

Human capital: the unsung hero of the company valuation equation



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Assessing the value of a company can be challenging. Typically, investors start by looking at its financial standing and records that reflect tangible investments, such as machinery purchases and building maintenance costs, to understand the company's revenue, debt obligations and other expenses.

These numbers are essential, but don't tell the whole story. Spending on employees, including training and healthcare benefits, often gets lumped together with other costs. At Comgest, we gauge how much companies are investing in their workforce. We see human capital expenditure ("Human CapEx"), the knowledge and skills people acquire throughout their lives, as a competitive edge for companies.¹

Post pandemic, companies have focused more on their softer benefits, from free parking to ping-pong tables, to attract and retain talent.² Many of these efforts aim to boost low employee engagement and stem the rise of so-called "quiet quitting".³

Beyond the cold brew

Free cold brew coffee is nice, but Comgest prioritises more substantial employee engagement strategies. We want to understand the steps a company is taking to ensure their workforce drives sustainable earnings growth. During our investment research process, we analyse employee wage structures, benefits, training programmes and promotion opportunities to ascertain whether a company meets our rigorous quality growth standards.

As we see it, companies that invest in their employees are more likely to attract, retain and develop workforces capable of delivering enduring financial performance. Capital expenditure ("CapEx") on new buildings, equipment and storage facilities can result in greater productivity and performance.⁴ In our opinion, investments in Human CapEx can achieve similar outcomes by motivating employees, increasing productivity, reducing staff turnover and strengthening a company's reputation.

Passing the baton to the next generation of leaders

We believe that high staff turnover is not a recipe for long-term growth as it can become difficult to establish a consistent and enduring corporate culture. Comgest prefers to invest in stable, growing companies that maintain a long-term vision and actively develop their workforce.

Brazilian electric motors manufacturer WEG exemplifies how a pioneering talent development programme can create generations of skilled employees and save costs by generating in-house talent. The company's vocational training school – CentroWEG – equips apprentices aged 16-18 with the technical skills and knowledge required to work at WEG. Every student receives a comprehensive education on how the company operates. With over 39,000 employees in 37 countries, this programme has served as a hotbed for in-house talent already steeped in WEG's history and values.

Its efforts to build a qualified workforce are deeply rooted in the company's culture. WEG also offers a profit-sharing scheme, giving employees a stake in the company's performance, which in turn - strengthens motivation and loyalty.

An environment that attracts innovators

As quality growth investors, we seek companies with competitive edges, but it's really their culture that keeps those edges sharp. We talk with employees and engage with leadership to evaluate how people interact and work together to achieve their goals.

A company's culture reflects how it invests in its employees. Consider VAT Group, the Swiss-based supplier of vacuum valves for the semiconductor industry. Demand for semiconductors and their associated components continues to rise and the wafer fab equipment (WFE) market, in which VAT Group operates, has recorded a compound annual growth rate of 9% in recent years. The employment market is extremely competitive, so the company has invested €50m in R&D over the past two years to create an innovative environment to attract highly skilled and technical experts.⁵

Human Capex is a lasting endeavour

Human CapEx operates on a different timeline compared with other forms of capital expenditure and it is hard to measure. But targeted investments in talented employees and an emphasis on internal promotion can be key strategies for strengthening loyalty and motivation. Both WEG and VAT Group have cultivated in-house talent and prepared the next generation of leaders.

Since Comgest's inception in 1985, we have engaged with thousands of companies. Based on our countless conversations with leadership, employees and customers, we believe culture is the glue that holds quality-growth companies together. Our bottom line is that we believe companies with long-term vision are more likely to take an active role in nurturing their workforce. That's why we seek companies that value an inspired, engaged and forward-looking team. In our view, these companies are capable of weathering tough times and achieving sustainable earnings growth over the long term.

Main Risks

- Investing involves risk including possible loss of principal.
- The value of all investments and the income derived therefrom can decrease as well as increase.
- Changes in exchange rates can negatively impact both the value of your investment and the level of income received.
- Comgest portfolios invest in a limited number of securities and may therefore entail higher risks than those which hold a very broad spread of investments.

Petra Daroczi joined Comgest in 2021 and is an ESG Analyst and Portfolio Manager responsible for ESG coverage of Europe.



¹"Human Capital Project." World Bank, January 31, 2019.

²Lucy Warwick-Ching. "How benefits have overtaken pay as the key to hiring and keeping staff." Financial Times, November 3, 2023.

³Klotz, Anthony C., and Mark C. Bolino. "When Quiet Quitting Is Worse than the Real

Thing." Harvard Business Review, September 15, 2022.

⁴Brinded, Tom, et al. "How Capital Expenditure Management Can Drive Performance." McKinsey & Company, June 29, 2022.

⁵Source: VAT Group Annual Report 2023

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