Norbury Capital – December ‘24

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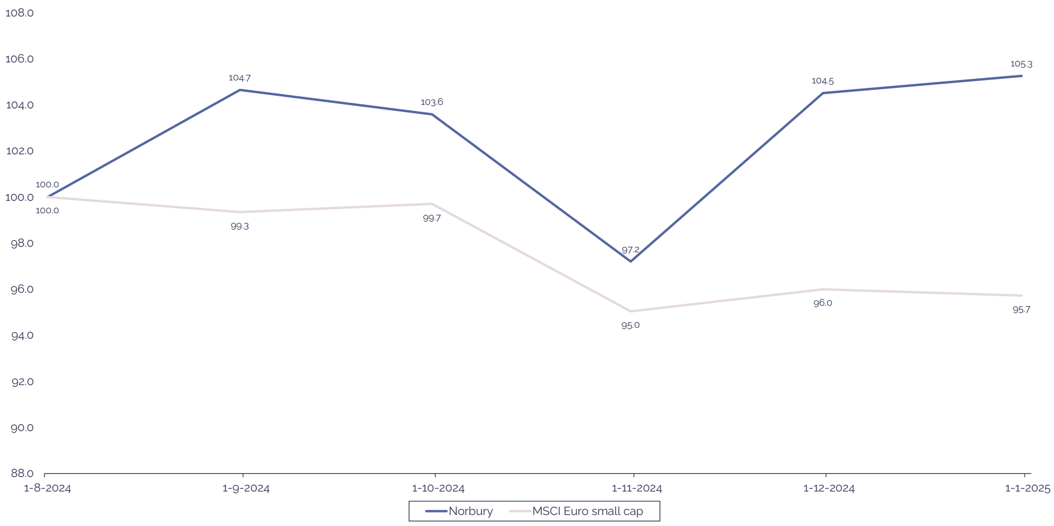
Monthly update

The Norbury Capital Fund was up 1.1% in December, outperforming the MSCI Europe small-cap index by 1.4% (-0.3%). Since our inception in August, we're up 5.3%, which is ~9.5% ahead of the MSCI Europe small-cap index (-4.3%). December was a tough month for global equity markets, with most of them ending in the red. We were able to escape this negativity, mainly because of a strong contribution from both Soitec and Zegona Communications, of which the latter rose more than 20% during the month. We'll dive deeper into why we believe this somewhat odd investment case remains extremely interesting.



MSCI Euro small cap ETF (ISIN:IE00BKWQ0M7)

Zegona is a UK-based investment vehicle that has acquired the Spanish Vodafone asset. The team behind this is experienced in buying Spanish telco assets, and previously executed a similar strategy with Euskaltel in Spain. Last year, they purchased Vodafone for €5 billion. Initially we think it was meant to be a 50-50 joint venture, but Vodafone ultimately needed to fully offload it from their balance sheet. To facilitate this, Vodafone provided a €900 million vendor loan to Zegona (structured as preference shares). Additionally, the deal included €3.8 billion in debt and only €300 million in equity. While the vendor loan appears to function as equity, a close reading of the prospectus reveals it can be redeemed at nominal value. We have been involved for over a year now and the execution by the management team has been impressive. The investment case from here onwards hinges on 2 key action buckets that are taken by management: 1) doubling free cash flow margins through cost savings, reducing capex, improving contracts with tower operators and 2) selling off their fixed infrastructure assets to transition to a purely service company model.

On both points the company is making progress. We believe the operational run-rate free cash flow has now more or less doubled. The company has taken out a third of the workforce, contracts with tower companies are being renegotiated and Vodafone is no longer a declining share donor in the Spanish market. More importantly, Zegona management has entered into 2 joint ventures around its fiber network (one with Telefonica and one with MasOrange) with the aim of selling a partial stake to a third-party infrastructure investor. This is happening as we speak: currently both JV's are in an active sale process. We believe Zegona's stakes in the 2 JV's will deliver more than EUR2bn for Zegona shareholders. This will be used to reduce leverage and more importantly, to pay down the Vodafone preference shares. The company will do this via the payment of a special dividend of 150GBp (or ~30% dividend yield) for all shareholders. This will redeem the Vodafone preference shares and reduce the outstanding equity by more than 70%. If we were to put a below industry 4x EV/EBITDA on the whole asset, this means that the share price needs to ~3x from here. A situation where a levered entity has a good line of sight towards reducing debt can typically work well in equity markets. We think we understand why the opportunity still exists here. This is currently a highly leveraged asset. The story is somewhat illiquid (and odd), and the underlying asset (a Spanish telco) is not particularly exceptional. It is easy to miss the fact that >70% of the shares are actually a debt instrument. Lastly, the share price has already performed well, which may deter some investors.

Zegona does not have the traits of a typical core portfolio holding for us, but it is one of the most interesting risk-rewards we have seen in a while. Zegona insiders tend to agree, and we have seen significant insider buying over the past year, with (ao) the operational CEO of Vodafone Spain buying for ~EUR1.5m in shares over the summer. We like the setup here and think we are set for attractive returns on our investment from here.

Partner letter #5 selling

Dear partners,

This month, we'd like to address a critical yet often overlooked aspect of investment management: knowing when to sell a position. While the investment industry tends to focus heavily on buying decisions, we believe that thoughtful selling is equally crucial for long-term success.

The Forever Stock Myth: While we occasionally find exceptional companies worthy of permanent positions in our portfolio, most investments have a natural lifecycle. These "forever stocks" that consistently deliver value are rare gems in the investment landscape- and when we find them we will definitely own them. More commonly, we must make careful decisions about when to reduce or exit positions as their risk/reward profiles evolve.

Primary Reasons for Selling:

- **Investment Thesis Materialization:** The most straightforward scenario occurs when our investment thesis plays out as anticipated. As share prices appreciate through earnings growth and multiple expansion, and market sentiment turns euphoric, our rigorous sizing and valuation processes (detailed in our previous letters) often signal it's time to sell.
- **Management Credibility Issues**: While all companies naturally present their best face to investors, there's a crucial distinction between simple optimism and deliberate misrepresentation. When we detect verifiably incorrect information from management, we must exit the position entirely. A culture of dishonesty invalidates all our investment assumptions and renders further analysis meaningless.
- **Red Flags**: We maintain vigilance for warning signs that might indicate underlying problems. A recent example was our decision to exit Renk AG following the unexpected, rapid succession of departures of their CEO, CFO, and Investor Relations lead. With our concentrated portfolio strategy, we cannot afford to ignore such significant red flags, even when we remain attracted to the underlying investment case.
- **Investment Case Drift:** Sometimes, our initial thesis simply fails to materialize, yet we find ourselves holding positions for different reasons—often purely valuation-based. To combat this "thesis drift," we maintain rigorous documentation of our investment rationale and emotional context through Journalytic, our specialized journaling tool.
- **Industry Bias and Cognitive Challenges**: It's worth noting that the investment industry shows a strong structural bias toward buying. Sell-side analysts typically maintain "buy" ratings on over 80% of their covered companies and project revenue growth across nearly all firms in their three-year forecasts. This bias is somewhat natural for long-only investors like ourselves, who can buy any security but can only sell what we already own. Furthermore, many investors continue holding positions they wouldn't purchase today if starting fresh. While liquidity constraints sometimes explain this behavior, it's more often rooted in cognitive biases such as the endowment effect and loss aversion.

Facilitating Better Selling Decisions: We believe in creating an environment that makes selling decisions as objective as possible. As discussed in our September letter, maintaining a robust pipeline of alternative investments helps overcome psychological barriers to selling. This approach not only helps protect capital but also promotes continuous, active due diligence on our existing holdings.

A disciplined selling framework, combined with our commitment to overcoming cognitive biases, enables us to maintain portfolio quality and capitalize on better opportunities when they arise.

Yours sincerely,

Thijs Buitenhuis Ernest van Tuyll