Rothschild & Co
Wealth Management

LongRun Equity

QUARTERLY LETTER

Advertising communication

JANUARY 2025

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.

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

LongRun's main financial metrics remain strong, with cross-cycle sales growth of 8%, a 31% operating margin, an operating return on invested capital of 74% 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.

Notes from the manager

LongRun was up 1.8% in Q4 2024

Strategy performance

The strategy was up 1.8% (in EUR, unhedged) in the fourth quarter compared to its benchmark which gained 6.7%. The main reason for our underperformance were the declines in our healthcare holdings, ASML, l'Oréal as well as the lack of exposure to winners of the 'Trump trade' such as banks, Tesla or the wider crypto complex.

For the full year, this resulted in a (disappointing) performance of +12.3%, compared to the index's +25.3%. Later in the letter we will look at our large underperformance this year in greater detail and try to provide some explanations.

Annualised returns since inception of the strategy over nine years ago stand at 11.3% compared to 11.4% for global equities.

Performance drivers

The main positive performance driver in Q4 was by quite some margin Alphabet while Costco and Mastercard also contributed nicely.

Alphabet, currently our biggest holding, increased by over 20% during the quarter. The company was buoyed by significant growth in its cloud business amid high demand for AI related computing and data services which resulted in bumper Q3 results.

Costco also performed well with continued same store sales well above the 3-5% trajectory we expect over the medium to long term. This has led to a continued rerating of the stock to more demanding valuations which have led us to slightly reduce our investment.

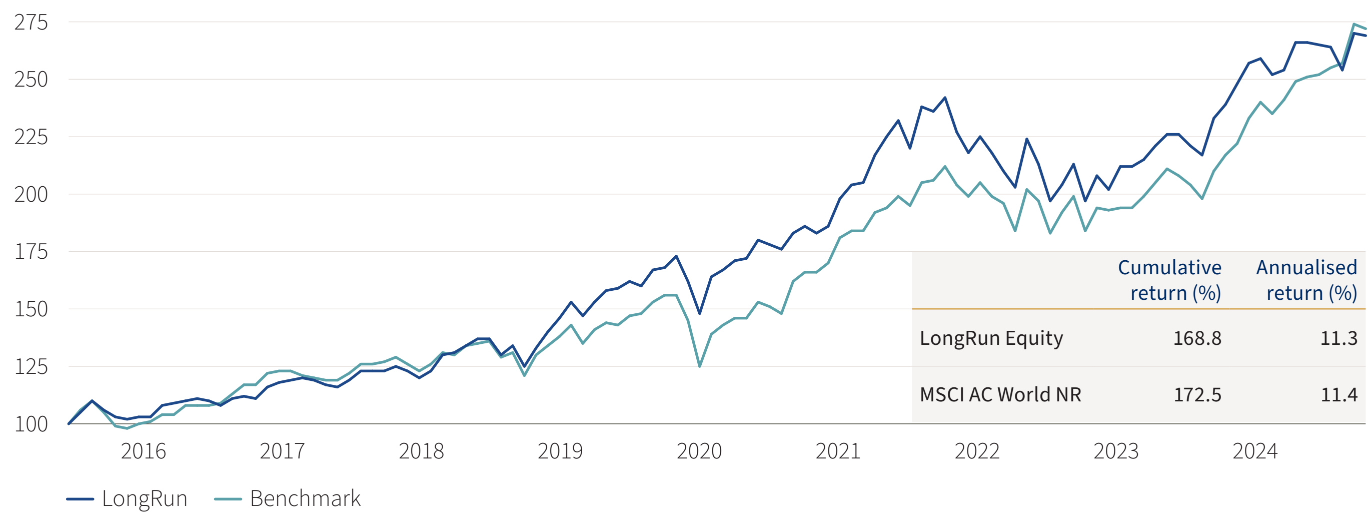
Mastercard also reported strong quarterly results. In addition, it presented with great clarity and conviction why it should be able to continue delivering double digit earnings per share growth over the mid term during its investor day.

Our healthcare holdings all fell with lower for longer organic growth weighing on performance as they grapple with a normalisation in demand post Covid.

ASML reported strong results but weak bookings for Q3. An upbeat long term message during its capital market day did little to allay fears with regard to weaker demand in the short term.

L'Oréal reported soft organic growth of just 3% in Q3, largely on account of weakness in China. Coupled with modest earnings downgrades, this compressed its multiple all the way down to five year trough levels. No prize for guessing what 'the other side of the Costco trade' was.

CUMULATIVE TRACK RECORD (EUR UNHEDGED, %)



	Cumulative return (%)	Annualised return (%)
LongRun Equity	168.8	11.3
MSCI AC World NR	172.5	11.4

Activity

In the fourth quarter we made one new investment, building a position in leading Index and investment decision support provider MSCI. No divestments were made.

MSCI's cornerstone has always been, and we believe will remain, its Index segment. As the leading and most focused provider of indexes used by investors (including us) to benchmark performance, MSCI has established a particularly strong position in global equities — exemplified by its flagship MSCI World Index. Through sustained investments and product innovation, MSCI has established a deeply entrenched positions from which it is almost impossible to dislodge.

MSCI exemplifies a benchmark business — a type of business we know well. Once entrenched, it is both cumbersome and risky for an asset manager to change index providers, as such a move could signal instability to investors. It is no surprise that retention rates in MSCI's Index business consistently exceed 90%, and pricing power is strong, too.

The outstanding quality of MSCI's Index business is mirrored in its profitability with operating margins comfortably eclipsing 70%. This segment is the crown jewel of MSCI's business portfolio, accounting for over 75% of earnings thanks to continued double digit growth.

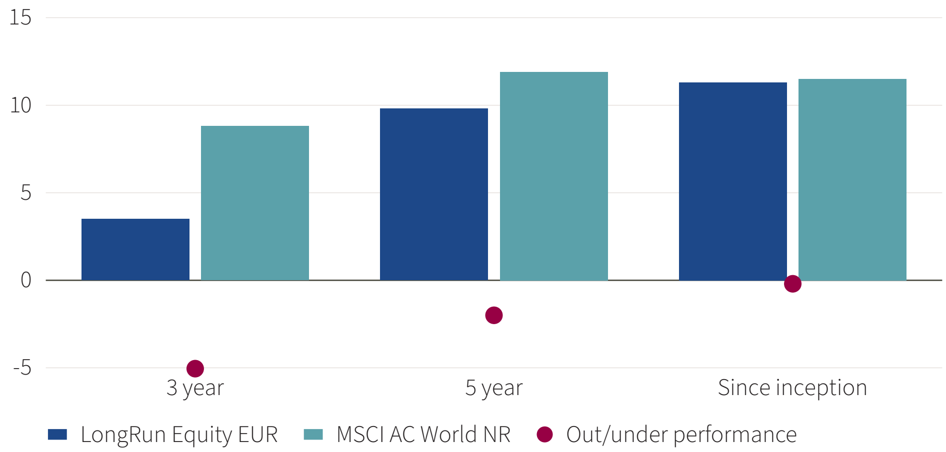
Under the stewardship of founder and owner operator Henry A Fernandez, MSCI has also done a commendable job in terms of capital allocation.

Organic investments continue to increase its product differentiation, while strategic acquisitions have helped it tap into the growth potential of adjacencies such as analytics, ESG and private markets – each with outsized potential for profitable and durable expansion. We seized the opportunity to become owners of this business following a meaningful compression in its rating this year.

ANNUAL PERFORMANCE

	Net asset value	QTD (%)	YTD (%)	Inception to date (%)
LongRun Equity EUR Unhedged	2,522.32	1.8	12.3	168.8
MSCI AC World NR	—	6.7	25.3	172.5
Out/under performance	—	-4.9	-13.0	-3.8

ANNUALISED PERFORMANCE (%)[1]



ANNUAL PERFORMANCE

	LongRun Equity (%)	MSCI AC World NR (%)
2024	12.3	25.3
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

[1] 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

LongRun financial vs. investment performance

The market as a voting vs. a weighing machine

In this section, we would like to dive deeper into the investment performance of our fund last year and how it compares to the financial performance of our individual investments.

As Benjamin Graham famously said, in the short run, the market is a voting machine, but in the long run, it is a weighing machine. Or, put differently, over a single month, quarter or year, investment performance is primarily be driven by sentiment. Over a longer time horizon, however, the main driver for investment returns is the growth in earnings of the underlying businesses.

Performance in 2024

As outlined earlier, the fund returned 12% in EUR and 5% in USD last year. Given that the majority of our companies report in USD, we prefer to focus on the latter when assessing the relative performance of LongRun in 2024. This performance can be broken down into two components: the growth in the earnings power of our fund and the multiple at which these earnings are valued.

Earnings growth for the fund as a whole is expected to come in at +10% (while most companies have yet to report their Q4-24 earnings, three quarters are already 'in the books,' and given our companies' high proportion of recurring revenues and earnings, we do not anticipate significant deviations from this figure). Apart from ASML, Danaher and LVMH, all our portfolio companies increased their earnings. In fact, one third actually posted earnings growth in excess of 10%, led by Alphabet at +38%. This 10% growth is actually broadly in line with the level of earnings growth we also expect over the long term for LongRun. Coupled with a free cash flow yield of around 3%, it is also the basis for the cross cycle investment returns in the low double digits that we target for the strategy.

Unfortunately, this positive earnings growth was partially offset by a derating of the fund's multiple from 31x to 30x which brought the total performance down to 5%.

The story was a different one for our benchmark, the MSCI World All Countries Index which gained a stellar 17% in USD last year (and 25% in EUR). While the benchmark index lagged LongRun in terms of earnings growth with 6%, this was more than made up for by a strong 9% rerating of its earnings multiple to 22x.

AS BENJAMIN GRAHAM FAMOUSLY SAID, IN THE SHORT RUN, THE MARKET IS A VOTING MACHINE, BUT IN THE LONG RUN, IT IS A WEIGHING MACHINE.

Performance drivers

As outlined in the investment philosophy section, wealth preservation is a key tenet of our strategy. We strongly want to avoid permanent capital loss. In turn, continued growth in earnings will eventually lead to continued positive compounding of their share prices.

Looking at the portfolio, there were four companies whose share prices declined by more than 10%: Adobe, Idexx, l'Oréal and LVMH. We have reviewed the investment case for each in depth to assess whether it is still intact. For each, the answer was a yes. With the exception of LVMH, earnings are actually expected to keep increasing for all of them in 2024. However, each has suffered a severe derating of its multiple to the tune of 20% or more. LVMH is the only company of the four where earnings are expected to fall, though its multiple remains broadly unchanged.

More specifically, l'Oréal and LVMH were negatively impacted by weaker consumption in China, one of their key growth markets. While this exposure may have provided them with some extra growth in the past, we do not think it materially changes their growth potential. Adobe, we think, has been impacted by market concerns over potential risks from AI, while the longer term opportunities from integrating AI into its product suite, and monetizing it, are mostly overlooked. Idexx continues to face headwinds from weaker growth, as veterinary visits remain slightly negative. We expect this to gradually improve as pets bought during the Covid-19 crisis reach an age where they require more intensive care.

Turning to the winners, seven companies saw their share prices increase by 20% or more: Alphabet, Costco, Mastercard, Moody's, Relx, Tencent and Veralto. Each of these are expected to grow their earnings by a healthy 5% or more, meaning that their share price appreciation is, at least partially, supported by an increase in earnings power. For most of them, we have taken the opportunity to slightly reduce our weightings, taking advantage of the rise in their share prices.

In the next section, we will give an update on the evolution of the fund in terms of the five key financial quality metrics we have defined.

We think a good way to start this is to briefly highlight these characteristics and link them to our latest investment in the fund, MSCI. MSCI is both a high quality business and one which further enhances the already strong quality characteristics of LongRun.

In terms or organic growth, MSCI has been able to grow at around 11% over the past five years, with remarkable resilience thanks to a high share of subscription revenues. Even more exceptional are its operating margins which routinely top 50%. Return on capital is equally impressive at over 100% thanks to its wide margins and capital light business model. Cash conversion is similarly strong, exceeding 110% on account of customers paying for their subscriptions upfront. With a net debt to EBITDA of around 2.5x, its financial leverage is not low but rather efficient – testament to the company's financial acumen and efficiency.

Organic growth

For 2024, our fund is expected to achieve another year of solid growth at +8%, the same as in 2023. Some of our businesses such as ASML or LVMH were impacted by weaker end markets and saw growth slow sharply. However this was mostly offset by the addition of Hermès and MSCI, both of which feature more steady and resilient growth by virtue of their unique and highly differentiated business models.

Our forecasts for organic growth over the next few years are in a broadly similar range of 8-9%, with a roughly 3%-point contribution from pricing with volumes and mix accounting for the remainder.

Operating margins

Gross margins for LongRun are expected to increase by around 2%-points to over 60%. Gross margins are a good, albeit somewhat crude indicator (as heavily influenced by a businesses' vertical integration) for a company's pricing power. As such, this further increase is yet another vindication of the improving quality of our portfolio of businesses.

Similar drivers as outlined above for organic growth were at play in terms of operating margins which we expect to increase from 27% in 2023 to 31% last year. This improvement was equally, and mostly, driven by increases in the profitability of existing positions as well as the purchases of said two new companies.

In terms of existing positions, strong margin improvements were delivered by Alphabet and Moody's both of which we expect to increase their (already high) operating profit margins by around 4%-points.

In terms of new positions, both Hermès and MSCI demonstrate exceptional profitability. Hermès achieves operating margins in the mid-40s, while MSCI surpasses this with margins close to 60%

Going forward, we expect operating margins to gradually increase further to the tune of around 50 basis points per year. This translates into operating profit for LongRun growing by around 2%-points faster than revenues, or around 10% in total.

Return on capital

In tandem with higher operating margins, return on capital, the single most important metric for the quality of our portfolio, is expected to increase by another 5%-points to 80%.

The increase in margins was actually the main driver for the higher return on capital. Asset efficiency overall was little changed. The working capital to sales ratio still stands at around 3% with close to half of the portfolio (mainly our information services and/or subscription businesses) actually featuring negative working capital. The capex to sales ratio ticked up slightly from 5% to 6%, by and large due to significant increase in AI related capital investments at Alphabet and Microsoft, our two biggest investments (yes, we watch this space).

In sync with higher margins, we expect return on capital to widen further going forward towards 85%.

Cash conversion

Cash conversion typically goes hand in hand with return on invested capital, but is naturally more volatile. We measure cash conversion as the ratio of free cash flow relative to net operating profits.

Another useful indicator linking return on capital and cash conversion is working capital. Companies with negative working capital not only fund their growth internally but also tend to achieve strong cash conversion, often exceeding 100%. Around half of our portfolio exhibits cash conversion rates above 100%. This underscores why we prioritise cash flows over earnings when valuing companies — not all earnings are created equal.

Over the medium term, we expect free cash flow conversion to remain stable at approximately 90%.

Financial leverage

Financial leverage, measured as net debt relative to EBITDA, remained largely unchanged over the past year. We anticipate it will stand at 0.4x at the end of 2024, compared to 0.3x in the previous year.

Business owner's portfolio

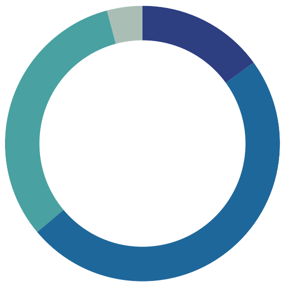
A deeper look into the strategy and its companies[2]

SALES BY BUSINESS (%)

Software	14
Online commerce and advertising	8
Payments	7
Professional Services	20
Capital goods	4
Fast moving consumer goods	7
Medtech	10
Other healthcare	4
Luxury	6
Semi-conductors	6
Industrial gases	5
Other	10

By weight in portfolio, excluding cash.

DEGREE OF PRICING POWER* (%)

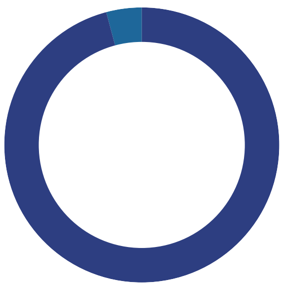


High	15
Medium	49
Low	32
None	4

*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

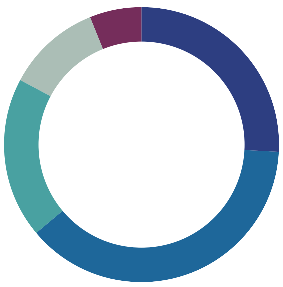
By weight in portfolio, excluding cash.

STRENGTH OF SWITCHING COSTS (%)

High	69
Medium	24
None	7

By weight in portfolio, excluding cash.

ESG RATING BREAKDOWN (%)[3]



AAA	26
AA	38
A	19
BBB	11
BB	6

By weight in portfolio, excluding cash.

CARBON EXPOSURE RISK BREAKDOWN (%)

1.5° aligned	49
2.0° aligned	22
Misaligned	27
Not rated	2

By weight in portfolio, excluding cash.

[2] Values: all data as at 31 December 2024, Source: Rothschild & Co.

[3] 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

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.

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

Rothschild & Co Bank AG

Zollikerstrasse 181,
8034 Zurich
Switzerland

+41 44 384 71 11

rothschildandco.com

Values: all data as at 31 December 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 net of fees, equals the performance of the SA EUR of the LongRun Equity Fund (reinvested dividends), 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