Make time work for you

Comgest Europe Compounders strategy

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Time is money. It also has the power to erode value. But what if you could harness this natural force and turn it to your financial advantage?

Lindy's Law – or the 'Lindy effect' as it is also known - states the longer something without an expiry date has existed, the more likely it is that it will be around for years to come. It was the brainchild of an astrophysicist from Princeton University who analysed Broadway and off-Broadway shows. He found – with 95% accuracy – that the longer a show had been performed, the longer it would continue to run.

His theory proved applicable beyond the realms of Shakespeare and musical theatre. For example, books that have been published for a long time will likely still be in print for many years.

The Comgest team became aware of this phenomenon when we analysed the performance of a company we sold several years previously. Founded in 1866, Nestlé is home to more than 2,000 food and beverage brands; including Cheerios, Häagen-Dazs, Nespresso and Perrier. While growing less quickly in the years following our exit, the Swiss conglomerate continued to achieve consistent, high-single-digit earnings growth. As a result, Nestlé has not only been able to increase its market share but has also undertaken share buybacks and issued generous dividends.

This realisation was the catalyst for launching the Comgest Europe Compounders strategy in 2019, a concentrated portfolio of high-quality companies we believe are positioned to deliver strong and stable growth for long-term investors.

Staying the course

Longevity and the ability to generate strong and predictable growth, however, are not reasons enough to consider a company a 'compounder'. At a minimum, they must also have robust balance sheets and low risk profiles with good visibility about where future growth is going to come from. In addition, we look for deep and expanding moats, as well as a strong corporate culture and stewardship on behalf of all stakeholders.

Some businesses are designed to sprint; to meet an emerging need or help push existing goods and services to the next frontier. Usain Bolt was 22 years old when he broke the 100m world record in 2009. The Jamaican sprinter retired in 2017 and his record of 9.58 seconds still stands.

Comgest Europe Compounders strategy is about harnessing the power of marathon runners. Kenya's Eliud Kipchoge was 34 when he became the first person to run a sub-two-hour marathon in 2019. Both he and Bolt are hugely successful, but the way they approached their respective careers was wholly different. A company with a marathon mindset can look through immediate turbulence, has endurance, long-term vision and resilience. It is about aiming for a target you cannot see.

That does not mean that these companies are infallible and we are ever-vigilant for any signs that growth is about to stall. After all, not all marathon runners last the pace.

Some of the drivers behind faltering growth are internal, but external pressures can be just as damaging. Elevator and escalator manufacturer Kone, for example, started life in 1908 as a machine repair shop in Helsinki and had all the hallmarks of a compounder. The sharp slowdown in China's property market, however, has changed its fortunes. Over the past 20 years, China has been responsible for 80% of the growth in new elevators, globally. With new equipment accounting for 50% of Kone's annual sales, the slump is a considerable blow.[1] While the company also provides maintenance services, that part of the market is more competitive and fragmented. The reduction in its long-term growth outlook, among other factors, led us to exit our position in 2023.

Resilient and sustainable growth

In addition to Nestlé, another company that we identified as a marathon runner is RELX. Based in London, the company is one of the world's largest providers of legal and scientific databases, boasting a vast pool of proprietary, and often mission-critical, data.

RELX's compounder status is, in part, predicated on the monopoly or duop0loly positions held in almost all of its end markets. One example is Dutch academic publishing house Elsevier, the home of many prestigious scientific publications. RELX also owns LexisNexis, a US-headquartered global provider of legal and regulatory information.

A large proportion of its revenue is based on recurring subscriptions, which can be extremely sticky. This gives investors great visibility on the company's future growth, another compounder criteria. Cash conversion is also extremely high which means RELX can return money to shareholders without compromising its investment in future growth.

The company has experienced a steady acceleration of organic growth due to its success in building sophisticated analytics tools that harness data and AI. This gives us confidence in the company's potential to further increase the quality of data for clients and grow its subscriber base.

Era-defining events

Even if 2024 manages to escape an economic downturn, markets will still be buffeted by elections in the US and the UK, the third year of war in Ukraine and escalating tensions in the Middle East. These are the known knowns. How the year unfolds economically and politically will only be revealed in time.

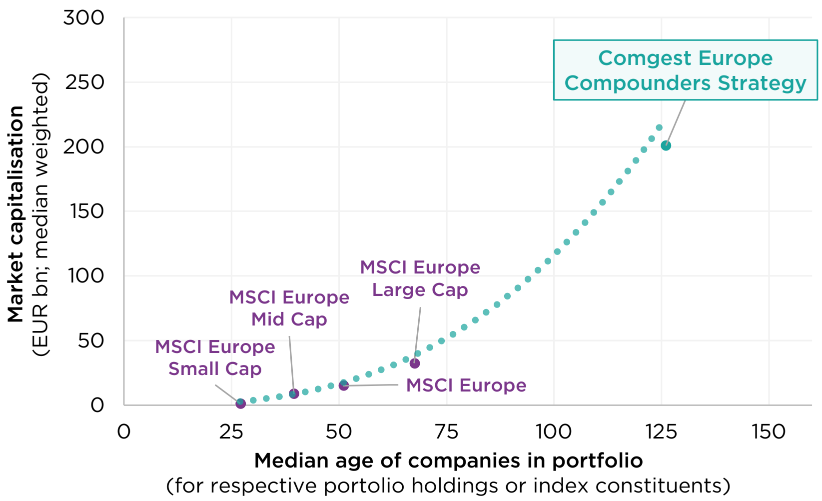
Quality companies, such as the names in Comgest Europe Compounders strategy, have weathered multiple financial, geopolitical and economic crises. The median age of our holdings is currently 126 years old, which covers a period of history indelibly marked by two World Wars, the Great Depression, hyperinflation in the 1970s, the advent of the digital age, the Global Financial Crisis and two global pandemics.

We have confidence these companies can withstand current market fluctuations and prosper in future; not based solely on their track records, but also on their continued investment in growth and respective rising market shares.

Although it is often considered a destructive force, time - as wine and cheese connoisseurs well know - can also serve to bring out the best in something. Provided, of course, that it was a quality product to begin with.

FOOTNOTE
1 Source: Company reports/website

The power of age and compounding



Past performance does not predict future returns. Source: Comgest / FactSet financial data and analytics, unless otherwise stated. Data as of 31-Mar-2023 expressed in EUR. See important information below for more details on the data presented.