January 2025

Church House Human Capital – Quarterly Letter

The final quarter of 2024 was about as noisy a period for global politics and economics as we have had in recent memory. From the perspective of the Human Capital Fund, it was (and always is) a matter of keeping our heads down and not letting Mr Market distract from what we have set out to achieve: high returns for investors via investing in a focused portfolio of exceptional businesses. To this end, we enjoyed an autumn/early-winter going through our share of shoe leather, meeting both potential businesses to invest in and companies that we are already shareholders in. We unearthed one new business that we have now invested in and identified a handful of possibles that we have added to our growing watchlist.

Our new investment is in US-listed **Tetra Tech** and with Los Angeles fighting wildfires as we write, this water-focused business appears more relevant than ever. Tetra Tech traces its origins back to the 1960s when it was founded as the Water Management Group, advising the US Navy on how best to protect the US Pacific Fleet's harbours against flooding and extreme weather. Fast-forward to today and Tetra is an $11bn market cap business, providing the brain power behind predominantly water-related projects across the globe. For example, Tetra are currently working with federal and state agencies in California on how better to collect (increasingly scarce) rainfall that otherwise would run straight off sun-baked soil and be lost to the ocean. Or in the UK, Tetra has recently won a major ten-year contract with United Utilities to *'support the improvement of river health across the North West of England'*.

In addition to working in attractive and growing end markets, what struck us about Tetra Tech was what an incredibly well run, ambitious and entrepreneurial business it is. Since IPO in 1991 Tetra equity has compounded at +16.4% and this has increased to over 20% in the last decade. Most of the workforce may be water and engineering "geeks", but their management team have a laser-focus on delivering financial returns on this brainpower. The company is hugely cash generative (they have minimal fixed assets) and we particularly liked the longevity of their leadership team – Dan Batrack, CEO, joined in 1980 and cut his teeth as an Arctic research scientist and oceanographer before swapping his wetsuit for a tie in head office. At their recent investor day Tetra publicly stated their target to **triple their earnings by 2030** – we are backing them to do just that.

Communicating concise financial goals to the market such as these from Tetra is a feature that we love to see in a business. This focuses the mind of a management team and gives us a clear idea of what a business is looking to achieve. To pick a few wonderfully pithy examples of financial targets given by companies we are shareholders in:

- **Lagercrantz**: have two goals (that is all!)
    1. Grow profit (EBT) by 15% annually
    2. Maintain return on equity > 25%

- **Addtech**: also have two goals
    1. Grow profit (EBT) > 15% annually
    2. Profit/Working Capital > 25%

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- **Savaria**: are targeting
    1. **Revenue** of $1bn by 2026 (+10% compounded)
    2. **EBITDA margin** increasing from 15% to 20% by 2026

Not only do these goals keep management teams honest, they demonstrate to the whole workforce what they collectively are working towards and incentives must be fair and reflective of these targets. We all remember what Charlie Munger said about incentives…

In terms of Fund performance, the NAV of Human Capital accumulation units stood at 98.7p at year-end. Given that we have no direct exposure to the Magnificent Seven or US banks, the remarkable market rally at the end of 2024 largely passed the Fund by. We also saw our US names take a hit in December when the Russell 2000 fell out of favour – there were no fundamental changes to our underlying US investments in this period, so we took the opportunity to add to a few of our US holdings at the time. Overall, we continue to see exceptional long-term growth ahead for our Human Capital businesses and with the portfolio currently standing on an earnings multiple of 17.2x, one is not paying a hefty premium to the market for this growth. As always at Church House, we will not compromise on the quality of businesses that we invest in; the return on capital employed of the Human Capital Fund portfolio is twice the market average and cash is king when it comes to balance sheets in our opinion.

Fred Mahon

9th January 2025

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