

# Fundsmith Equity Fund

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## BCI CONFERENCE

*How do we identify great companies to invest in ?*

GREVILLE WARD

PARTNER

FUNDSMITH LLP

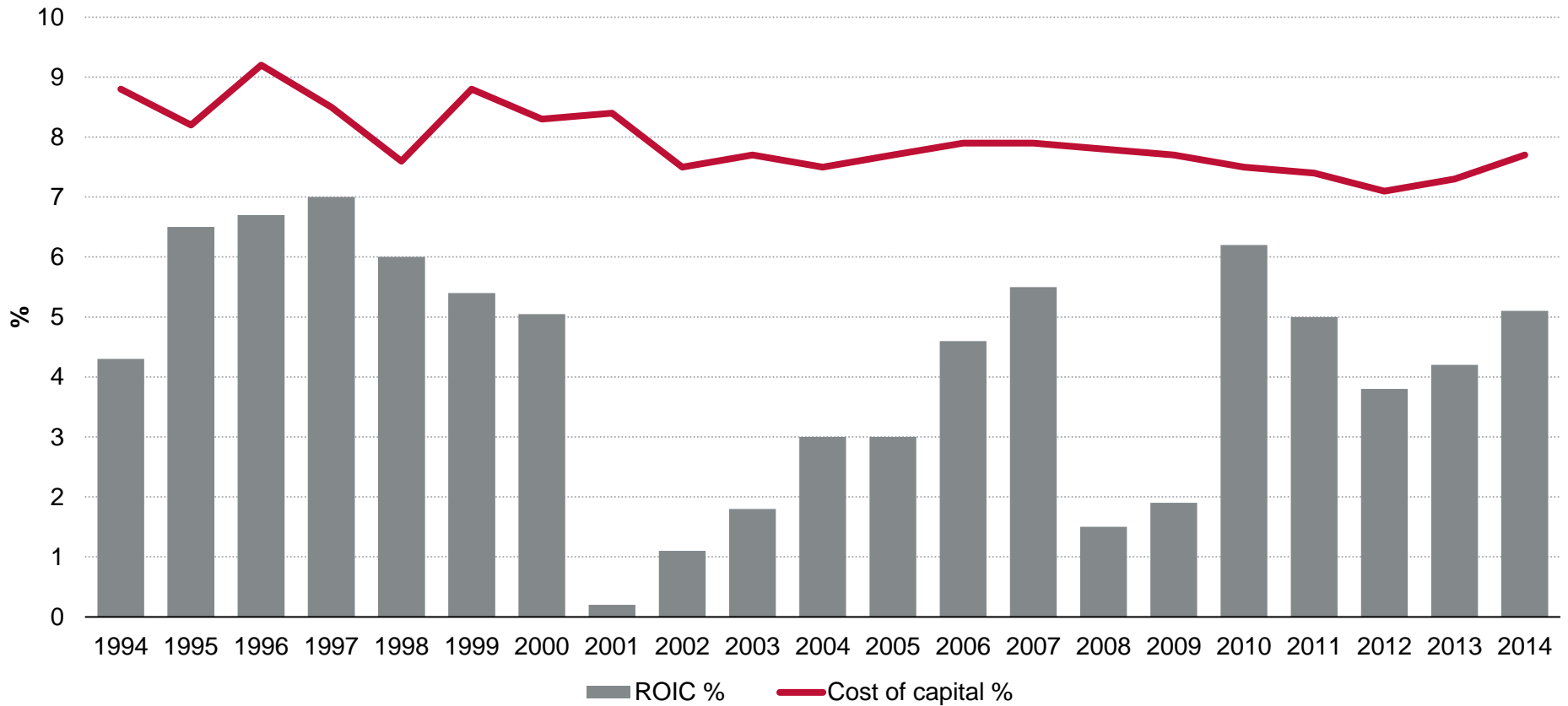
May 2024

## What did the Sage of Omaha say?

“The primary test of managerial economic performance is the achievement of a high earnings rate on equity capital employed (without undue leverage, accounting gimmickry, etc.) and not the achievement of consistent gains in earnings per share.”

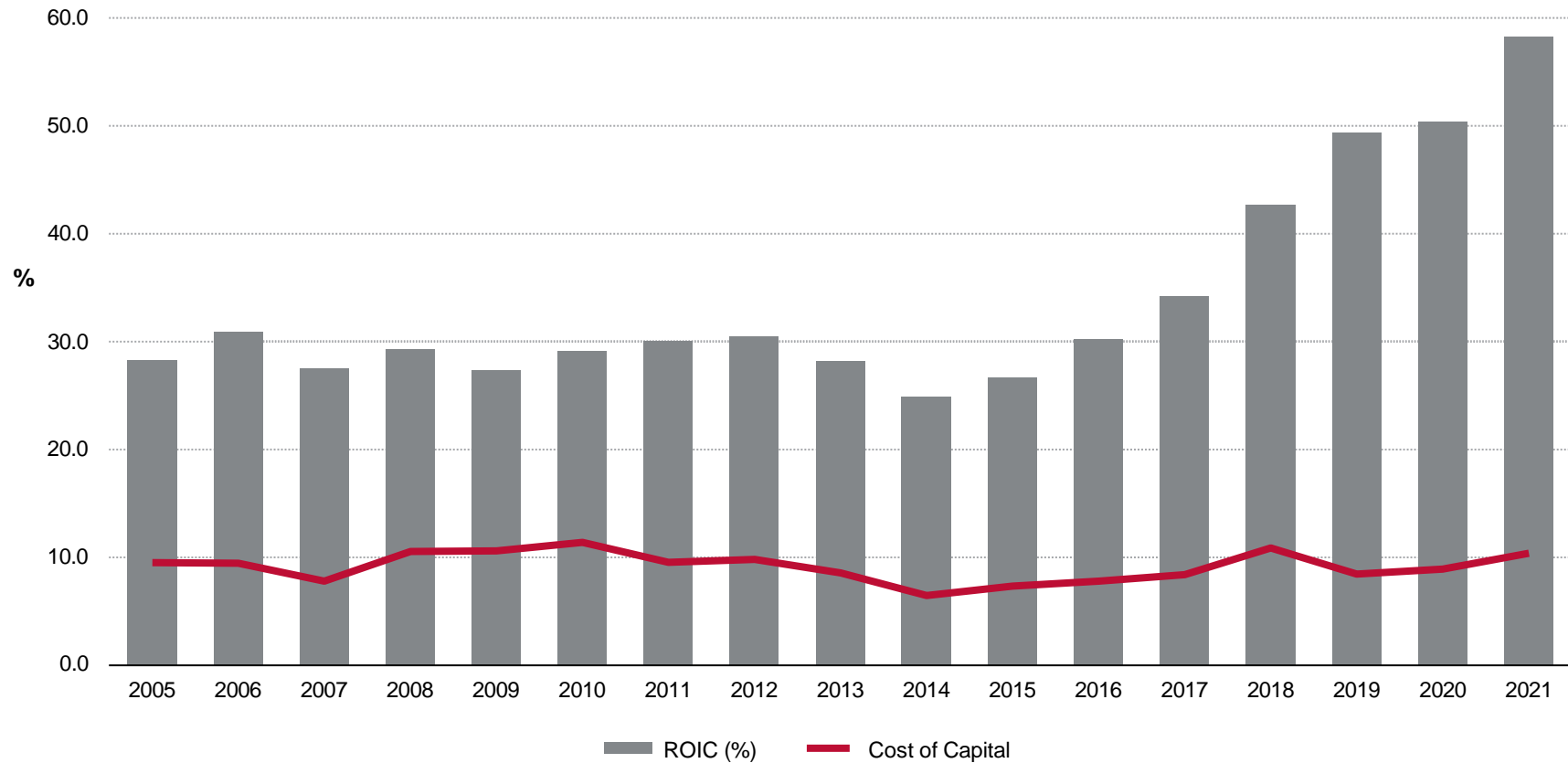
*Warren Buffett  
Berkshire Hathaway  
1979 Annual Letter to Shareholders*

# Airline industry cost of capital vs ROIC



# What a good company looks like

### IDEXX Laboratories



Source: Bloomberg, IDEXX Laboratories Report and Accounts, Fundsmith Research, July 2022

For illustrative purposes only

# Examples of good and bad businesses

"Best" businesses (2013-2022)				
Industry name	Number of firms	ROCE	WACC	ROCE-WACC
Tobacco	56	35.4%	6.9%	28.4%
Information Services	242	32.9%	9.3%	23.7%
Healthcare Support Services	460	28.8%	7.7%	21.1%
Advertising	362	25.9%	8.4%	17.5%
Household Products	589	24.4%	8.2%	16.2%
Computer Services	1,105	21.8%	8.4%	13.4%
Beverage (Soft)	100	20.3%	7.1%	13.3%
Retail (Building Supply)	98	20.2%	7.8%	12.4%
Business & Consumer Services	961	20.3%	8.0%	12.3%
Aerospace/Defense	278	20.4%	8.7%	11.7%

"Worst" businesses in (2013-2022)				
Industry name	Number of firms	ROCE	WACC	ROCE-WACC
Brokerage & Investment Banking	592	0.1%	5.3%	-5.2%
Bank (Money Centre)	596	0.0%	4.7%	-4.6%
Banks (Regional)	800	0.0%	4.6%	-4.6%
Financial Svcs. (Non-bank & Insurance)	1,089	0.5%	4.2%	-3.7%
Oil/Gas (Production and Exploration)	616	6.1%	9.5%	-3.4%
Air Transport	155	3.6%	6.6%	-3.0%
R.E.I.T.	792	3.1%	5.6%	-2.5%
Auto & Truck	154	5.9%	7.7%	-1.9%
Real Estate (Operations & Svcs)	730	4.6%	6.0%	-1.4%
Real Estate (General/ Diversified)	342	5.1%	6.4%	-1.3%

Source: Aswath Damodaran, Professor of Finance at Stern School of Business at New York University, Jan 2023 data.

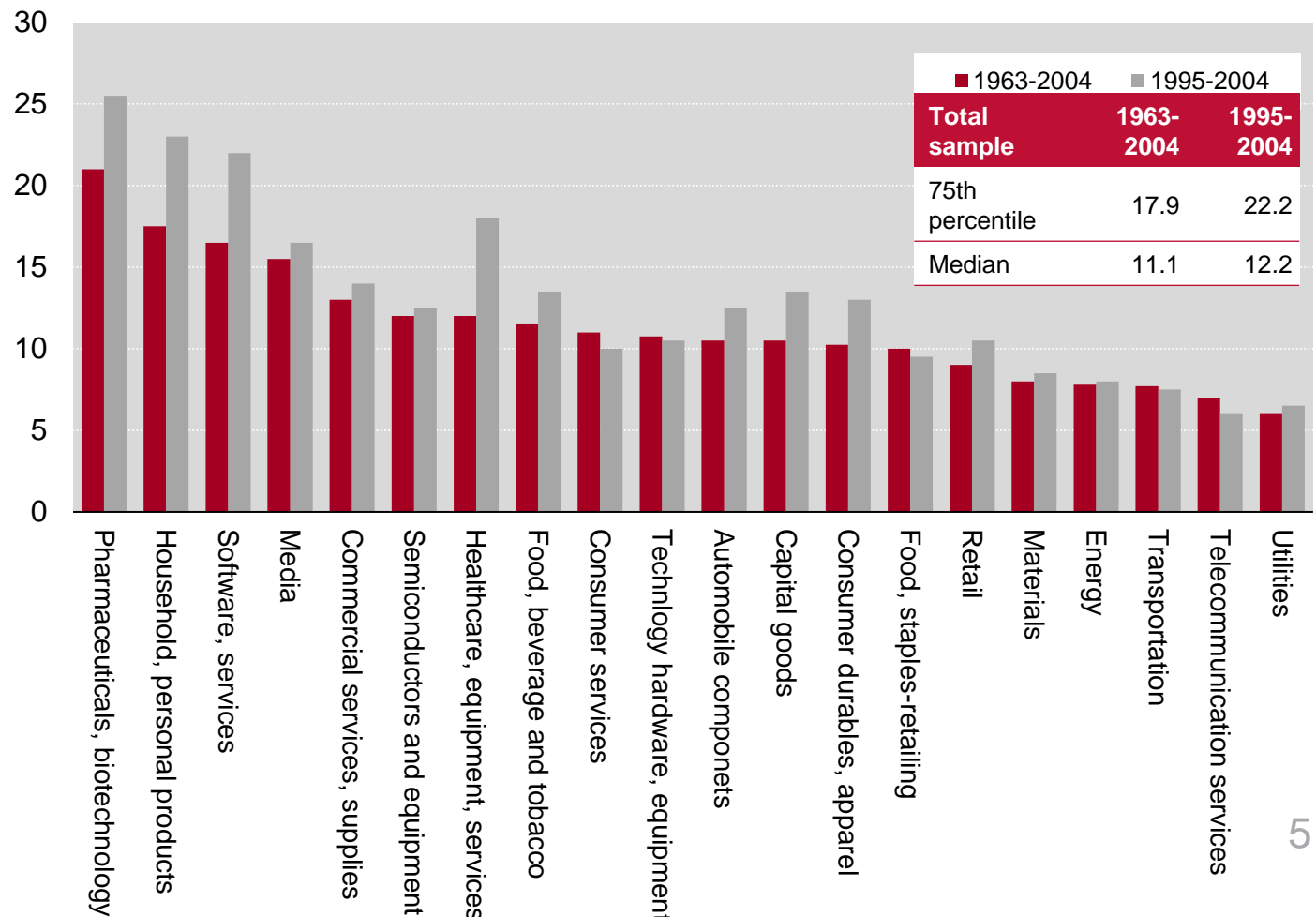
# Return on capital is persistent for industries

Median and annual Return On Invested Capital (ROIC), excluding goodwill, %

Return on invested capital for industries is stable.

Industries with poor returns remain poor industries over time.

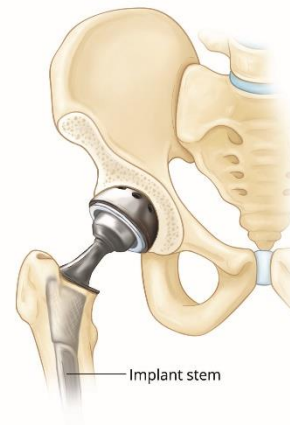
Being cheap or lowly rated does not make them good companies.



## What is a good company?

- High returns on operating capital employed in cash
- Growth driven from reinvestment of their cash flows at high rates of return
- Make money from a large number of everyday, small-ticket, repeat, predictable transactions
- Able to protect returns against competition
- Resilient to change, particularly to technological innovation
- Operating in sectors with intangible advantages: brands, distribution, installed base, franchisors

# Everyday repeat predictable events





Such as:

**Fundsmith  
Equity Fund**

**P&G**

**Nestlé**

**stryker<sup>®</sup>**

**OTIS**



**COLGATE PALMOLIVE<sup>®</sup>**



**BROWN-FORMAN**

# The Groucho Marx of investment

**Fundsmith  
Equity Fund**



BACARDI LIMITED



A FAMILY COMPANY

**B | BRAUN**



# Look-through ratios

	Fundsmith Equity Fund								S&P 500	FTSE 100
	2016	2017	2018	2019	2020	2021	2022	2023	2023	2023
<b>ROCE</b>	27%	28%	29%	29%	25%	28%	32%	32%	18%	17%
<b>Gross margin</b>	62%	63%	65%	66%	65%	64%	64%	63%	45%	41%
<b>Operating profit margin</b>	26%	26%	28%	27%	23%	26%	28%	29%	16%	15%
<b>Cash conversion</b>	99%	102%	95%	97%	101%	95%	88%	91%	76%	85%
<b>Interest cover</b>	17x	17x	17x	16x	16x	23x	20x	20x	11x	10x

**Source:** Fundsmith/Bloomberg.

ROCE, Gross Margin, Operating Profit Margin and Cash Conversion are the weighted mean of the underlying companies invested in by the Fundsmith Equity Fund and mean for the FTSE 100 and S&P 500 Indices. The FTSE 100 and S&P 500 numbers exclude financial stocks. Interest Cover is median. 2016-2019 ratios are based on last reported fiscal year accounts as at 31st December and for 2020-23 are Trailing Twelve Months and as defined by Bloomberg. Cash Conversion compares Free Cash Flow per Share with Net Income per Share. Percentage change is not calculated if the TTM period contains a net loss.

# Disclaimer

- Collective Investment Schemes in Securities (CIS) should be considered as medium to long-term investments. The value may go up as well as down and past performance is not necessarily a guide to future performance. CIS's are traded at the ruling price and can engage in scrip lending and borrowing. A schedule of fees, charges and maximum commissions is available on request from the Manager. A CIS may be closed to new investors in order for it to be managed more efficiently in accordance with its mandate. There is no guarantee in respect of capital or returns in a portfolio. Performance has been calculated using net NAV to NAV numbers with income reinvested. The performance for each period shown reflects the return for investors who have been fully invested for that period. Individual investor performance may differ as a result of initial fees, the actual investment date, the date of reinvestments and dividend withholding tax. Full performance calculations are available from the manager on request. Annualised performance shows longer term performance rescaled to a 1-year period. Annualised performance is the average return per year over the period. Actual annual figures are available to the investor on request. Highest and lowest is returns for any 1 year over the period since inception have been shown. NAV is the net asset value represents the assets of a Fund less its liabilities.
- This is a Section 65 approved fund under the Collective Investment Schemes Control Act 45, 2002 (CISCA). Boutique Collective Investments (RF) (Pty) Ltd is the South African Representative Office for this fund. Boutique Collective Investments (RF) (Pty) Ltd is registered and approved under the Collective Investment Schemes Control Act (No.45 of 2002).
- For any additional information such as fund prices, fees, brochures, minimum disclosure documents and application forms please go to [www.fundsmith.co.za](http://www.fundsmith.co.za).