LATITUDE
INVESTMENT MANAGEMENT

Dear Shareholder,

Last year saw a continuation of the bull market which has produced stellar returns since 2009, interrupted briefly by the crash at the onset of the pandemic. Our portfolio rose 14%[1], with broad based performance from some well-known, and lesser-known, holdings. As regular readers of our letters will know, we are highly doubtful that the US equity bull market can continue, given the starting valuations and margins, both of which are near the highest levels in history. Our portfolio is constructed in such a way as to avoid both of these risks and deliver ample returns to investors even if the US market, notably led by AI and the Magnificent Seven[2] stocks, does endure a period of weakness.

Indeed, our portfolio is dramatically different to the world market index[3] with the primary difference being the absence of exposure to the AI boom. When analysing this theme, we see major risks of overcapacity, and lower future returns on capital for the companies involved. We also note that during previous technological revolutions, patience was rewarded. Mobile phones changed the world in the 1990s, yet the intelligent trade was waiting until the release of the iPhone in 2007 and buying Apple shares then. Similarly with eCommerce in the 2000s, investors were rewarded handsomely for waiting a decade and buying Amazon shares once their leadership was clear. Chasing stocks which are already expensive, especially in the face of highly uncertain forward earnings, is a recipe for regret and we believe we can generate strong returns without taking this risk for our investors.

Below we show the updated figures for our portfolio, tracking our performance as well as the operating performance of our stocks using the proxy of GAAP earnings per share (EPS). In the past eighteen months our aggregated portfolio EPS has seen some non-cash impairments, notably through our energy stocks, Cencora, and our holding in Dollar Tree. These amount to around £1 of EPS and will flatter the growth rate to that degree in 2025 as these effects cycle out.

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[1] *Latitude Global Fund GBP Acc I share class*
[2] *Nvidia, Microsoft, Tesla, Alphabet, Meta, Apple and Amazon*
[3] *Our "active share" is 96%*

All performance data is quoted in local currency unless stated otherwise.

Year	Latitude Portfolio Earnings (EPS)	Latitude Portfolio NAV / Price
Nov 2016	£4.3	£100
Dec 2016	£4.7	£106
Dec 2017	£5.1	£119
Dec 2018	£6.0	£126
Dec 2019	£7.3	£146
Dec 2020	£7.9	£156
Dec 2021	£11.2	£199
Dec 2022	£13.0	£201
Dec 2023	£13.0	£211
Dec 2024*	£14.1	£240
CAGR	**15.6%**	**11.3%**

Source: Latitude, Institutional Share Class Performance

*We report the portfolio level EPS each year, allowing investors to track a proxy for the underlying growth in fundamental value. In last year's annual report, we estimated £14.2 EPS for Dec 2023. This figure has been revised in this report to £13 after the remaining companies finished reporting full year results earlier this year.

Over the long term, price follows value, and we focus our attention on delivering demonstrable value growth (through earnings and cash flow per share) within the portfolio. While we obviously like to see gains in both, we will focus predominantly on building operating earnings within the portfolio, paying less attention to short-term changes in price.

These earnings numbers are *unadjusted GAAP* figures reported by the companies. In many cases we believe that underlying earnings are higher, often substantially, although the transparency and comparability of showing unadjusted figures is likely of more benefit to shareholders. Over time, GAAP earnings should converge to our estimates of underlying earnings.

It's worth stating that GAAP EPS is one way to consider the underlying intrinsic value of a business. We always ensure that our portfolio is converting these earnings into actual cash flow and often consider other financial attributes as superior when analysing individual companies. That said, GAAP EPS is a *reasonable* proxy to allow shareholders to track our performance over time and is the one we intend to show in the future.

Our businesses are, in general, investing for growth so the GAAP figures do not represent the maximal free cash flow they can generate today, rather the optimal (in the view of management whose opinion we trust) amount to balance the rewards of today while protecting and growing the rewards of tomorrow.

The Year in Review

Volatility as a reward, not a risk

As we have mentioned in previous letters, we like stocks with volatile share prices, especially ones we don't own yet! The greater the volatility, the greater the opportunity for patient investors to trade at truly excellent prices. So it was with some excitement that we entered this year with the threat of major interest rate cuts in the US creating an opportunity we'd been waiting for to invest in a business we had been following since around 2020: **Interactive Brokers**, itself a beneficiary of market volatility.

As it happens the company was our best performing stock for the year, up c.110%. We are even more excited today than we were a year ago about the business' prospects, although we have trimmed the position back post US election. As readers will know, the company operates an online stockbroker which is the fully automated, lowest cost provider[4], with, by far, the best availability of financial instruments. The platform is so good that an increasing number of sophisticated hedge funds are using it for their trading rather than traditional brokers like Goldman Sachs and Morgan Stanley.

2024 was another extraordinary year for the company. The number of accounts grew almost 30% to 3.4m and the number of trades executed per account grew almost 20%, with a particularly strong development since the election of Donald Trump in November.

As we highlighted in our first quarter letter in 2024[5], The company makes more than half of its profit from Net Interest Margin (NIM) and the fact that rate cuts were lower than expected helped profits comfortably beat expectations. We like the company's simple and fair approach to paying interest on customer's cash balances. Above a certain size per account, the company pays local base rates less 0.5% on all cash accounts, in stark contrast to competitors who pay close to nothing.

The stock started the year on 13x earnings and ended it at 25x. 2025 will likely bring another year of 30% account growth, to close to 4m, and we believe that, over time, 10m or higher is easily achievable. The company also has a balance sheet sporting excess capital of $16bn, should they decide to start returning it to shareholders or use it productively, then the multiple paid would look very low.

[4] *Barron's Ranking of Best Online Brokers*
[5] *Latitude Global Fund Quarterly Letter Q1 2024*

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LATITUDE
INVESTMENT MANAGEMENT

Banking on the Banks

It was another very strong year for our US bank stocks with **Goldman Sachs** delivering +52% total return, **JP Morgan** +44% and **Bank of America** +34%. During the year we sold our position in Goldman Sachs which we had held in our equity strategy since the launch of the firm in 2016. It had been a good stock for us, generating more than 20% annualised returns. The shares have re-rated significantly and today trade at 1.8x tangible book value and 14x PE. From this starting point we saw better relative opportunities elsewhere.

Two years ago, when rates rose rapidly and Silicon Valley Bank failed, the sector was in crisis; it's precisely in these moments of crisis when great businesses can thrive.

JP Morgan saw the benefits of its opportunistic First Republic acquisition come through with incremental profits from the deal exceeding the initial target by 3x. Misplaced worries about Bank of America's held-to-maturity securities portfolio (as discussed in our Q1 2023 Investor Letter[6]) have gradually faded and the rollover of those lower yielding treasuries at higher current yields now represents a strong tailwind to their revenue growth ahead. The US banking sector continues to consolidate from a fairly fragmented starting point: JP Morgan's share of non-interest-bearing deposits in the US (think "current accounts") now stands at nearly 16%, up from 12.5% pre-Covid (we estimate ~15% excluding the First Republic deposits). We expect JP Morgan's share gains to continue not least thanks to its unmatched investment in technology which is also ideally positioning it to capture the benefits of increased automation over time.

While the US banking system is willing and very able to lend, loan growth in recent years has been weak thanks to muted loan *demand*. Leverage for both households and corporates today is low. The economic expansion post-Covid has been income not credit driven (and therefore could not be more different to the expansion pre-financial crisis). This means credit risks to banks are lower. There are also tentative signs of a pickup in lending already and a more dramatic acceleration represents a notable positive opportunity in 2025.

We continue to view JP Morgan and Bank of America as offering attractive long-term structural growth, inherently linked to the outperforming US economy, at attractive through-cycle returns on capital. Valuations are still acceptable for that growth and profitability. After a long difficult period of recovery and regulation post-GFC, the next 5-10 years could be much more favourable for the US banks. A new higher neutral rate of interest vs pre-Covid could see prolonged higher

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[6] *Latitude Global Fund Quarterly Letter Q1 2023*

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profitability from interest-free deposits and under the new Trump administration we are likely to see an improved regulatory environment benefiting capital returns as well as supporting M&A revenues.

Visa had a strong year, returning 22%. Recent years have seen Visa shrug off a number of investor concerns, the passing of which has highlighted the strength of the business model. Fintech disruption concerns have abated as the higher interest rate regime increased the cost of capital to finance the very high customer acquisition costs facing new entrants. More recently, concerns shifted to payment volume growth which has been falling, from 10-12% to 6-8% as the 'cash to card' shift of personal consumption expenditures matures. Offsetting this trend is the growing monetisation of its payment technology services business (c. 25% of revenues) growing >20% per annum, itself accounting for 4-5% of revenue growth per annum. These services span areas such as business-to-business payments, fraud and identification. The key observation here is that Visa's ubiquitous adoption is the result of decades of investment in payment technologies which has manifested in an enviable network; this network now offers the opportunity for further services to be gradually monetised, while cementing Visa's competitive advantages. We look forward to Visa's February Investor Day which we believe will give investors much greater insight into the services businesses.

The All Consuming Economy

Notwithstanding the recent pick up in infrastructure investment, consumption remains the primary force which drives the world economy, and, while we have been reducing it, we still maintain a diversified portfolio of consumer stocks.

One of the most noteworthy of these is **Sony**. The long-term prospects for Sony's key franchises remain strong and the business is taking encouraging steps to simplify itself. The business is a world leading technology, media and entertainment conglomerate, with market-leading positions in film, music, gaming and image sensors. Having successfully executed the rollout of the PlayStation 5, the next few years of harvesting those investments promise to be particularly exciting for the Gaming business, contributing to margin expansion across the group.

2025 will see the launch of *Ghost of Yotei*, a sequel to the hugely successful triple-A title *Ghost of Tsushima* which has sold more than 13m copies since its release in June 2020. Assuming historic patterns apply, this should drive a material acceleration in software sales. As a first party title, *Ghost of Yotei* will also come at an above average price and margin (potentially twice the gross margin compared to third-party titles). Another powerful driver will come with the release of Take

Two's *Grand Theft Auto VI,* also set for 2025. Overall, we see the potential for Gaming margins to increase materially in the next two years and come in well above Sony's mid-term target for the division.

In the image sensors business, the resolution of production ramp issues relating to a new product launch should drive a cyclical margin recovery. In the otherwise fairly uninteresting Pictures segment lies a hidden gem worth mentioning, *Crunchyroll*. This is an anime focused streaming service with ~13m paid subscribers, enjoying tremendous growth at highly attractive margins. *Crunchyroll* represents less than 20% of Sony's Pictures business today but is growing at a much faster rate with margins nearly 3x the wider segment. Over the coming years we are likely to see the overall Pictures business accelerate in terms of both growth and profitability as this important asset becomes a meaningful driver.

In October 2025 Sony is due to partially spin off its financial services business which will continue to operate under the same brand name (Sony will retain a 20% stake). We strongly support this move which will greatly simplify the consolidated financial statements and hopefully reduce some of the conglomerate discount in the shares.

When you consider the significant structural margin potential in the Gaming business and the cyclical recovery ahead in sensors, the stock looks compelling to us on 19x PE.

A small mention goes to consistent **AutoZone**, an investment that has been in the fund since inception and rose 24% last year. End markets were always going to be tough last year as discretionary spend on auto repair was impacted by high prices and inflation for the low-end consumer, yet AutoZone managed to deliver another year of more than 10% growth in EPS, thanks to store openings, a consistent level of growth in its "do-it-for-me" business (i.e. selling to garages) and expense discipline that kept operating margins close to a record 20%. Share buybacks continued at their customary high pace; the company has bought back 83% of all its shares in circulation in the last 20 years alone. We remain positive on the company mostly because it is increasingly clear that the pace of adoption of EVs in North America[7] has slowed down very substantially and that the #3 competitor in the US market is facing financial difficulties, likely meaning further increases in market share. We continue to expect EPS growth of 15% over the medium-term. On 18x forward earnings we view the stock as a very solid core investment for the fund.

[7] *Latitude Q3 2024 Comment Piece: EVs*

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Dollar Tree was our worst performing stock in 2024, down 47%, two thirds of which came from a collapsing valuation multiple and one third from lower-than-expected profits. The key challenge has been a squeezed low-end consumer, who is buying less, without the same level of pressure on lower-middle income consumers. Ordinarily, a squeezed consumer *drives* customer traffic, as higher unemployment means customers seek out the deep value offered at dollar stores and the pickup in traffic offsets the smaller basket size. Absent an uptick in unemployment, the key trend has been a shift from higher margin discretionary items to lower margin consumables as low-income consumers prioritise everyday essentials. This has been a disappointing development which led to lower margins across the group.

During the year, Dollar Tree put its Family Dollar banner into strategic review. Over the years we've been relatively sanguine on Family Dollar, viewing it as offering potential upside having been profit neutral to mildly loss-making, with the Dollar Tree banner being the sole driver of growth. We welcome the strategic review, as at this point, Family Dollar losses and cash consumption are being capitalised into the valuation of Dollar Tree, and it reflects a sound capital allocation decision to remove these. Dollar Tree is the unwelcome proof that we make mistakes. The principal errors here have been a failure to appreciate the degree of underinvestment in the Family Dollar banner and underestimating the scale of de-rating witnessed across the sector as the low-end consumer came under pressure. A small silver lining is our practice of never averaging down into positions without concrete evidence of operational improvement in the numbers, which means that today Dollar Tree represents a 2% holding. The second minor consolation is we've not lost money in absolute terms in Dollar Tree - the principal cost has been opportunity cost. As the reader might surmise, Dollar Tree's present valuation is well below our (reduced) estimate of its intrinsic value. In the third quarter of 2024 we saw early signs of operational trends stabilising and improving, both in terms of the improving performance of discretionary sales and the welcome reduction in 'shrink', or theft.

Our investments in consumer staple stocks have had very divergent outcomes in 2024. On one side **Tesco**, **Unilever** and **Imperial Brands** delivered market beating returns of 31%, 20% and 48%. On the other side the more “cyclical” exposure towards beverages has been disappointing, with negative returns from **Diageo** and **Heineken** and a marginally positive one from **Coca-Cola**.

It is worth examining why, in the modern world, we think it makes sense to own consumer staples.

What attracts us to these are the following features:

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1) They do remain the ultimate defensive stocks and they achieve their defensiveness in a relatively capital light way.
2) There has never been a five-year trailing period where owning a basket of consumer staples stocks has delivered a negative total return, which is unique to this sector[8]. In buoyant markets it can be easily forgotten that consumer staples provide a stream of returns that are positive, highly defensive, inflation-linked, and at times, uncorrelated from the rest of the market.
3) Valuations are indiscriminately at a generational low.

With this backdrop our disciplined approach tries to sort out which companies are likely to perform the best, by trying to understand where the sources of organic growth might be significantly underappreciated after a period of subpar performance. Tesco, Unilever and Imperial Brands' returns are the output of years of work and patience that is just starting to pay off.

Going deeper into the stocks, **Unilever** performed well in 2024. What was considered, only twelve months ago, a business that had lost its way is now squarely back in form thanks to the diet suggested by chairman Ian Meakins, the prior CEO responsible for all the good work done at Ferguson after the Great Financial Crisis. Also, the new CEO and CFO, both of whom joined after an investment from the activist investor Nelson Peltz of Trian, have done an admirable job refocusing the business towards the faster growing areas of cosmetics and body care and bringing incentives back in line with driving volume and total revenue growth, while cutting wasteful spending. What should result from the spin-off of the remaining food division is a Unilever whose Euro denominated earnings growth could easily be top quartile, in excess of 8% per annum, on top of which shareholders receive an attractive dividend yield of 3.5%, trading today at a valuation of just c.17x PE, 30% below historic averages.

Tesco had another great year enjoying a +32% total return in 2024 following the +35% delivered in 2023. It may surprise readers that despite these very commendable returns, it trades on 13.5x earnings (less than its average over the last 10 and 20 years) and margins are well below historic peaks.

We remain enthused about Tesco's prospects from here. Industry volumes turned positive in January 2024 and remained so throughout the year. Disinflation appeared to end during the

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[8] *Data from Bloomberg, based on MSCI indices GICS ("Global Industry Classification Standards")*

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summer and food price inflation appears to be reaccelerating into year end. Tesco's market share is up nearly 1% over the last 12 months while Asda and Morrisons continue to languish, burdened by debt, inhibiting their ability to be price competitive. Nevertheless, they still account for 21% of the market[9], meaning there is still plenty of opportunity for Tesco to gain further share.

You would be forgiven for thinking that 1% of market share sounds a bit pedestrian. To understand why these seemingly small and nearly imperceptible changes are so powerful, investors need to consider the *incremental* drop-through margins for Tesco. Tesco, like other supermarkets, makes slender margins. Gross profit margins are 26%, with the majority of the costs below this line fixed in nature. We calculate incremental contribution margins of retail sales growth as close to 20%, which is four times higher than current operating margins of 4.5%. Tesco has two good options for what to do with this incremental profit; it can reinvest in price competitiveness to drive further topline volume growth, or it can allow some of it to drop through to drive operating margin expansion. Tesco is already the cheapest full line grocer, and has been for the last two years[10], so our basic premise is that we will see a bit of both going forward.

Finally, with balance sheet leverage below the low end of their target range, there is ample room for further shareholder returns through dividend and share buyback. We believe Tesco is therefore very well positioned to continue to perform in 2025.

Alcoholic Beverages have been a different state of affairs. **Diageo**, after a booming '21 and a good '22, saw a meaningful correction in share price dictated by a relatively sharp inventory correction in the United States where it makes 60% of its profits. When industries suffer, it's common for investors to paint narratives compounding that weakness, and to confuse cyclical issues for structural ones. This is what we believe is taking place at the moment.

Theses around slower consumption due to GLP-1s or Gen Z drinking habits are weakened due to lack of evidence outside of anecdote. Moreover, premium spirits consumption starts later in life (i.e. when disposable income rises above a certain level) and we estimate Gen Z accounts for less than 3% of Diageo's sales today[11]. This means, while it *may* become a threat in the future, this cannot be the cause of recent weakness. Similarly, with GLP-1s, the evidence thus far is notable by its absence.

[9] *Grocery Market Share - Kantar*
[10] *Tesco Interim Results 2024-25*
[11] *Nielsen Data*

Diageo is very well positioned to go through this period, with 60% of profits coming from higher-end Scotch, the world leading premium beer, Guinness (which is having a worldwide revival) and a good exposure to premium Tequilas and Gin. There are various considerations also to be made on the P&L structure of companies like Diageo. If it was that alcoholic drinks are much like tobacco 25 years ago, then the amount of spend in advertising and marketing (around 25% of sales) is much too high as there will be no need to capture new clients, but rather maximise economic value from the existing ones.

We believe organic growth should restart in fiscal year '25 (FY25) and with lower advertising, marketing spend and market share growth, which is showing in the latest market data[12], Diageo should go back to 7-8% per share growth, complemented by >3.2% dividend yield. Share buybacks should also come back in the next 18 months augmenting shareholder returns. With the stock on the lowest forward valuation in 15 years, we remain modestly optimistic about the future of the company and hope to see ~50% total shareholder returns in the next couple of years.

Heineken has been hit by idiosyncratic issues in their fastest growing and most profitable market, Vietnam. The local government, rightly, decided to tackle the elevated number of car accidents by making it illegal to drink and drive. This initially hit the market volumes while beer companies, of which Heineken is the leading one, had also responded post-Covid-19 with too much capacity, which ended up hitting profitability. There is no hiding behind the fact that beer is not a growing category of the alcohol market and that currency swings in Heineken's mostly emerging markets portfolio have made some of their brands (which need to translate revenues into EUR) more expensive and less competitive. Despite that, Heineken still owns the single largest premium brand in beers across the world, one that has been growing volumes at 2-4% for a long time, while profit growth has been impacted by falling emerging markets profitability. We do believe it is possible for Heineken to perform better by adopting a radically different strategy, more focused on optimising the assets they already have, cutting costs, nurturing their eponymous Heineken brand and stopping acquisitions, while embracing share buybacks. At the current valuation of 13x forward PE, this would be a powerful cocktail to generate outsized total shareholder returns.

Coca-Cola delivered relatively solid operating results and upgraded its organic growth rate twice during the year (led by inflationary pricing). Unfortunately, much of the growth was eaten away by a very strong US dollar, resulting in flat US Dollar earnings growth. Since the election of President Trump and the new Health Secretary Robert Kennedy Jr, the stock de-rated back to close to 20x

[12] Nielsen and Nabca datasets

forward earnings on fears that the new administration would somehow crackdown on fizzy drinks. Most of Coca-Cola's growth has been driven by its own healthier portfolio of products ("Zero") and the company is well diversified globally and by business line to confront any such threat. Going forward we expect Coca-Cola to sell down incremental stakes in their bottlers, releasing capital and returning this to shareholders. After this, the business will be driven simply by concentrate sales and with this renewed focus, we expect the company to continue to gain market share from competitors PepsiCo and Keurig. This will support many years of 10% profit growth in US Dollars and a continued increase in its dividend, from a starting yield of 3.3%. Given fully franchised businesses trade in the stock market for mouthwatering multiples of more than 30x earnings we believe the margin of safety at current levels is high.

Emerging Opportunities in Healthcare Stocks

Healthcare is another sector which, like consumer staples, is being somewhat left behind in an otherwise ebullient market. Over the past two years we have significantly increased our exposure here and continue to find new opportunities presenting themselves.

United Health was a new position added during the fourth quarter. United Health provides health insurance to companies and individuals, claims management services and care delivery through its subsidiary Optum Health. It benefits from the secular trends of ageing demographics in the US, the expansion of treatment offerings and the trend towards the outsourcing of US government health programs to companies such as United who can offer greater value to members, as well as savings to the government. We expect all three to continue.

The sector has underperformed for two years, principally due to higher than forecast treatment utilisation following the bounce back of procedures delayed by COVID-19. This trend saw margins contract materially, especially for United Health's weaker competitors. Over the coming two years government contracts will reprice[13] while capacity will be withdrawn from the industry leading to market share growth and normalising margins at United Healthcare, given their position as the largest and lowest cost provider. Moreover, we observe that utilisation has been returning toward trend since the summer, implying lower future treatment costs for the company.

Over the longer term, United Healthcare is uniquely positioned to benefit from the transition to *value-based care* (VBC) through its Optum Health care provision business. VBC prioritises earlier

[13] CMS Releases CY26 MA and Part D Advance Notice | AAMC

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intervention and the use of more preventative measures to deliver better health outcomes in lower cost settings, delivering savings to members and the government. Ultimately, VBC will be the key to delivering more effective and affordable healthcare in the US.

McKesson, and its direct competitor **Cencora,** both had a very good operating year, growing EPS 10-15% with an outlook for more of the same in FY25. Extreme share price volatility midyear allowed us to initiate a position in Cencora alongside McKesson. The business is very similar and #2 in market share to McKesson in US drug distribution. US drug distributors are truly an oligopoly of just three companies but one weakness in the model is that customer concentration is high. The biggest risk is therefore a loss of contract for distributors. We believe that McKesson and Cencora are also meaningfully better than Cardinal Health, the third competitor, so if Cencora were to lose a large client it would highly likely be to McKesson and vice versa. Hence owning two shares in this attractive space should result in additional diversification for shareholders. The US prescription market should continue to grow in real terms at 1% driven by new drugs (GLPs) and, with some inflation, the underlying market should compound at 4-6%. Cencora and McKesson have made investments to grow in the more promising parts of healthcare distribution, that is biosimilars and cancer related drugs, which should propel their growth above the market, towards 6-7% per year. On top of this, margins remain at cyclical lows and could see a meaningful improvement and the companies are committed to material 5% annual share buybacks. All together, we could see these two companies compound their earnings at a 14-15% rate for a very long time to come which, from a starting valuation of 14-15x earnings and almost no cyclicality, offers potential for substantial gains ahead.

France Discount

We own three French stocks which this year were a source of strong operational success, sadly accompanied by relatively weak share price performance given their regional listing and exposure.

Vinci and **Eiffage** performed very well from an operational point of view, outperforming our expectations, with strong airport traffic (+8% on '23 and +4% on '19), flat motorway traffic despite disruptions in January and February from a farmers' protest, and record profits and order books in both the energy contracting and construction divisions.

This would have driven c.8-10% EBIT growth YoY. Unfortunately, this was a year of political risk.

What most impacted the stocks was French politics. After significant increases in fiscal spending in 2022 and 2023, in order to comply with European Union limits on deficits as a percentage of GDP, the French government enacted a number of tax increases. This included a broad-based 8%-of-revenue corporate-tax surcharge for 2024 and 4% for 2025, for companies like Vinci and Eiffage with more than €1 billion in annual French turnover. The government has also imposed special taxes of 4% of revenues on French motorway and airport operators for the period 2024 to 2030. Assuming all the new taxes are imposed as planned (some are being challenged in court and have a very strong chance of being overruled) it would reduce the discounted-cash-flow values by 3-4%, a far cry from the 70-100% upside we see in both stocks from current valuations. Apart from the obvious attraction of the monopolistic assets that both own, we are increasingly confident that the energy contracting divisions are likely to see structural 7-9% yearly profit growth over a very long period of time and, eventually, fetch the valuation multiples that the market awards today to high quality European industrials and capital goods companies exposed to themes of digitalisation, energy efficiency and electrification, which would help close the gap with intrinsic value.

Air Liquide, while not having really much of an exposure to the French taxation theme, is a large company within the French index (CAC 40) and has likely suffered by association. 2024 has been a good year, beating record revenues and profits from '21-'23 thanks to strong pricing in industrial gases. 2025 looks set to be even better, thanks to the strong dollar (>50% of profits) and the fact that projects for large scale ASUs ("Air Separation Units") should start ramping up and scale, therefore producing strong profits. With a valuation that is c.30% discount to American peer, Linde, a strong opportunity to improve margins over time (by more than 3%, in our view) and solid revenue growth, we believe we can earn an annual return of 12-13% from owning a very resilient global giant.

Elsewhere in Europe, this summer we were presented with a double opportunity when it came to **Ryanair**. The first was a profit warning due to declining fares, caused by the company's conscious decision to exit certain online travel agent arrangements, resulting in a stock price fall of almost 40%. Ryanair is a business we have been following and admiring since Latitude's inception. It is a typical Latitude company with a vast moat thanks to its incredibly low-cost structure, backed by a wholly owned, new, fleet of planes and run by a very capable management team. The fall this summer was a short-term hiccup in what otherwise looks increasingly like one of the best times to be a low-cost airline in Europe with demand growing, constrained supply of aircraft to

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competitors and a wider industry which needs higher prices to clear its cost of capital and pay back debts. On top of this, we benefitted from a strange quirk of EU regulation. Ryanair shares trade in Europe and, through an American Depository Receipt (ADR), in the US. Since the Brexit vote in the UK, because regulations state that non-EU investors cannot own more than 49.99% of an EU airline, the local shares began trading at a meaningful discount, widening recently to close to 20%. The company's decision to start returning cash to shareholders through more buybacks has allowed them to benefit from this discount, which has closed dramatically since our investment to close to 0%. We remain confident in Ryanair's fundamentals, with rising fares, growing passenger numbers and a 10% combined dividend + buyback yield, we think cyclical compounding could be in the 25% range per annum.

Powering the World

WEC Energy Group (WEC), the Wisconsin based utility delivered a +16% return in a manner consistent with our expectations set out in last year's annual report. For two decades WEC has compounded at 13%, comprising of 7-8% earnings growth complemented by a 4% dividend yield, with a beta of half the market. The outlook from here shines incrementally brighter as electricity consumption is poised to accelerate from 1% per annum growth to 4-5%, driven by electrification and the enormous demands of datacentres. It's sobering to consider the vast scale of demand with the first phase of Microsoft's datacentre campus in Wisconsin equating to 10% of the entire state's current energy consumption. During the year WEC revised its 5-year capital plan to $28bn securing at least 7-8% EPS growth until the end of the decade. As we noted last year, a key attraction of this growth is that it's underwritten by commercial demand which doesn't place stress on ordinary household bills. WEC has a long history of exemplary operational execution and the low risk nature of its current and prospective suite of capital projects provides for highly rateable and durable growth.

Energy had a subdued year with **Shell** flat for the year and **BP** -10% as crude oil prices were also flat on the year. We believe BP's relative underperformance reflects uncertainty caused by strategic back-peddling from its investments in nascent alternative energies although, now this is completed, we see potential for the underlying assets to be reappraised by the market.

As a reminder to newer readers, we bought energy in 2020 via BP and Equinor, ultimately swapping Equinor for Shell after the significant outperformance from Equinor's exposure to elevated European gas prices following Russia's invasion of Ukraine. Since 2020, BP and Shell have delivered average yearly total returns of 16% and 20% respectively. Despite a muted year, with oil prices around $75, both companies generated free cash flow yields of over 15%, 12% of which is returned to shareholders through dividends and buybacks, an ample return for shareholders given the compelling and asymmetric future potential.

The asymmetry arises from the supply side for two reasons. First, the incentive price for new wells in the US is already c. $60-65 and onshore production growth has been decelerating rapidly recently. Second, throughout 2024 OPEC has shown a strong preference for prices above $70 per barrel. While we would certainly never claim any special insight into what Trump's second Presidential term might bring, we would note investors remain sanguine about the potential for renewed Iranian sanctions and the potential disruption to supply that may bring.

This asymmetry is enhanced when one considers that 2024 was a year in which companies and countries have meaningfully dialled back forecasts surrounding the pace of adoption of alternative renewable energy technologies. The key lesson being that energy transitions have always been long and transition fuels like gas will remain critical contributors to the energy mix for decades to come.

Finally, from a portfolio construction perspective, we view energy as an effective inflation hedge. The energy intensity of the economy changes slowly. Our view remains that inflation will be higher and more volatile over the next decade. If it does reaccelerate it will show up in energy prices and consequently, we believe it offers both generous returns and a valuable hedge in the portfolio.

Our Remaining Technology Exposure

In the technology arena it was the year of artificial intelligence (AI) and the massive capital expenditure deemed necessary to fuel this expansion. While the market started the year thinking **Alphabet** was on the losing end of this, the stock rose 38% over the year as these fears subsided and the company's search and cloud businesses continued to deliver. There are several angles to the AI debate. Starting with the negatives, one can increasingly see how products being developed by Big Tech companies are highly commoditised, not yet particularly useful to corporates (usage and uptake remains low and the monetizable use case uncertain) and they require a level of capital expenditure that makes us uncomfortable.

We note that there has been no case in history where a boom in capital expenditure of this scale hasn't ended up with major overcapacity and we would be surprised if this cycle was any different. The fact that Microsoft's free cash flow this year is likely to trend to zero in order to finance additional data centres would make us particularly nervous if we were investors.

So what are the positives, and why do we remain invested in Alphabet? We see the AI battleground split three ways, between 1. Access to data, 2. Processing power and 3. Distribution. Through their Search, YouTube and other properties, Google has the largest proprietary source of training data for large language models. Through their existing AI models and their enormous cloud computing power, they have the processing power. Finally, they have nine different apps with more than one billion global users, implying a huge, multifaceted distribution advantage. But the primary reason we remain invested is that the shares continue to price in an almost $0 return from these latent AI investments, allowing us to focus on the core businesses.

Across the core platforms (Search, Chrome, YouTube etc.) performance has been strong with revenues rising 15% in 2024 driven by strong performance in advertising. The company has developed a substantial cloud business with $40bn of recurring revenue and the fastest growth rates in the industry. Most encouraging is the fact that Google Cloud has a far larger market share than competitors with tech “unicorns”, that is, the companies that should become the backbone of tomorrow’s tech economy. This signals to us that these new businesses, unincumbered with legacy IT (i.e. Microsoft Office) are preferring the flexibility and software stack provided by G Suite.

Outside the core franchises, this year will be remembered as the year when Waymo (Alphabet’s driverless car subsidiary) started to gain real traction, with the latest funding rounds valuing it at $45b[14]. The company is rolling out its service in several new US cities and has already surpassed Lyft in market share for hails in San Francisco[15]. Waymo has both a technological, data and hardware advantage versus the market and a ten-year first mover advantage. If autonomous driving does ever catch on, this could constitute the next phase of growth for the company. It is still possible to purchase Alphabet shares at 21x 2025 earnings, a slight discount to the market, despite its net-cash capital structure and the fact that valuable assets like Waymo are still penalizing the P&L with losses. We believe the positives still outweigh the negatives and think Alphabet should provide strong investor returns from current levels.

We exited our position in **Texas Instruments** this year at an average price of $195, having acquired the stock in June 2020 at $118. The shares ended the year up 13% on a total return basis. Our view remains unchanged that Texas Instruments is a business with demonstrable

[14] *Deal logic data intelligence*
[15] *App Economy Insight*

competitive advantages, managed by an excellent management team, supporting strong, dependable long-term growth. Stocks often trade on elevated multiples of cyclically depressed earnings but, even in bullish scenarios for Texas Instruments' future mid-cycle profits, you are left with a relatively unattractive earnings yield looking out to 2030 and beyond. We hope, and expect, we may be presented with another opportunity to own the shares in the future but see the current valuation as simply too expensive relative to our range of future earnings estimates when compared to alternative opportunities.

Investing decisions are always ones of *relative* value and we will continue to make changes within the portfolio when we see these opportunities. We believe the current collection of holdings offers our investors a diversified source of earnings growth, as well as the potential for meaningful re-rating of certain stocks' valuation discounts. All without exposure to the highly prized, highly valued stocks which constitute the majority of the index today.

We look forward to discussing these views with you in 2025.

Freddie Lait