HAYDEN CAPITAL

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August 12, 2020

Dear Partners and Friends,

What a wild ride of a year… and it's hard to believe we're only halfway through. By this point, our partners should recognize that when I say that our strategy is volatile and that they need to be mentally & emotionally prepared, I'm not exaggerating.

We've probably seen more days where our portfolio has been either up or down >5% per day these last few months, than at any point since our inception (obviously, we'd prefer the former than the latter). It's simply a feature of owning a concentrated portfolio, especially during an already volatile market.

Time Period	Hayden (Net)[1]	S&P 500	MSCI World (ACWI)
2014[2]	**(4.9%)**	**1.3%**	**(0.9%)**
2015	**17.2%**	**1.4%**	**(2.2%)**
2016	**3.9%**	**12.0%**	**8.4%**
2017	**28.2%**	**21.8%**	**24.4%**
2018	**(15.4%)**	**(4.4%)**	**(9.2%)**
1st Quarter	14.7%	13.7%	12.5%
2nd Quarter	12.0%	4.3%	3.5%
3rd Quarter	(6.0%)	1.7%	0.1%
4th Quarter	16.8%	9.1%	8.8%
2019	**41.0%**	**31.5%**	**26.6%**
1st Quarter	4.1%	(20.0%)	(21.1%)
2nd Quarter	93.2%	20.0%	18.8%
2020	**101.2%**	**(4.0%)**	**(6.2%)**
Annualized	**25.3%**	**9.8%**	**6.3%**
Total Return			
1 Year	**120.3%**	**7.5%**	**2.1%**
5 Years	**215.2%**	**66.4%**	**38.3%**
Since Inception	**256.3%**	**68.9%**	**40.9%**

The benefit for our partners though, is that there's very few investors who are set up to tolerate such volatility – which means that we have sparse competition for our strategy & return profile. The group of partners

[1] Hayden Capital returns are net of actual fees. Individual client performance may differ based on fee schedule and date of funding.

[2] Hayden Capital launched on November 13, 2014. Performance for both Hayden Capital and the indexes reflects performance beginning on this date.

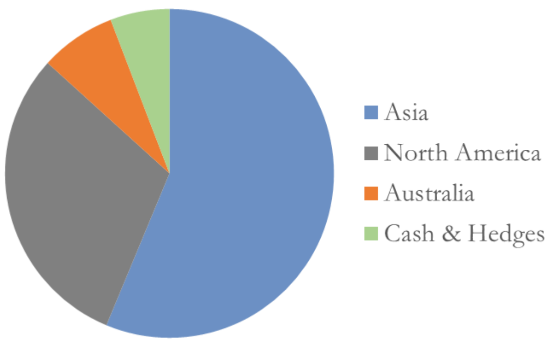
we've cultivated is rare. Like a bouncer at a popular nightclub, I promise I will continue curating and ensuring that any new partners who join alongside you in our Hayden "family" will be emotionally qualified and like-minded[3]. On that note, thank you once again, to all of our partners who answered our capital call on April 3rd.

During the second quarter, we generated +93.2% for our partners. This is compared to the S&P 500 which returned +20.0% and the MSCI World which returned +18.8%. Year-to-date, Hayden's portfolio is now up +101.2% versus -4.0% for the S&P 500 and -6.2% for the MSCI World indices.

We continue to be invested in predominately Asian companies. 56% of our portfolio is in companies whose primary businesses operate in Asia, while 30% is North America, 8% in Australia, and the rest across cash and hedges[4].

Geographic Allocation %

As of June 2020



While I'm happy with our performance this quarter, I'd also like to remind our partners of this quote from our letter last quarter:

"Even though our investments have performed well since that capital call a few weeks ago, I firmly believe the real money is going to be made in the next several years, as consumers take their new habits and the increased online reliance developed during this period, into well after this virus subsides.

There's going to be multi-bagger returns for the winners, far beyond the mid-teens percentage rebound we've seen in the indices these last few weeks" (LINK).

I firmly believe that's still the case, and that we're going to start seeing evidence of that in the coming quarters as our companies prove to investors that these are structural shifts, not temporary, ephemeral uplifts. The best days for our partnership still lie ahead of us.

[3] In our case, a mis-aligned partner can be a distraction on our time and resources, to appease that single partner without benefits for the rest of our group. These efforts would be better spent on hunting for and researching high-quality businesses – an effort that would result in equal benefit for our entire group of partners.

[4] Our Australian investment is a new position we took during the second quarter, which also derives a significant amount of business from the US (and increasingly more so).

The 10-Bagger Club

In the past few months, we achieved an important milestone for Hayden… not one, but *two*, of our investments achieved the elusive 10-bagger club (a 10x return on our original investment)[5]. These two investments in Sea Ltd and Amazon, achieved this feat in less than 2 years and 6 years, respectively[6].

Given this milestone, I thought it'd be worthwhile to take a high-level look back on how these businesses have progressed over the years, and what drove such an impressive performance. Please do not take this as a victory lap by any means though. There are still many, many years of opportunity ahead for both these companies to capture and create value, and during that journey it's very possible they will stumble or run into obstacles along the way.

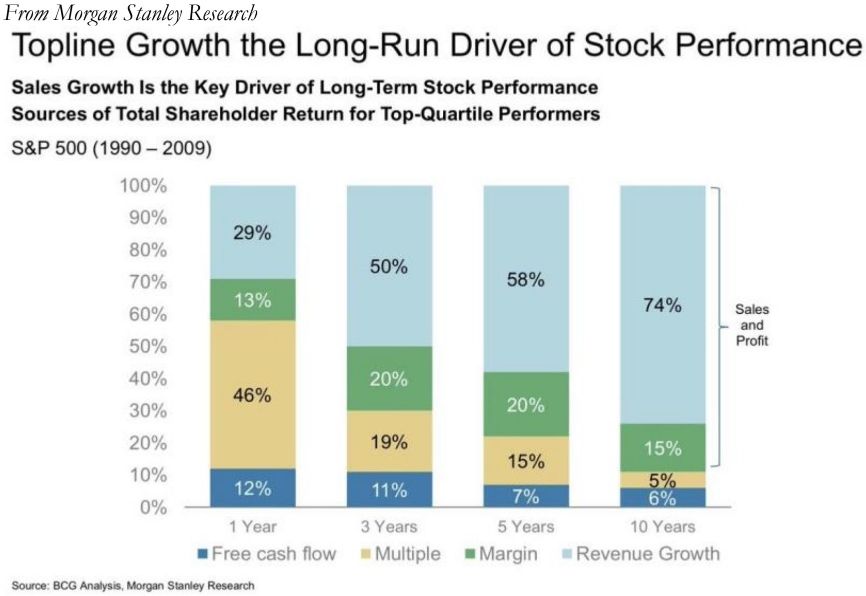
But because these businesses have "proven themselves" by now (and investors have rewarded them, as *perceived* uncertainty around the business model dissipated), I think it's useful to dissect how their stocks appreciated so rapidly. The goal is to learn from these case studies, and hopefully apply these lessons when evaluating new investments for their potential to be Hayden's next 10-baggers.

I think a good reference point, is a study conducted by Boston Consulting Group and Morgan Stanley. The study of individual stock performance between 1990 – 2009 found that the primary drivers of stock performance are sales and (eventual) profit growth. In fact, the longer the investment period, the less the entry / purchase multiple mattered and the more these two fundamental business factors determined the stock's return[7].

So how did our investments stack up to this study?

Sales and Earnings Growth Drive Returns Over the Long-term

From Morgan Stanley Research



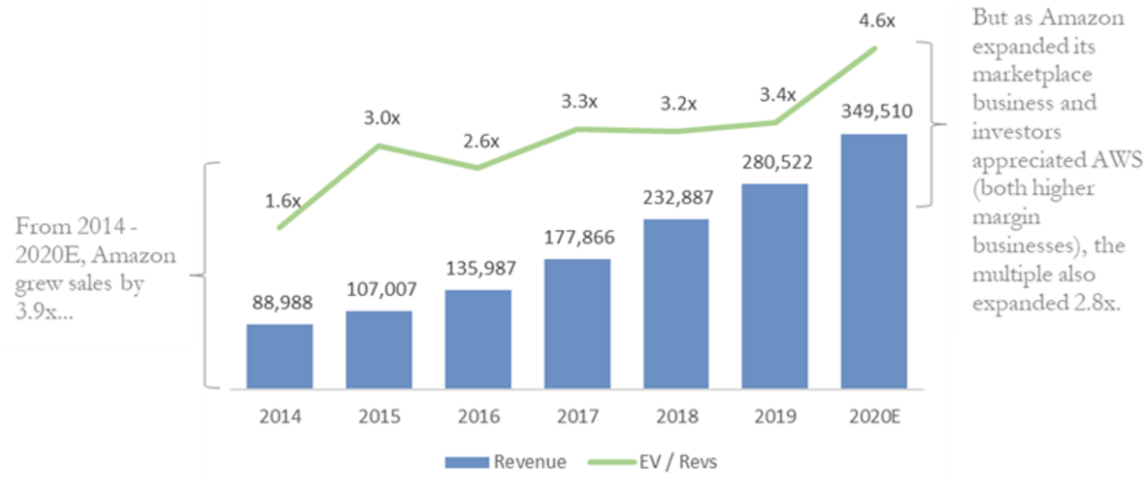
[5] The term "ten bagger" was originally coined by Peter Lynch, and is described in his book "One Up on Wall Street" (LINK). Chapter 6 is even titled "Stalking the Tenbagger".

[6] We established our initial position in Amazon at ~$317, on the first day of Hayden's inception. Our initial position in Sea Ltd was built over several months, with an average price of ~$13. Our lowest block was bought at ~$11 though, so I'll classify that on a technicality to call it a 10-bagger.

[7] With many more companies choosing to reinvest in their businesses through the balance sheet (and thus earnings potential depressed for longer), I'd bet a refresh of the study would find that sales growth is an even larger portion of stock performance over the last 10 years.

Below, we can see the revenue figures and enterprise value / revenue multiples for Amazon, since our initial 2014 investment. [Note, I use sales figures only since Amazon amazingly is still reinvesting into their business (even after 26 years!), so earnings figures are more volatile / don't show the full picture of the business' intrinsic value.]

Amazon's Sales Growth and Multiple Expansion
From 2014 – 2020E



We can see that sales have grown 3.9x over the last 6 years. Using revenue multiples is frequently criticized, since a company can artificially inflate sales quickly by simply giving away products / services below cost, thus actually destroying shareholder value[8]. But in Amazon's case, they not only grew revenues by 290%, but did it by growing their *higher*-margin business lines (Amazon Web Services & 3rd Party Marketplace)!

For example, Amazon Web Services (AWS) grew from $4.6BN revenue in 2014 to an estimated ~$45.6BN in 2020E. This would be ~880% growth in 6 years. Additionally, AWS has 30%+ operating margins, compared to low-single digit margins for the core retail business, so every dollar of AWS revenue is worth ~6 - 8x more than that in retail.

Amazon doesn't disclose marketplace figures neatly (where third party sellers own the inventory, instead of Amazon itself), but we know from numerous global marketplace benchmarks, that margins tend to hover around the 30 – 40% operating margin level. Additionally, in Amazon's 2018 shareholder letter, Bezos disclosed that third-party marketplace had grown from 49% of sales in 2014, to 58% in 2018 (LINK). Based on this and our own estimates, I estimate that marketplace sales have grown ~390% over the last 6 years, or more than twice that of the ~180% for Amazon's traditional first-party retail business.

Of course, higher-margin business lines command higher revenue multiples (since Amazon keeps more of each dollar of revenue). As a result, it only makes sense that Amazon's multiples have also expanded during this period. In 2014, Amazon was trading at 1.6x EV / sales, but today is at 4.6x 2020E EV / sales.

When you multiply the sales increase by the multiple expansion, you can see how Amazon has achieved its 10x stock price performance.

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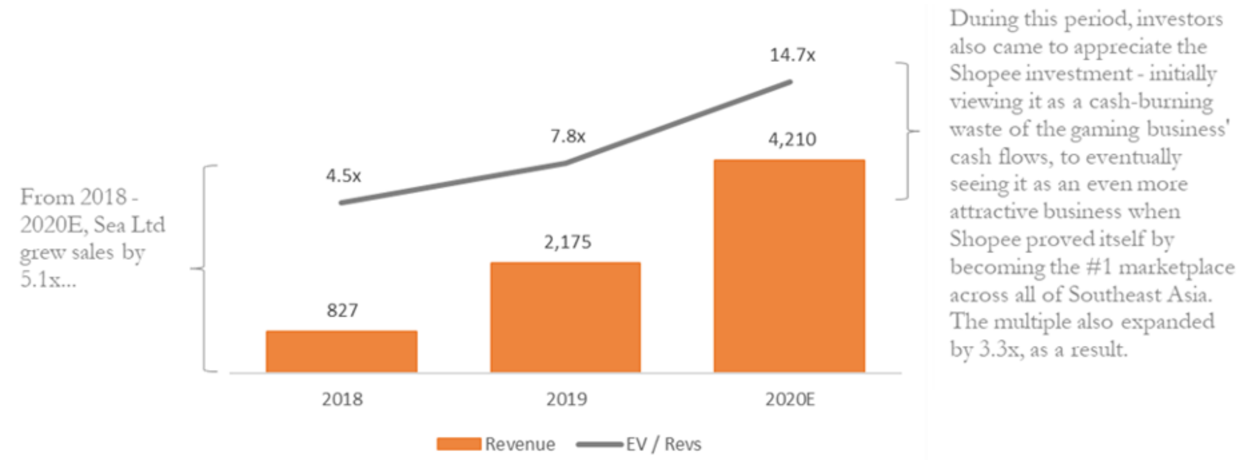
[8] Sometimes this is a good initial customer acquisition strategy, especially when trying to "jump start" a new network-effect based business model. But here, I assume they're simply giving away product permanently to get a higher valuation (which if the market is smart, will see through that).

Sea Ltd's Sales Growth and Multiple Expansion

From 2018 – 2020E



Sea Ltd also experienced a similar dynamic of both rapid revenue growth and expanding multiples. But how it achieved this was a bit different.

When we invested in late 2018, I could see that Garena (the gaming business) was a phenomenal business, but I had trouble underwriting the newly self-developed (and less than a year old at the time) game Free Fire[9]. Additionally, Garena was providing all the cash flow for Sea Ltd to invest in its Shopee e-commerce platform.

If Garena stumbled (which I thought unlikely given the robustness of its core republishing model), then the cash stream to invest in Shopee would stop, and it would put the entire firm in a precarious position, have to raise far more outside capital, and during that time risk losing the momentum it had to reach its marketplace "tipping point" before competitors (see our Q1 2019 letter for our initial Sea Ltd thesis + more discussion on the marketplace / network effect "tipping point" concept; LINK).

It was really a "bet the farm" moment for Sea Ltd – but one that I thought was the correct decision given the sheer size of the prize if it worked, and the ability to retrench and still salvage value on the Garena side if it didn't. I had indications that Shopee's marketplace was performing far better than the competition, which was confirmed in the following months when Sea released the division's KPIs[10]. Plus, the market was actually punishing the company for this move at the time, so we were getting paid for taking the optionality. In short, I saw a massive opportunity, while the market saw a gaming company burning cash on an ecommerce business it had no right to be in. This allowed us to buy the shares at a very low entry multiple.

In the past two years, Garena's Free Fire has become one of the Top 3 downloaded mobile games worldwide (LINK). These profits have in turn have fueled Shopee's rise to be the #1 ecommerce marketplace across Southeast Asia, and most importantly, profitability (read: self-sustainability) in its two largest markets. As a result, these two drivers have resulted in a 5.1x increase in revenues.

But unlike Amazon, the multiple expansion wasn't because Sea Ltd pivoted into higher margin business lines – gaming and retail marketplaces both have roughly the same 40 - 60% margin profiles at maturity[11]. The

[9] Free Fire was launched in fall of 2017. It was Garena's first self-developed game, and as with most games, it was very hard to have visibility as to how popular it would be beforehand. For an idea of the lack of predictability or just the video game development model in general, I recommend reading the book "Blood, Sweat, and Pixels" (LINK).

[10] Sea was originally a "tracking position" for us, but we added aggressively to the position in Q1 & Q2 2019, after I had confirmation that our thesis was correct and it looked like Shopee had a formidable shot of beating the competition.

[11] Garena's republishing business has ~40% op margins, while its self-developed games like Free Fire have ~70% margins (since they don't need to pay a licensing fee). Asian ecommerce marketplaces broadly have ~40% operating margins.

company simply executed on its strategic plan that was well-known at our initial investment – it's just other investors didn't believe they could pull it off.

The multiple expansion came from Shopee gradually "proving itself" in the last two years, and investors having more confidence that the 40% operating margins that marketplaces tend to enjoy will eventually reach investor's pockets. The fact that Shopee Taiwan already enjoys 20%+ margins and Indonesia is at break-even levels, only provides further confidence of this pathway.

As a result, the multiples have simply expanded from "extremely pessimistic" to "fair". Considering I expect Shopee to continue growing 70 - 90% per year over the next couple years, while Garena shows no signs of stopping with Free Fire still helping to add gamers at +50% y/y and revenues 20 - 30% y/y, and Shopee's new e-wallet business executing aggressively, I can imagine Sea Ltd will be a core part of our portfolio for many years. Sea Ltd management team's execution continues to exceed even our loftiest initial expectations.

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The lessons from these two case studies show that in order to achieve 10x type returns, you likely need a combination of rapid value creation, along with the market's increasing appreciation of the company's trajectory demonstrated via multiple expansion.

At first glance, finding companies with the first element of rapid value creation (most often signaled by revenue growth) should be relatively easy. Any investor can easily run a screen to generate a list of fast growing companies.

However, the nuance is that the sales growth must come from value-adding activities, either in the form of direct profits, or by strengthening the business' network effect with each new customer added[12]. This element is tougher, since the only way to make this qualitative judgement, is by truly becoming an expert in the given industry and being a student of business models. This is why the investor's "circle of competence" and studying business case studies is so important – this judgement comes from extensive pattern recognition.

Getting the above two elements right is a good starting point and will likely lead to decent (but not outstanding) returns. For example, if a company were to grow 3x over 5 years, that would lead to annual growth of ~25%.

But the problem is that all too often investors over-pay for these companies initially, as the market has already become overly excited about them and bid up the prices. Everyone knows they're great companies, and have high confidence in their growth trajectory. As such, the starting multiples will be very high – even if the company executes as investors expect, the multiple will still likely compress over time as the company matures. The stock is constantly fighting a headwind, looking for intrinsic value growth to outpace the degree of multiple compression.

In the above example, even if the company grew 3x more valuable over 5 years, but the multiple compressed by 50% over that time period, it would only return a ~8.5% annualized return to the investor – roughly in-line with the broader stock market's annual return. This is where investors stumble, and the primary criticism of most "growth investors"[13].

Instead at Hayden, I prefer to "invert" this process, and buy shares at a "fair" to "below-average" valuation, and only at very conservative valuations. For example in the case of Shopee, global marketplaces trade at

[12] For an example of "artificial", value-destroying sales growth, just take a look at MoviePass (LINK).

[13] In parentheses since I personally don't believe in style buckets such as "growth" or "value". Each company is unique, and every investor is simply trying to generate the highest returns possible for themselves and / or their partners, regardless of the "levers pulled" to generate it.

~0.7x GMV, with "only" ~30% annual growth. If we were buying Shopee today, this is the multiple we'd be looking to purchase the company at.

With the Southeast Asia ecommerce industry itself growing by 30% (i.e. the tailwind), and as Shopee takes share, they will grow at far above this rate. As mentioned earlier, I expect the company to grow 70 - 90% y/y, so our upside comes from the differential between the company's actual growth and the benchmark rate.

Simplistically, we are saying "what is this company worth in a very conservative low / no-growth scenario?" and are looking to get the additional realized growth for free.

The takeaway is, we need to find companies that 1) are growing quickly, 2) are capturing more value as they grow (as opposed to leaking that value away into their ecosystem), and 3) buy them at an underappreciate multiple which will (hopefully) expand over time as the company proves itself, and thus providing a tailwind to our stock performance.

It's tough to find investments with all three factors… even when we think we've found such companies, we still only have a 20% chance of being correct (see our Q4 2019 letter on the Pareto principle in portfolio construction; LINK). This is why we only find 1 – 2 new ideas a year, and hold such a concentrated portfolio.

But it's enough to generate outsized returns for our investors, if we execute the strategy correctly. We know what we're looking for, and over time as we continually gather more case studies and hone our process, hopefully our output (i.e. investment performance) will continue to showcase that over the next decade.

Portfolio Updates

Zooplus (ZO1): We finally sold our investment in Zooplus, after three and a half years of ownership. Back in late 2016, I was originally attracted to the company as I saw a dominant pet supply retailer that was well positioned to benefit as pet owners gravitated towards online channels to purchase food for their furry family members (carrying a 15kg bag of dog food home, especially in an urban environment / on public transportation is inconvenient).

In addition, as pets became viewed more and more as a part of the family, owners wanted to upgrade to premium options – for example, pet food geared towards their specific breed or medical conditions[14]. In this world, where pet food becomes specialized and non-generic, having a wide variety of options was an advantage, and something that brick & mortar stores would have a hard time offering with their limited shelf-space. Pet food is also a highly recurring transaction, which led to ~94% annual sales retention for Zooplus.

Up until the point of our investment, Zooplus had grown at high 20's – low 30's % annual rates. With them having dominant market share in the online channel at >50%, but still only single digit market share overall and thus a long runway to grow, I saw an advantaged player than could only be hindered by its own ability to execute[15]. But lo and behold, as time passed, some executional problems started to emerge.

First, over the past few years it has become increasingly more expensive to acquire customers via Google. This was especially problematic for Zooplus, who in their 20 year history, had consistently relied upon

[14] For example, Royal Canin offers an extensive selection of dog food that's tailored by dog breed and / or medical condition (LINK). If you have a Golden Retriever under 1 years old, or perhaps a large dog with sensitive skin, you can find dog food that's specially tailored for their condition.

[15] Interested readers can find our original Zooplus writeup on our website (LINK).

Google's ads to generate new traffic for them (~80% of marketing spend was on Google). It made sense when the internet was immature, and competition for keywords was lower. By advertising via Google, they could capture customers who were already searching for options to purchase pet food online, and thus had already shown intent to make a purchase.

But the internet of 2020 is very different than the 2000's. Not only is European internet usage maturing (fewer new users going online, which means a slowing of the "inventory growth" of new ad impressions, which results in higher costs per impression), but also Brick & Mortar competitors have increased their own online sales channels and thus are competing for the same keywords. This resulted in Zooplus' Customer Acquisition Costs doubling from 2016 – 2019, and thus affecting these new customer economics.

I had always encouraged the company to explore new marketing channels, since it was obvious that this would be a lasting issue for them going forward. I thought that this change, along with a subscription offering and enhanced mobile application design could dramatically improve their business.

I had seen other US and European online retailers face the same issue, and make a successful pivot from Google to more offline marketing channels (direct mailings, TV & radio advertisements, sponsored events, etc). Over the years, I had repeatedly brought these issues up with the company and their former CFO many times in person, and had even wrote a section in our Q4 2018 investor letter about this industry-wide dynamic of running into the "Google Wall" (LINK). I believed they needed to go "above the funnel", and acquire customers before they even made it onto Google (later described in our following Q1 2019 letter; LINK).

By educating brick & mortar customers about the benefits of shopping for pet food online, and about why Zooplus is the superior choice, they could "pull" customers into the sales funnel, bypassing all the competitors that were out bidding with each other for customers who had already showed purchase intent on Google. Yes, conversion rates would be lower. But if executed correctly, the lower acquisition costs would more than make up for it.

After moving (in my view) extremely slowly to address these issues, the company finally seemed to embrace the reality and began trialing offline marketing last year. They sent out direct mailing flyers to a small area of Germany last April, and created a "floating dog park" in Cologne and Dusseldorf. They even started running TV advertising campaigns in select markets last summer (but only on niche, female-focused channels)[16].

However just a couple months later, they cancelled these initiatives. This is despite their own CCO reportedly telling Cornelius Patt (co-founder and CEO) that offline brand-based marketing needs at least 6 touch-points / impressions and thus requires a longer timeframe to convert a customer (unlike Google ads, where conversion is near-immediate). From what I can tell, Patt essentially made a half-hearted effort, told investors "See, we tried!" and it didn't work, and then threw up his hands and gave up.

To me, it seems the initiative never had buy-in from the CEO to begin with and thus in hindsight was doomed to fail. It's ironic how slow the company was to implement these trials after years of asking, but that they would be so quick to pull the plug. It was at this point, that I in turn pulled the plug on our investment.

When we originally invested, I was already aware that Zooplus' management team was no Amazon. This was a B-level management team, but I derived comfort that upon analyzing their competitors, they seemed to be competing against D-level teams. Certainly, this was a large enough gap, for Zooplus to still create value for their customers (especially versus the alternative offerings), and with the benefit of an already large lead versus the competition, right? It turns out not…

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[16] Presumably, this is because Zooplus believes this is their core customer, and that the TV ad costs for these channels were far lower than more popular channels.

For example, one of Zooplus' former board member was asked in an interview, whether the company needs to evaluate advertising offline. This was his response:

"So, the company was almost single-mindedly focused on online kind of customer acquisition and management. My sense is that this would be, and again, this may be a disadvantage, this would be a whole new territory or world to explore… like the simple question what's the right marketing mix for the next five years?

When I was there, it was there it was never asked or answered… [regarding the] overall marketing spend and mix that were at the time, [it] was not asked or answered in any kind of specific or detailed way. *Probably high time to ask and answer those questions if it hasn't been done yet.*[17]*."*

On the Q1 2020 earnings call, management explains the move away from offline marketing, by blaming the types of customers who were attracted by the offline channels as not the "right type" of customers – saying that the customers in this channel weren't loyal and didn't have the same high-level retention rates they typically achieved with Google[18].

He even goes so far as to blame it on cultural differences / a Europe specific issue, stating "a clear learning from 2019 that the push into new marketing channels, and that is mainly off-line, proves not to be efficient at least in our major geographies in which we operate here in Europe"[19].

But as I've shown above, it seems the real issue is that they just didn't have the internal knowledge / expertise – for the last 20 years their marketing teams have focused almost exclusively on Google and nothing else. Of course if you've never done social media marketing, sent out direct mailings, or done brand-awareness based advertising, you're going to be bad at it / it will be less efficient than the channel you've spent 20 years perfecting. But good managers recognize that as part of the learning process, and are willing to keep investing in the initiative because it's healthy (and crucial) for the business long-term. They don't give up after six months.

A mouse-trap maker doesn't blame the *mice* for not falling into the trap. Instead, they reevaluate why the mouse-trap isn't working, look at other successful trap makers to see what they're doing wrong, hire outside experts to give advice and lend their experience, and then continue to improve it.

But that's exactly opposite of what the CEO did – he's blaming the mice attracted as the "wrong type of mice" and after a short period of time, abandoning the trap all together saying traps in general don't work (or at least doesn't in Europe). This doesn't pass my sniff test… after all, offline marketing seems to be working for plenty of other European companies…

In hindsight, I probably gave Zooplus management "too long of a leash", thinking that they would be open-minded enough to eventually find their way out of the strategy hiccup. I underestimated the dogmatism within the firm's culture – something that seems to originate specifically with the founder / CEO. It is even evidenced by the employee reviews at the company.

For example, here is the latest employee review of the company (it was literally at the top of the reviews list at the time of this writing. I assure you it wasn't cherry picked… plenty of other reviews say the same):

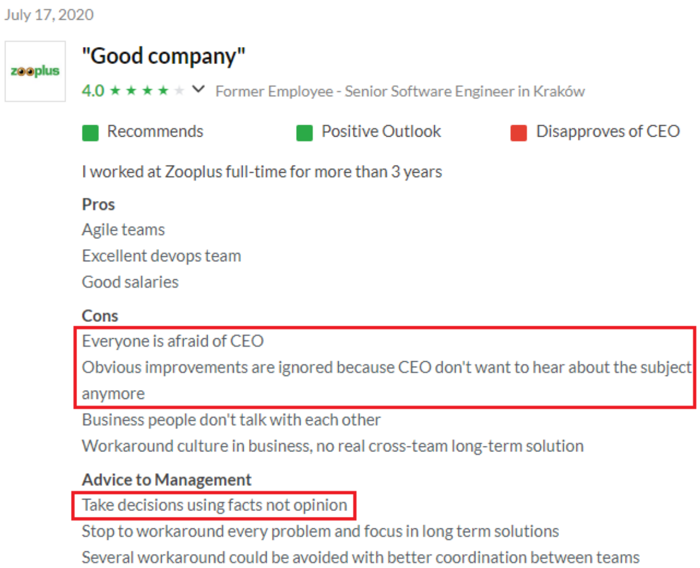
[17] This quote is from a Tegus interview, conducted in 2019.

[18] This is true, as evidence by the decline in sales retention last year.

[19] From Zooplus' Q1 2020 Earnings call on May 14, 2020.

Zooplus Employee Reviews

From Glassdoor; As of July 29, 2020


July 17, 2020

"Good company"

4.0 ★★★★ Former Employee - Senior Software Engineer in Kraków

Recommends Positive Outlook Disapproves of CEO

I worked at Zooplus full-time for more than 3 years

Pros

Agile teams
Excellent devops team
Good salaries

Cons

Everyone is afraid of CEO
Obvious improvements are ignored because CEO don't want to hear about the subject anymore
Business people don't talk with each other
Workaround culture in business, no real cross-team long-term solution

Advice to Management

Take decisions using facts not opinion
Stop to workaround every problem and focus in long term solutions
Several workaround could be avoided with better coordination between teams

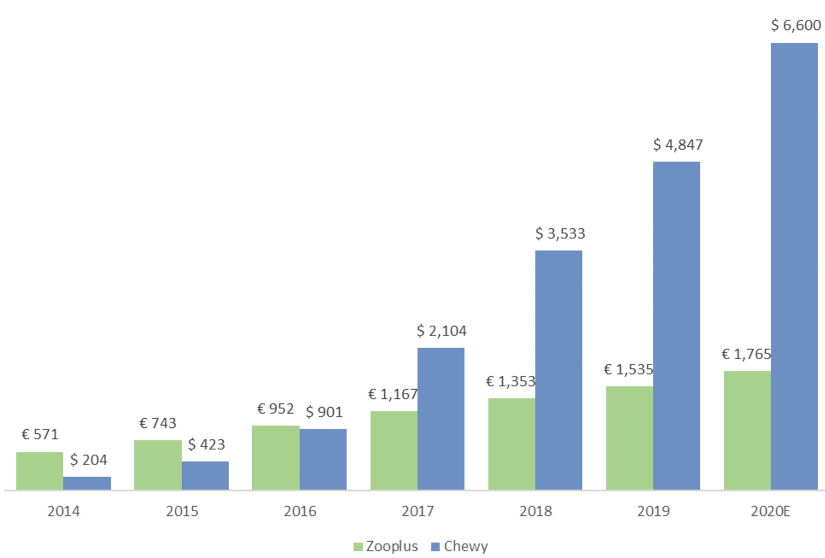
It's okay if our management teams make a mistake or their business strategy stumbles - so long as they take ownership and are open-minded enough to try solutions that are outside the company's comfort-zone to address the problem. By definition, this is the trait of an innovative company (new ideas come from trial and error).

But I absolutely have no tolerance for management incompetence and close-mindedness. Especially if we're looking for world-class companies operating in the highly competitive field of ecommerce.

I firmly believe that Zooplus has a lot of potential – the issue is with the management team running the company, and not with the business model itself. One only has to look at Chewy in the US, which has almost the exact same cost structure and product offering as Zooplus, as an example of what "could have been".

Zooplus vs. Chewy - Revenues By Year

Revenues from 2014 – 2020E



Notably, Chewy as recently as 2014, was only 1/3rd the size of Zooplus (~$200M in annual sales, vs. Zooplus at €571M). By 2016 (the year of our investment in Zooplus), Chewy had caught up at $901M in sales vs. Zooplus' €952M. Chewy launched many innovative features such as auto-ship (which reduces the initial customer churn after the first order)[20], and also spent a lot of capital building an emotional bond with the customer via expensive brand-building marketing campaigns, and even sending out custom paintings of customers' dogs (which were a great social-media / viral customer referral tool).

Today, Chewy is triple the size of Zooplus, and still growing at twice the rate (+46% y/y in Q1 2020 vs. Zooplus' +21% y/y). This has led the market to give them a $22BN valuation, or 17x that of Zooplus at €1.1BN.

If there's any lesson here, it's that we should only invest with A-level management teams. With such a concentrated portfolio, we can't afford to partner with anything less. That's my mistake as your portfolio manager, and is something I take responsibility for and will take to heart in our future investments.

It's such a shame that the management-led, self-inflected cultural issues have cost them over $20BN of potential value creation for their shareholders. The management team and its board of directors should be embarrassed of missing this opportunity and take responsibility.

Maybe one day we'll have another occasion to invest in Zooplus, but we'd have to see a change in the leadership first for that to happen[21]. I wish them and their employees well, and hope that perhaps my comments will help spur some self-examination inside the company and create a stronger firm for everyone involved.

We sold Zooplus this quarter at an average price of ~$126. This is equivalent to our initial purchase price back in 2016, so we had a neutral return for our partners (but was expensive in terms of the opportunity cost).

Note: Zooplus also experienced two major executive departures in recent months. Andreas Grandinger, who was the CFO and our primary Investor Relations contact, left the company at the end of last year (December 31, 2019).

Florian Welz, the Chief Commercial Officer, also resigned as of July 13, 2020. Florian was hired less than two years ago, and lead Zooplus' offline marketing attempt / tried to reduce the company's reliance on Google. In addition, one of Florian's first objectives when he was hired was to launch an auto-ship offering across all of Europe, viewing it as strategically important (which from what I understand, required significant buy-in and effort convincing Cornelius Patt (CEO) and Mischa Ritter (COO)).

From all indications, they both attempted to move the company in the direction I outlined above. However, they faced resistance with other members of the management team and were unsuccessful. I applaud both of them for their efforts.

It seems like the CEO / founder is taking greater control of the company, and those who have disagreed with his strategic vision are leaving. These are worrying signs, so it was time for us to exit as well.

New Position (Undisclosed): We made one new investment this quarter, in a company based in Australia. Typically when establishing new positions, I choose to move slowly over a period of several months.

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[20] I've seen Chewy's cohort metrics, and their cohorts follow a very similar pattern to Zooplus'. After the first order, a portion of these customers will drop-off – either because they only wanted the first-time customer discount, or because they found that the service wasn't right for their needs. But after a customer orders a few times, it becomes part of their habits and retention goes to almost 99%. Auto-ship (i.e. subscription) helps to smooth that customer journey from the 1st order to 5th, so that fewer drop off before they become loyal customers.

[21] Over the past year, I have actually been asked if I would consider running for the board of directors, by fellow institutional shareholders. While I was flattered by the request, I personally came to the conclusion that culture is one of the hardest to change, and our efforts would be better spent by finding companies that don't need to be fixed. Doing so is a more enjoyable investment journey, and I'd rather not try to waste efforts changing people's though processes, who aren't open and receptive to listening.

However given the dynamism of the markets this quarter, this process turned out to be a detriment to us. The shares of this company have risen over +150% since we first started buying, and I have slowed down our purchases at these levels.

I will talk about the company in due course, hopefully when we can establish a bigger position at better prices. The company's pace of execution is very impressive, and there are several exciting launches happening in the next few months. I'm excited to share our thesis for the company, and will do so once we have a full position. This investment comprises ~8% of our portfolio after the price appreciation.

Tracking Position (Undisclosed): We also sold one of our China-based tracking positions, which we first bought in Q4 2019. The final research showed that for the new strategy they're embarking on, their future economics are going to look very different than the past. Given this, I decided to sell our position with a ~22% gain.

As always, partners can reach out anytime to discuss these positions off-line.

Conclusion

Even though our partners had a good return this quarter, I would like to reiterate that over the short-term, our results will likely be volatile. This volatility can be both to the downside, or the upside (but let's be honest, most investors don't mind upside volatility).

In fact, volatility can be a good signal for us, since more volatile mark-to-market prices generally means that the particular stock is inefficient – investors are unsure of how to forecast / value the company, and thus don't know where it should trade. If we're able to obtain a differentiated view in these situations, the upside can be quite large (as described above, the business' earnings potential is growing, plus we get multiple expansion as investors become more confident in that trajectory).

Since last quarter, not much has changed. We still hold only a handful of high-conviction investments. Our day-to-day is still spent on collecting more information / datapoints on these investments and their competitors, in addition to learning about new industries / businesses that we find interesting.

At the beginning of this letter, I repeated a quote from last quarter's letter, stating that consumer habits have permanently changed for certain industries, and that there will be multi-bagger returns for the winners. I still stand by this statement, and we're still hunting for the next multi-baggers (with a couple potential candidates already identified). I'm excited for our prospects in coming years. Stay tuned.

I look forward to seeing all our partners at some point in the near future. Please keep well in the meantime, and thank you again for entrusting your hard-earning assets with us.

P.S. I also did an interview with Tilman at ValueDACH a couple months ago. It's a follow up to our interview in Omaha last year, and I give some updates on our investment process, and our positions in Sea Ltd and Carvana. I hope our partners enjoy it (LINK).

Sincerely,

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