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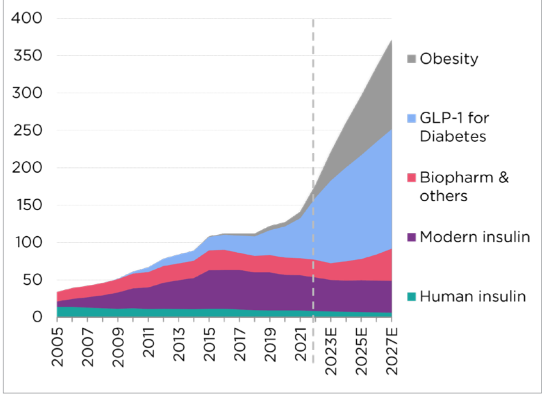
EUROPE EQUITIES
THE COMPANIES DEFYING THE AGEING PROCESS: OLDER, STRONGER, BETTER

Against a backdrop of stubbornly high inflation and interest rates in Europe, some venerated companies are proving that age is a state of mind, and experience – especially in navigating choppy markets – is what really counts.

This year marks the 100th anniversary of **Novo Nordisk**, a Danish healthcare company whose diabetes remedies aim to treat the growing end market of around 400 million patients worldwide. Over their century of operation, the company has taken advantage of opportunities in adjacent markets that benefit from their drug therapies, moving from insulin to GLP-1 (a hormone which stimulates the body to produce more insulin) to obesity products. Thanks to their consistent innovation, this latter market has opened up an entirely new avenue of growth that has enabled them to become "Europe's most valuable company in September 2023, overtaking luxury goods maker LVMH."[1]

FIGURE 1. EXPANDING INTO ADJACENCIES
Sales by therapy area 2005-2025E (DKK; Bn)



Sources: "Worldwide trends in diabetes since 1980", The Lancet, 387:10027, pp. 1513-1530, 09-Apr-2016; Novo Nordisk quarterly reports as of 4-May-2023.

— In September 2023, the 100-year-old Danish pharmaceutical company, Novo Nordisk, was ranked "Europe's most valuable company"

While this sounds like a significant achievement, Novo Nordisk is not alone in this regard. Within our Comgest Pan Europe Large Cap Equity strategy[2] (the "Comgest Pan Europe Large Cap portfolio" or "portfolio"), we have invested in a range of companies with substantial records of longevity. Thus far, as of the date of this publication, these "elder" companies have continued to achieve sustainable growth over extended periods of time with high visibility of earnings.

— A structurally growing end user market is very important to a company having sustainable long-term growth.

First, a structurally growing end user market is very important to a company having sustainable long-term growth. This can be seen in another of our portfolio companies, **L'Oréal**, whose beauty products were first brought to the French market in 1909.

Source: Comgest, Getty images (L); L'Oreal Annual Report 2022 (R).

[1] Willmot, Stephen. "Ozempic Maker Novo Nordisk Has a Weight Problem", The Wall Street Journal, 23-Oct-2023.
[2] Information for Comgest's Pan Europe Large Cap Equity Representative Account, a pooled investment vehicle which has been managed in accordance with the Composite discussed since inception of the Composite. For further information, please see the Important Information section.

— L'Oréal's market share has risen from 10% in 2001 to around 15% in 2022

— In 114 years, L'Oréal has had only 6 CEOs

Given that beauty and cosmetics products have been used for thousands of years, it's a relatively safe bet to say that they are likely to be used for many more.

Secondly, companies can also grow by expanding their addressable market and moving into adjacent ones, as evidenced by Novo Nordisk's moves into hormone and weight loss therapies.

Another important factor is the ability to grow market share in fragmented end user markets. Amid the extremely fragmented beauty market, L'Oréal's market share has risen from 10% in 2001 to around 15% in 2022.[3] The company increased their market share via organic expansion of their existing brands as well as acquiring new brands and expanding into those areas, such as their purchase of the skincare company, CeraVe. Six years after boosting CeraVe's distribution and marketing through L'Oréal's robust and experienced network, the company has gone from €150 million in sales to more than €1 billion.[3]

Consistency of strategy and management is also indicative of an enduring company. L'Oréal, for example, has had only six CEOs throughout its entire 114 years. A further path to prolonging a company's existence is their ability to innovate, reinvent and transform themselves and we have examples of those in the portfolio too.

Lindy's Deli and Restaurant, Broadway & W. 51st St., New York City, circa 1940.

(Photo by Michael Ochs Archives/Getty Images)

LINDY'S LAW

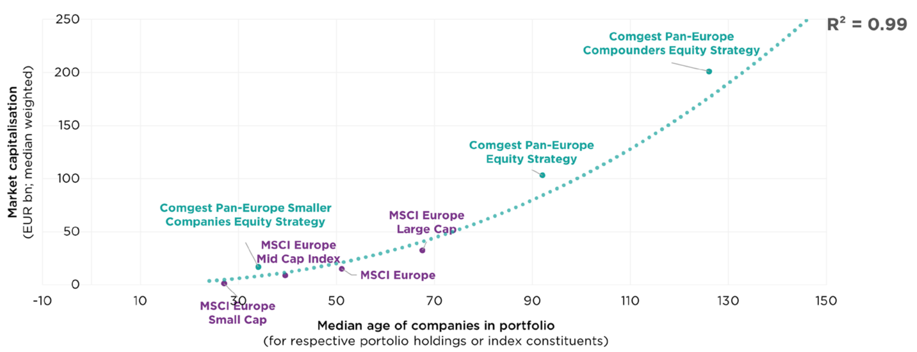
Another way to gauge a company's staying power is to apply Lindy's Law. Named after Lindy's Deli in New York, the law was first theorised in a 1964 article after writer Albert Goldman observed actors in the restaurant trying to estimate their post-show career prospects.

In 1993, Princeton astrophysicist Richard Gott took this power of prediction a step further and compiled a list of all the then-current Broadway and off-Broadway shows and noted when each had first opened in New York's famous theatre district. He then predicted, "how long each show would run, based solely on how long it had been running already". Ultimately, Gott was proven right – with an accuracy of 95%.

How can this be applied to portfolio management? At face value, Lindy's Law seems to contradict traditional financial theory, which states that the competitive advantage period (CAP) – during which a company generates returns on investment that exceed its cost of capital – is limited.

However, across our European strategies there is a clear correlation between the size of the market caps of each strategy and the age of our portfolio companies. By comparing the overall returns over the last 30 years with the duration of our holding period for each stock, we found that only a relatively small number of long-held stocks contributed to a large percentage of our returns.

FIGURE 2. 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. The Comgest Equity portfolios refer to the following: Comgest's Pan Europe Large Cap Equities Representative Account, Pan Europe Smaller Companies Equities Representative Account and Pan Europe Large Cap Compounders Equities Representative Account, which are pooled investment vehicles that have been managed in accordance with their respective Composites discussed since inception of each Composite. Please refer to the important information section for more details on the representative accounts, their selection methodology and where to receive a GIPS report of the Composites. The MSCI Europe Large Cap, MSCI Europe Mid Cap and MSCI Europe Small Cap indices are used for comparative purposes only and the portfolios do not seek to replicate the indices.

[3] L'Oréal, company data as of 31-Dec-2022.

ARTIFICIAL INTELLIGENCE: THE RISE OF THE MACHINES

Source: Getty images

As noted, there are several ways to determine a company's staying power. Artificial Intelligence (AI) could offer companies opportunities to not just reinvent themselves, but also to expand their addressable markets and more. Following the excitement around ChatGPT and advancements in AI this year, we evaluated every position within our portfolios with the aim of understanding how they could be impacted, while also being cognizant that rapid change is inevitable in this field.

— This year, Comgest evaluated every position in our portfolios with the aim of understanding any potential impact from AI

In our view, the majority of the companies in our portfolio are unlikely to be negatively impacted by AI. In fact, we are confident that some will be positively impacted, such as **ASML**, the Dutch semiconductor chip manufacturer. As more companies introduce AI into their operations, it will boost demand for the leading-edge chips produced by ASML machines. ASML dominates the global market for lithography equipment used in the semiconductor industry with an overall market share of more than 80% and a share of 100% on EUV (extreme ultraviolet) machines, which produce advanced microchips that power smarter smartphones, biotechnology, AI and more.[4]

Across the wider software industry, following our research, we took advantage of the share price weakness in some of our portfolio companies and increased our allocations. For example, we identified companies such as **Accenture** and **Halma** as strong businesses that are currently experiencing short-term issues.

— Industry consultants believe that AI semiconductor revenue should increase by approximately 150% over the next five years, from $50 billion to $120 billion by 2027.

AI has been the major driving force behind semiconductor demand in recent years. The semiconductor market has grown by an estimated 6% per year since PCs became mainstream in the 1990s. The boom in smartphones then took over in pushing semiconductor demand, but AI has now become a key driver. AI servers contain around 30 times the semiconductor content compared to a general purpose server. The industry is placing a considerable emphasis on large language models for semiconductor demand for the next 10 years, and industry consultants believe that AI semiconductor revenue should increase by approximately 150% over the next five years, from $50 billion to $120 billion by 2027.

Many people underestimate the impact that AI will have in the same way the Internet was underestimated; the full scope of uses for the technology likely won't be realised for many years. Anticipating how our companies could be affected offers another path to determine their durability through such market changes.

FUNDAMENTALLY GROWING

2023 has been a year driven by fundamentals: companies' underlying profits and growth trajectory. To date, earnings have been the major driver behind the returns generated by our Comgest Pan Europe Large Cap portfolio.

[4] Moody's Investor Services, Credit Opinion, ASML Holding N.V., 9-Aug-2023.

This year, our portfolio has benefited from 15% organic sales growth thanks to large, fast-growing positions such as Novo Nordisk and ASML, both growing around 30% this year.[5] Despite these figures being slightly elevated due to low-to-mid single-digit inflation, we believe that the sustained growth of the portfolio remains strong, even without the tailwind.

This type of resilience underlines the importance of investing in established companies that can continue to generate growth in a challenging environment and is a testament to the deep moats and pricing power of our portfolio companies.

At Comgest, we seek to find businesses with sustainable, visible and anti-fragile growth that are able to resist an occasionally difficult market environment.

Novo Nordisk, L'Oréal, and other of our portfolio companies have withstood crisis after crisis: from the burst of the "dot-com" bubble through the European debt crisis to the Covid-19 pandemic. Many of these companies even benefitted from the impact of the Covid-19 pandemic. There were trickle-down effects as well such as companies accelerated their digitisation and e-commerce strategies due to lockdowns, which helped their supply chain companies to reap the benefits arising from the accelerated digitisation.

— Comgest's Pan Europe Large Cap portfolio is laden with centennials and multi-decade-old companies that have built resilience into their business models.

Comgest's Pan Europe Large Cap portfolio is laden with centennials and multi-decade-old companies that have built resilience into their business models. In fact, our analysis shows that Comgest's portfolio remains as resilient today as it was in 2009 when it was able to generate organic sales growth despite the worst recession in over a century.

As we look towards a looming recession, we believe that our portfolios – exposed to companies with deep moats and experience weathering previous storms – offer long-term equity investors the right balance between taking advantage of strong fundamentals while also buffering against a market full of mounting risk and volatility.

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- Changes in exchange rates can negatively impact both the value of your investment and the level of income received.
- Comgest portfolios invest in limited number of securities and may entail higher risks than those which hold a very broad spread of investments.

[5] Company data as of 1H 2023.

James Hanford joined Comgest in 2018 and is an Analyst and Portfolio Manager specialising in European equities. James contributes widely to the investment team's research coverage for a diverse selection of pan-European quality growth stocks. He started his career in 2011 as an Analyst at Credit Suisse and prior to joining Comgest spent four years as a global generalist at Capital Group. He obtained his Bachelor's degree in Economics from the University of Durham where he graduated top of his class and holds a Master's degree in Finance from the University of Cambridge. He is also a CFA® charterholder.

Alistair Wittet joined Comgest in 2012 and is an Analyst and Portfolio Manager specialising in European equities. He is also a member of the Comgest Group's Investment Committee. Alistair co-leads Comgest's Pan Europe and Europe ex UK strategies. He started his career in 2006 as an Analyst at Standard Life Investments in Edinburgh. He went on to join Citigroup's London office in 2009, specialising in the pan-European food retail sector as an Equity Analyst. A British and French national, Alistair is a Geography graduate from Durham University and a CFA® charterholder.

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