

"The object of life is not to be on the side of the majority, but to escape finding oneself in the ranks of the insane." – Marcus Aurelius (121 ad – 180 ad)

Execution and Ownership – Part II

Dear Investors,

In our last letter we discussed the differences between executives and owners and how the combination of excellent execution and the right approach to risk taking is the cornerstone of every successful company we have ever owned. We also recognized that these attributes are necessary but not sufficient to build exceptional businesses. Every impenetrable fortress starts from this strong foundation, but not all strong foundations lead to impenetrable fortresses.

But what happens when a business model, built on what is second to none execution and a proven track record of capital allocation, starts to show signs of exhaustion? And what if this happens after the stock has compounded at more than 20% per year for 20 years and trades at a high multiple, praised by analysts and investors as one of the great compounders of the last 30 years?

In our experience, most companies, led by executives and boards, will double down on what has been a winning strategy, trying to improve at the margin, doing whatever they can to keep the momentum of the shares and the high valuation going. But how would a founder or a generational owner (someone who knows they will own the stock for decades) tackle this situation?

While it is impossible to generalize, we believe that we have a very good example of how real owners assess risk and make decisions focused on the long-term success even if that means departing from a formula that has worked incredibly well for decades. It is particularly interesting given that the company in focus, Danaher, happens to be the largest position in Zeno Investment Fund. In the last few years we have had the opportunity to have many high-level conversations with the company which have informed the view we are sharing here.

Danaher is one of the most celebrated investment cases of the last 30 years. It has also been the object of a myriad of academic business cases tracing its history, deals, culture and highly successful Danaher Business System, a collection of practices and management tools that have significantly impacted the performance of the businesses acquired by the conglomerate over the years. Given such exhaustive coverage, we will not spend these pages on yet another detailed deep dive on these topics. Instead, we want to examine how and why Danaher has threaded a different path from so many other contemporaneous businesses.

Readers may have noticed that we described Danaher as a conglomerate, a word that would be aptly applied to the company for most of its existence. Danaher was born, like so many companies in the 80s as a product of an aggressive acquisition strategy led by its two founders, Steve and Mitch Rales. The Rales brothers were viewed at the time as just another set of corporate raiders, attempting hostile take-overs of undervalued public companies deploying significant amounts of leverage. However, that's where the similarities with the likes of Carl Icahn, Ron Perelman or Nelson Peltz stop.

Unlike many of their peers, the Rales brothers, from the very early days, developed an obsessive focus on systematic execution of the businesses they acquired. Their strategy was not just about cheap valuations and leverage and cutting costs and selling assets. It was about real business improvement, cultivating talent and redeploying capital intelligently, with a very long-term mindset. Very early in their careers, the brothers realized that being real owners and focusing on compounding value offered a path to wealth creation that not only suited their personalities better, but that ultimately proved to offer a superior risk-adjusted return.

As such, it is hardly surprising to us that Danaher is, by far, the most successful of the 1980s conglomerates. In fact, it is one of the most successful investments in the US stock market overall. Between 1984 and 2025, Danaher stock compounded at 21% per year, far exceeding the vast majority of companies in existence during this period. Names like Berkshire Hathaway, Johnson Controls, ITW, GE or United Technologies pale in comparison. As impressive, Steve and Mitch Rales have remained substantial shareholders and actively involved with the company they created more than 40 years ago. And in our view, this continued ownership and involvement is the key to the incredible transformation that Danaher went through over the last 10 years. This transformation and the context in which it is taking place is, in our view, a testament to how owners are able to make decisions that would be nearly impossible for almost any combination of executives and board members.

In the decades leading up to the 2008/09 Great Financial Crisis (GFC), Danaher, which started operating as a public company in 1984, had built a portfolio of businesses across a variety of industrial end-markets. In that 25-year period, Danaher actively shaped its portfolio of businesses, divesting opportunistically from some businesses while reallocating capital to others. The common thread in most of these acquisitions was a strong focus on paying low valuations for businesses where there were obvious opportunities for operational improvement. Given Danaher's superior execution, the company was usually able to extract significant value, above what other owners could. What Danaher didn't seem to be focused on was buying businesses where aspects such as long-term organic growth, market power and low cyclicality were outstanding. Instead, growth of cash flow through continued operational improvement and capital redeployment into further acquisitions were the drivers of equity compounding.

By 2007, Danaher's business was divided into 4 separate business units, which for the most part were composed of highly efficient, well run, low growth, cyclical businesses. Sitting in one of these divisions were two businesses, acquired in 2004 and 2005 which would become the seeds of Danaher's future, Radiometer and Leica Microsystems.

At that point, the stock had compounded at roughly 22% for the prior 10 years, traded at a healthy 20x earnings and was generating very good returns on capital deployed. The playbook was not only working but was well-liked by the market.

Then, the GFC arrived. Like all companies, Danaher had to endure a tough 2009, which saw its main business units drop organic sales by 9% in the case of Dental, 17% in Industrial Technologies and 22% in Test and Measurement. Meanwhile, the newly created Life Sciences and Diagnostics division formed by Radiometer and Leica and the Environmental division both dropped by only 1% in 2009.

As markets and economies recovered, these new business units proved not only to be resilient during the recession but also delivered healthy growth in the following years. Their end markets presented higher structural growth rates, were less cyclical and more recurring.

In the following years leading up to 2015, the same pattern repeated itself, with Life Sciences and Environmental organic growth consistently outpacing the other segments. By 2015 these two segments had posted organic growth well above the remaining segments.

From the perspective of market participants, Danaher continued to ride high. Between 2006 and 2015 the stock compounded at 11.5% per year, while the S&P 500 delivered 4.4% returns and the company was praised as one of the highest quality compounders in the world.

However, beneath the surface, things might not have been as good. Despite its incredible execution, driven by well-developed business systems and a top-notch management team, Danaher was showing signs that its business was not delivering at the same level as it had before.

In the 5-year period between 2009 (a trough year for the business) and 2014, Danaher grew its operating cash flow before working capital (a metric we always follow closely for all companies) at 13% per year. This is not bad, except for the fact that, to achieve that growth, the company had to retain more than 100% of that cash flow, which implies a marginal return just above 10%. This was far from brilliant considering that i) 2009 was a low base of comparison and ii) in the 5 years leading up to 2009, the business grew operating cash flows by 21% at a marginal return of 15%. Clearly, the increased scale and diversification of the

company was not driving improved returns on capital even though the company had been allocating more of their capital to the Life Sciences and Diagnostics space. The market didn't seem to care much, but the owners clearly did and big changes were brewing.

Before we continue with the story, it's worth taking a moment now to reflect on how most companies led by executives and boards would react to the set up described above. Let's imagine a CEO, who has been with the company for 6 years (longer than the average tenure of an executive office in the US), who was picked by a board formed by independent directors through a diligent process, supported by the best consultants out there. This CEO has an excellent execution track record, having successfully dealt with turnarounds, M&A and business transformation. He or she is incentivized by a 3-year stock grant that vests annually assuming the company can deliver a certain revenue and eps growth. In the last 6 years, with the stock having compounded at 12%, far outperforming the broader market, the CEO has sold 80% of his or her vested stock and still owns 46% of all the shares granted in 6 years, most of which will vest in the next 2 years.

The CEO is well aware of the deteriorating performance, driven by the increased complexity that has been creeping in as more acquisitions are made to sustain top and bottom-line growth and has a plan to address it. The company will roll out a number of cost cutting initiatives, and it will implement new processes that will streamline operations, all while maintaining a disciplined but strong pace of new acquisitions. This will be communicated to analysts and investors through conferences, Capital Market Days and well written annual reports. The board, meanwhile, will make sure that it is properly informed and, through its committees and with the help of paid consultants, will keep a diligent eye on the actions of the CEO and the achievement of the main metrics defined by the Compensation Committee in consultation with the CEO and the compensation consultant.

This seems a very reasonable course of action for a company that has enjoyed so many years of success in business and in capital markets following this exact same strategy. It is also well aligned with the personal objectives of the CEO, who will continue to manage an ever-growing business, with more economic and political clout, which in turn will create a bigger compensation pool and set him or her up well for the next opportunity in the future. In the meantime, shares earned through the stock ownership program will continue to be monetized regularly in the market. But is it the right course of action for the long term of the business and its owners? Or is it the most convenient for the group of people managing the company on behalf of shareholders?

The problem here is that we just don't know. And we don't know exactly because the people making these decisions are not really aligned with the long-term owners of the business. As outside investors who follow the company closely and worry about the deteriorating fundamentals, we are left second-guessing management's decisions and intentions.

Now, let's go back to real life and the Danaher case. In the years between 2011 and 2015, Danaher continued to pursue M&A vigorously and across all the segments, but there was a clear bias towards Life Sciences and Diagnostics. At the same time, the company also accelerated its divestments from a number of businesses in the Industrial Technology and Test and Measurement segments. By the end of 2014, Life Sciences and Diagnostics represented 36% of sales, compared to 17% just 4 years before. Chief among the acquisitions in this period was Beckman Coulter, a leader in diagnostics, and, up to that point, Danaher's largest acquisition ever.

Then, in 2015, things really got interesting. On the 13th of May, Danaher makes two public announcements: its largest acquisition ever, a \$14 billion cash offer for Pall Systems, which adds \$1.6 billion in sales to its Life Sciences segment and gives Danaher a foothold in the bioprocessing space which entails the manufacturing and sales of consumables and equipment used in the production of biotech drugs. At the same time, Danaher announced it was breaking up in two companies: keeping the Life Sciences, Diagnostics and Environmental divisions within Danaher, while spinning off all the other businesses to a new public company called Fortive. Initial reactions from market participants were of confusion and doubt. At first, many didn't quite understand why the company was doing this.

A few years later, the pattern was repeated. In 2019 Danaher announced the IPO and subsequent spin-off of its dental business, now called Envista. A few months later, Danaher announced yet another largest

acquisition ever, the bioprocessing business of General Electric, GE Biopharma. Finally, in 2023, Danaher spun off its Environmental and Applied Solutions business into a new public company called Veralto. With that, in the space of 7 years, Danaher went from a diversified industrial conglomerate to a pure play Bioprocessing, Life Sciences and Diagnostics business, industries where the company has clear global leadership and best in class profitability. We intend to deep dive on the new Danaher (or, as Mitch calls it, Danaher 4.0) and explain why we view it as a great investment opportunity.

But what is so special about this path taken by Danaher? Spin-offs happen all the time in the US. In 2024 and 2025, 14 large companies announced that they were breaking up or spinning off subsidiaries. There is one major difference though. All these 14 companies had significantly underperformed markets in the 5 years prior to the announcement of the spin-off, were trading at sub-par valuations, and were not only under external pressure to take action but were also experiencing high talent turnover and sluggish growth. In our experience, CEO's and boards don't like to consider spin-offs and will almost always only do it after a long period of value destruction or if their hands are forced by outside pressure. And this is where Danaher is different. The decisions to spin-off profitable businesses, which drastically reduce complexity and refocus the attention of the management, were made from a position of strength. Leading up to 2015, Danaher's share price had compounded at 22% per year and earnings had compounded at 14% per year, far outpacing the market and the industry.

As shareholders, we can take comfort in the fact that management and the board didn't make a decision on their back foot, nor do we need to question if this was a job preservation, or short-term share price maximization exercise. The company made those decisions based on their assessment of risks and opportunities for shareholders in the long term. Steve and Mitch Rales, who, at the end of the day, have huge influence on such decisions, are not worried about their stock options, their bonuses or their jobs. They have none of these things. They are simply founders and shareholders, who have a very significant part of their wealth invested in the company and a generational view of value creation. We can only speculate what would have happened if Mr. Welch or Mr. Inmelt had taken similar measures at GE instead of holding on to the conglomerate well past its due date. Instead, GE shareholders had to suffer huge losses and wait for the arrival of former Danaher CEO, Larry Culp, to finally take action that would deliver significant value creation. Sometimes, the counterfactual does show up eventually!

At some point, the Rales and the excellent team of people who they brought to the company over decades (names like Tom Joyce, Larry Culp and George Sherman) started to realize that their playbook needed to change. That exceptional execution was necessary but not sufficient and that long term business quality, supported by market power and clear organic reinvestment opportunities, was at least as important as paying the right price for businesses.

To be clear, we have little doubt that mistakes were made along the way and that a lot can go wrong still. But, when we look at where Danaher is today, compared to where it would have been if these changes were not implemented, we are quite confident that shareholders are much better off. All one must do is observe the operational performance of the spun-off businesses and their current trading multiples¹.

Like everything else that deals with the future, investing is a game of probabilities. The best we can hope for is that we and the companies we invest in are making decisions that will, over time, increase the odds of success. There is always a chance of failure, but if we can stay playing the game long enough, eventually the right decision making and risk assessment will tilt outcomes in our favour. Investing in companies that show the kind of founder mindset that Danaher has shown over the last 40 years is one of the key components to improve our odds of success as investors.

Thank you as always for your attention and your trust.

Zeno Equity Partners

London, 21st January 2026

¹ Danaher has delivered approximately double the total shareholder return for both the Fortive and Envista spin-offs since they first traded independently