Stocks in motion

Act your age: navigating global equities with the corporate life cycle

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- Understanding where a company sits in the corporate Life Cycle is vital when identifying investment opportunities
- Companies that are more mature are often overlooked, but can offer just as attractive potential returns as those that are growing fast
- Merck is a great example of a Slowing & Maturing company that has created wealth for investors throughout its Life Cycle

We believe timing is everything. This statement usually invokes images of the most intricate and extravagant charts, the way Hollywood likes to portray professional money management. Sadly, this couldn't be further from the truth. Our strategy hinges on our understanding of where a company sits on its corporate Life Cycle, a time frame which spans years and decades.

Our Global Equity funds all target either capital growth or income over longer time periods by investing in a diversified portfolio of shares listed on global stock exchanges. To identify companies that are poised to defy market expectations, one of the key metrics we analyse is cash-based returns on invested capital, relative to cost of capital.

This determines whether a company creates economic value and is an important input allowing us to map the five stages of the corporate life cycle: Accelerating, Compounding, Slowing & Maturing, Mature or Turnaround. This lens, applied to global equity markets, reveals opportunities where others see only returns.

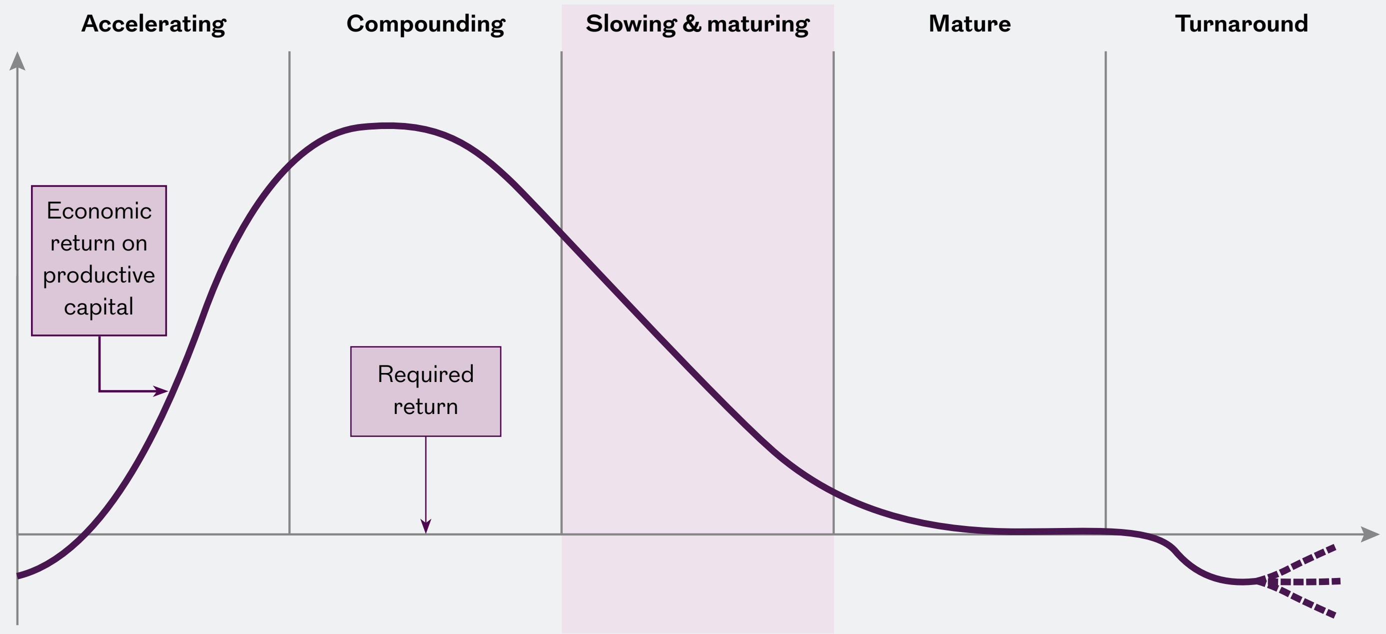
This month, we zoom in on the Slowing & Maturing stage, spotlighting Merck & Co., and explore how "acting your age" can unlock value in global equities.

Slowing & maturing: the art of aging gracefully

In the Slowing & Maturing stage, growth moderates as products mature and competition intensifies. It's a pivot point— companies must adapt or risk fading into obscurity. Success here isn't always about reclaiming youthful exuberance, but acting your age: refining operations, innovating within core strengths, and expanding thoughtfully. The key question is, can the company beat the fade in returns the market has priced in? For a Slowing & Maturing firm, this means a deep understanding of its competitive advantages.

Figure 1: Corporate Life Cycle

Corporate returns on productive capital and growth tend to progress along a Life Cycle. Every company can be located economically in a Life Cycle category.



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Merck: a masterclass in maturing

In our view, Merck & Co., the pharmaceutical titan, embodies this stage. Merck has been wealth creating through all stages of its corporate life cycle. Merck researched, developed and commercialised the most successful drug in pharma history, Keytruda. The oncology mega-blockbuster generated almost $30bn in worldwide sales last year, accounting for 46% of Merck's global sales. Now that the business is maturing, the market is currently pricing in a sharp decline in the company's returns, owing to Keytruda's main patent expiry in 2028[1].

We believe the market underestimates Merck's ability to beat the fade. It has proven itself to be an exceptional drug developer, but also capital allocator. Since 2021 the company has increased its assets in phase three trial development from nine to twenty-six, many of which have blockbuster potential. Merck's leadership in oncology means the company has a further $25bn of forecast revenues in this disease area, as it extends its exclusivity through various technology innovations and applies these to earlier stage cancers[2]. The market's focus on Keytruda's loss of exclusivity also misses the significant optionality embedded through its other assets in vaccines, cardiometabolic diseases and immunology. Leveraging its mature, cash generating base, Merck is thoughtfully deploying capital at rates of return nearly double that implied by the market.

Portfolio playbook: why it matters

So how does this fit into our investment process? Slowing & Maturing companies like Merck are often overlooked by investors. They don't offer the high revenue-expansion rates which appeal to growth investors but are also less static than mature cash-generating firms that value investors favour. Instead, they require a contrarian mindset and a deep understanding of the competitive advantages which allow a company to beat the fade. We scour the data to find these characteristics and blend them with earlier and later life cycle plays for balance. Patent expiry concerns about a drug as successful as Keytruda are understandable. But Merck's stability and upside potential make it a linchpin, offsetting riskier investments while delivering consistent cash flows.

In a world obsessed with youth, there's wisdom in aging well. We believe Merck's products, wealth creation and investment case prove this.

References

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2. https://citywire.com/new-model-adviser/news/merck-is-too-cheap-on-pipeline-potential/a2445331
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