LongRun Swiss Small & Mid Cap Fund

QUARTERLY LETTER

Advertising communication

JANUARY 2025

Investment philosophy

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

Happy 2025 to everyone, and welcome to the fifth LongRun Swiss Small and Mid Cap fund letter. We have kept the structure of previous editions which consists of three sections: a description of our investment philosophy, followed by a review of the quarter, and finally an investment discussion, such as a company case study. The section on our investment philosophy will not change in content although we may from time-to-time sharpen the wording. The review of the quarter covers performance and portfolio changes, while the investment discussion focuses on a different topic each time. We will review the largest holdings first before we tackle other topics. Please feel free to skip to whichever section interests you most.

Our aim is to invest in a concentrated portfolio of high quality Swiss small and mid-cap businesses and hold these for the long-term. Put differently, we simply want the best. More detail on our investment philosophy below.

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 commoditised 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 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 invest a lot of 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.

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 finalised. 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 manager'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 exceeds 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.

[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.

Portfolio review

A look at performance and changes over the quarter

Performance

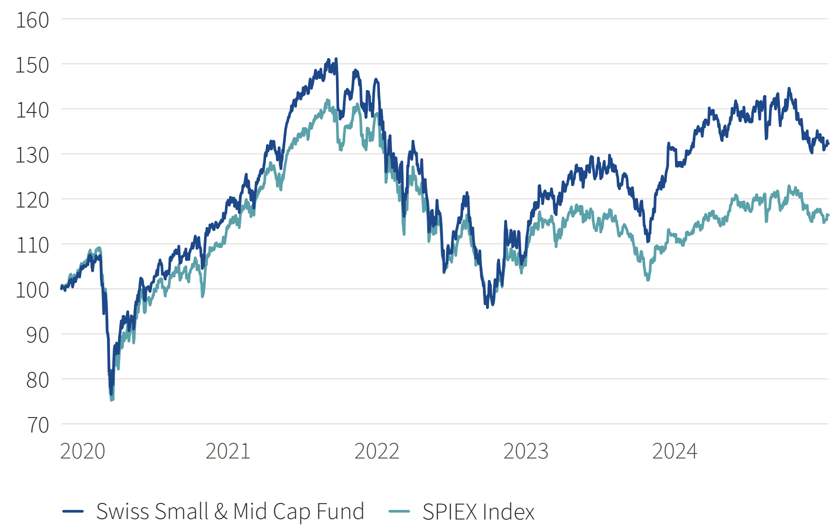
The fund lost -8.2% over the fourth quarter but gained +1.0% for the year 2024. In comparison, the SPI Extra, serving as the fund's yardstick, lost -5.0% and gained +3.8% for the same periods, respectively. Annualised returns since the strategy's inception some four years ago stand at +5.6% for the strategy and +3.0% for the benchmark. This results in an annualised outperformance of +2.6%.

Positive contribution over the quarter came from Galderma (+28.0% share price change over the quarter), Accelleron (+6.5%), and Flughafen Zürich (+7.0%). Detractors included Tecan (-27.2%), Comet (-25.5%) and VAT (-20.4%). Each of these will be discussed in turn.

Galderma is a pharmaceutical company specialising in beauty and dermatology. Since its IPO in the first quarter of 2024, the company has exceeded expectations, with its share price rising more than 55% by year-end. Galderma operates across three business segments: injectable aesthetics (including fillers and toxins), dermatological skincare (including the well-known Cetaphil brand), and therapeutic dermatology (offering a variety of treatments). The injectable aesthetics segment competes with Allergan's Botox, differentiating itself through advantages such as ease of handling, simpler distribution post-injection and longer-lasting effects. As these treatment effects fade over time, customers return for repeat treatment and rely on the dermatologist to choose the most suitable product.

Recently, the firm launched Relfydess, a long-lasting liquid neuromodulator with strong margin potential. In therapeutic dermatology, the recently approved Nemluvio for the treatment of prurigo nodularis has seen strong patient uptake and growing reimbursement progress which points to strong revenue contributions in 2025. As a leader in the beauty and dermatology space, Galderma offers the most attractive growth profile in Europe's beauty and healthcare space. Recent developments have further strengthened its position and point to a solid outlook.

FIGURE 1: PERFORMANCE (%)[2]



	Fund	Benchmark	Difference
2024	1.0	3.8	-2.8
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	32.3	16.4	15.9
Annualised return	5.6	3.0	2.6

[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.

Accelleron continues to fire on all cylinders. Our comment from last quarter remains valid: "*Accelleron has been going from strength to strength since being spun-off from ABB in the third quarter of 2022. Its dominant position in industrial turbochargers and related services remains largely unchallenged, though this market typically allows for only modest revenue growth of around +5%. Yet, several bolt-on acquisitions have increased its growth profile slightly and demonstrated strong capital allocation. For the current year, Accelleron is expecting exceptionally high revenue growth, double its usual rate, along with an operating margin of around 25%.*" We have nothing to add at this time.

Flughafen Zürich's share price rose over the quarter as passenger volumes continued to recover more strongly than anticipated. Total passengers for 2024 are expected to reach 31 million, just shy of 2019 pre-pandemic levels. Further, the newly constructed Noida airport near India's capital Delhi, is set to open in April 2025 with an initial capacity of 12 million passengers. Flughafen Zürich holds the operating rights for this airport for a 40-year term. Moreover, the Swiss Federal Council approved a new roll-over mechanism which allows Flughafen Zürich to carry forward excess returns or shortfalls to the subsequent charge period. This does not, however, apply to the Covid pandemic but it may be a hint that the upcoming charge negotiations may be amicable. Note that these charges are usually negotiated and then set for a period of 10 years. So we remain excited about the company's progress.

Tecan is a leading medical equipment maker specialising in lab automation. Its products are used by researchers, by pharma companies for drug discovery and by practitioners for clinical diagnosis. The processing of liquid samples requires skills and time, and Tecan addresses this challenge with automated robotic solutions. These solutions include both machines and consumables and are sold under Tecan's own brand or, for clinical diagnostics, via OEM partners such as Thermo Fisher. Additionally, the firm also develops and manufactures other medical devices for companies, including Intuitive Surgical. Generally, the partnering business benefits from long-term relationships and higher volumes but less from recurring sales of consumables. 2024 was a difficult year for Tecan as the end demand continued to decline. There was little spending from biopharma research labs in the US, uncertainty around potential changes to US healthcare policy, delayed stimulus in China and general destocking from clients. These factors led Tecan to miss sales repeatedly and issue a profit warning which tested investors' patience. Despite these headwinds, the company continued to relentlessly invest in R&D and improve its products. The launch of its new entry-level Veya platform is highly anticipated and should yield some revenue soon. With destocking largely complete, demand should start to improve throughout 2025.

Two detractors were semiconductor-related companies, namely Comet and VAT. We explained the industry dynamics briefly in our last letter. In short, while the semiconductor industry remains cyclical, it is less so than in the past due to more diversified end market demand. In 2023, global semiconductor sales totalled about USD 530 billion, with annual growth forecasted at +10% and expected to exceed USD 1 trillion by 2030. The end markets and their average share of total semiconductor sales are: servers, datacentres & storage (25%), smartphones (20%), personal computing (15%), industrial electronics (15%), automotive (10%), consumer electronics (10%) and wired & wireless infrastructure (5%). Short-term demand for any single end market is uncertain. For instance, throughout 2024, investments in AI capabilities drove server, datacentre & storage market sales, whilst most other end markets suffered from lacklustre demand. This meant that only some semiconductor manufacturing plants making the most advanced devices were running on full steam and overall capacity expansion plans were slowed down. The companies we own, Comet and VAT, are component makers for semiconductor manufacturing equipment. Hence, if there is not a lot of new equipment being made or existing equipment is not used at full capacity, they do not benefit from new sales or service revenue. These conditions contributed to a decline in their share prices during the quarter. Nevertheless, both companies are market and technology leaders in their respective niches. We therefore remain confident that as demand recovers, revenue growth will resume, and their share prices should follow suit.

Activity

The fourth quarter saw no changes to portfolio constituents and only small changes to individual weights. This is in-line with our long-term investment philosophy.

Result[3]

Our portfolio consists of high quality businesses, as evident from their robust financial metrics: cross-cycle sales growth of 8%, an operating margin of 20%, an operating return on invested capital of 28%, a net-debt-to-EBITDA leverage ratio of 0.0x and a strong cash conversion of 80%. We consider the current valuation to be attractive, with the portfolio offering a free cash flow yield of 3.2%, which is in line with our benchmark.

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

Chocolate

Indulgence in everyday luxury

This section focuses on a single investment because we select businesses purely based on their fundamentals and aim to share some of our insights. This time, we take a closer look at the chocolate maker Lindt & Sprüngli. As we wrote a year ago in our Q4-23 letter, business-to-consumer companies are not typically our focus. This is because consumer tastes can often be fickle, making purchase decisions less rational and limiting pricing power, especially in the consumer staples sector. However, there are notable exceptions, such as Lindt & Sprüngli, which we argue is in the business of luxury indulgence rather than simple snacking.

Rudolf(s) and the chocolate factory

Among the earliest cocoa consumers were the Olmecs, Mayas and Aztecs, as early as 1500 BC. Back then cocoa was consumed as a bitter and spicy drink. In Europe, cocoa first gained popularity in the 17th century, where it was enjoyed warm and sweetened. It wasn't until the industrial revolution, towards the end of the 18th century, that experimentation and discovery accelerated and eventually led to the development of solid chocolate bars.

In 1836, Rudolf Sprüngli and his father established a confectionary shop. Soon, their high-quality chocolate became all the rage among the local high society. As demand grew, manufacturing changed form man to machine, and the company expanded. When Rudolf retired in 1892, he divided the company into two independent entities: the confectionary and patisserie shops, based at Paradeplatz in Zurich, and the chocolate factory. The former was taken over by his younger son and remains in family ownership to this day. The latter had a different fate under the leadership of Johann Rudolf.

Johann Rudolf was a visionary leader determined to expand. In 1899, he converted the business into a joint-stock company and eventually relocated to Kilchberg, on the shores of lake Zurich, where Lindt & Sprüngli remains headquartered to this day. That same year, he acquired Rudolf Lindt's chocolate factory in Berne, along with its proprietary processing secrets. Among these was the conching machine[4], which revolutionised chocolate production by making it smooth through continuous stirring. At 70 years young, Johann Rudolf laid the foundation for what would become the world's leading premium chocolate maker.

In 1953, Rudolph Robert joined the company, listing it on the stock exchange in 1986. He remained honorary president of the board of directors until his passing in 2008.

Elsewhere in Switzerland, there were similarly important developments involving chocolate but explaining these in detail would stretch the scope of our letter as we have already covered four important Rudolfs (we ignored different name spellings here). For those interested, we encourage you to explore more of Switzerland's fascinating chocolate history.[5]

Competing for the chocolate market

The world chocolate market was estimated at around CHF 110 billion in 2023, with a hand full of companies controlling 60% of the market. These are Mars, Mondelez, Ferrero, Hershey, Nestlé and Lindt & Sprüngli. Mars holds the largest share at 15%, while Lindt & Sprüngli has the smallest share at 5%. Globally, premium chocolate makes up less than 20% of the total market, although its share varies geographically. In mature European markets, premium chocolate represents 30% of sales, compared to 20% in the less mature North American market, and much less elsewhere. Lindt & Sprüngli is the only pure-play premium chocolate maker and controls more than 15% of that niche.

Unlike snacking chocolate, premium chocolate uses high-quality raw materials, offers unique flavour experiences, innovative product

[4] Chocolate is made of cocoa butter, cocoa mass, sugar and milk powder. The mixed mass is initially moist and resulting chocolate cracked and brittle. Rudof Lindt invented the Conche to extract moisture. In the device, continuous moving of the mass and heat from friction reduce moisture. Maybe Rudolf experimented with run-times or left the machine on accidentally overnight. The result remains, he brought us smooth and melting chocolate.

[5] Just as a teaser: Switzerland had many confectioneries, and several breakthroughs came from the French speaking part. For instance, the former grocer François-Louis Cailler in Vevey discovered how to solidify chocolate into a, initially, cracked and brittle mass. His son in law established his own, initially struggling, chocolate factory but invented milk chocolate which became a hit across Europe. The condensed milk used in the process was provided by his friend and neighbour Henri Nestlé who would start Nestlé.

offerings, and premium positioning through sophisticated packaging and selective distribution. These factors allow premium chocolate to command price points up to 100% higher than ordinary snacking chocolate – a detail we verified through our own price checks in supermarkets. Of course, Lindt & Sprüngli's competitors may also own premium brands, but the company's singular focus on that segment is unique. In 2023, Lindt & Sprüngli's premium sales were five times that of its closest competitor.[6]

Figure 2 below suggests that Lindt & Sprüngli has broadened its geographic reach over time. In 1990, more than 80% of sales came from Germany and Switzerland (including exports). This changed with geographical expansion, especially with the acquisitions of Gihardelli in 1998 and Russel Stover in 2014. Alongside Lindt, these remain the company's most prominent brands. Today, Europe accounts for just under 50% of sales, while North America contributes 40%, with several other promising but still immature markets accounting for the remainder. This development reflects not only a shift from one region to another but also an expansion of the company's overall market share and revenue. During this time, revenue grew from about CHF 1.5 billion in 2000 to more than CHF 5 billion by 2023.

Lindt & Sprüngli is the market leader in its home market Switzerland and its largest European market, Germany. It also holds the number two position in France and is likely the number three player in the US. As mentioned earlier, premium chocolate consumption is well-established in Switzerland and Germany though in other European countries and North America, there is some room for improvement. Nevertheless, Lindt & Sprüngli continues to grow even in its mature market, albeit at a lower rate. Furthermore, careful expansion to largely untapped markets elsewhere should be possible, especially with the uniquely strong brands of the company. For example, certain countries in Asia could present excellent opportunities, where consumers place high value on premium products and have a well-established tradition of gifting.

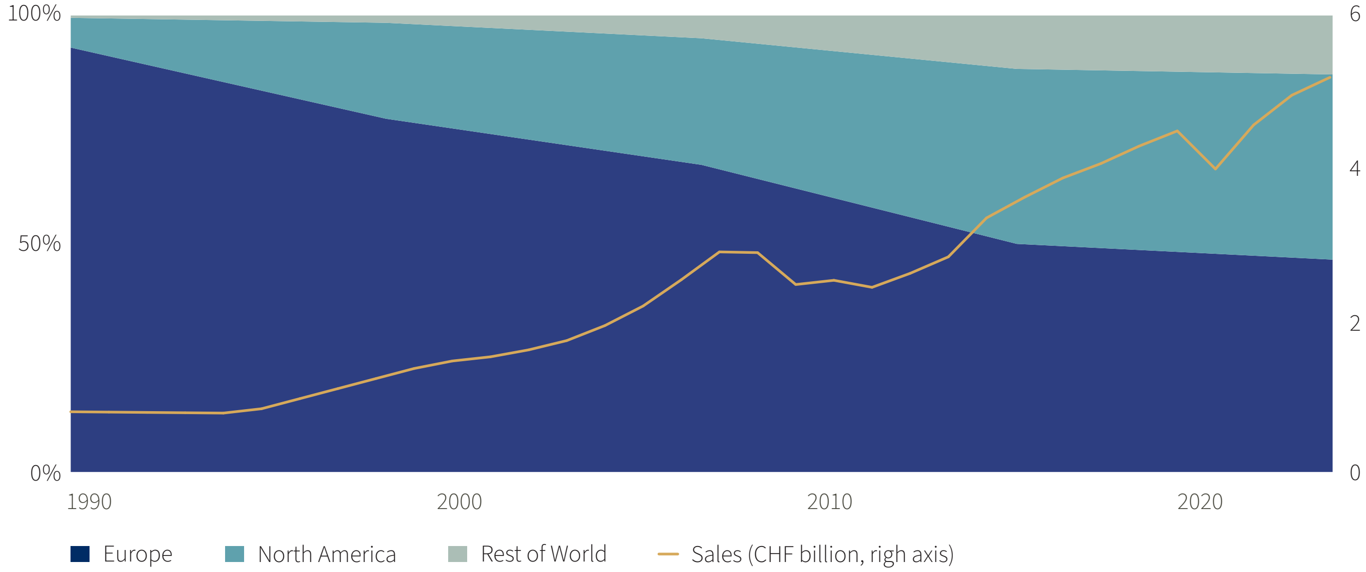
Brand management

Lindt & Sprüngli's exclusive focus on premium chocolate means that all its brands are meticulously managed to uphold and enhance its reputation as the leading premium chocolate house. Hence, brand control is the responsibility of the headquarters including relentless product innovation and thoughtful advertising. Lindt remains the company's flagship brand by revenue contribution (75% Lindt, 15% Gihradelli, and 10% Russel Stover). The Lindt portfolio boasts thousands of products which are sorted into three main categories: Lindt Excellence, Lindor and Seasonal.

Firstly, Lindt Excellence bars were introduced in 1989 and are available in many intense aromas. They account for up to 10% of the company's sales. Secondly, Lindor includes truffles and balls. The latter were introduced in 1967 and are now available in over 30 flavours. In 2023, around seven billion Lindor balls were sold worldwide. Lastly, seasonal products also play a significant role, with highlights including Valentine's gift boxes and many more festive offerings. However, the clear winner is the Gold Easter Bunny. Introduced in 1952, it continues to thrive, accounting for up to 5% of total sales today.

Advertising is consistent and thoughtful. In the late 1990s, the brand introduced the concept of master chocolatiers in its campaigns.

FIGURE 2: SALES EVOLUTION BY GEOGRAPHY AND AS A GROUP-WIDE TOTAL



[6] In 2023 Lindt & Sprüngli made more than CHF 5 billion in sales, Ferrero made around CHF 1 billion and all other brands less than CHF 0.5 billion each from premium chocolate sales. Note that for Lindt & Sprüngli all sales are premium chocolate.

Since then, they have appeared in numerous print and television commercials, explaining the way of chocolate-making and oftentimes showcasing new product creations. A competitor later picked this up and made a similar television advertisement featuring Mr. Bean, which can be seen as a nod to the success of Lindt & Sprüngli's original concept.[7]

The master chocolatier also appeared in Lindt & Sprüngli's first-ever Super Bowl commercial in 2024. The cost of CHF 6 million seems a worthwhile investment considering it reached more than 120 million viewers.[8]

In early 2024, a new product trend emerged on TikTok, which propelled "Dubai Chocolate" into the global spotlight.[9] In response, Lindt & Sprüngli launched its own premium, handmade, limited-edition chocolate bar in mid-November 2024. The bars, priced at CHF 15 each, caused a sensation, with customers queuing overnight at the Kilchberg factory to secure one. Shortly after, these bars appeared on online marketplaces for up to ten times that amount, a trend that continues today. The company is reportedly considering launching a slightly more accessible, mass-market version of the product soon.

To better control product quality, the company operates eleven factories, with six in Europe and five in the United States and largely shies away from contract manufacturing to better control the quality of its products. These are available in about 120 countries, mostly at large retailers which account for around 75% of sales. However, Lindt & Sprüngli's own boutiques currently account for 15% of sales and are becoming increasingly more important. The number of boutiques has grown substantially, from around 230 in 2009 to 530 today.

To sum up, Lindt & Sprüngli has a highly differentiated product offering and benefits from high customer loyalty. We think that centralised brand management and clear focus have strengthened its premium chocolate leadership position. Further, its bean-to-bar manufacturing and the own store network enhance product quality and overall experience. In the words of the iconic advertising executive Don Draper: "*Success comes from standing out, not fitting in*".

From the chocolate factory to financial numbers

Sales have grown organically by +7% over the past 10 years, driven by an increase in volume +4% and a +3% rise in price. This performance aligns perfectly with the company's mid-term organic sales growth target of +6-8% and surpasses the growth rate of the general chocolate market, which stands at ca. 5% over the same period. Price increases are easier to realise for premium than snacking chocolate as customers are more loyal. This has allowed the company to pass on input costs increases, such as rising cocoa prices.

The expansion into the US has taken time to implement, but the results have proven worthwhile. There remain, however, efficiency improvements, as North American margins trail the group's at ca. 12% versus ca. 16% in 2023. Aligning these margins with the group's standard will likely contribute significantly to the company's annual margin improvement target of 20-40 basis points.

The company's balance sheet remains solid, with very limited debt, which allows for increasing dividends and some share buy backs. This provides Lindt & Sprüngli the flexibility to capitalise on new expansion opportunities as they arise.

We believe the company is well-positioned to continue outgrowing the general chocolate market. This should allow Lindt & Sprüngli to further benefit from economies of scale, which in turn will aid margin improvements. We acknowledge that at a free cash flow yield of 2.8% and an EV/EBITDA multiple of 18x, the shares are not cheap. However, quality has its price!

Conclusion

Lindt & Sprüngli is an outstanding business, solely focussed on premium chocolate. Unlike snacking chocolates, it commands a price premium thanks to its strong customer loyalty. The integrated bean-to-bar approach gives the company better control over its product quality. To us, Lindt & Sprüngli is more than premium chocolate: we view its products as an everyday affordable luxury. Customers enjoy indulging in these treats, and we don't believe that people would downgrade in an economic downturn, as its products are relatively inexpensive. As such, we believe that Lindt & Sprüngli will continue to flourish for years to come. That said, the transition to the next leadership generation remains a key question. The chief architect behind decades of success, Ernst Tanner, is turning 79 this year and as an actively involved chairman likely takes part in many decisions. Finding a leadership team to pass on the torch is surely not an easy task, but the company is on solid footing.

Finally, while Charlie Bucket may have won Willy Wonka's factory in Roald Dahl's famous tale, there are no such golden tickets at Lindt & Sprüngli. However, a visit to their museum in Kilchberg offers a delightful experience in its own right – and we wholeheartedly recommend it.

[7] Mr. Bean's commercial is here https://www.youtube.com/watch?v=opfUZeM2ze8, one from Lindt & Sprüngli is here https://www.youtube.com/watch?v=cFB0XBV6JdU.

[8] In the commercial, a ball-shaped Lindor chocolate bounces through scenes to Perry Como's 1957 number 1 hit "round and round", a real catchy tune. Watch it here: https://www.youtube.com/watch?v=Neul4wINfUQ

[9] The video which went viral was food blogger Maria Vehera eating Dubai chocolate without saying a word but the characteristic crunchy sound is clearly audible. Her video has been watched more than 100 million times.

Business owner's portfolio

A deeper look into the strategy and its companies

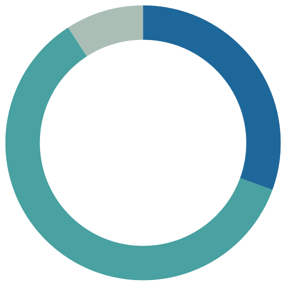
SALES BY BUSINESS (%)

Materials	8
Machinery	22
Other cap goods	10
Transportation	7
Semiconductors	13
Health care	18
Food	8
Real estate	1
AM	5
Other	9

Based on internal analysis.

By weight in portfolio, excluding cash.

DEGREE OF PRICING POWER* (%)



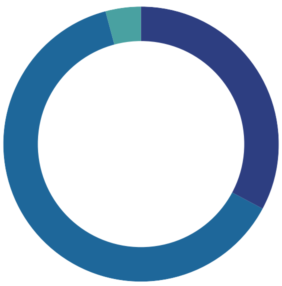
High	0
Medium	31
Low	61
None	9

*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 (%)

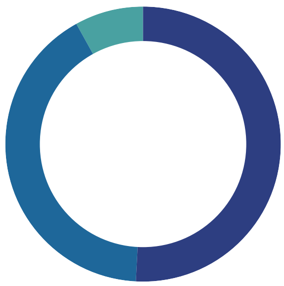


High	33
Medium	63
Low	4

Based on internal analysis.

By weight in portfolio, excluding cash.

STRENGTH OF SWITCHING COSTS (%)



High	50
Medium	41
None	8

Based on internal analysis.

By weight in portfolio, excluding cash.

ESG RATING BREAKDOWN (%)

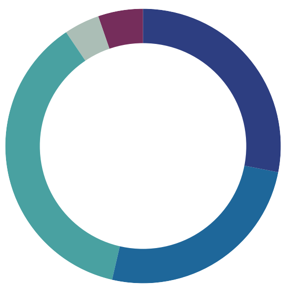
AAA	31
AA	16
A	38
BBB	13
BB	0

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.

CARBON EXPOSURE RISK BREAKDOWN (%)



1.5°C Aligned	28
2°C Aligned	25
Misaligned	37
Strongly misaligned	4
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.

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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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 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