July 2024

Dear Partners

**6 months to 30 June 2024**

Our reference portfolio returned 0.77% in the 6 months to 30 June 2024, a number that belies positive developments both at the companies we own and in the construction of our portfolio. During the period, we sold our shares in Wise and Litigation Capital Management, realising significant gains. We also exited our position in Marlowe, realising a small gain, following the announcement that they would dispose of their GRC division, and that CEO Alex Dacre would be going along with it. We used the proceeds of these disposals to purchase shares in Auction Technology Group and Watches of Switzerland Group. I will discuss all these decisions in more detail below.

**NAHL plc developments**

In my letter to you a year ago in July 2023, I discussed the prospect of NAH selling their Critical Care business:

*For some time now, I have been suggesting to management that the logical way forward in the medium term is to sell the more mature Critical Care division, the economics of which have been disguised by the loss making and cash consumptive Personal Injury (PI) business. I suggested that they could use some of the proceeds to continue to fund growth in the PI division, repay outstanding debt, and then distribute the remainder to shareholders. The PI division has now reached sufficient scale that it can feasibly operate as a standalone business, provided it has access to a small amount of additional working capital. Recently, I have sensed a change in tone, and I believe the board are now open to the idea. I think it is therefore likely that they will begin a process to sell the Critical Care division within the next 12 months.*

That turned out to be one of my better predictions; management confirmed that they had begun such a process in April this year. I understand that the process is going well, with a number of interested parties providing competitive tension. Management have also been busily squirrelling their shareholdings into tax wrappers, which I am taking as a positive sign too.

Less positive in the short term is that the group's personal injury business is experiencing a period of elevated customer acquisition cost, driven by a change to Google's search protocols that has forced NAH and their competitors to increasingly rely on paid search, pushing the prices paid at auctions up dramatically. Management are confident that this is a temporary headwind and I think it's probable that a period of elevated CAC is value accretive to NAH in the long term, as less efficient claims processors are forced to leave the market. However, the timing of the short-term impact to cashflow and profit means that the PI business would now be less able to standalone following a disposal of Critical Care later this year.

In light of this, I believe that NAH should be considering all options for the PI business alongside the Critical Care process. After numerous productive conversations with CEO James Saralis, board members and shareholders, I am confident that they will do so. I would expect us to receive c.80p per share from the sale of Critical Care and c.30p per share for the PI business would represent a decent outcome[1]. While the priority has understandably been on realising value from Critical Care, as owners,

[1] NAH's share price was 57p on 30 June 2024



*Colebrooke Partners IM Limited is an appointed representative of Eschler Asset Management LLP, which is authorised and regulated by the Financial Conduct Authority (510079), and a registered investment adviser with the SEC*

we have invested significant capital into the PI business over the years and I'm determined to do everything we can to ensure that we earn the best return possible on that investment.

**Sale of Marlowe plc**

Moving quickly from a prediction that I got right to one that I got almost exactly wrong. We exited our position in Marlowe during the period after the company announced that they would be selling their Governance, Risk and Compliance business (GRC) and that CEO Alex Dacre would be leaving to continue to run it. You may remember that in my letter to you in January I predicted that Marlowe would sell their Testing, Inspection and Certification business (TIC) to pay down debt and provide Alex with the capital needed to push on with the expansion of the higher margin and more technology focused GRC business. An interesting example of how one can be right on the inputs but still get the outcome completely backwards.

While I think Marlowe's TIC business is a decent business, it was the division I was least excited about owning, and without Alex at the helm and fully cashed out of his shareholding, I decided that our capital was better invested elsewhere.

**Sale of Litigation Capital Management plc**

We first purchased shares in LCM in mid-2020, taking advantage of an irrational under-pricing of both their book of claims and the prospects of the nascent fund management business, in particular the operating leverage that business would enjoy as it scaled. Since then, Patrick Maloney and his team have executed well, expanding their fund management business significantly, continuing to carefully invest their balance sheet in a diversified array of claims alongside third-party LPs and taking advantages of the tailwinds in the litigation financing industry.

However, since 2020 two things have changed in how I view the business:

1. I changed my mind about smaller funders having a competitive advantage over larger funders. I had theorised that smaller funders were like smaller investment managers; operating in an environment where mispricings of risk are more common and not burdened with so much capital that they cannot take advantage of them and move the needle. I now believe that to be wrong and that major mispricings of risk are more likely to occur in the 'super litigation' category, where there are fewer sources of capital available to litigants and so funders can effectively name terms. There has been a dramatic increase in the amount of capital looking to fund small-mid size pieces of litigation, as new funders and insurance companies enter the market, which will have the effect of competing away a portion of the returns that LCM can earn; and
2. Funders by their nature are opaque businesses, but as an investor in LCM's listed operating company (probably more than as an LP in their funds), you are necessarily placing your faith in the team's ability to underwrite sensibly without the ability to monitor and review outside of the higher profile and larger cases. It is, I believe, analogous to investing in a reinsurance business, where long duration tail risks can lurk unnoticed for years, as can misaligned incentives that are not rectified until after the damage is done. If I am right that competition will erode returns for LCM, the temptation to loosen underwriting standards will increase as the team seek to maintain the record they are rightly proud of.

When the business recently traded at 120p, we therefore crystalised a significant gain and redeployed the capital into businesses that I consider myself more able to predict and which have more advantaged competitive positions.



*Colebrooke Partners IM Limited is an appointed representative of Eschler Asset Management LLP, which is authorised and regulated by the Financial Conduct Authority (510079), and a registered investment adviser with the SEC*

**Sale of Wise plc**

One of the tenets of my framework of when to sell a holding is 'Sell if there is a better idea – investing is an exercise in opportunity costs'. When we built our position in Wise last year at c.550p, we were paying up for a high-quality founder-led management team who understood the nature of business they were in flawlessly and were determined to stay true to course to pursue the opportunity in front of them. While earnings in 2023 were already benefiting from high levels of net interest income (NII) earned on customers' cash balances, at the valuation we paid, I calculated that we were paying for long-term earning power and getting optionality on NII for free, which is important because management have been clear that they intend to find ways to return the vast majority of this income to customers (which I like). Despite good (not great) operational progress and customer growth, when we sold our last shares in the business for 950p earlier this year, that NII optionality had become a pillar of the valuation case.

With our current opportunity set, I was reluctant to continue to make an implicit bet on interest rates and I worry that pressure will mount on management as shareholders become accustomed to elevated earnings from NII. I therefore redeployed our capital into companies that I think offer us better return expectations. I remain a big fan of the business, team and model, both as a customer and analyst, and we may well be owners of the company again in the future.

**Purchase of Auction Technology Group plc**

I have followed ATG since its IPO in February 2021. For most of that time I considered it to be fully priced (or even richly so in late 2021). That changed in December 2023 when volatile trading in its underlying markets led to significant volatility in ATG's share price and we were able to purchase shares at what I consider to be an extremely attractive valuation for a business of this quality.

ATG operates several leading auction platforms across two main verticals: art and antiques (A&A); and industrial and commercial (I&C). It is not an auctioneer but a marketplace, allowing auction houses to connect with bidders globally by running auctions online, either through white labelled solutions (in the auction house's name and on their website) or on one of the market leading platforms that ATG have acquired.

As with similar businesses, the key to ATG's competitive position (and therefore to the success of our investment!) is the ability to aggregate the most bidders for a particular auction, meaning the seller realises the highest possible price for a sale. That attracts more auction houses to a platform, which in turn attracts even more bidders. Scale enhances the network effects present on both the demand (bidder) and supply (auction house) sides of the model. Auctions also have a few quirks that further favour a dominant platform. For example, auction houses need to know that the bidders they are receiving prices and commitments from are real and can settle the transaction. Whichever platform can supply the largest pool of verified bidders should therefore win out in the long term. ATG fulfils this role in several of the key markets around the world across each of its verticals.

While circular economy trends may or may not lead to an organic increase in interest in auctions, ATG are focused on pulling in new bidders by transforming a reasonably complex and unfamiliar purchasing journey into one that is more akin to an ecommerce experience, with ATG Ship and ATG Pay both smoothing out particularly gnarly pain points. These value-added services will benefit ATG's take rate over time while improving the offering to auction houses, a powerful combination.



*Colebrooke Partners IM Limited is an appointed representative of Eschler Asset Management LLP, which is authorised and regulated by the Financial Conduct Authority (510079), and a registered investment adviser with the SEC*

Students of the US tech behemoths will recognise this as the 'Marketplace Playbook' or as an example of 'Aggregation Theory'. Whisper it, but I think we have an aggregator lurking on the LSE, far away from the West Coast and its natural constituency of investors.

CEO John Paul Savant joined the business in 2016 specifically to execute this playbook. He is surrounded by a very capable and experienced team, and they have a singular understanding of what success looks like. This includes continuing to make acquisitions of dominant platforms in near adjacencies to their existing offerings, which would normally raise flags with anti-trust regulators. Management tell me that so far they have met little resistance from regulators in Europe or the US; maybe the physical auction business is so disparate and 'Old Economy' that it can fly under the radar for a while yet. Let's hope so, because even a couple of additional astute acquisitions coupled with ongoing execution of their operational plan could turn a very powerful competitive position into a near unassailable one.

**Purchase of Watches of Switzerland Group plc**

WOSG is a retailer of luxury jewellery and high-end watches. It has relationships stretching back over 100 years with some of the top watch brands in the world and is seen as an important guardian of their brand equity. It is the leading retailer of Rolex watches in both the UK and is rapidly growing its presence in the US market. WOSG has one of the strongest competitive positions I have ever seen and a terrific and motivated management team, led by CEO Brian Duffy.

We purchased shares in WOSG earlier this year after a collapse in sentiment triggered by a combination of: Rolex's purchase of Swiss distributor Bucherer in August 2023, which has been seen by some (incorrectly in my opinion) as a signal that Rolex intends to take distribution in house; and a trading update revealing that sales in the UK had been soft over the 2023 Christmas trading period, driven in part by the mix of steel to precious metal Rolexes that WOSG had been allocated.

From its IPO in 2019 to today, WOSG has compounded revenues at c.20% and profits at 37% without issuing new shares or significantly increasing debt yet is currently trading at a valuation of 8x my estimate of FY25 earnings. What's more, they have ambitious plans to double sales and more than double EBIT by FY28. I have had numerous conversations with management, former employees and industry insiders (including at Rolex) to test how realistic these plans are and came away with the following conclusions:

1. It is clear to me that Rolex are tying their US plans to WOSG's. Rolex are fully supportive of WOSG's US growth plans, which necessitate making numerous acquisitions of existing authorised dealerships. WOSG recently pulled out of Europe, where Bucherer predominantly operate. I believe this was part of the deal to secure Rolex's unequivocal support for WOSG's US expansion plans.
2. To some extent the timing of achieving these ambitions is out of WOSG's control, so it may well be FY29 rather than FY28 when they meet their milestones. Our purchase price means that we will do very well if WOSG execute their plan regardless of whether they do so over 4 or 5 years.
3. Management are excited and confident about the long-term expectations that they have put into the market, indicating that despite difficult current trading, the foundations of their growth plan remain intact.

It is rare in investing that you have a high level of confidence in the bets that you are making. However, in this case, I am confident our investment in WOSG will be successful if the following are true:



*Colebrooke Partners IM Limited is an appointed representative of Eschler Asset Management LLP, which is authorised and regulated by the Financial Conduct Authority (510079), and a registered investment adviser with the SEC*

1. Rolex will remain the top selling luxury watch brand in the world for the next 5 years;
2. Rolex will not seek to bring distribution fully in-house, despite its acquisition of Bucherer and if I am wrong and it does, it buys WOSG as the most logical route into distribution in the UK and US (top two markets);
3. Rolex and other major brands will continue to manage demand and supply in such a way that demand for new watches significantly outstrips supply;
4. Luxury watch brands will continue to closely guard their brand equity and seek to control the interaction of brand and customer by prioritising in-person sales over DTC online sales; and
5. Luxury watch brands will continue to favour trusted long-term partners over new entrants when planning their expansion and growth plans.

Before signing off, I'd like to spend a couple of paragraphs on number 2 above and why I do not consider the acquisition of Bucherer to be a statement of intent to bring distribution in house, as that is probably the one point that marks our stance as contrarian versus the market.

First, it is important to put the acquisition of Bucherer in context. Bucherer accounts for 10% of Rolex's revenues and is focused mainly on Europe. It is an important partner of Rolex and has been since 1924, 5 years after the partnership with WOSG was formed. 2 years ago, the 4th generation of the Bucherer family let it be known that they did not wish to continue the family's active involvement and wished to sell the company. The natural purchasers were likely to be either private equity or one of the major luxury houses (for example LVMH). I am told that Rolex, which takes its role in the Swiss economy very seriously, decided that it could not countenance the idea of a major Swiss partner falling into the hands of a competitor or private equity ownership. It therefore agreed to buy the group but promised to maintain status quo, keeping management in place and assuring competitor brands such as Patek Philippe that also sell through Bucherer that it would not favour Bucherer stores when making its model allocations.

Second, Rolex is structured as a non-profit foundation and its primary purpose is to support its perpetual initiatives. Its primary identify is that of a watch *manufacturer* and it has long espoused the view that specialisation and focus is the route to lasting brand value. The main reason to bring distribution in house and take on the added cost (and distraction) of running your own extensive retail network is to capture the margin lost to distributors and retailers. It strikes me that adopting this course of action would not be aligned with either its primary purpose or its primary identity. However, as I note above, if I am wrong about this and Rolex surprise me, I think there's a very good chance that the logical route into distribution and retail is to acquire WOSG and its footprint of ultra-prime stores in the UK and US.

**Thank you**

This will be the last letter I write to you before most of our separate managed accounts are consolidated into the Colebrooke Opportunities Fund, which is scheduled for launch in September. I'm very much looking forward to this next stage in our investing relationship (pooling our money at long last!). If you know anyone that might be interested in joining us, please send them my way.

As always, please shout with any questions you have. Thank you for your continued and patient confidence.

Yours

Jack



*Colebrooke Partners IM Limited is an appointed representative of Eschler Asset Management LLP, which is authorised and regulated by the Financial Conduct Authority (510079), and a registered investment adviser with the SEC*

**Appendix**

**Holdings as at 30 June 2024 (alphabetical order):**

ASOS plc (ASC.L)

Auction Technology Group (ATG.L)

Midwich plc (MIDW.L)

Moonpig plc (MOON.L)

NAHL Group plc (NAH.L)

Naked Wines plc (WINE.L)

THG plc (THG.L)

Watches of Switzerland Group (WOSG.L)



*Colebrooke Partners IM Limited is an appointed representative of Eschler Asset Management LLP, which is authorised and regulated by the Financial Conduct Authority (510079), and a registered investment adviser with the SEC*

**Disclaimer**

The contents of this document are communicated by, and the property of, Colebrooke Partners IM Limited (“Colebrooke”). Colebrooke is an appointed representative of Eschler Asset Management LLP (“Eschler”), which is authorised and regulated by the Financial Conduct Authority (“FCA”). The information and opinions contained in this document are subject to updating and verification and may be subject to amendment. No representation, warranty, or undertaking, express or limited, is given as to the accuracy or completeness of the information or opinions contained in this document by Colebrooke or its directors. No liability is accepted by such persons for the accuracy or completeness of any information or opinions. The information contained in this document is strictly confidential. The value of investments and any income generated may go down as well as up and is not guaranteed. Past performance is not necessarily a guide to future performance. Investment is only suitable for professional, certificated high net worth and sophisticated clients as set out in COBS 4.12 of the FCA handbook. If you do not meet these criteria, you must not place reliance on this document and will not be eligible to invest in the strategy. This document has been created for information purposes only and has been compiled from sources believed to be reliable. Neither Eschler, Colebrooke or their directors, officers or employees accepts liability or for any loss arising from the use here of or reliance hereon or for any act or omission by such person or makes any representations as to its accuracy and completeness. No part of this report may be reproduced or distributed in any manner without the written permission of Eschler. No investment in the strategy should be considered without reading the management agreement in relation thereto and the risk warnings contained therein.