

September 27th, 2025

2025 Third Letter to Shareholders



Dear partners,

The last few months have been abnormally positive for our portfolio, in terms of both performance and smoothness. We have endured too little suffering; let us beware of the possibility of complacency born of it.

A study ([“Even God would get fired as an active investor”](#)) of US-listed stocks has shown that even if you had perfect clairvoyance during the past 100 years, and were able to pick the top decile portfolio in every five-year window, you would have multiple double-digit drawdowns.

That is the nature of stock picking. Opportunities exist precisely because of such short term losses. Let us embrace them when they - inevitably - return.

	Annual	ACWI	SPY
2020 (Dec)	3.7%	3.4%	3.3%
2021	23.2%	16.6%	27.0%
2022	-17.1%	-19.8%	-19.5%
2023	8.6%	19.9%	24.3%
2024	35.8%	15.5%	23.3%
2025 (Jan-Aug)	35.2%	13.6%	10.1%
Accumulated	111.1%	52.8%	78.2%
Annualized	17.0%	9.3%	12.9%

ACWI and SPY are ETFs that track the performance of the MSCI All-Country World and the S&P 500 indexes, respectively.

As a reminder, the ETFs shown in the table above are not benchmarks. The Fund at the moment has no position in any of their constituents. Its NAV (Net Asset Value) is calculated after all fees and expenses.

So, temper your excitement. Do not expect these recent returns to be recurring - that would be a recipe for disappointment. Painful drawdowns are not only absolutely bound to happen again, but they may even be just around the corner.

The (un-)importance of catalysts

Catalysts are corporate events - such as share repurchases, spinoffs, M&A - that have not yet occurred but, once they do, can trigger a re-rating of undervalued securities towards their intrinsic value¹.

While I do recognize their importance, I would argue they are not requirements. From the beginning of the year until the end of August, both Tianjin Development Holdings and First Pacific shares are up more than 40%. These are remarkable movements, and yet had no particular reason to happen. As [Walter Schloss](#), whose portfolio returned more than 15% per year, after fees², during 47 years, used to say: *“If you buy low enough, something good may happen to you”*.

The stock market is, after all, a complex system. I certainly try to shy away from trying to attribute justifications for (most) securities movements. My job is to find extremely undervalued securities, and wait. If I could buy on day one at an extremely discounted price, and sell on day two at fair value - repeat that over and over -, that would be amazing, wouldn't it? Instead, more often than not, the waiting time is measured in years.

Usefulness and limitations of AI

1) Usefulness

Recently, a discussion about the potential [replacement of stock analysts by AI](#) has made the news. It can certainly, and easily, provide a shortcut for summaries and introductory explanations of industries and companies.

¹ If they are expected to happen, should not they already be priced in?

² Quercus Fund's fee structure is actually similar to his (and Warren Buffett's original partnerships): 25% of the profit after a 6% hurdle rate

That is especially true if you know what you are trying to understand, and knows how to ask³.

You may remember that Indofood was the primary reason we are invested in First Pacific (if you do not, don't worry: [2023 Third Letter to Shareholders](#) is still available). Even if I learned that noodles "do not travel well" - in most large countries (and that is true for Indonesia, South Korea, Japan, Vietnam, India, Pakistan, Philippines, Egypt, Nigeria, or even Brazil), the 40%+ market share leader produces them locally - I struggled to understand why. Capacity is not that difficult to build, and the product does not exactly require rocket science.

Logistics costs kept coming to mind. But valued at more than USD 500 per ton, that did not look like an issue: after all, commodities costing less than USD 200 per ton have active seaborne markets.

I decided to dig into it with the help of ChatGPT. After a few iterations - the answer did not come easily, and even when it came, the software was not able to recognize it - we reached a satisfactory conclusion. While in theory the value per ton could allow it to be sold internationally, the low density (in other words, the volumetric value) is the constraint! Stack a cubic meter of noodle packs, and it would be worth maybe USD 150. International freight costs alone would be in the vicinity of 80 usd/m³. A single 40ft container would only be able to carry as little as USD 20,000 of merchandise.

Well done, virtual research analyst.

But how can it be helpful if you do not know what to ask?

(Quasi) post-mortem: West China Cement bonds and equity

2) Limitations

In normal circumstances, cement does not travel well either: its value per ton is too low, so beyond a few hundred kilometers, its competitiveness is limited by transportation costs.

Therefore, within a certain radius of the limestone quarry, the local production may be as dominant as a local monopoly⁴, as long as it prices it accordingly. It may be a great

³ Saying "please" may not be enough

⁴ Is cement a cartel-prone industry? Historically, there were notable (and sanctioned) cases in Brazil, Germany, India, Italy, South Africa, Spain, USA...

business: the richest man in Africa, Aliko Dangote, is the leading cement producer in Nigeria.

Except if you are in China. Abundant availability of limestone, associated with outstanding transportation networks, leads to one of the most competitive markets of the world. Add to that a weak demand environment - the real estate sector has been struggling for years -, and the substantial over capacity becomes a problem to any player.

This was not my first adventure with West China Cement. Hidden at the last page of the [2023 Annual Event presentation](#), it was mentioned as a potential next core position.

Although it has “China” in its name, most of its profits actually come from Africa. With Chinese speed of expansion, it quickly became one of the leading producers of the continent, especially in capacity-constrained countries such as Ethiopia, Mozambique and Democratic Republic of Congo.

But after a year (and a 50%+ increase in the stock price), its high leverage started to worry me. Not that it was extremely high per se; a potential issue was that it may be easy to invest in Africa in general, but less so to disinvest - capital controls could restrict the company’s ability to repatriate funds when needed. So its debts may have to be paid with free cash flow from Chinese operations. Given the domestic market situation, those would not be enough to pay the totality of the senior notes due in 2026. So at some point in 2024, I decided to pocket the profits.

But I remained optimistic about its plans for sub-Saharan Africa, a continent with huge pent up demand in infrastructure, positive demographics, and where cement prices tend to be higher, leading to (at least on paper) superior returns of greenfield projects.

So I kept track of the company. In January 2025, it announced the acquisition of an older existing cement plant in DRC, owned by Heidelberg and World Bank’s International Finance Corp. Intriguing. Perhaps the relatively high leverage is not a significant constraint after all.

When its annual report was out, hidden somewhere in the 170 pages document, it was explicitly stated: “(...) certain financial institutions that have expressed intention to offer to the Group new banking facilities. The Group received banking facility proposals and/or letter of intent amounting to (...)” an amount larger than the total of the senior notes due the following year.

That phrasing looks more solid than Drexel Burnham Lambert's famous - and consequential - [highly confident letter](#) (an eventful development that catapulted the LBO market and, together with it, the fortunes of Carl Icahn and so many others).

At the time, the bonds were trading at a whopping 30% yield to maturity (granted, it was due in a year, so the price upside was smaller than it looks).

Even if the banks backed out, or the statement was simply untrue, there were still a few quite feasible alternatives for the company to dodge a default.

- a) It had just started production at the massive, brand new 5 Mtpy plant in Ethiopia. With project risks behind it, any major global producer would be interested in buying it.
- b) Its second largest shareholder is Anhui Conch Cement, one of the largest cement companies in the world, which has a negligible presence in Africa. Keeping West China Cement alive is definitely in its interest. So it could either loan the funds to refinance the bond, buy some of WCC's Chinese assets, buy some of WCC's African assets, or even participate in a capital raise.
- c) Worst case scenario, in the event of a default and restructuring, the pricing of all its listed assets would be messy, and I am sure the NAV of the Fund would be heavily affected in the short term. However, at the end of the day I would not mind receiving equity in lieu of the bonds. Actually, since I believe the whole company is worth (much) more than the value of all its liabilities, I would probably be happy, depending on the price of the recovery value of the bonds.

The odds of a default on the bonds appeared low - and even if that happened, an actual downside seemed unlikely. So I decided to be versatile, and bought a high yield bond for the first time for the Fund. No brilliance, no multibagger hopes. Only a safe(ish) proposition to earn 30% in a year.

At some point, it became our largest position.

A few months later, WCC announced the sale of its Xinjiang plants to Anhui Conch, and the stress was over. That should be enough to ease the short term liquidity needs. Both the bond and the equity promptly re-rated. The timing of the purchase of the bond was sheer luck.

That can be described as a positive catalyst. Yes, life gets easier when they happen; I can't argue against it.

That also makes for an example of something that an AI would probably not be able to find for me - especially because I did not know what to ask for. I was not looking for details on how the company would address the upcoming refinancing needs.

Reading whole documents, digging through them, remains important. We do not know when we will just stumble on opportunities, by both luck and some insight. And I am sure I missed plenty of similar opportunities simply because I was not attentive enough while reading.

The bond is no longer part of the Fund's portfolio; those were sold after the quick re-rating. At the moment, the Fund continues to be a shareholder of West China Cement, on the thesis that at least a decade of profitable expansion in Africa seems likely, and the Chinese operations seem to have reached an inflection point.

Best regards,

Diego B. Milano

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