LONG EQUITY

Annual Letter

Long Equity Fund

2024

23 December 2024

Dear Reader,

The portfolio's market performance in 2024

At the time of writing, **the portfolio is up 22.1% year to date**. Only four of our positions outperformed the S&P 500 this year (see table below). Unlike last year, the share price growth of our positions hasn't always been linear, with only **Constellation**, **Fair Isaac** and **NVIDIA** demonstrating 1-year share price linearity greater than 0.90, and all positions have linearity less than the S&P 500.

Company	YTD CAGR	1yr Linearity
NVIDIA	188%	0.94
Fair Isaac	84%	0.93
Fortinet	66%	0.79
Constellation Software	37%	0.95
S&P 500	26%	0.98
Mastercard	25%	0.83
Visa	22%	0.72
Microsoft	17%	0.61
KLA	15%	0.28
Cadence	15%	-0.13
ATOSS	11%	0.35
MSCI	9%	0.37
Applied Materials	8%	-0.03

The positions new to the portfolio this year are **Fortinet** (up 65% since first buying in January), **KLA Corp** (down -14% since first buying in June) and **ATOSS Software** (down -5% since first buying in November). This year we sold **Alphabet** in March, **ASML** in June and **Novo Nordisk** in December.

The portfolio's quality in 2024

We continue to endeavour to only own the highest quality growth companies available. The below table sets out the portfolio's weighted average for a selection of financial metrics.

Financial metric	Portfolio
5yr FCF/share CAGR	24%
5yr Revenue CAGR	18%
FCF ROC	38%
FCF Margin	35%
FCF Margin Expansion	6%
SBC/OCF	10%
5yr Δ Share Count	-7%
Long-Term Debt	33%
Interest Expense	6%

The 5-year FCF per share annualised growth rate is currently 24% (compared to 20% last year), while the 5-year revenue annualised growth rate is 18% (14% last year). The 6 percentage point spread between revenue and FCF per share reflects that our portfolio companies are selling more, raising their prices (typically above the rate of inflation) and becoming increasingly efficient through cost cutting. The FCF margin is 34% and has expanded by 6 percentage points over the last 5 years, supporting the pricing power of these companies. The return on capital is considerably above average at 38% (compared to 31% last year).

Share-based compensation continues to be employed by many companies for attracting and retaining talent. We monitor (i) the ratio of share-based compensation to operating cash flow (SBC/OCF), and (ii) the 5-year change in share count, to help get a sense of the cost and dilutive effect of this practice. While a 10% SBC/OCF is not a low figure (also 10% last year), this is considerably below the +25% figure seen in some companies. It's also comforting to see a decline in share count over the last 5 years by -7%, which further concentrates the interest of shareholders.

With regard to balance sheet strength, our holdings are conservatively financed, with long-term debt representing 33% of the balance sheet and the cost of servicing this debt (interest expense) being only 6% of operating profit. In conclusion, we continue to own conservatively financed, cash-generating, price setting, compounding assets.

The portfolio's valuation in 2024

The weighted FCF yield of the portfolio was 3.34% at the beginning of the year and, at the time of writing, is 2.71%. The 0.63 percentage point decrease over the last 12 months means that the portfolio is now more highly rated. This could be interpreted as the portfolio now being more expensive. But it's worth remembering that the companies in the portfolio have a high and consistent growth rate, which in our view justifies their valuation. The portfolio companies with the highest FCF yield are currently **Applied Materials** and **Fortinet**, while **Fair Isaac** and **Cadence Design Systems** have the lowest FCF yield. Time will tell whether valuation will be a headwind for the portfolio in the new year. It's worth noting that this time last year **NVIDIA** was the holding with the lowest FCF yield, while **Applied Materials** had the highest. **NVIDIA's** shares then went up 188%, while **Applied Material's** shares only went up 8% - suggesting that FCF yield is not the best predictor of short-term share price growth. Valuation will continue to be closely monitored and we remain mindful of valuation risk, but find comfort in the fact that high and consistent growth rates may more than justify these valuations.

The portfolio's turnover in 2024

One of the most significant changes to the portfolio in 2023 was reducing the number of positions from 23 to 12. Over the course of 2024 we maintained this concentration between 11-13 positions (we currently have 12) and intend to continue to do so in 2025. It is worth highlighting that despite being a concentrated portfolio, it still benefits from diversification, given that all our holdings are multinationals, generating revenues from across the globe and from a wide range of products and services. The portfolio is invested in a range of sectors including credit scores, cybersecurity, payment processing, semiconductors and software.

While concentration was the biggest change last year, this year we have increasingly looked to only invest in companies that have the following three qualities. Firstly, we continue to look for the optimal intersection between high growth and predictable growth. We continue to apply linear and exponential regressions to help us find the most consistent, least cyclical, quality growth businesses available. Secondly, we continue to look for companies providing mission-critical services to other businesses, ideally at a cost that is a small proportion of their customer's expenditure. It's our view that this is the foundation of pricing power. And finally, we continue to look for companies that are capital-light and asset-light. While it's great when a company can retain and reinvest their profits at high returns, we've become increasingly aware that capital-light compounders are capable of growing with minimal reinvestment, which results in both growing returns on capital, as well as growing free cash flow per share.

Outside of our portfolio, we maintain a watchlist of quality growth companies that we follow closely. This includes new names and also companies that we have held in the past. In software we follow **Cerillion**, **Fortnox**, **Qualys** and **TechnologyOne**. In semiconductors we follow **ASML**, **Lam Research** and **Synopsys**. In finance we follow **S&P Global** and **Moody's**. And in other sectors we follow **IDEXX**, **Mettler Toledo** and **Parker-Hannifin**.

To track turnover we monitor the number of companies in the portfolio that have been held for less than 1 year, which is currently 3 out of 12. 3 was also the average number over the course of last year and in 2025 we expect that to continue or possibly drop to 2. We will continue to prioritise only owning the highest quality growth stocks over having the lowest turnover. This means we won't hesitate to sell if the quality of one of our holdings deteriorates, or to buy if we think a company's quality and growth justify it having a position in our portfolio.

Final greetings

We look forward to 2025 and wish you all a Merry Christmas and a Happy New Year.

www.longeq.com @long_equity