April 2025

Church House Human Capital – Quarterly Letter

Sticking to the Process

It is an ugly market and there is no hiding from it. Donald Trump has driven his metaphorical gas-guzzling MAGA pickup straight over countless political and economic lines and in doing so markets are understandably running scared. Are Trump and his cronies bent on forcing their agenda at all costs or is this horrible brinksmanship that will be confined to history before long? They are playing with fire, as we saw in the early-1930s when the misguided Smoot-Hawley Tariff Act led US exports to fall from $5.2bn in 1929 to $1.7bn in 1933. The US economy may be mighty, but no man is an island. In his last public interview, Charlie Munger left us all with some uncompromising words for the years ahead:

"I have one bit of advice for tough conditions – suck it in and cope" – Charlie Munger, 2023

As is often the case with Munger/Buffett quotations, these are pithy and wise but have no footnotes to help us mortals. What does Charlie mean by 'cope' and how can we do this in a world where Trump and his experts are at large?

Our strategy for coping from a Human Capital Fund perspective is to have a clearly defined plan in place and to be rigorous in sticking to the process. As we put in our first investor letter nine months ago, we are looking to generate high long-term returns for shareholders by investing in businesses who 'believe in the power of steadily acquiring niche, cash generative businesses within a decentralised structure'. Every company we invest in must demonstrate:

1. **Decentralised Culture**
2. **Organic growth**
3. **Impressive financials (CASH IS KING)**
4. **Acquisitive**
5. **Exceptional leadership**

These are our clear and non-negotiable targets for every business that we invest in for Human Capital. We have found that the process of sticking to these five pillars often makes investment decisions non-negotiable, before we have had a chance to let emotion creep in. For example, over the quarter we exited our position in **Hexpol** after they appointed a new CEO who announced that their acquisition rate

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will be declining (one red flag) and that he is looking to centralise their operations (two red flags). We needed to look no further than these two facts before hitting the sell button. As the founder of Halma, David Barber said in his leaving speech to employees in 1997:

> *"There is tremendous virtue in having relatively simply, relatively understandable key targets."*

In this spirit, we have added another non-negotiable to our checklist for all investments:

> Can this business compound equity value at 15% annually for the foreseeable future?

We borrowed this shamelessly from one our Swedish holding companies who set themselves this target decades ago AND delivered the results many times over. 15% compounded is the equivalent to doubling shareholder value every five years – a lofty target for our holdings to hit, but when we have a focused portfolio of 20-25 positions, there is no room for businesses and management teams who are not striving to build something special. In the case of Hexpol, one can see that the foot was taken off the accelerator in favour of an easier life in the income sector – as Per Waldemarson (CEO of Lifco, one of our investments) told us at a recent meeting, 'compounding at 15% is bl**dy hard work, it is not for everyone'.

Top Ten Holdings:

		Weight	Listing
1	LIFCO	6.2%	Nordic
2	CHAPTERS GROUP	6.1%	Europe
3	LAGERCRANTZ GROUP	5.6%	Nordic
4	LUMINE GROUP	5.3%	Canada
5	BERGMAN & BEVING	5.0%	Nordic
6	DIPLOMA	5.0%	London
7	BROWN & BROWN	5.0%	USA
8	TOPICUS.COM	4.9%	Canada
9	VITEC SOFTWARE GROUP	4.8%	Nordic
10	WATSCO	4.7%	USA

Source: Church House

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Fund Activity

It has been a busy period for the team as most of our holdings reported their annual results during February and March. We have a whiteboard on our desk where all results are marked up for us to analyse in depth – full year results season can feel like a battle against the board at times, but we are pleased to report that we have now run our fine toothed-comb through all of these statements and all, but two positions passed with flying colours. We sold both outliers – Hexpol (already mentioned) and **TopBuild**, who in our opinion are falling short of our expectations on both organic and acquisitive growth. We also must confess to initiating a small position in **TFI International**, an acquirer of North American trucking companies, just before they released a profit warning. On review, we concluded that our investment case no longer held for TFI and so we swiftly sold the shares.

We have had a steady inflow of new money for the Fund and have been putting this money to work in core holdings that regular readers will recognise. To pick out two companies that we have met with recently that may be new to readers:

- **Chapters Group**: is a Hamburg-based holding company investing in small businesses across Northern Europe. Chapters own software businesses predominantly across a wide variety of sectors and the unifying thread is that they must provide ‘mission critical services to customers’ – for example, their operating company Solarys Software provides alarm and management software for fire departments, about as mission critical as it gets. We have met with their CEO, Jan-Hendrik Mohr, several times and we are backing him to generate exceptional returns for shareholders.
- **Momentum Group**: are relatively new to listed markets but has a wonderful pedigree, having originated from the Bergman and Beving school of Swedish compounders (as did our holdings **Lagercrantz** and **AddTech**). Momentum focus on acquiring businesses that sell into the industrial and infrastructure sectors. They have a clear and publicly stated target to grow earnings at 15% annually (sound familiar?) and are 55% owned by the Ax:son Johnson family, who provide long-term continuity for their equity base. If Momentum come close to achieving what Lagercrantz and AddTech have done (and we believe they will), then we will be happy shareholders.

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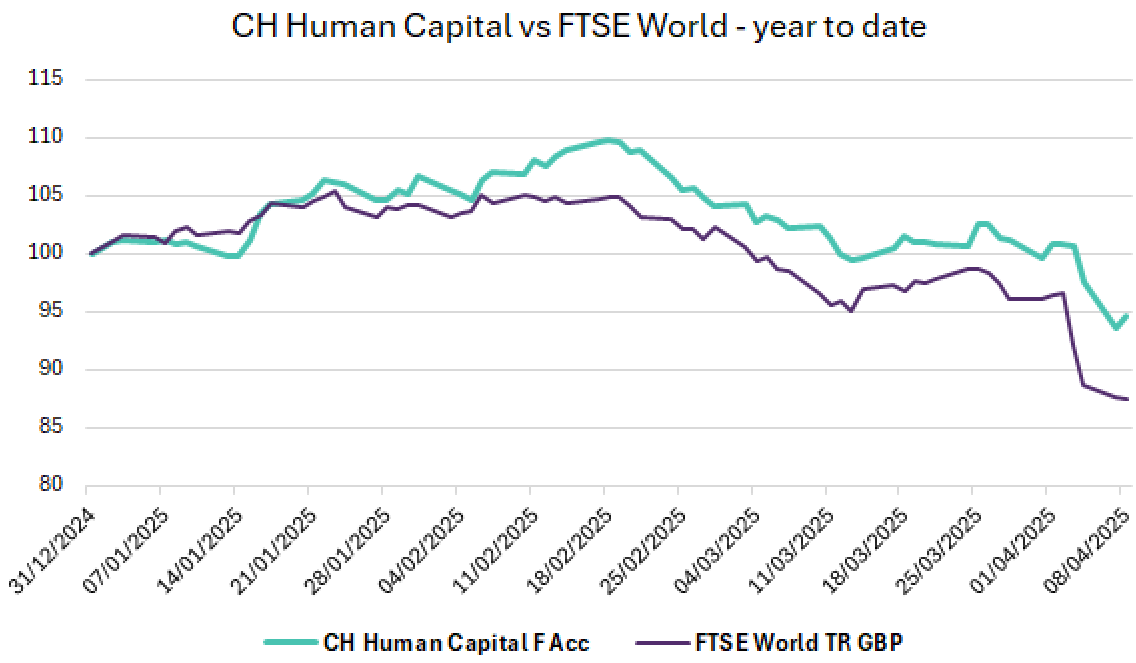
Recent Performance and Outlook



Source: Bloomberg

As both managers and shareholders in Human Capital, seeing the unit price come under pressure since mid-February is, of course, disappointing. We would make three points to co-owners of the Fund:

1. We have added to our personal holdings in the Fund over recent weeks.
2. We have been encouraged that our investments have to date proven more defensive relative to wider global equity markets, which is exactly what we would hope from a select portfolio of high-quality businesses backed, in most of our holdings, by cornerstone inside and/or family ownership.
3. At the Fund level, the numbers are compelling. Human Capital has a weighted average return on capital employed of 20.8%, sales growth of 15.3% and gearing of 1.4x. In our opinion that is an exceptionally high-quality portfolio, growing at a handsome rate, taking on only modest levels of debt. With the portfolio currently standing on an earnings multiple of 17x, one is not paying a hefty premium.

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Thank you

Thank you all for your ongoing support for the Human Capital Fund. We are delighted to be building a core group of likeminded shareholders with a fundamental understanding of long-term investment. We are always here to discuss the Fund or indeed any investment ideas, so please do call / email / knock on our door at any time.

Fred Mahon

April 2025

The above article has been prepared for investment professionals. Any other readers should note this content does not constitute advice or a solicitation to buy, sell, or hold any investment. We strongly recommend speaking to an investment adviser before taking any action based on the information contained in this article.

Please also note the value of investments and the income you get from them may fall as well as rise, and there is no certainty that you will get back the amount of your original investment. You should also be aware that past performance may not be a reliable guide to future performance.