shareholder to this day controlling over one third of L'Oréal's stock.

This strong alignment of interests has also impacted capital allocation positively. The acquisition track record is excellent with hardly any blemishes (apart from the Body Shop acquisition). Typically, their playbook is to buy up and coming businesses with strong scientific credentials and brand equity and then help them scale globally.

A recent, and perhaps the most successful example, is the 2017 acquisition of dermatological beauty brand Cerave. Sales have increased by more than 10 times since as L'Oréal has successfully pushed the brand onto the shelves of its brick-and-mortar retail partners.

QUALITY, QUANTIFIED

L'Oréal's leading position in an attractive growth market underpinned by secular demographic tailwinds is evidenced by its strong compound annual growth rate of 8% since 2019. This figure is around double that of the underlying market and broadly in line with LongRun overall.

Operating margins of around 20% are well above consumer sector peer levels, albeit slightly below the fund overall where they sit in the high 20s.

The same goes for return on capital at around 60% compared with 75% for LongRun. Importantly, even including acquisitions, return on capital is above 20%. This figure is in sharp contrast to most of its larger peers, which have been both more active and less successful acquirers.

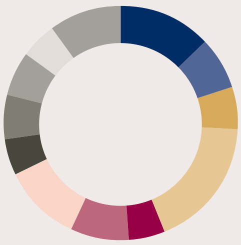
Cash conversion is equally strong, and at around 90% in line with the overall fund, boosted by the capital light nature of its operations.

In the manner of a typical family business, the balance sheet is strong with no financial gearing, which is slightly better than LongRun as a whole.

Business owner's portfolio

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

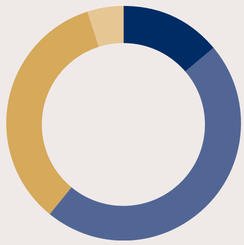
SALES BY BUSINESS (%)



Software	13
Online commerce and advertising	7
Payments	6
Professional Services	18
Capital goods	5
Fast moving consumer goods	8
Medtech	11
Other healthcare	5
Luxury	6
Semi-conductors	6
Industrial gases	5
Other	10

By weight in portfolio, excluding cash

DEGREE OF PRICING POWER* (%)

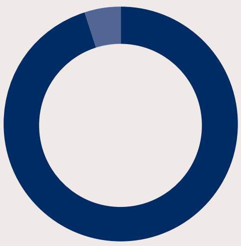


High	14
Medium	47
Low	34
None	5

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

By weight in portfolio, excluding cash

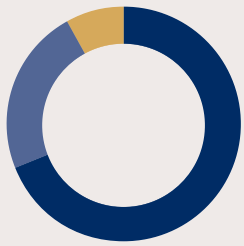
STRENGTH OF COMPETITIVE ADVANTAGE (%)



High	95
Medium	5

By weight in portfolio, excluding cash

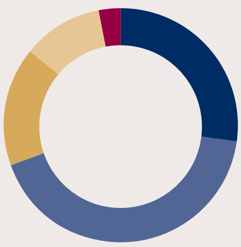
STRENGTH OF SWITCHING COSTS (%)



High	69
Medium	24
None	8

By weight in portfolio, excluding cash

ESG RATING BREAKDOWN (%)[5]



AAA	27
AA	42
A	16
BBB	11
BB	3

By weight in portfolio, excluding cash

CARBON EXPOSURE RISK BREAKDOWN (%)

1.5° aligned	49
2.0° aligned	26
Misaligned	25

By weight in portfolio, excluding cash

[4] Values: all data as at 30 September 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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