EXCELLENT MANAGEMENT

Albin Kistler AG opinion piece
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Shares in high-quality Swiss companies from the cyclical industrial sector have achieved above-average returns on investment since the start of this millennium, despite three major crises. What lies behind this?

Albin Kistler AG   Stauffacherstrasse 5   8004 Zürich   +41 44 224 60 24   info@albinkistler.ch   www.albinkistler.ch

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Many unknowns

Investments in equities should be made with a calm head and a long-term investment horizon. Cyclical sectors in particular require strong nerves in economic downturns or when unforeseen events suddenly occur. Since the turn of the millennium, we have experienced three crises with different causes – so it's time to take a look at how selected high-quality Swiss industrial stocks have performed over this period.

Fig. 1: Swiss industrial stocks are gems

2000–2022 period Company	Performance p.a. in CHF (total return)
Belimo	15.5%
Bucher Industries	11.3%
Geberit	12.3%
Interroll	14.3%
Swiss equities (SPI)	4.5%
Global equities (MSCI)	2.7%

Source: Bloomberg; total return = share price gains and dividends

How do these companies manage to significantly outperform the broad market despite the bursting of the dot-com bubble after the turn of the millennium, the terrifying financial crisis and the surreal experience of the Covid pandemic?

Management is key

There are numerous factors required for a company to prosper. As our analysis keeps confirming, one of the essentials for success – possibly even the single most important factor – is the quality of the company's management (its executive board and board of directors). This is because the management sets the course for everything that happens there – staff, operations and strategy. But what does that mean in practice? Good management can be recognised from three attributes:

- The treatment of key stakeholders
- Long-term corporate strategy
- Ambitious in performance, down to earth in communication (corporate DNA)

Some Swiss industrial gems offer prime examples of these attributes, as in the following cases.

Belimo

This success story from the Zürcher Oberland region came onto the radar of international investors with unglamorous-sounding products such as damper actuators, control valves and sensors. The name Belimo is an abbreviation of "beraten, liefern, montieren" (advise, deliver, install) – which shows an agreeably down to earth approach at a time when high-tech and fancy names are in favour with newly floated companies.

As a niche provider that launched in the mid-1970s, Belimo today generates annual revenue of around CHF 850 million and has an impressive market cap of CHF 6 billion. With roots in Switzerland, its successful business model has been rolled out globally with sound judgement and foresight. Today, just under 60% of Belimo's income is generated overseas (Americas, Asia/Pacific).

The high predictability of its impressive profitability (operating profit margins of 16–18%), its significant organic sales growth and its rock-solid finances are attributes every success-hungry investor dreams of. This sort of track record practically always correlates with management quality.

<u>Treatment of stakeholders (suppliers)</u>

Fair dealings with suppliers and end-customers were already important to Belimo long before the outbreak of the pandemic. After being dismissed for years as an insignificant detail, in 2021 it suddenly became clear to the world just how essential such business practices are.

Unlike numerous other companies and competitors, Belimo's ability to supply goods was irreproachable, allowing it to profit from the strong upturn after Covid-19 measures were eased. This competitive edge meant the company was able to gain significant market share in the US, and the Americas became the group's largest region in 2022.

Bucher Industries

Bucher Industries, with its more than 200 years of history, proves that even conglomerates with strong family ownership – a category that is widely shunned – have a place in client portfolios.

The group's positioning, in which its five divisions have a high level of independence and their own objectives, ensuring that cross-subsidisation is not tolerated for any businesses that do not have a promising future. On the transparency front, the company's reporting meets the very highest standards.

The company is promisingly positioned for lasting success with capital goods that support meeting people's basic needs (food, drink, infrastructure). The global population is rising, while the space available to grow food is finite. Rising to this challenge will require agriculture to be more efficient and more productive. The company's largest division, Kuhn Group, is well-positioned to benefit from this trend, having a very wide product range in tractor-drawn agricultural and self-propelled specialised machinery.

Unchecked urbanisation around the world poses numerous challenges for governments. The Municipal division provides hygiene and infrastructure solutions in the shape of its refuse vehicles, sweepers and sewer cleaning equipment. Despite global warming, winter maintenance vehicles remain essential, which is another need that Bucher meets. The divisions offering hydraulic solutions and machines for glass container production have doubled their revenue and increased their profitability over the last decade (EBIT contributions have tripled and quadrupled respectively).

The company has been able to defy adverse economic cycles thanks to continuous optimisation of processes and products driven by innovative research and development successes. In 2022, it generated record results for almost all key performance indicators despite supply chain problems and high materials, personnel and energy costs.

<u>Long-term corporate strategy</u>

In 1998, Bucher acquired Emhart Glass (glass-forming and inspection machines) – a world leader in this area. Its profitability tended to lag behind levels in the other divisions, and it was nowhere near achieving a double-digit EBIT margin. Financial investors repeatedly demanded that management sell the activity and reallocate the capital to more profitable areas. However, Bucher had unwavering faith in the forward-looking positioning and continued to work assiduously on improvements. From 2018, its end-customers embarked on a new investment cycle, and Bucher was able to fully participate in this thanks to its hard work. In the last two years, the division has delighted investors with the highest profitability in the group (EBIT margins of 16% and 19% respectively). The critical voices from the financial community were silenced, and management is enjoying its success in its usual manner – quietly and modestly.

Geberit

Geberit – the European market leader in sanitary products, with a headcount of around 12,000 – has been in the top echelons of the Swiss stock market for many years. This is not because of excessive remuneration practices, but thanks to its impressive track record. Its unrivalled profitability in the industry (EBITDA margin of nearly 30%) is just one of its many quality indicators.

The company's business model is based on three production areas: installation and flushing systems, piping systems and bathroom systems. Bathroom systems were added to the group in 2015 through the acquisition of the Scandinavian company Sanitec. This was tantamount to a strategic U-turn, as chairman Albert M. Baehny had always emphasised that Geberit was and would remain behind the wall, with the exception of toilet flush releases. A successful company trusts in its strengths, but when opportunities arrive, it is flexible and bold enough to seize them. Following some initial dilution of margins and a temporary dip in return on investment, the acquired business was developed to the usual, much-envied Geberit level.

The Jona-based company comes top of the class when it comes to continuity of management. Albert Baehny (CEO 2005–2014, Chairman of the Board of Directors since 2015) and Christian Buhl (CEO since 2015) skilfully navigate the group through whatever crises it encounters. For this reason, we find it inexplicable that a successful CEO moving to the board of directors is often viewed very negatively. It means the company and the CEO's successors continue to benefit from years of industry knowledge and a wealth of experience. If you also choose the successor well, this ensures that the success story will continue. It is worth noting that Bucher Industries has made the same choice with flying colours, with the pairing of Philip Mosimann (Chairman of the Board of Directors) and Jacques Sanche (CEO).

Treatment of stakeholders (employees)

In the second quarter of 2020, after the Covid pandemic reached Europe, Geberit's revenue slumped by around 10%. This was due to the health measures implemented and the closure of construction sites. The headcount was kept roughly constant in 2020, in the knowledge that this key success factor would be urgently needed in the coming upswing. Other players reacted to this period with redundancies, only to find themselves desperately trying to recruit skilled workers after the end of the lockdown, often without success. Geberit, by contrast, stepped up the training of its sales force and digital interaction with customers at the height of the pandemic. Its employees' great loyalty and their flexibility regarding holiday planning and overtime compensation also helped the company to get through the crisis. The targeted accumulation of inventory in readiness for the ensuing recovery proved a particularly shrewd move.

Interroll

Interroll, which was founded more than 60 years ago, is dedicated to material handling solutions for logistics applications. Largely through organic growth, it has secured a double-digit share of a structural growth market worth around CHF 7 billion. Major international groups from the express and postal services, e-commerce, airports, food, retail and automotive industries swear by Interroll's reliability and quality.

Knowing that the business has greater-than-average cyclical exposure, the company's corporate strategy is built on solid financing. An equity ratio of around 65%, low levels of intangible assets and no debt mean the management and investors can look to an attractive future with confidence. Capacity expansions to cope with growth are systematically financed from operating cash flows.

Exemplary customer focus combined with high innovation have helped the company expand its business model beyond Europe to the rest of the world. Today, the Americas and Asia regions account for nearly half of revenues. The tripling of revenue and ninefold(!) leap in operating income in around 20 years represent an outstanding business achievement. This track record is grounded in the corporate culture, which has been nurtured over the years, constant cost discipline and an untiring drive for efficiency gains.

Ambitious in performance, down to earth in communication (corporate DNA)

Interroll's management has for years stood out from the crowd for its conservative forecasts and humble attitude in the face of shifting challenges. In contrast to the increasingly hectic reporting of listed companies, the company refrains from publishing quarterly figures in order to underpin the long-term nature of its corporate strategy. Contrary to its modest statements in 2018/19 that profitability had reached its peak, Interroll has delighted its shareholders since the pandemic with continuing record figures. The company's hard work to earn investors' respect over the years has given the stock a justified premium over the sector and its peers – actions speak louder than words.

Invest in excellent companies

Share prices are driven by short-term events and emotions, which can lead to temporary price exaggerations in both directions. However, anyone who invests with the necessary patience can cope with this situation because, in the long term, the stock market rewards companies that deliver sustainable profit growth.

The companies described above are, without doubt, this sort of industrial gem. Outstanding management performance is not the only factor in success, but it is an important one.

Identifying these high-quality companies is a challenge that should not be underestimated. It requires many years of meticulous analysis, based on clear principles and criteria. This creates the best conditions for long-term investment success.

Christian Wildhaber
Deputy Head of Research, Industry Analyst
Moritz Baumann
Head of Research