



Friday Morning Coffee

Nr. 144 — Change is around the corner

With the hindsight bias of course, but sometimes we get a sense that not all investment decisions are tricky. Follow the established market wisdom and sit out a quarter or two; Change is around the corner. Today we would like to bring your attention to one such investment decision that we took back in 2019 that can simply be framed around three markets wisdoms;

“You should invest in a business that even a fool can run, because someday a fool will.”

...Warren Buffett

“Invest in a good business with a bad management and wait for heads to roll”

...Ashwath Damodaran

“Just as the London buses, profit warnings come in threes”

...Anonymous

The business under consideration is Norma Group. The company produces clamps, couplings and connectors and fluid handling devices. It services wide range of industries and customers. No single customer account for more than 5% of the revenues. Norma has the product range of over 40 thousand SKUs and sells over 2 billion units annually, which has on average ASP of 60 cents EUR. The aspect of the case that we liked the most was the visibility the business had historically shown on the costs and operation side.

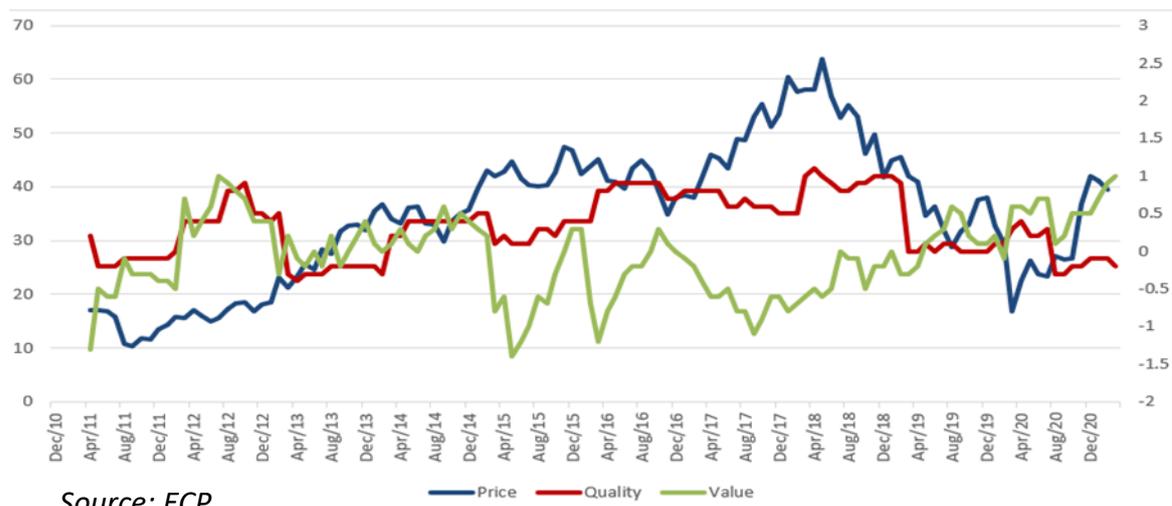
The products that Norma sells are lowly valued, but mission critical that is why we see more than 50% of the sales come from customized solution wherein Norma engages with OEMs in the early stages of product development whereas the remaining share comes from standardised products. Irrespective of how unexciting its product portfolio is for market participants, the business had historically generated a ROIC of 10% and in combination with strict control over working capital, opportunistic M&As led the company becoming an undiscovered cash and earning compounding machine. Norma was able to grow profitably, even after not having such a great product portfolio due to a very scalable platform it had built and as is the nature of any scalable businesses, these businesses generate extremely attractive incremental returns.

Even a good business such as Norma could be taken to the cleaners by the market participants, if the fundamentals go out of sync. Seeing the mispricing of the underlying business due to short term hindrances bring us, the longer-term investors, come into picture. Norma had been having tough times since 2018, as the then existing management, going tangent to predecessors' footsteps, prioritised growth over profitable growth and ended up adding too much capacity. Not a wise decision when the global PMIs are softening. Fast forward to last quarter of 2019, Norma had already come out with three back-to-back profit warnings, that ticked two of the wisdoms mentioned earlier and we built a starter small position in the company. A month later after building our position the inevitable happened; Norma's CEO had resigned. That's it. We increased our position given that the incoming CEO was long term veteran at Norma and all he has to do is to rationalize the cost base and capacity.

Nr. 144 — Change is around the corner

At the time of writing, Norma has published its annual report yesterday. Although the Covid crisis made the year a bit challenging, but the progress that new CEO has made looks very commendable. The Norma story is yet unfold, as can be seen from our Q-V chart, but point we are trying to make is you don't really need sophisticated AI algorithms and alternative data to generate returns in the markets, just stick to age old principles.

Norma



Have a nice weekend,

Your ECP Team
March 26th, 2021