March 2025

Dear Fellow Investors,

Adestella advanced 4.2% in the final portion of the year. Long positions gained 5.1%, slightly offset by 23 basis points of losses from shorts. US markets rose in Q4 as prospects for faster growth and lesser regulation improved following the election. 2024 marked the second straight year of 20%+ S&P gains driven largely by a small group of large-cap tech stocks. On the flip side, concerns about the potential impact of tariffs and relatively weak growth led many international markets to decline sharply, and neither our developed nor emerging market holdings were spared as European and EM indices fell 7% to 10% in USD terms. The result was a continuation of a trend we've seen for several years now, with our US-based stocks generating a 6.8% net contribution while foreign equities produced a 2% drag.

Setting the Screen

I have spent a lot of time recently reviewing our idea generation processes and asking myself whether they are efficiently uncovering actual edge opportunities. They have worked well in finding under-the-radar compounders, but in my view, the effective radar of market participants is likely to continue to increase in the years ahead and cause this particular opportunity set to dwindle. Meanwhile, a fairly large portion of our holdings in the "variant view" category have been sourced via outside entities – stock theses posted on online forums, shared during idea dinners, etc. While perhaps this is solely a function of a particularly strong run of pitches, it also suggests that our screens and alerts could be producing a more effective pipeline. Outsourcing this search process is not a reliable portfolio construction option for the long term, and we don't want to become complacent and expect future opportunities to fall in our lap.

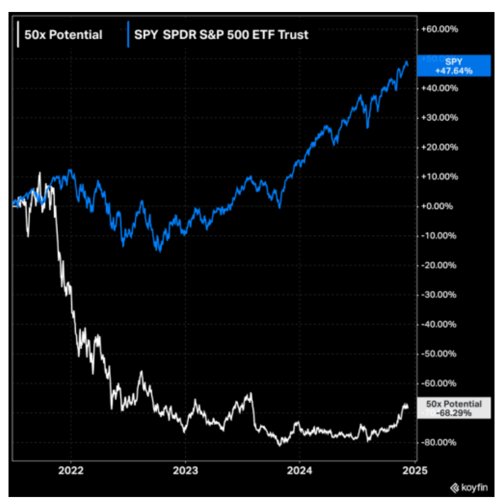
Thus, we are adding some new data providers and refining our gathering and filtering methods. Central to this push is identifying situations that may be approaching an inflection point of some sort. In contrast with a catalyst, an inflection represents a sustainable change in the status quo rather than just a one-off event. Sometimes this can be a technical factor like the ease and availability of trading (such as with PSIX & NBIS), but usually it is instead related to business fundamentals – margins expanding as an industry consolidates, free cash flow finally materializing after years of heavy investment, and the like. Honing in on these "in flux" situations increases the odds that we can come to a fair value estimation that, at least in the short term, varies significantly from the market's. Finding such setups in a systematic manner is tricky, but combining various sources, tolerating many false positives, and applying discretion to separate wheat and chaff should give us a good chance of uncovering a few. One recent portfolio addition that fits this mold is discussed in more detail in the following section.

Twilio Zone

Twilio (TWLO) is a Bay Area-based provider of cloud communication services (via its CPaaS). It started as a voice and message provider; a famous early use case was enabling communication between Uber drivers and passengers without either side needing to share their real phone numbers. Twilio went public in 2016, and in the years that followed the company gradually expanded into related verticals, such as 2FA and customer data analytics. The Everything Bubble that peaked in 2021 was particularly kind to software companies. Revenue growth was the holy grail, and firms that could deliver it often traded at nosebleed multiples regardless of operating losses or shareholder dilution. TWLO's stock thrived in this environment, and encouraged by investor enthusiasm during these heady times, it (like many other tech firms) dramatically ramped hiring in the post-pandemic period and tried to buy further growth via M&A.

A reversal of fortune came in 2022 as interest rates rose and investors reassessed the actual economic value fast growers were creating. The Everything Bubble popped; as one illustration, the graphics below show the actual performance of 20 companies that in mid-2021 were often deemed on social media forums to have 50x potential based on their buzzword industries and huge purported TAMs.

Symbol	July 20, 2021 Price	Current Price	Percentage Decline
AYX	79.89	48.25	-39.6%
BOMN	31.51	14.76	-53.2%
BYND	130.60	4.40	-96.6%
DM	9.22	2.48	-73.1%
WISH	304.20	0.35	-99.9%
FVRR	225.96	33.06	-85.4%
GLBE	56.02	61.90	10.5%
JMIA	23.33	4.04	-82.7%
LMND	86.59	38.49	-55.5%
UPST	117.63	86.89	-26.1%
LTCH	11.14	0.16	-98.6%
NNOX	27.82	6.54	-76.5%
OPEN	14.60	1.58	-89.2%
SOFI	15.06	16.83	11.8%
RDFN	58.22	8.84	-84.8%
OZON	53.75	38.23	-28.9%
SPCE	32.03	4.56	-85.8%
TWST	121.31	46.70	-61.5%
YETI	91.80	38.43	-58.1%
		Average:	-61.7%
		Median:	-73.1%



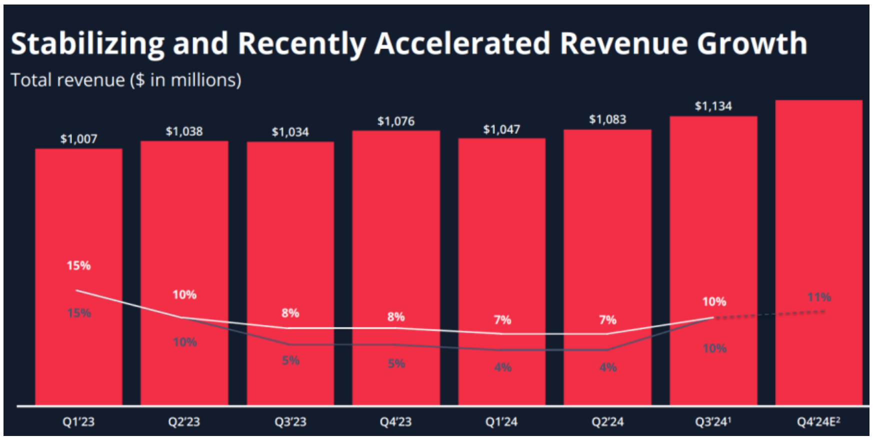
TWLO was not at all immune to this reset, and over a nearly two-year period fell roughly 90% peak-to-trough. To make matters worse, its major M&A deal, a customer-data platform called Segment – a transaction that at the time was described as being completed "astonishingly fast for an acquisition of this size" – did not grow anywhere fast enough to justify its lofty purchase price. This return to earth (along with mounting activist attention) forced TWLO to reassess its priorities and shift from a "growth at any costs" mindset to one where profitability was the north star. The company then attempted to reverse some of its missteps from the previous years by slimming down via three rounds of layoffs and unit restructurings from late 2022 to 2023.

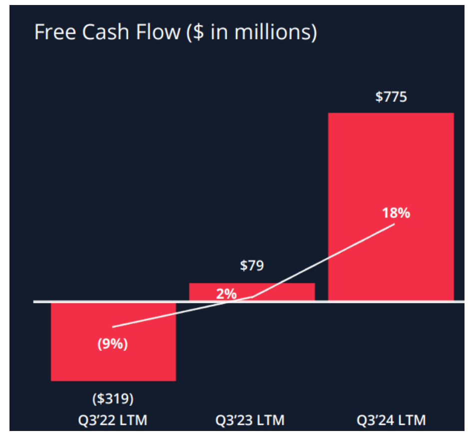
The reductions remained inadequate though, and activists Anson Funds and Legion Partners continued to press for further improvements. Founder and CEO Jeff Lawson's mistakes had proven too much to overcome, and he stepped down in January 2024. His replacement is the current CEO, Khozema Shipchandler, who had been successful as the head of TWLO's larger Communications segment. Shipchandler is generally liked by comrades, and his performance to date shows he was the right choice for the job. He began executing immediately on his announced plans, and within a month of taking the reins, TWLO had already recorded an impairment charge on the ill-fated Segment unit and began a full operational review.

TWLO has continued down this prudent path over the past year, taking cost out of the business and returning capital to shareholders. Equity grants have been greatly reduced, and the company is repurchasing shares – not only on a gross basis to offset dilution, but on a net basis after the grants. Management incentive bonuses are now geared toward free cash flow and total shareholder return. Further improvements are on the way, too; following the recent completion of its strategic review, the Segment unit should finally start breaking even by Q2 of this year. The declassification of the board and removal of supermajority provision from the company charter, slated for this spring, are incrementally beneficial to outside shareholders as well.

As I write this, we are certainly not the first on the scene here; the stock is well off its lows. So why invest now? Is it too late? We don't think so. TWLO remains down 70% over the past 4 years. Its current EV/S multiple is 4x versus over 40x at the bubble peak, and the stock trades at the same price as it did in early 2019 but with 4x as much revenue. We don't expect or think the stock should return anywhere close those peak levels, but we also don't think the price today fully reflects fair value. Twilio remains the clear leader in the CPaaS market, with nearly twice the revenues as the #2 player. It's managed to hold gross margins and continued to grow the customer base each year. And at the company's investor day event last month, it became clear to us that the business had finally turned the corner and was primed to start reaping the operational benefits of their overhaul, and that the valuation was still attractive even at current prices.

In the section above we discussed inflection points, and we see two here for Twilio. First, after a prolonged period of slowing growth, revenue is finally beginning to accelerate again (see chart below left). Second, the company has shifted from being a cash burner to a cash generator (below right) and will be profitable on a GAAP basis for the full year 2025 now that all restructuring charges have been run through the income statement. This will not only help the stock screen better, but it will also open it up to a wide new swathe of potential buyers.



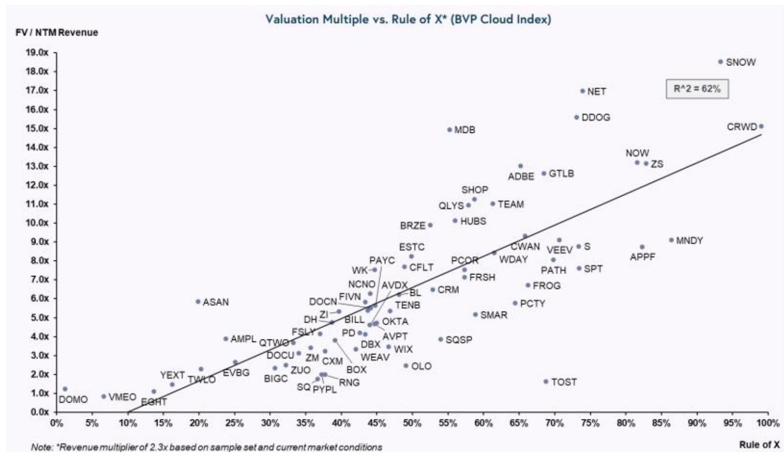


Twilio has guided to $3 B in cumulative FCF from 2025-2027, and $825-850 M for 2025. Importantly, the company's guidance for margins and cash flow does not bake in any incremental operating leverage from double-digit sales growth past 2025; this would instead serve as a source of potential further upside. We think the company is being conservative based on their last quarter's performance, addressable market expansion, and history of managing expectations. Any transaction that offloads the underperforming Segment business, a move both activists have pushed for, would likely be received positively by the market as well.

For the time being, though, we will simply take the FCF guidance as is. Assuming a gradual growth cadence, we can estimate roughly $1 B and $1.2 B for 2026 and 2027. That means by the end of this year, TWLO will be trading at 18x forward FCF vs. 20% NTM growth, a ratio which is well below similarly-sized software peers. An analysis based on the current NTM is shown further below for a large group of peers. By the end of next year, TWLO will have over $1 B in trailing FCF and should grow cash flows by another 20% in the NTM period. At the growth-adjusted peer median, and simply allowing the interim FCF to pile up on the balance sheet, this produces a two-year target of just under $200, or about a 35% IRR.

And while we generally prefer to focus on items further down the line, the metric that allows for the greatest range of comparison to software peers (many of which remain unprofitable) is EV/sales. We will use a modified version of the Rule of 40 that weights growth 2.3x more than profitability, an approach that has historically better modeled actual EV/S ratios; it is actually punitive here given TWLO's profitability shift. Using the methodology described here, TWLO's fair multiple of NTM sales will be 5.1x by year end 2025 (2.3x 10.5% sales growth + 17% FCF margin; see example chart from last year below). This works out to about a $180 price target, which is roughly equivalent to the 2-year target above discounted back a year by 10%, and it serves as a sanity check on the reasonability of our FCF-based estimate. This target is well within not only peer ranges, but also the company's own historical ranges, even excluding the outlier 2020-2021 period.

	Communications/Customer Engagement Software Comps				
	LTM EV/FCF	NTM FCF growth	FCF Mult./Growth Ratio	LTM EV/Sales	NTM Sales growth
SHOP	187.8	41.5%	4.53	18.2	23.3%
ZI	10.4	1.8%	5.78	3.9	2.4%
DDOG	59.8	16.9%	3.54	15.7	21.9%
TEAM	51.1	28.9%	1.77	16.9	20.7%
NOW	59.7	23.2%	2.58	17.8	20.3%
HUBS	77.6	39.0%	1.99	15.6	17.1%
WDAY	29.3	25.4%	1.16	8.0	15.3%
DOCU	14.4	31.6%	0.46	5.8	7.8%
FIVN	16.0	60.2%	0.27	3.3	13.5%
RNG	7.4	22.7%	0.33	2.0	9.0%
APP	93.7	49.0%	1.91	37.4	29.2%
FRSH	18.3	48.0%	0.38	5.7	15.7%
AI	189.4	59.5%	3.18	9.7	21.2%
CXM	25.7	8.1%	3.17	2.4	9.9%
APPN	93.0	135.0%	0.69	4.2	13.3%
MGNI	18.0	32.6%	0.55	4.6	8.7%
PRO	40.0	52.9%	0.76	4.3	8.8%
EGHT	5.9	-9.9%	n/a	1.0	-1.0%
BAND	15.4	13.9%	1.11	1.4	9.9%
SMWB	24.1	nmf	n/a	3.5	14.9%
Mean	*51.9*	*35.8%*	*1.90*	*9.1*	*14.1%*
Median	*27.5*	*31.6%*	*1.46*	*5.2*	*14.2%*
TWLO	**27.3**	**26.7%**	**1.02**	**4.0**	**10.5%**



Like with any inflection-driven investment, there is a material risk that the metrics that created the inflection in the first place reverse again. We need to see double-digit revenue growth and continued progress on operating margin expansion in order to feel comfortable that things are progressing as planned. While Twilio's decision to become a remote-first company has helped keep real estate costs down, it does open the possibility of reduced productivity, which some other firms have struggled with. Having multiple activists on the scene does provide some incremental comfort, though, as management's feet will be held to the fire for any operational missteps.

In summary, Twilio is a high-quality business that flipped from a market darling to a pariah in a few short years. But over that same period, TWLO flipped from a growth-at-any-cost cash burner to a more balanced and sustainable model. This setup has allowed us to invest in an industry-leading company with strengthening fundamentals yet still trading at a reasonable valuation. We like the stock at current prices and further added to our position in recent weeks on the weakness following its uneventful earnings report.

Outlook & Conclusion

Adestella is launching a quantamental strategy, one that selects stocks by applying quantitative analysis to fundamental investing. I have long been interested in such hybrid approaches for everything from position sizing to purchase timing, and this new fund is a natural extension of that. Whereas the Rigel fund’s positions ultimately come down to my discretion, the positions in the new fund will be selected by an algorithm. In the near-term it will likely just be an incubator fund, as I prefer to test in real time than to rely on backtested data. Early performance has been strong, and I think it makes sense timing-wise given the context of our new RIA structure. Current and prospective investors are of course welcome to reach out for more information.

Due to the extra work required for registration compliance and a new fund launch, especially as a solo manager with limited time to allocate, we will also be changing the format of our letters, at least for the next few quarters. Rather than providing the same market commentary that can be found in many other places, or trying to rework eight years’ worth of investment philosophy pieces into new material, we will instead focus solely on the current portfolio – recent changes and the rationale behind our new holdings. This will streamline what is currently a very time-consuming process while still allowing us to offer differentiated content on a regular basis. Historical letters will remain available in their current location on the website; future ones will likely have their own new section.

I hope everyone’s year is off to a good start and look forward to sharing more of our work as we move through 2025.

“The greatest risk is to risk nothing at all”

- Leo Buscaglia

Per Ardua Ad Stella,

Andrew Jakubowski

Andrew Jakubowski

Performance Summary:

	4Q 2024	YTD	Since Inception
S&P 500	2.5%	24.9%	261.4%
Vanguard Total World Stock ETF	-1.1%	16.5%	138.2%
Russell 2000	0.3%	11.4%	111.3%
HFRI Equity-Hedge (Total) Index	4.9%	15.8%	92.0%
Adestella Investment Management	**4.2%**	**14.0%**	**314.5%**