

Bilbel Capital

Annual Letter - 2nd February 2023

Returns Since Inception	Bilbel Capital	S&P 500 Index
2022	208.74%	-4.84%
Total Return	208.74%	-4.84%

Returns are time-weighted, and measured in EUR. Periods run from February 1 to January 31.

Portfolio

Reysas Logistics	100%
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As the first year of our partnership has come to a close, we wanted to take a moment to express our gratitude for the trust you have placed in us. Your support has been invaluable, and we are truly grateful.

As investors, we have realised that we have learned much, and we have also realised there is much to learn...

We know a drop. We may know it well, but we know a drop. And there's an ocean to discover, and most will probably never be discovered.

What Have We Done?

Since inception, we have put all our capital into Reysas Logistics. We estimated that its liquidation value was around 1 Billion USD, and its intrinsic value considerably higher.

Reysas Logistics

Reysas owns 62% of Reysas REIT (RYGYO), which is the entity that holds the warehousing business. This is currently the most valuable part of Reysas.

The rents from warehouses increased significantly from \$3-5/sq.ft to \$10/sq.ft in the past few years.

Their latest 10 year lease contracts done this year were going around \$20/sq. Ft.

Taking the 2 largest (sqm) contracts done in 2H 2022,

1. Mercedes, October 2022:

- 35M USD, 15,000 sqm, leased for 11 years.
(20 USD per sqft + VAT + PPI + CPI)

Represents 1.25% of RYGYO warehouse space for 3.2M euro (p.a), or around 1.9% of REYSAS warehousing share.

2. Carrefour, November 2022:

- 13M USD, 18,000 sqm was leased for 5 years.

(13.5 USD per sqft + VAT + PPI + CPI)

Represents 1.5% of RYGYO warehouse space for 2.6M USD (p.a), or around 2.4% of REYSAS warehousing share.

(This was after their previous 5 year contract for 7 USD per sqft in 2017 had expired)

The main causes for the lease price surge are two-fold.

1. Zoning issues (Somewhat of an impact)
2. Pullback in bank lending in Turkey (High Impact)

Zoning Issues

When regulations become more restrictive in one market, investors often seek alternative markets where they can invest with greater ease and flexibility.

In this case, the restrictive zoning regulations in Russia led to increased demand for real estate in Turkey, where investment is also much easier to make. Turkey also sits at quite a good location where it can serve many markets, and is also a free trade area for the EU.

Pullback In Bank Lending In Turkey

Despite heavy inflation and devaluation of the Turkish lira, the Government holds restrictions on the bank's interest rates. Banks are forced to loan out money for most real estate in Turkish lira at around 12-20% interest per year.

This significantly hurt the banks, and since this was in no way sustainable, the banks had to pull back on lending at low rates because of immediate default concerns.

This heavily reduces the supply for new Warehouses, as the investment without lending is much less attractive. The reduced supply, in turn, increases the rent yield as tenants have less to choose from, which makes the existing warehouses more valuable.

Lease Agreements

On average, the duration of a lease agreement is 5-10 years, meaning they (roughly) re-lease 10-20% of warehouse space each year.

Is the 'boom' in Warehouse rents sustainable?

In business nature, the discrepancy between the time of demand and the time of supply dictates the discrepancy between price fluctuations.

Let's look at high rise commercial real estate, such as office towers. Generally speaking, these office towers take 5-6 years to build.

When the market is really tight, rents start rising, and a lot of these projects get started, because the economics look so favourable.

What happens, due to herd-like behaviour, is that all these towers get started at about the same time, and get delivered at around the same time.

So you go from a very tight market, to a depressed market, because there's too much supply.

This 5-6 year period in office towers leads to booms and busts in commercial real estate.

We don't see the same nuance in commercial warehouses, simply because the discrepancy in time between demand and supply is lower. Around 12 months.

Therefore, the boom and bust cycles are much smaller.

Since the leases for the warehouses have been increasing significantly in the last 5 years, the cycles should have caught onto themselves by now. This means that the current trend of rents is unlikely to drift downwards.

Why don't people ever learn about these boom and bust cycles?

Humans tend to extrapolate current conditions for an infinite time horizon, maybe as a survival mechanism to adapt quicker to the environment around them. We tend to believe that thinking independently from first principles is a better system to use.

Our estimated replacement value of RYGYO today is around \$1-1.2B. The solar business is roughly around \$200M and carries \$80M of debt.

Reysas Logistics' share is around \$750-850M.

The other Reysas Logistics businesses are very hard to value, but my best guess would be around \$200M. The main reason they're hard to value is because these businesses are easier to expense investments in, (Tax efficient), making the profits mis-represented.

Reysas Warehouses + Solar: \$750-850M

Rest (Logistics Businesses): \$200M (Very rough estimation)

Total liquidation value is ca. \$1B vs. a market cap of \$0.25B. A 4x from today's liquidation value.

Looking at intrinsic value, this is basically what a private business would be ready to pay for all of Reysas logistics. We would say the reasonable case would be \$1.5B (today).

Since Reysas earns revenue in Euro/USD but has expenses in TRY, we think that, despite high inflation and Turkey's monetary policies, these economic challenges won't heavily affect Reysas' long-term value.

Over the long term, the internal economics of the business are much more impactful than the environment that surrounds it. That being said, any business in North Korea might not be the best idea to buy, regardless of valuation.

We try to assess everything by thinking independently for ourselves.

Concentration Risk

Most of what has to be understood about diversification has been addressed in the last report.

Since a stock is a fractional ownership in a business, the only real risk one faces relates solely to the discrepancy between the current price of the business and the value.

The price is known, so the risk relates to:

The deterioration of the value of the business.

The warehousing business is not a tough business to understand. It's relatively straightforward. We might be wrong by 5, 10, 20%, but not by much more than that.

The deterioration of the value of the business will mostly come from internal business problems, not from monetary policies and inflation.

Since the father and son are the sole decision makers of the company, most of the risk relates to their future capital allocation skills. They have allocated well in the past, and will probably continue to do well in the future.

The incentives are aligned correctly. They own 35% of the company and it's their baby. They are the founders. If they do well, we do well. If we do well, they do well.

These warehouses are prime properties, in prime areas. Rents are stable with inflation hedged, 5-10 year long contracts with blue-chip international tenants; and over 99% occupancy rate. This also suggests the prices of the leases are reasonable.

It doesn't get much better than this.

Having said that, the management does not need to deliver extraordinary results for us to have an exceptional record.

If they grow the business' value at 7% a year, the value of the business would double in 10 years.

In 10 years, we would be owners of a business that is at least 10 times more valuable than the stock we bought today.

How we see Reysas as a company in the next 10 years:

Warehouses: at least 15 USD per sqft p.a, would yield roughly 120-150M normalised earnings for Reysas Logistics, reasonably around \$1.5-3 Billion USD Warehouse value.

Solar: Continued expansion of solar until storage limit. We do not have any insight on the storage limit, so we will not make any predictions on this. Having said that, the return will likely be more than the assumed 7% below.

Other Logistics: These are the hardest to value. If we assume these businesses to be worth cumulatively around 200M, and will probably grow at 10-20% a year for a considerable amount of time. They seem to have very favourable economics, from the return on capital they have gotten and are expecting to get. These businesses do not face heavy competition.

Retained Earnings

The Logistics part, with growth only from their retained operating earnings, can be worth anywhere from 400M to 1B in the next 10 years.

(Assuming the growth rate to be between 7% and 15%)

Retained earnings from Warehouse leasing + Solar in the next 10 years would be around 800M-1.5B, and would be worth 1.2-2.2B USD.

(Assuming the growth rate for Warehousing to be around 7%, they are smart in the way they buy land and secure real estate deals.

Assuming Solar return on capital to be around 7%, a global standard for solar panels. On a pure equity basis, from solar investment in 2019 they were expecting to get their investment back in 4 years, however I believe this was with government grants/benefits which are not guaranteed to remain)

Total Reysas Logistics Value In 10 years (2033)(USD)

Today's Warehouses: \$1.5B - \$3B

Today's Solar: \$100 - \$150M

Other Logistics: \$0.4B - \$1B

Retained earnings from Warehouses + Solar at 7% returns: \$1.2 - \$2.2B

Total Book Value in 2033: \$3B - \$6B

Stock today: \$0.25B

If the expected return on capital after 10 years is above average, Reysas would be worth **at least** book value.

Since the management team is significantly above average in terms of capital allocation skills with \$1B, we would assume that there is a high probability that they can deliver at least average returns on capital, even with \$5B or \$10B in Capital.

Maintenance CAPEX (expenses) -> rather difficult to calculate, but near 0 for warehouses, and near 0 for solar.

(Depreciation charges account for more than enough, as these assets are appreciating, not depreciating)

For other logistics, we would say this is roughly covered by the depreciation charges, no need for further adjustments.

Potential Solar Value Risk

Nuclear fusion has the potential to produce clean, abundant, and safe energy. Fusion reactors could be made small enough to be deployed anywhere, making it possible to generate energy in remote locations without the need for extensive transmission lines. The successful development of fusion could ultimately make solar power obsolete, however it seems like we are still very far from that.

We regard the probability of a total loss of capital from solar to be low for the next 10 years. Having said that, we do not really have a clear insight on what will happen after that.

Even if the value of solar in 10 years is 0, our investment in Reysas will still work out fine. Reysas gets back the solar investment within 4 years (by using leverage), so we don't see much risk.

Having said that, Turkey has no fossil fuels, and the amount of electricity they are importing every year is increasing significantly, which increases the rates they are ready to pay for electricity produced in house from solar.

Why Founder Led Businesses Are Generally Superior

Founder-led companies have a unique competitive advantage due to the incentive of the founder. A founder's personal stake in the success of the business often leads to long-term decision-making that benefits the company and its shareholders, because the incentives are aligned.

The time horizon of the manager dictates what types of actions are to be done in order for him to benefit the most.

If we take a CEO that stays 3 years in a company, the incentive is to show growth externally as much as possible in those 3 years, regardless of what long term consequences exist. Reason being that he benefits the most because the stock of the company performs well. It's worth noting that many CEO's get compensated based on how the stock does during his time employed (Absolute nonsense).

If the founder has a 20 year horizon, the only thing that would drive him to more success in those 20 years is how the business internally performs. The stock will follow.

The results are a product of the variables that are focused on.

These variables change according to the incentive, and the incentive changes according to time horizon.

Another competitive advantage of a long time horizon is simply less competition due to less people being willing to wait years or decades for exceptional end results.

The fact that Reysas is founder-led gives us plenty of comfort, and much more trust.

How Will We Proceed?

We will buy and hold stocks in which we think we have a very low chance of permanent loss of capital and a high chance of high returns.

We will keep Reysas, and move accordingly. If we had a clear vision on other companies that can give us much higher returns at the same or less risk, we would take it any day of the week. But we haven't, yet.

One Thing We Have Discovered

Intelligence can only be measured by the discrepancy between what is seen and what is there. The lower the discrepancy, the greater the intelligence.

The less suffering one feels, and the easier it is to achieve what one wants to achieve, also in a shorter period of time.

Seeing is the ultimate doing.

Only by seeing what others don't, do we get what others don't.

Yours sincerely,

Gabriel Sammut.