CRUX ASSET MANAGEMENT

Fund Manager: Daniel Avigad

This is a Marketing Communication

TM CRUX European Special Situations Fund

> "We have conducted an extensive review of 2023 quarter performance and made some adjustments to the portfolio. This has increased the focus within the less-economically sensitive portion of the portfolio on net beneficiaries of secular disruption, a dynamic that our analysis concludes has accelerated notably last year."

Annual and Quarterly Review

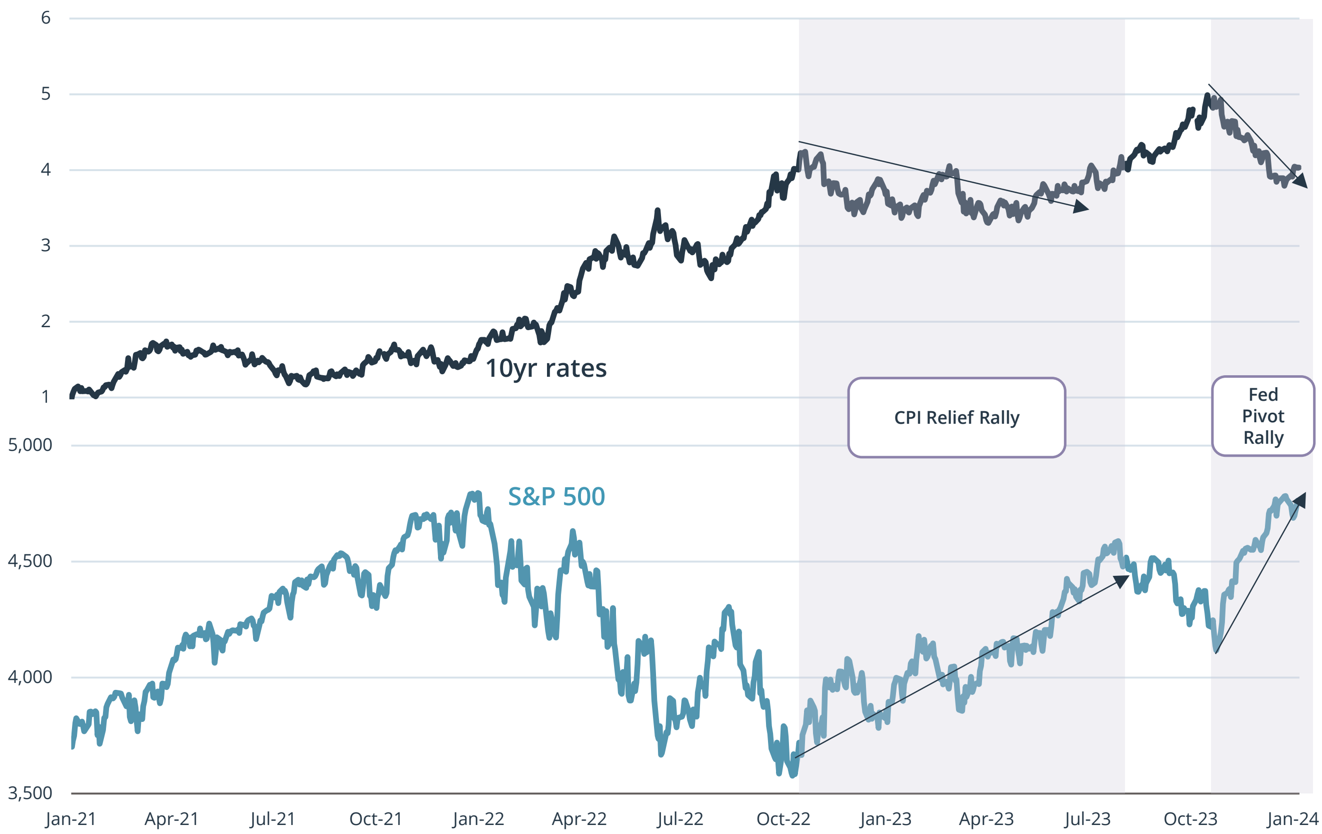
Following a brief but smooth period of transition, we formally took over the fund at the beginning of September 2023. The fund was up 7.7% compared to the MSCI Europe Ex-UK Index which rose 4.8%.

The high correlation between equity and bonds has been a defining characteristic of the year. Shares rallied strongly through H1 on relief that inflation was cooling and then again in Q4 in anticipation this would enable central banks to shift focus from price stability to employment maximisation and start cutting rates.

Our highest conviction positions (sized 4%+) generated solid returns where our batting average i.e. ratio of the number of winners vs losers was favourable at 180%. Positive alpha relative to factor came from Ryanair (83bps), Iberdrola (39bps), Intesa (33bps) Vinci (28bps), as well as Novo, Total Energies, Tele2, Schneider, Sika, and Michelin, also between 10-25bps each.

Ryanair continued to benefit from a confluence of limited supply growth in intra European airline capacity and strong consumer demand for travel driving sustained growth in fares. With strong growth in earnings leaving the shares trading on still only 8x forward earnings, the shares seem poised for further gains in the coming months. Iberdrola has continued to deliver well against its CMD targets and was able to positive upgrade net profit guidance following better asset base growth and faster debt paydown assisted by asset rotations. Intesa delivered strong earnings growth and capital generation in this interest rate cycle as a well structured supply side in the Italian banking industry has meant limited deposit pass through whereas loans have repriced tracking ECB rate hikes. With a well capitalised balance sheet, Intesa has been able to generate all of its profit generation leaving the shares on a double digit dividend yield.

US Asset Prices: High Equity-Bond Correlation Throughout 2023
US 10 Year Bond Yield (%) vs S&P 500 Price Index (x)



Source: Bloomberg, Lansdowne analysis

While we are encouraged by our positive performance this quarter, we remain vigilant and did a thorough review of our fund underperformers. Negative alpha relative to factor came from Rentokil (-65bps), KBC (-55bps), Sanofi (-47bps) and Nestle (-44bps). Our detractors can divided into two categories. The first bucket comprises a limited number of holdings that experienced more-painful-than-typical idiosyncratic events that were by nature hard to foresee but cost the fund -60bps. The second, consists of exposure to 'defensive' companies that underperformed their own factor by c.-120bps in a way that was arguably more possible to predict, but also in consequence more amenable to prospectively resolve.

A key holding in the first bucket was KBC (c.-44bps) where we think of the causes of the relative loss as being more temporal than structural in nature. The Belgian government forced KBC's liabilities to reprice in August by structuring new State bond issuance to be both tax exempt and at a rate premium to demand deposits. Already by December however, the terms of the next retail bond issuance had been re-designed to better protect banks' deposit bases and thus financial stability of the system (i.e. no longer tax exempt, 5 year not 1 year maturity). This should allow NII and equity risk premium to stabilise for KBC, a quality well-capitalised franchise on 1x book, 8x P/E and 8% dividend yield.

It is the second bucket of losses that we view as more systemic in problem structure, and so focus our analysis on below. Underperformance within the defensive portion of the portfolio versus defensives in the benchmark has been quite substantial this year. It has also been an issue before, several years ago, at that time due to our holdings in telecoms and so the greatest potential for process improvement would appear to reside here. Dividing the MSCI Europe equity universe by type, our subsequent analysis has generated some clear conclusions and next steps.

Key Performance Contributors: FY 2023
BPs NAV

	Absolute Contribution		Alpha Contribution
Top			
Ryanair	140	Ryanair	83
Schneider	75	Ibedrola	39
Intesa SanPaolo	74	Intesa SanPaolo	33
Sika	71	Vinci	28
Michelin	66	Novo Nordisk	21
Vinci	63	Total Energies	21
Ibedrola	57	Tele 2	21
Boliden	56	Boliden	19
Bottom			
Nestle	(33)	Nestle	(44)
Sanofi	(39)	Sanofi	(47)
KBC	(44)	KBC	(55)
Rentokil	(53)	Rentokil	(65)

Source: Lansdowne analysis. Data as at 31/12/2023

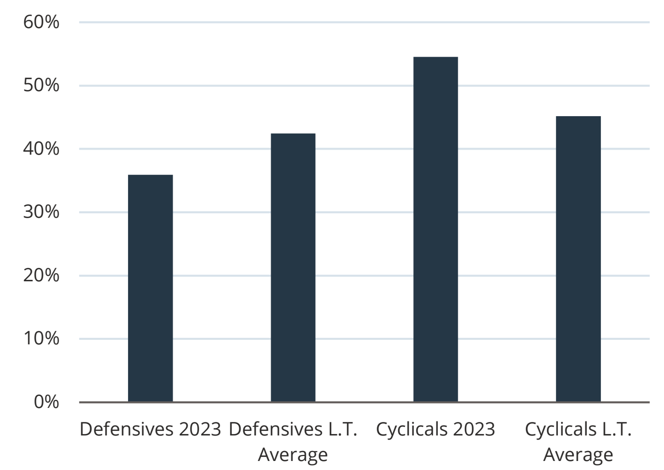
Firstly, it shows that the likelihood of generating in-factor alpha within defensives meaningfully deteriorated in 2023. Only 1 in 3 defensives outperformed their defensive factor (36%) last year compared to 55% for cyclicals versus their cyclical factor. This divergence in probability of success has not been the case historically with the average hit rate for defensives over the last 8 years being broadly similar to cyclicals at 42% and 45% respectively.

Secondly, the alpha on offer also deteriorated within defensives in 2023 compared to both historically and within cyclicals. For defensives, the positive alpha from winners was -50bps less on average than the negative alpha from losers, much less than the +400bps average spread since 2016. Conversely, winning cyclicals generated a +550bps spread versus losing cyclicals in 2023, much more akin to the identical 8 year average of +400bps.

Thirdly, the deterioration in probability and magnitude of alpha capture within defensives last year was driven by the more highly rated of its constituents, i.e. those companies with a starting forward consensus P/E ratio above the mean for their industry sector. The hit rate within this "expensive defensive" category was only 34%, markedly below the long-run average of 52% while the alpha spread between winners and losers fell to -600bps, a full 10 percentage points worse than the 8 year average of +400bps. Conversely, the alpha opportunity within "cheap defensives", i.e. those with a P/E below the mean for their respective industry sectors, was not materially different to history.

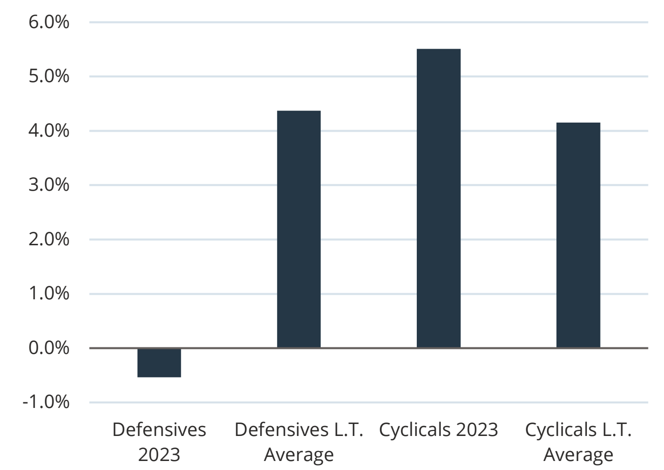
These empirical points resonate with developments that we also observe at a company level. We think that the relevance of some economically less sensitive industry sectors relative to the economy is deteriorating. This is visible in the widening underperformance of sectoral revenue growth to GDP growth where the latter is weighted for geographic revenue composition. For us, it is critical to differentiate between cyclical and structural drivers of this effect. The current period of high nominal growth accompanied by higher interest rates is the type of environment where higher rated defensives naturally have greater vulnerability, but this may either already be discounted or prove to be cyclical. More structurally however, GLP1s, AI and government activism / expropriation in numerous forms are amongst the disruptive dynamics that directly challenge the terms of trade of historically winning business models today to a greater extent than in the post GFC cycle.

2023 Hit-Rate vs Long-Term Average: Defensives Drag %



Source: Lansdowne analysis. Data as at 31/12/2023

2023 Alpha Spread vs Average: Defensives Drag %



Source: Lansdowne analysis. Data as at 31/12/2023

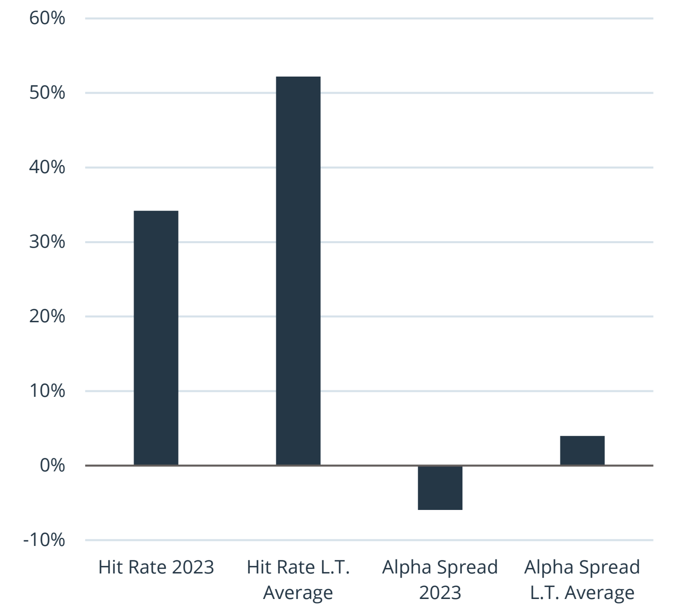
Ultimately, we think that valuation multiples within the array of economically-less sensitive business models has entered a period of increased divergence. In our view, scarcity value will accrue to such companies that are able to retain or grow relevance within the economy but crucially as measured in hard currency terms (USD). This was already visible in 2023 within the portfolio given the share price performance of Novo (+50%), Compass (+x%) and Linde (+y%) outperforming not just defensives but the wider equity universe, and in some cases significantly despite the cyclical tilt to market performance. All three delivered at least high single digit growth in revenues and cash flows in US Dollars, and in each case, relative economic relevance has clearly increased. Novo due to the uptake of obesity drugs, Compass as outsourcing to professional caterers is structurally accelerating and Linde as the energy transition and reshoring dynamic expands intensity of industrial gas consumption across the wider economy.

More broadly however, it has become rarer for constituents of Europe's less cyclical universe of listed companies to outgrow the economy as secular dynamics have become less virtuous. The internet disrupts retail and media whereas the tech counterpart is primarily domiciled elsewhere. Oil demand approaches a peak and consumer habits are shifting adversely within staples. Meanwhile utility profits are at risk of expropriation in up-cycles and telcos struggle to generate sustainable returns without supply-side consolidation that is not permitted yet allowed on other continents.

We think there are three potential responses to such a fact pattern. The first is to hold a cyclical-only book but we think this would jeopardise any benefit from balanced portfolio construction. Also given the counterpart is that un-disrupted secular growth should be remunerated with rising scarcity value, this also implies un-necessarily taking on excess cyclical beta risk at a potentially inopportune time.

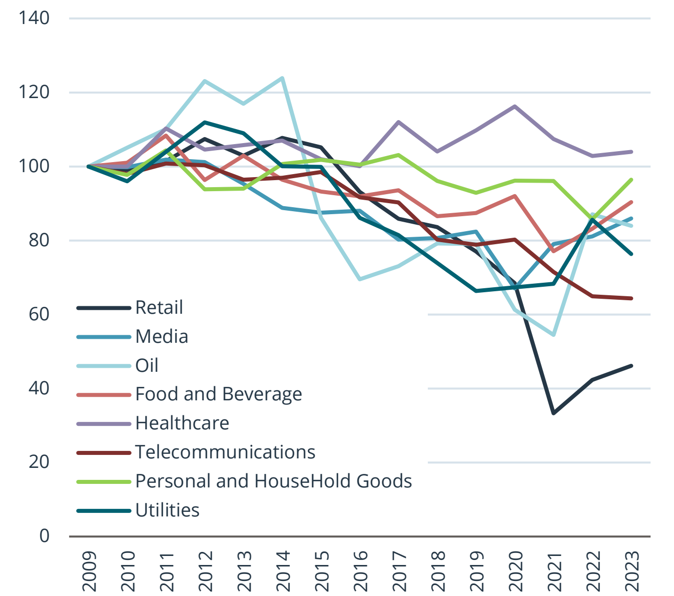
The second potential response is to focus within the defensive universe only on the lowest-multiples stocks within each respective sector. This seems the best representation of what most market participants are currently doing. That such a list is dominated by beaten-up restructuring and turnaround cases is we think symptomatic of a general lack of conviction in the long-term attractiveness of business models and rather the desire to extract short-term alpha from interest-rate volatility driving valuation multiple convergence. Indeed in 2023, the lowest multiple stocks outperformed the highest multiple shares in sectors that represent 78% of the MSCI Europe universe. However, if the terms of trade remain impaired, restructurings in our experience rarely resolve the underlying issue (e.g. Bayer, Alstom) while other names have substantially re-rated without commensurate positive earnings surprises (e.g. Danone). We continue to work hard in this area but are mindful of the trade-off between elusive trading alpha and structural alpha in many cases.

"Expensive" Defensives: 2023 Performance
Hit-Rate & Alpha for Expensive Defensives vs LT Avg, %



Source: Lansdowne analysis. Data as at 31/12/2023

European Defensives: Loss of Relevance Over Time
Sector Sales growth - GDP growth, 2009 Indexed to 100



Note: Varying GDP comp for each sector= Retail, Media, Utilities,Telco 100% EU, Oil 100% Global , F&B 50% EU/25% US/25% EM, Personal & HH Good 40% EU/30% US/30%EM, Healthcare 30% EU/60%US/10%EM
Source: IMF, Bloomberg

The third alternative response is to re-orient the defensive book to become a greater net beneficiary from the diaspora of disruptive dynamics at play, and indeed this is the step we have taken. To contextualise this, one can divide the defensive portion of the book into three groups. The first group comprised of holdings such as Compass, Linde and Novo, are largely economically insensitive opportunities where the accelerating secular component of idiosyncratic growth has already started to be rewarded. We expect this broadly to continue as the increased scarcity of compounding of this nature becomes more well understood.

The second group is comprised of equally idiosyncratic growth-exposed holdings but where short-term negative news has dominated near term performance though without impact to terminal value. Sanofi and Rentokil are the two pertinent examples, especially given Q4 developments which together largely explained the fund's underperformance in the period. For Rentokil, integration execution will take time but we see c.50% upside once the merger with Terminix propels the group to market leadership of the US outsourced pest control industry, a relatively economically insensitive category in which demand growth has historically averaged as high as 5% p.a. For Sanofi, the decision to accelerate R&D investment hit the share price short term but we think reflects the strength of its leadership position and pipeline in immunology, a market set to grow 9% CAGR over the next decade which is not discounted at a P/E of only 11x. We discuss proprietary evidence including survey work that we have gathered to reinforce our analysis for both, later in the stock section of the letter.

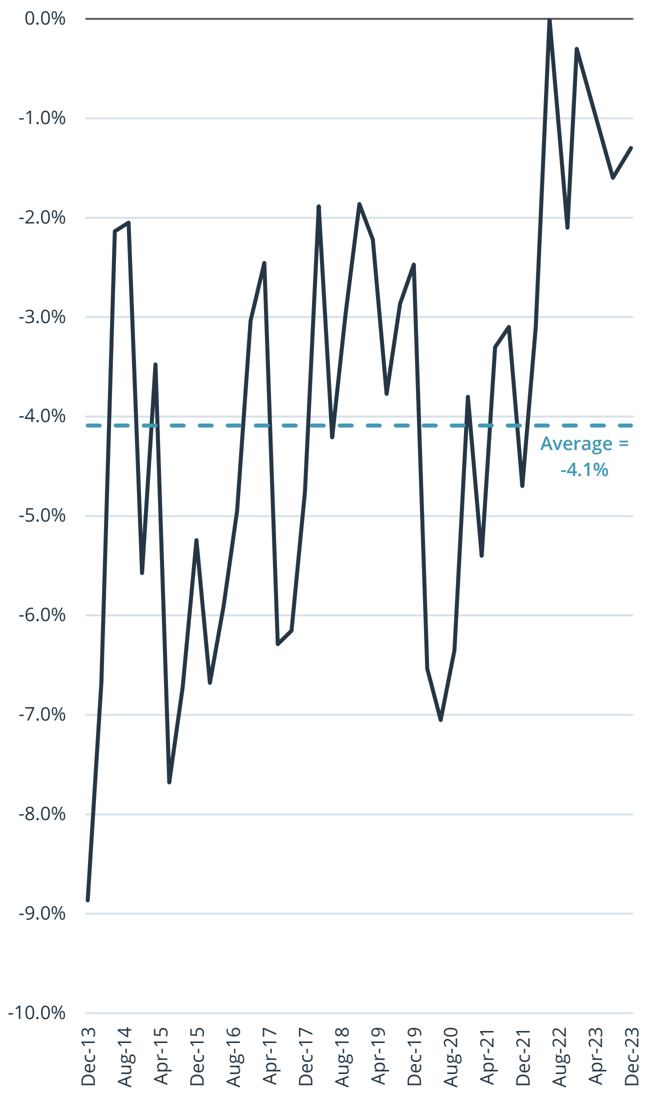
While our holdings in the first two groups remains largely unchanged, the third and final group comprises companies in which disruptive effects have become less clear cut and we have made some changes. Specifically, we have reduced the position in Nestle and exited holdings Pernod. For a meeting with the CEO of Nestle in Switzerland in December, we produced a very in-depth analytical presentation upon which the ensuing discussion was based. We think there is a lot of original content in this document, please ask for it if you are interested. Leaving a more detailed discussion to the stock section later, our principal conclusion is that the nutritional transition underway is step-shifting at a speed that challenges the economics of distribution platforms designed for mass consumption of highly calorific, processed foods. Consistently achieving the volume gains required to drive mid single digit revenue growth in hard currencies is not guaranteed even for best in class Nestle.

Fund: Attractive Double-Digit IRRs
%

	% NAV	IRR
Vinci	7%	11%
Schneider Electric	6%	10%
Iberdrola	6%	6%
Linde	6%	8%
Michelin	6%	22%
Intesa Sanpaolo	5%	19%
EssilorLuxottica	5%	9%
Sika	5%	13%
Capgemini	5%	14%
Sampo	5%	9%
Sanofi	5%	10%
Ryanair	4%	29%
Nestle	4%	9%
Novo Nordisk	4%	6%
ASML	4%	15%
TotalEnergies	4%	6%
KBC	3%	12%
Alcon	3%	9%
Informa	2%	13%
Tele2	2%	9%
Wolters Kluwer	2%	10%
Compass Group	2%	12%
Boliden	2%	5%
UPM	1%	1%
Rentokil	1%	18%
Richemont	1%	15%
CBK	1%	33%
Epiroc	0%	13%
Fund	**100%**	**12%**

Source: Lansdowne analysis

Fund Rotational Risk*: Near All-Time Lows
% NAV



Source: Lansdowne analysis

At the aggregate portfolio level, the changes described above have a limited impact on overall factoral character and the core list of holdings otherwise remain the same. We feel optimistic noting the attractive valuation of the fund today given the weighted average internal rate of return of the book is 12%, even using conservative exit multiples. This would seem to embed a substantial equity risk premium buffer to risk free rates, irrespective of whether they settle at 3% or 5%. Moreover, the rotational risk in the fund is also at the lowest level in its history as shown in the chart below.

Turning to leading indicators, I am also personally encouraged by the quality of company-level due diligence within the team at present. Adding a fourth analyst has expanded our ability to differentiate through deeper understanding of companies and as importantly enables each respective individual to focus more specifically on stages of the due diligence process for which they have the greatest aptitude (i.e. hypothesis generation, evidence gathering, analysis, communication with management). Reviewing the last six months with our two new members, I am pleased by the quality of work as measured by the degree of primary evidence-led proprietary analysis that we have created.

By way of example in the last quarter alone, we have prepared and presented our detailed views as to long-term shareholder value creation to Michelin's top 100 managers and to Nestle's CEO. Additionally, we have produced substantive survey work on Rentokil, in-depth analysis of Sanofi's existing and pipeline position in immunology and an analytical assessment of Boliden's capital allocation contextualised versus the peer group. We have also physically kicked the tires for a number of companies visiting Informa's key trade event in Spain, had discussions with Siemens Healthineers' divisional managers in Germany and met Sanofi's R&D team in New York. In fact over the last 6 months, we have held meetings with 152 investible corporates, 83 company-specific analysts and spoken with 35 industry experts. This translates into growth in our collective team's activities of +10% year on year. We are confident that this granular focus on investment inputs, whilst ensuring that a large number of small things are done as well as possible, will over time manifest in benchmark outperformance as the output.

An update of our thoughts on macro follows in the next section.

Macro

US personal consumption expenditure is the most significant driver of global growth hence our focus on this topic below. In our view, it is important to differentiate between the nearer and longer term outlook given the potential for cyclical and structural divergence.

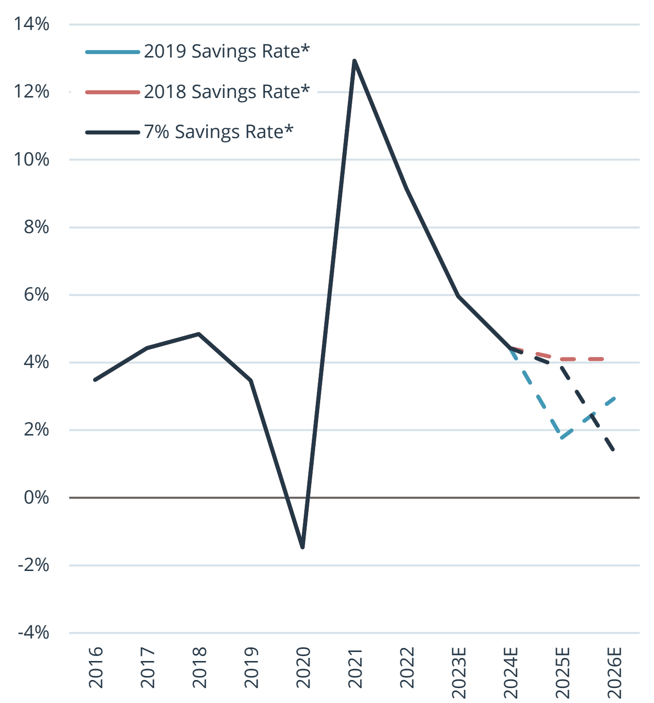
In the near term, the generosity of post-pandemic fiscal transfers appears likely still to dominate US consumer behaviour. Entering this year, we think excess savings have already halved from peak thus the exuberant period of 2021-2023 in which personal consumption expenditure (PCE) grew 9% CAGR is likely over. That said, we think the US consumer retains an extra kitty of c. $0.8-1.6 trillion leftover which will still be important in 2024. Given the lower annual cost of living adjustment will automatically constrain growth in social benefits, the labour market will also play a greater role too.

Overall, our central case is that PCE growth should slow to a mid-cycle type level of c. 4% YoY in 2024. Given the residual stock of excess savings, this would seem achievable in the near term even for a wide range of assumptions for terminal annual savings rate i.e. irrespective of whether the pre-pandemic level is defined as 6% (i.e. like in 2018) or 8% (2019) to which the current very low savings rate of 4% eventually reverts. It is however more vulnerable to softening in the labour market and although the evidence is not clear cut today, this is not entirely surprising given the lags, and thus we think there is more downside than upside.

The main point to us is that even a slowdown in US consumption growth to 4% would make the environment feel quite different to the last 2 years with respect to corporate earnings. Many companies have ridden the wave of the expansion in US nominal GDP growth of 40% since the pandemic. Without this tailwind, pricing power of individual business models is likely to regain relevance recalling that US profits ex-tech have grown only 3-4%p.a. historically while consensus estimates are for double digit growth again this year. This could prove an attractive backdrop for active managers in our opinion.

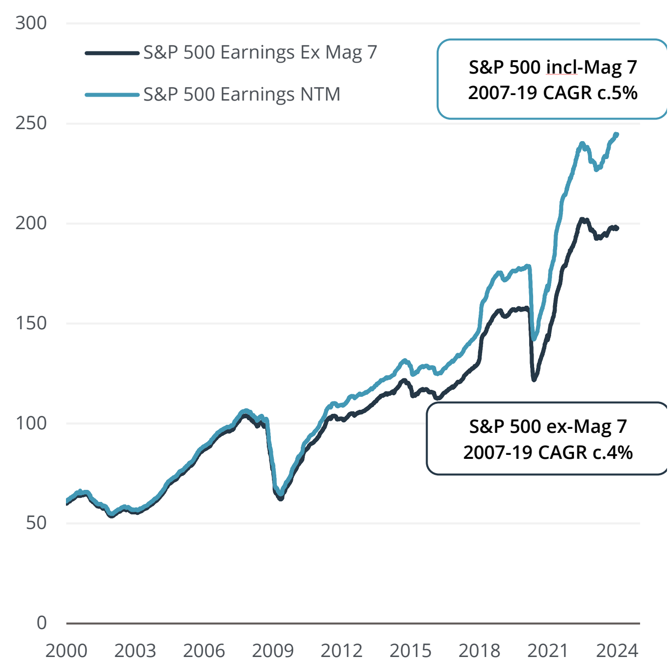
In the longer term, the real question is not whether generous fiscal transfers can boost near term consumption expenditure, as it can, but whether fiscal dominance, which arguably started with the response to the pandemic, is a viable strategy to reduce whole-economy debt ratios. The most comprehensive dataset we can find is provided by the Bank Of International Settlements (BIS) and we use this to compare current total debt ratios to those just prior to onset of the pandemic i.e. Q4 2019. Interestingly, this data only shows that debt ratios have been reduced if the price of government debt is taken at spot market value which given the rise in interest rates is currently below par. However, such an approach seems to create an inconsistency. Firstly, governments lack sufficient resources to repurchase the stock of outstanding public debt therefore the nominal rather than spot value is most relevant. Secondly, if one calculates the debt to GDP ratio using spot prices for the debt, then the GDP denominator should also be adjusted down for the impact of higher spot interest rates on economic activity versus when the debt was issued. Since the BIS recognise this inconsistency, it also publishes the statistics based upon nominal values for government debt. On this basis, and despite an enormous inflationary shock (i.e. CPI > 10%) and correspondent boost to nominal GDP growth, whole-economy debt ratios in most advanced economies are either flat or even up in Q2 2023 versus pre-pandemic levels. Given inflation cooled further in H2 of last year, we would guess that at best there has been no improvement since.

US PCE Growth: Likely to Slow In Most Scenarios
Personal Consumption Expenditure (PCE) Growth, % YoY



* Assumed steady state savings rate, 2019 was 7.4%, 2018 6.4%, 1950-2023 average 8.5%
Source: BEA, Bloomberg, Lansdowne analysis

S&P 500 ex Mag-7: c4% EPS Growth in 2% Inflation
% 12m Forward EPS CAGR, 2007-2019



Source: Piper Sandler. Data as at 18/12/2023

That both Trump and Biden are running on pro-fiscal agendas at this point in the cycle is noteworthy, but it isn't actually that surprising when contextualised versus the trajectory of recent history. Across 54 advanced and emerging countries in the 40 year period to 2013, in only 15% of the 235 nonoverlapping 5 year periods in the dataset has an economy run with an average government primary surplus of 3%.

While the recent reduction in market interest rates has been helpful, it is not yet of a magnitude that obviates the need for fiscal tightening if government debt sustainability metrics are to stabilise. For example, we estimate that the required primary budget balance in France for government debt ratio stability has improved from +0.8% of GDP to -0.2% but this still implies fiscal tightening of more than 300bps is needed. Similarly, the US appears likely to continue to outspend the neutral level of affordable government primary budget even under the assumption that Trump's tax cuts are expired.

Inflation Ambush: Limited De-Leverage if Rates Revert
Total Economy Non-Financial Debt / GDP, %

	Q4 2019 (At Market Value)	Q4 2023 (At Market Value)	Q4 2023 (At Nominal Value)	
Euro Area	255	240	255	=
France	325	323	343	↑
Germany	187	186	196	↑
Italy	258	243	262	↑
Spain	264	241	262	↓
United Kingdom	268	237	274	↑
United States	253	253	264	↑

Source: BIS, Lansdowne analysis

Historical Debt Reductions: Driven by Primary Surplus
%, x

		UK	USA	France
Period		1822-1913	1867-1913	1896-1913
Debt / GDP Ratio	Start	194	30	96
	End	28	3	51
Decomposition (in ppt)	Primary Balance	181	151	100
	Interest rate growth rate differential	-96	-46	-2
	g	88	48	96
	r	-184	-95	-98
	SFA	15	-5	2
Average real GDP growth		2	4	3
Average real interest rate		4	4	3

Source: Eichengreen, El-Ganainy, Esteves and Mitchener (2021)

Without conditions yet ripe to restore primary surpluses, debt reduction is dependent to a greater extent on fiscal repression or the constraint of interest rates to levels below GDP growth. While the post WWII period (1945-75) is commonly cited as evidence that financial repression can achieve meaningful deleveraging, the academic literature suggests firstly that 1/4th to 1/3rd of the reduction in debt ratio in advanced economies was actually due to primary surplus generation and more importantly, that real interest rates (outside of 1951 Korean War) were at or only slightly below 0%. This suggests that the interest rate-growth rate differential was driven by a high level of average real economic growth during that period which was as much as +4.5% p.a on average. If we are to achieve as high a level of real growth again, an acceleration in productivity is likely needed to make the numbers work given the slower rate of population expansion of recent decades and with the unemployment rate already so low.

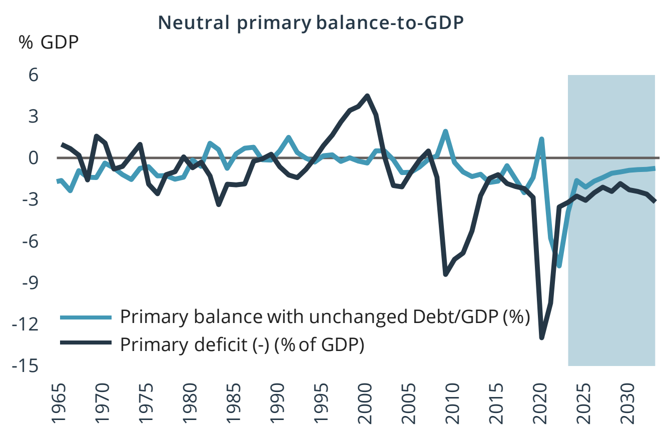
debt reduction under current political conditions and thus is likely to continue. While this has boosted near term spending power, neither the evidence historically nor so far from the present episode makes a compelling case that it will succeed in the long term in reducing total debt ratios. AI or other innovations may indeed lift productivity but with uncertainty around timing and magnitude, we would not presume an acceleration in real growth will be sufficient to curtail indebtedness. The eventual successful policy mix therefore still feels some way off being achieved and the pathway is likely to remain volatile. Ultimately, the magnitude of accumulated excess savings that remain to support US household consumption is dependent upon the level to which the annual savings rate will normalise. This in turn depends upon perspectives on the trajectory of government deficits and their compatibility with sustainable total debt ratios. With both presidential candidates campaigning on pro-fiscal narratives, the citizenship appears sanguine though capital markets less so. While inflation appears to be slowing cyclically, these are the types of condition where over time the market may demand a higher interest rate structurally than in the past. Primarily for us, this means we should seek balance at the aggregate portfolio level rather than try to time markets. As such, we continue to spend the risk budget and our analytical resources on company-specific ideas rather than take a major macro view.

EZ: Rates Still Incompatible With Debt Sustainability Required vs Current Primary Balance*, % GDP

	Required Primary Balance Q2 2023	Required Primary Balance Q3 2023	2024E Primary Balance	Pre-Pandemic Average Primary Balance	Required Fiscal Tightening
Italy	1.3%	2.7%	-0.4%	1.5%	1.7%
Spain	0.3%	1.2%	-0.6%	-1.1%	0.9%
France	-0.2%	0.8%	-3.0%	-1.4%	2.8%

* For stabilising Government Debt / GDP assuming debt refinanced at spot interest rates, and assuming 2.5% terminal nominal GDP growth for each of Italy, Spain and France
Source: Eurostat, Goldman Sachs, Lansdowne analysis

US: Actual Primary Balance Undershooting Neutral* % GDP



*Neutral Primary Balance defined as level required to sustain unchanged government debt / GDP
Note: Shaded area represents projection.
Source: US Treasury, BEA, Haver Analytics, Barclays Research

Putting this all together, we think that fiscal activism to induce inflation remains the most expedient pathway to attempt

In the next section of the letter we discuss a number of positions in the fund. Michelin and Ryanair were two of the largest positive contributors in 2023. Conversely, Sanofi and Rentokil were two of the biggest detractors in Q4 as was Boliden over the full year. Finally we discuss Nestle, and the analysis work underpinning our presentation to management.

Discussion of Holdings

Michelin

Michelin contributed +66bps to fund performance in the quarter. What is exceptional about the group is that it is responsible for nearly all the innovations in its industry over the last 150 years spanning the invention of radial, all-weather, energy-efficient and earthmoving tire technologies. Michelin is also a leader in tires for electric vehicles which should offer a new source of secular growth as a replacement cycle unfolds over the coming decade.

Recently, as a long-term shareholder, we gave a presentation to Michelin’s top 100 managers at an internal company conference. We made the point that while IP leadership is clear, it will likely prove insufficient to drive sustainable value creation without modernisation of the legacy manufacturing footprint. This has become a strategic imperative as the group seeks inorganic opportunities to open up additional end markets over which to deploy deep R&D expertise in rubber and related polymers. At current valuation multiples, the implied cost of capital is so high that it is hard for Michelin to financially justify acquisitions which otherwise would make sound strategic sense. By addressing the excessively fragmented footprint of small plants in high cost countries, Michelin can ensure its brand and pricing premium translate into more attractive returns on capital and thus re-rate the valuation multiple of the shares making such acquisitions viable.

In the last couple of months, Michelin has made purposeful steps to tackle this issue. A series of recent announcements amount to the closure of 9m units or as much as 5% of total tire capacity. This will reduce the proportion of plant in high cost countries to a level in line with Goodyear and closer to Bridgestone too. While further progress is still required, the evidence supports our feeling that management understands and is prepared to act. We estimate that decisions to date already create opex savings worth a 5% uplift to Group EBIT.

We think Michelin is very cheap trading on a P/E of less than 10x and at 1x invested capital. The stock offers a 5% dividend yield, barely has financial debt and generates compound FCF growth of 5%p.a. The IRR based on a conservative exit multiple of 11x is particularly high at 24%.

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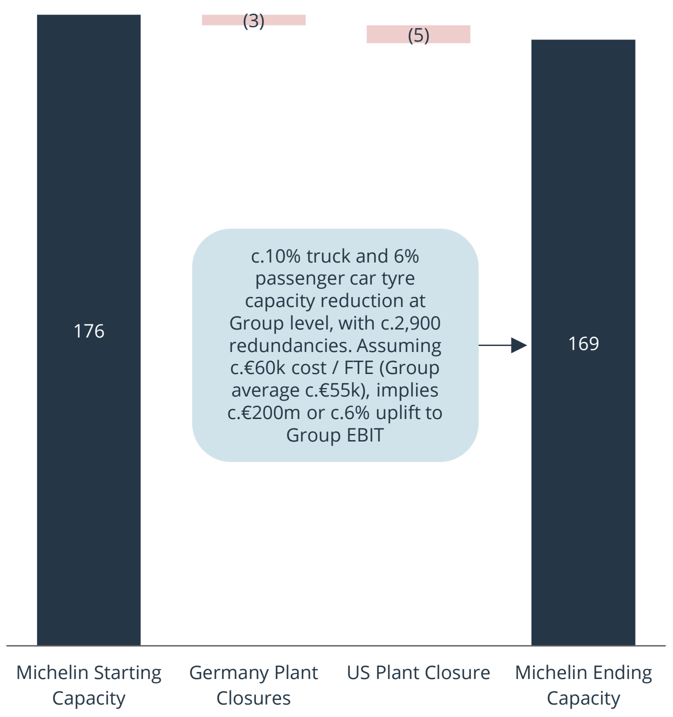
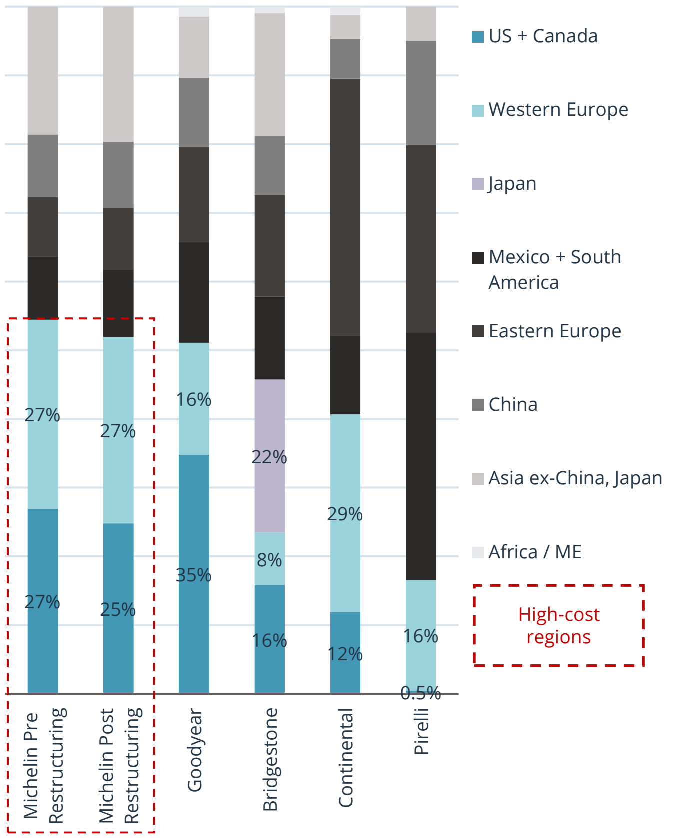
Michelin: Resumption in Closure of High-Cost Footprint
Capacity closure in High-Cost countries, m units, x



Source: Company reports, Lansdowne analysis

Michelin: Reduction In High-Cost Over Indexation
Manufacturer Capacity By Region, %



Source: Tire Business, Lansdowne analysis

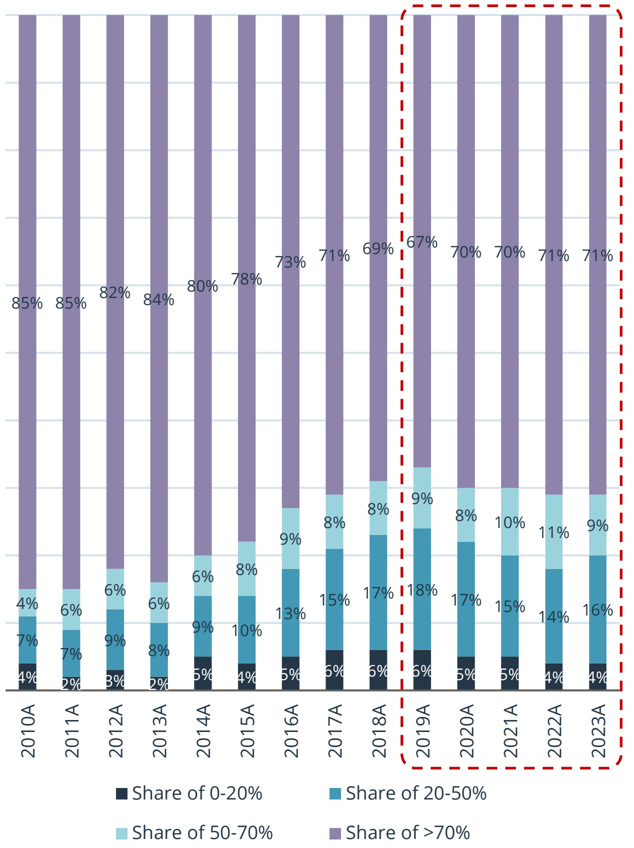
Ryanair

Ryanair contributed +140bps to fund performance. Despite consumer preference increasingly favouring experiences such as travel over tangible goods, industry supply is only just returning to pre-pandemic levels of 2019. Flag carriers and smaller competitors struggle to fund capacity expansion leaving Ryanair the principal source of regional growth to the air transport eco-system. This ensures favourable terms of trade for the airline with its key counterparties such as airports, pilots and manufacturers driving a cost advantage versus rivals that manifests in a virtuous cycle of market share gains and higher returns. As the chart below shows, this positive dynamic has become especially pronounced since the pandemic with the share of routes on which Ryanair has a 70% share rising again to c. 70%.

Given Ryanair's greater scale today, it can afford to slow capacity growth while still adding more passengers (pax) each year than when it was an immature airline. To illustrate, in the period from 2009-2019, Ryanair grew by 9% CAGR adding 8m pax p.a. whereas we expect growth to slow to 5% CAGR over 2024-2030 but this still implies a larger absolute increase in pax of 10m p.a. This dynamic should allow Ryanair to maintain attractive terms of trade with its ecosystem whilst simultaneously enabling strategy to shift from a focus solely on load factors towards greater ticket price maximisation.

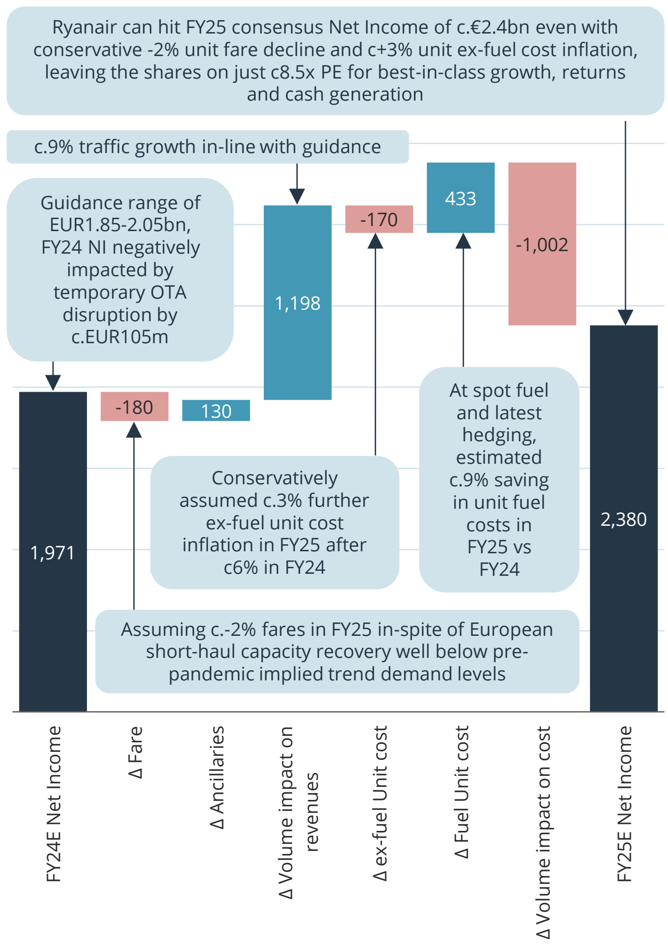
More near term, we think Ryanair is likely to have locked in next year's oil hedge at low prices which on our calculations implies that earnings estimates are potentially too conservative. We think the consensus for net profit requires fares to fall by -2% or in other words already builds in a recession that very few other cyclicals currently do. In terms of valuation, the stock is trading on a Mar 2025 PE of 8.4x, a FCF yield of 13% and EV/IC of 1.5x despite a ROIC of 21%. The IRR is similarly very attractive at 33% in our opinion.

Ryanair: Best-in-Class Route Network Improving Further
Ryanair Capacity By Route Market Share, %



Source: Citi Research, Diio Mii, Lansdowne analysis

Ryanair: Trading on just 8.5x P/E On De-risked Numbers
FY24-25E Net Income Bridge, €m



Source: Lansdowne analysis

Sanofi

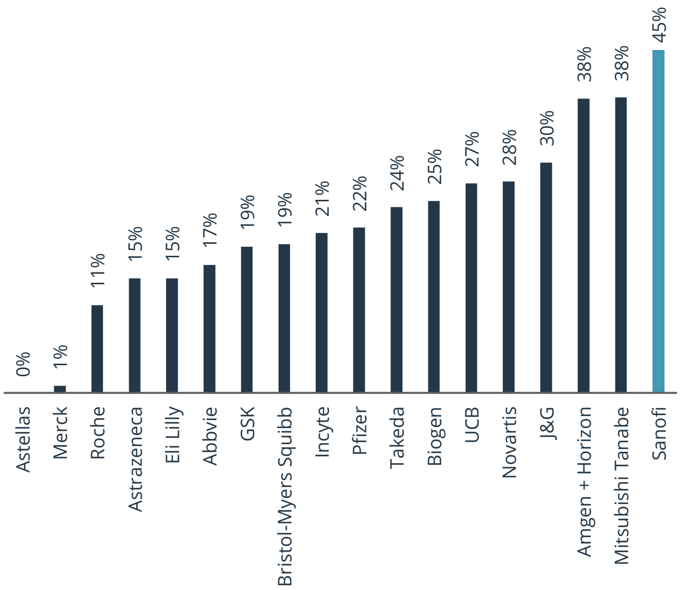
Sanofi had a tough Q4 (-39%) which was a principal driver of fund underperformance of c.-39bps in the period. The market responded negatively to a strategic pivot towards greater investment in research and development, but we think it was an appropriate decision.

We think Sanofi is undergoing a cultural transformation that was badly needed and greatly reduces terminal value risks. Priced on a PE of 11x or a 30% discount to peer group, any hint of success offers material upside. Conversely downside is rather limited given 4% dividend yield and balance sheet strength.

The decision to prioritise immunology at the expense of oncology makes a lot of sense to us. Firstly, oncology is much more competitive, IQVIA estimate that this therapeutic area represents as much as 40% of total industry pipeline. Competition is also highly fragmented with the top 12 players managing only 457 of the 2,200 trials underway at present or less than 20%.

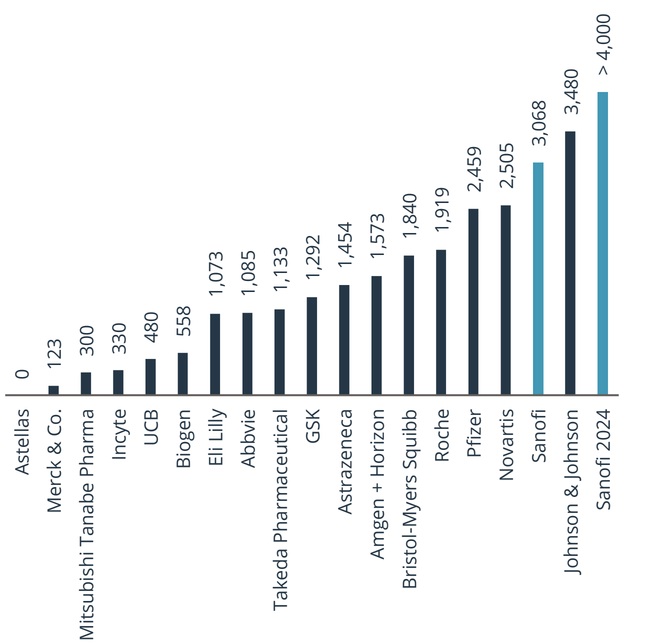
Conversely, immunology has a number of favourable characteristics, both more generally and also specifically given Sanofi's incumbent position. Key immunity pathways are associated with multiple diseases thus offer the potential to amortise the cost of researching a single mechanism of action over many different end indications. Moreover, multiple blockbusters can coexist simultaneously given biologic penetration is starting from a low level and translational pathways are heterogenous and manifest in patient populations differently. Competition is also less intense with the top 4 players representing 30% share, 3x more than in oncology whereas the global immunology market is still expected to grow as much as 9% CAGR over the next 5 years (gross of LoEs to which Sanofi is not exposed).

Sanofi: Clear Focus On Immunology
Immunology as % Company's Total Trials



Note: Data based on pipeline programs as of 18 Dec 2023, SAN includes announced programs on R&D Day, Immunology includes respiratory and dermatological indications that are immuno-related and excludes immuno-oncology
Source: Company Data, Lansdowne Analysis

Sanofi: Outspending Peers in Immunology
Estimated Immunology R&D Spend in 2022, $m



Note: Spend estimated in 2022 unless indicated otherwise
Source: Company Data, Lansdowne Analysis

Sanofi seeks to replicate the success of Humira in this space and has already partly succeeded via rolling out its $10bn drug, Dupixent, across 7 indications. Ahead of patent expiry in the 2030's, R&D commitment to accelerating this strategy is being increased and thus the expected return on the investment is a critical question. Acknowledging Sanofi's historic track record, we think that a lot has changed internally under new management with ex-Humira and ex-Dupixent people now filling many of the critical leadership roles across prioritised clinical projects. Our proprietary analysis aggregating therapeutic-area specific data across the competitor universe also demonstrates Sanofi's leading position. Following the uplift, we estimate Sanofi's R&D investment in immunology will be c. $4bn, making it the largest player and at least 1.5x the size of any other player except J&J. We calculate that 45% of trials for Sanofi are in immunology and that the group represents 16% of all trials currently underway. This translates to the greatest number of immunology assets in pipeline and commercial stages (19), the largest number of asset-indication pairs (33) and the 2nd highest potential first-in-class pipeline drugs (21).

With the stock underpinned by a solid balance sheet, dividend and on an IRR of 11%, we think the optionality skews favourably especially given the recent move, although it appears at time of writing that a recovery has potentially already started.

Rentokil

Rentokil was the biggest detractor to performance in Q4 (c.-53bp) as Q3 organic growth in the US pest control business disappointed (2.8% vs 5% consensus) and divisional guidance for FY margin expansion was reduced from over 200bps to 150-200bps. While group-level targets remained unchanged, the market is concerned about execution of the integration of the recent acquisition of Terminix. Indeed, this was not helped by the CEO blaming slower end market activity followed swiftly by two competitors, Rollins and Ecolab, reporting much stronger revenue growth.

We have deployed a variety of resources to assess this issue including a proprietary survey of owners and senior managers of 50 US outsourced pest control providers. We have obtained timely data on industry-specific labour activity from the US Bureau of Labor Statistics (BLS), spoken to over 10 former employees of the merging entities including ex-top management and trawled the podcast library of the leading M&A broker, a US local pest control boutique.

We conclude that the company's claim that industry growth has cyclically slowed, so that it's not just Rentokil, is indeed accurate. BLS data shows aggregate pest control industry employee growth running at 12% March to July but flat in August and September. Similarly, average pest control industry weekly earnings growth has fallen from 11% in January to July to 3% from August to October. We do however also think that Rentokil has lost some market share which would also explain the strong results of its largest competitors.

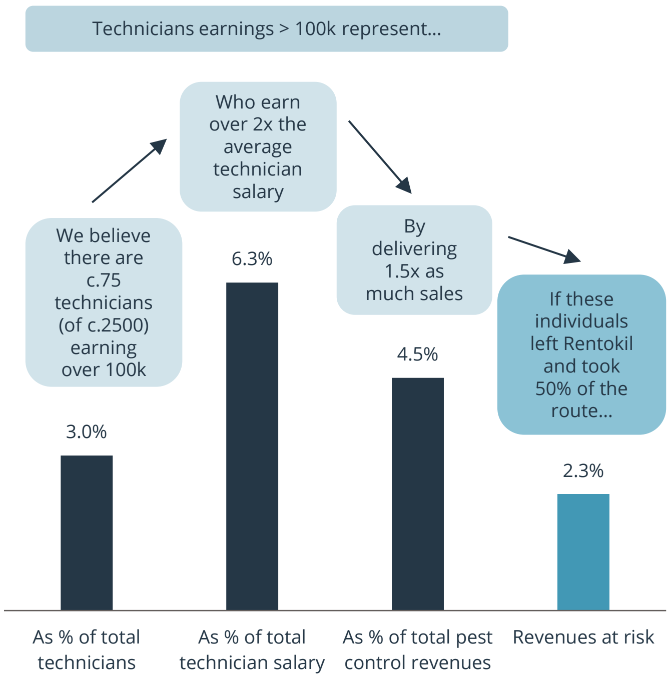
During a major integration, a degree of employee and customer attrition is perhaps inevitable. In a controlled fashion, it is even desired given the objective to reduce the number of combined branches and shrink the excess footprint by 30%. Critical to the success of the merger will be a well-structured package to harmonise the pay plan of the two companies. Although the market is concerned that technicians on lucrative Terminix routes will leave rather than accept lower pay, we think the problem is of a solvable structure and would require a management mis-step to destroy shareholder value.

We ascertain that the salary range across Terminix's pest technicians ($35k-$110k) is slightly wider than at Rentokil ($42k - $90k). Following discussions, we think about 75 frontline staff earn about $110k each which means the top-earners comprise 3% out of the total number of technicians at Terminix of 2,500 but represent 6% of the total salary cost. Billing $50k in sales per month compared to the company average of $33k, these same top-earners generate an estimated 5% of total revenues. The Pareto Effect describes many industries (e.g. consumer goods) in which only 20% of the input drives 80% of the output. Here, c. 5% of the cost base drives c. 5% of the revenues which would seem to limit the downside. Becoming self-employed is difficult for a technician as route density is key and the required customer defection rate is too high a hurdle. Moving to a competitor is possible but the value is typically in the route, and that would most likely have to change at another company.

We agree that the integration will take longer, and we think the company is likely to err on the cautious side. With resources so internally focused, we also think marketing spend may be increased as we estimate it is 1% of sales less than Rollins. Combined with slower industry growth, near term estimates are likely to reduce by 5-10%, at least for the division.

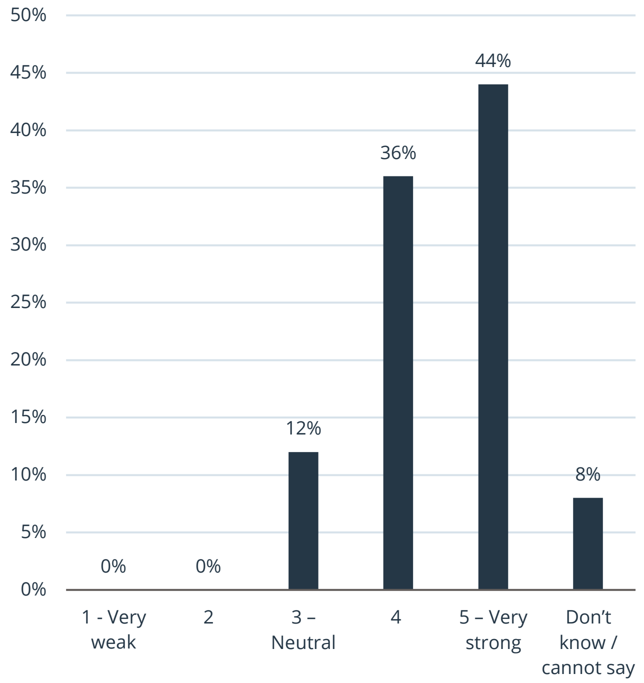
Nevertheless, it is rare for a relatively economically insensitive industry to grow 5%p.a. in hard currencies driven by compelling structural tailwinds such as rising pest prevalence, propensity to outsource and population migration. It is rarer still for a merger to result in the two largest players, Rentokil and Rollins, collectively controlling over 50% of the US market, when route density drives network economics. It is also we think worth noting the scope for margin uplift potential given Rentokil will be c. 1.4x the size but currently has a 300bps lower EBIT margin (c. 18%) than Rollins despite the latter's guidance for further improvement.

Terminix: Limited High-Paid Technician Attrition Risk %



Source: Lansdowne analysis

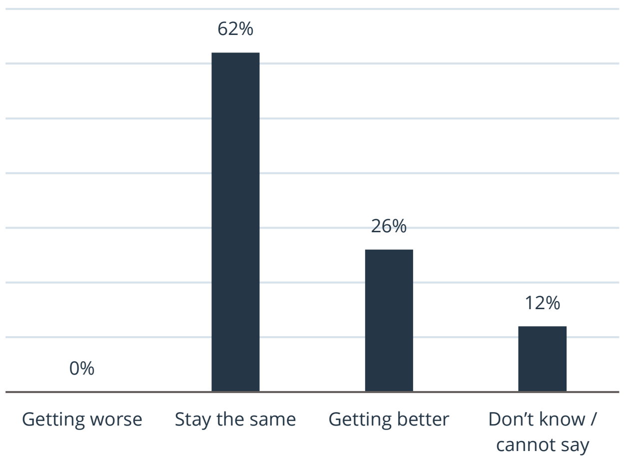
Q: How Do You Rank Terminix As A Competitor On The Following Metric?



n = 50
Source: Lansdowne Proprietary B2B Survey of US Pest Control Businesses. Data as at November 2023

The view of 50 competitors in our proprietary survey is that the Terminix brand remains strong and on a marginal basis is actually strengthening. Indeed, consumer polls suggest that Terminix is the most recognised residential pest services provider in the United States and a household name. Ultimately, we think that either the current management team will execute the integration or be replaced but that the businesses are neither tangibly nor intangibly broken in the eyes of the customer. The problem is therefore of a fixable structure either way and having de-rated from 22x to 18x PE, the distribution of equity outcomes is skewed positively over time.

Q: How Do You Think Terminix Is Performing On The Following Metrics?
Strength of Brand



n = 50
Source: Lansdowne Proprietary B2B Survey of US Pest Control Businesses. Data as at November 2023

Rentokil: Asymmetric Risk-Reward Pay-off At Spot
% Upside / Downside In Various Operating Scenarios

	Low Case	High Case
Terminal Organic Growth	3%	5%
Terminal Operating Margin	17%	18%
Terminal P/E Multiple	16	24
% Downside	-12%	45%
% IRR	-1%	28%

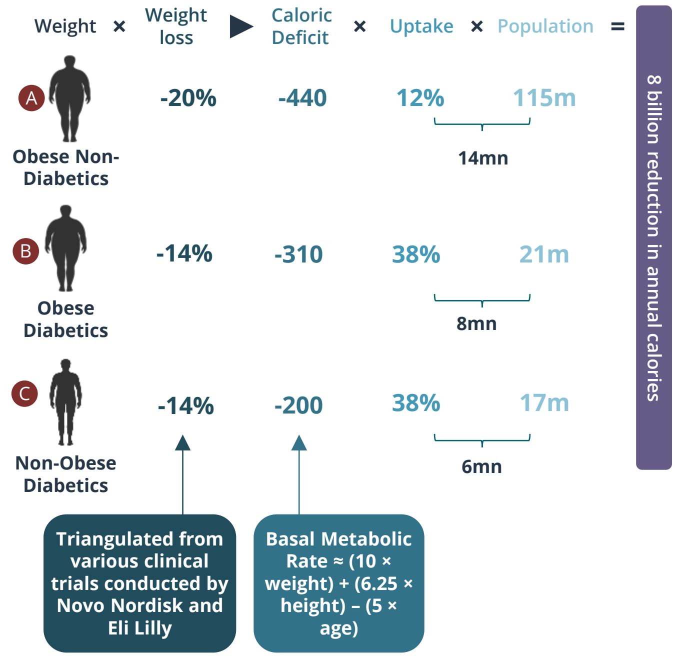
Source: Lansdowne analysis

Nestlé

The core of Nestle is dominance in high potential categories such as pet food and coffee and we estimate that 60% of the portfolio has a market share above 20%. Under the tenure of the CEO, these strong franchises have increased from 40% to 60% of Group and organic growth has accelerated.

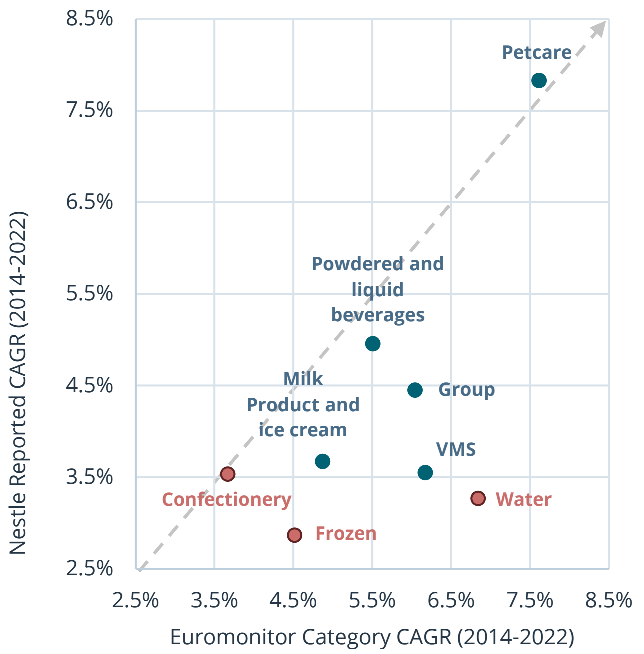
The issue is with the remaining 40%, where potential for negative convexity from scale in mature categories is increasing as demand uncertainty rises. GLP1 usage is a headwind but only a modest one, certainly versus expectations. We have combined a proprietary consumer survey, a calorific model that we have built with empirical evidence of GLP1 users' changing consumption habits to assess the impact. Our two key conclusions are that only 3% or 8 trillion calories by 3030 are at risk and that the impact would be less than 1% to Nestle group revenues. Crucially, coffee habits also appear relatively unaffected by weight loss drugs and in any event coffee consumption is not correlated with excess body mass.

GLP-1s: c8tn / 3% Calorie Reduction vs Counter Factual
GLP-1 Uptake and Calorie Reduction By Cohort, %, x



Source: Lansdowne analysis

Nestle: c20% Revenues Slow Growth With Secular Risks
Nestle Segment Organic Growth (y-axis) vs Euromonitor Category Growth (x-axis), %



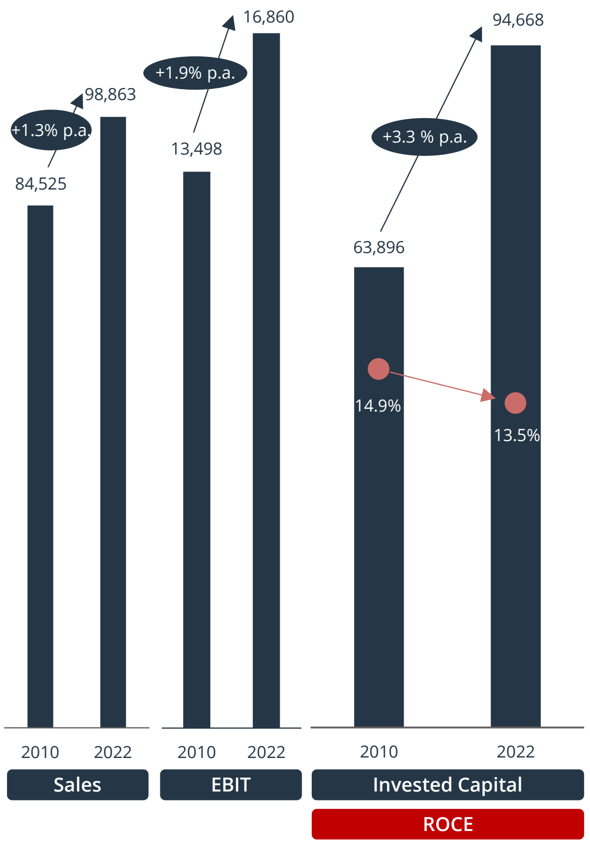
Source: Euromonitor, Company Filings, Lansdowne Analysis. Note: Frozen uses Prepared Dishes And Cooking Aids segment organic growth for Y-Axis

Rather we think that Nestle is still too exposed to categories such as frozen, chocolate and water that prevent it becoming a net beneficiary of potential secular change in consumer behaviour in developed markets. These are non-core in our view and we estimate could be divested for CHF35bn, unlocking potential to create positive optionality with reduced tail risks and without upfront value destruction. Unfortunately, we think the company may be unwilling to act 'radically' at this time and thus more evidence will be required first.

In developing economies, Nestle has not really succeeded in outgrowing its early coffee and dairy heritage yet, and at current deal multiples the opportunity to expand in India and more broadly in pet are limited at this time. Nestle's sales in its two large EM markets, China and Brazil have actually shrunk in hard US Dollar terms since 2013 evidencing how difficult the challenge for this industry to remain relevant really is. Indeed at a group level since 2010, Nestle's sales are +1% CAGR, EBIT +2% and ROCE -150bps in USD. Given these metrics, we think Nestle may need to be more ambitious both with respect to review of its portfolio but also in maximising productivity. While revenue and EBIT per employee are up 20-30% in the last 10 years, neither have reached levels comparable with the wider US peer group and we think P&G's transformation represents an analogue to which to aspire.

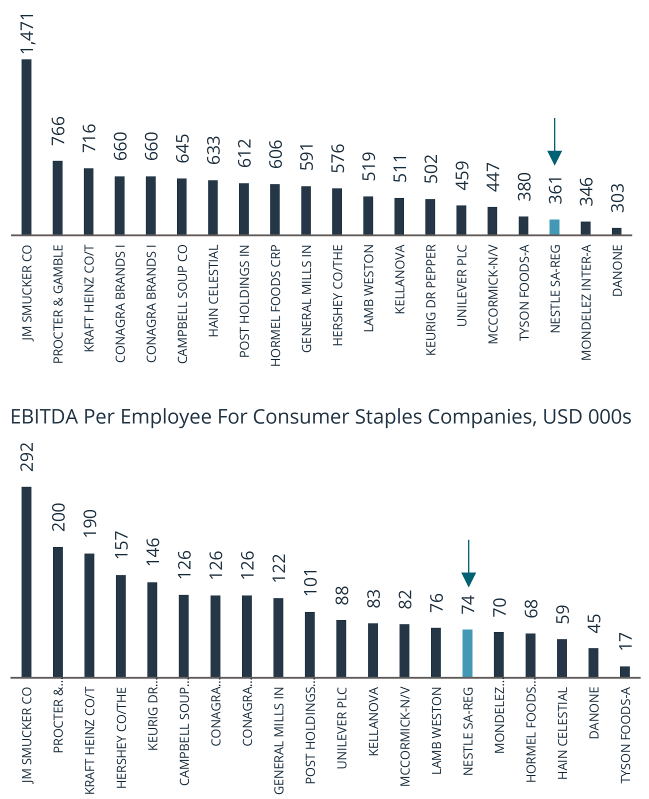
To put it together, we think the core of Nestle is very attractive and the GLP1 risk is probably over-stated. Management is executing operationally well and valuation has already de-rated. The share is still likely to do well should nominal growth and interest rates decline. However, the non-core business should be exited in our opinion and overall productivity focus further accelerated. Relevance amongst fast changing consumer habits is difficult to maintain and thus we decided to reduce our position.

Nestle: Limited Growth In Hard Currencies (2010-22)
$ m, %



Source: Bloomberg, Lansdowne analysis

Nestle: Employee Productivity Still Lagging Peers
Revenue and EBITDA / Employee, $ 000s, 2022



Source: Bloomberg, Lansdowne analysis

Conclusion

Despite double digit inflation and nominal GDP growth of over 40% in the last few years, whole-economy debt ratios are flat or even up versus pre-pandemic levels. The academic literature reviewed in this letter intimates that primary surpluses or high real growth rates have typically been required for a successful financial repression to reduce excess indebtedness. At present, neither the economic nor political conditions seem likely to produce this thus the pathway to the most appropriate policy remains unclear and conditions likely to stay volatile.

In the immediate future, the consumer still has excess savings from the post pandemic fiscal support and we expect US consumption to continue to be responsive. A slowdown to mid-cycle levels in 2024 is our central case but the important point here is we expect that would feel a very different environment with respect to corporate pricing power and earnings growth to the last few years. Active managers could stand to benefit if so.

We have conducted an extensive review of 2023 quarter performance and made some adjustments to the portfolio. This has increased the focus within the less-economically sensitive portion of the portfolio on net beneficiaries of secular disruption, a dynamic that our analysis concludes has accelerated notably last year.

Turning to lead indicators, adding a fourth analyst has expanded our ability to differentiate through deeper understanding of companies and I am pleased by the quality of the work as measured by the degree of primary evidence-led proprietary analysis that we have created. Interactions with managements of potential investee companies and industry experts has risen by a further 10% this year.

We are very conscious of fund returns and highlight the attractiveness of the IRR of the portfolio at 12% currently, which would seem to a yield a substantial risk premium buffer, irrespective of whether rates settle at 3% or 5%.

As a result, we are optimistic and as always would like to thank our investors for their continued support and are confident that it will be rewarded.

Daniel Avigad, Shashwat Verma, Darren Ho and Valerio Dussizza