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KIG Investment Partnership, L.P.
2019 Letter

Trailing returns	KIG Investment Partnership, L.P.
One year	0.9%
Two years	9.9%
Three years	40.4%
Four years	34.1%
Five years	11.5%
Six years	60.7%
Since inception (February 1st, 2013)	141.0%
Annualized since inception	13.6%

The figures above are net of all costs and fees under the founding partners' terms and 2019 figures are yet to be audited. Close to 100% of KIG's capital is currently invested in ten businesses.

Bad News First

In 2016 I invested in Metro Bank, a retail and commercial UK bank founded in 2010. At its launch it was the first new high street bank to launch in the United Kingdom in over 150 years. By offering an unparalleled level of customer service, Metro grew accounts organically at very high annual rates well above 40% and reached over fifteen billion pounds in deposits in just nine years. Metro was very different from your typical bank. Picking the best locations in town, their branches looked more like an Apple store than a bank and their staff was obsessed with its customers. For instance, employees were only allowed to say "No" to a customer request in front of their manager. At the time, if you wanted to open an account in any of the major UK banks, you were asked to make an appointment and come back in two weeks. At Metro the same request took fifteen minutes and that included your credit card. The difference was abysmal. In addition, Metro had none of the legacy issues that competitors were suffering from such as old IT or a bad balance sheet. They invested heavily in mobile technology and their approach to taking credit risk was very prudent.

Things looked more than bright, so what happened? In 2019 a perfect storm of unforced errors, an unfair set of regulatory rules, an unfavorable yield environment, and a UK press that is well known to exacerbate bad situations almost brought the bank down. The list of bad decisions and events is too long and depressing to list here. What you need to know is that by the end of 2019 the stock price trades about 85% lower than our original buying price. The board is now looking for new leadership and re assessing its entire business plan.

As an investor, my mistakes were on multiple fronts. Allocating mid-teens percentage of our capital to a regulated financial was not your managers' strongest moment. Investing in a bank during a low yielding environment was also far from smart. The biggest mistake, however, was investing in people that I did not love. In January 2019 management announced an internal accounting mistake that affected the bank's capital ratio. Instead of raising capital right away, management wrongly bet on a rebound of the bank's stock price. This rebound never materialized and management was forced to raise capital well below book value diluting our ownership of the bank. It is important to mention that Metro Bank was a big mistake not because the stock price is down so much – for better or for worse, these drawdowns are far more common than people think[1] –, but rather because of the impairment of capital caused by the dilution described above.

The bank is now very well capitalized. With the stock trading at about 0.2x book value and our holdings representing a very small percentage of our portfolio I continue to hold and wait patiently for a better exit opportunity.

Following People You Love

Back in 2004 I was living in New York and went to a place called Union Square Café. Both service and food were great. I did not know it at the time but that was my first interaction with any creation by restauranteur Danny Meyer. My first of many.

It was not until 2011 or so that I came to understand who Danny Meyer was. I was interviewing a young bright candidate for a job and asked him for the people / experiences / books that have taught him the most. "*You have* to read *Setting The Table*! *It's one of the best business books I ever read,"* he replied enthusiastically. I followed his suggestion and came to agree with him.

While I read it many years ago, there are two main insights that have stuck with me ever since. The first one is Danny Meyer's commitment to *Enlightened Hospitality*; a term I believe he came up with. *Enlightened Hospital* is about having his people willing to always go the extra mile for the customer. According to Meyer you can teach all sort of skills to people, but you cannot teach them how to be hospitable. They either have it or they don't. Meyer has been known for quoting Maya Angelou, *"…people will forget what you said, people will forget what you did, but people will never forget how you make them feel."*

The second takeaway was his managerial style which he defined as *constant gentle pressure.* Once, he was at his restaurant bemoaning about the challenges of his business to his mentor Pat Cetta. Pat then asked him to empty a table except for the saltshaker. Meyer placed the saltshaker a quarter of an inch off the center. *"Are you sure that is where you want it?"* Pat asked. Meyer then placed it right on the center. His mentor then moved the saltshaker away from the center and repeated the exercise a few more times. He then said *"Listen, luvah. Your staff and your guests are always moving your saltshaker off center. That's their job. It is the job of life. It's the law of entropy!"* He then continued, *"…Your job is just to move the shaker back each time and let them know exactly what you stand for. Let them know*

[1] High volatility and large drawdowns should be expected when investing in businesses that are investing aggressively. For instance, in 2001 Amazon's stock price was down more than 90% from its 2000 peak. While certainly not for the faint of heart, it is important to keep in mind that these drawdowns in themselves do not impact the intrinsic value of the company.

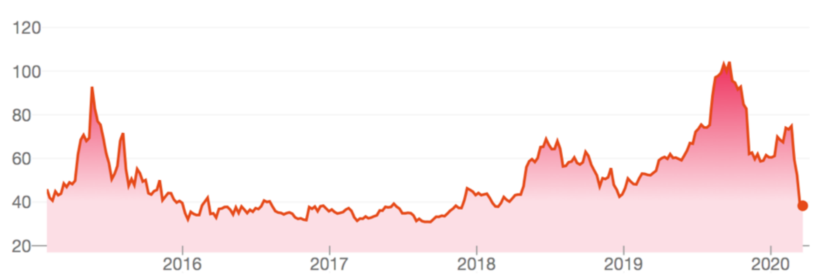
what excellence looks like to you." Enlightened hospitality and *constant, gentle pressure.* I will never forget these two concepts.

Around the same time Shake Shack opened a restaurant – aka as Shaks – in the Boston area near my house in Newton. Shake Shack restaurant is a fast-casual burger place that started as a hot dog cart in an effort from Danny Meyer to rejuvenate Madison Square. The *New York Times* called Shake Shack the *"anti-chain chain"* saying that its dedication to quality and customer service bucked stereotypes of traditional fast food. Shake Shack's impressive CEO Randy Garutti always says *"the bigger we are, the smaller we need to act."* While more expensive than other burger joints, in my opinion Shake Shack offers great value through higher quality of food, service and hospitality.

Needless to say, my kids love the food and the ambience. Real estate is a page that Shake Shack clearly borrowed from the Starbucks playbook – as a starting point; they have their own vision that is continuously evolving. Each Shack is designed differently depending on its environment. The Shack near my home, for instance, had an outdoor ping pong table where my older son first tried the activity. It was not just the kids who loved it. My dad who was never a burger joint kind of guy also digs it. He had two burgers in his first visit and could not stopped talking about how good they were. That's when the thought first crossed my mind: who would not eat at Shake Shack a couple of times a year? The potential for a very sizable business was certainly there. So was the *Enlightened Hospitality*. In one of my first visits I remember getting our order messed up and told a staff member there were a few things missing. He did not hesitate for a second and right away gave me what I asked for. He did not care who was right and who was wrong; he just saw an opportunity to go the extra mile for the customer. He was making Danny Meyer proud!

In 2015, Shake Shack was taken public at a very high valuation. I continued researching the company, and among other things, I shared the potential investment idea with a close friend who is also an investor. He loved it and came up with a little form / questionnaire about the hospitality, speed of service, and cleanliness experienced in each visit. We added a third friend to our effort and the three of us recorded multiple visits to more than 35 different Shaks all over the US – at the time there were less than one hundred Shaks in the US. I even recruited my kids who filled in these forms whenever they visited a Shak. We all came to the conclusion that this was an exceptional business with very good unit economics and a large opportunity to grow into. In 2016 Shake Sack's valuation became attractive and I started building a position in the company that I grew to approximately 10% of the portfolio in the next few years. I sold practically our entire position at last year's highs when the company was trading at an irrationally high valuation.

Shake Shack's stock price



In Shake Shack's case I followed Danny Meyer. I also followed a young bright candidate who pointed to *Setting The Table*[2] and two friends who came up with the initiative to visit a good number of Shaks. The best part is that to this day we are all good friends that are there for each other for much more than business. Surrounding yourself with great people might very well be the gift that keeps on giving.

Bouncing Back

About two years ago I was talking to the same friend who recommended *Setting The Table* about the advantages and perils of investing in a concentrated portfolio. *"The problem with concentration is that it is not that difficult to be down 50%. And the problem with being 50% down is that you have to come back 100% just to be even!"* he said to me. *"I agree, but when you are concentrated in a few great businesses that are relatively unknown coming back 100% is not that difficult. It often happens before you know it,"* I replied.

At the other end of the outcome spectrum from Metro Bank in 2019 is our investment in Carvana. Carvana's stock returned close to 200% in 2019. The company founded in 2012 by Ernie Garcia and his team allows shoppers to buy a car online, get the car delivered to their home, and then enjoy a full week to test the car before having the option to return it. It's a dramatically superior proposition to the in-person experience at traditional car dealerships. Shoppers are voting and the business has now enjoyed twenty-three straight quarters of triple digit annual revenue growth!

Carvana's business model benefits from superior economies of scale on a number of fronts. It's not hard to see the advantages they have and/or are developing in their buying, car repairing, inventory, marketing and customer service efforts. They have a fun culture and are obsessed with making things easier for the customer. For instance, Carvana incentivizes customer advocates that are responsible for answering incoming calls for service rather than for speed or for selling additional attachment products. This is extremely rare in an industry that is typified by the pushy salesman.

Lead by CEO Ernie Garcia, the Carvana team is executing at a tremendous pace. Ernie impresses at a number of levels. The first time I met him I asked him a touchy personal question. His extremely candid answer led me to believe that he lives with an open heart. His charisma and energy level are also up there. He is in constant movement, he talks fast, and clearly has a "Keep It Going" mentality. He is the kind of guy who does what he does for much more than monetary reasons. He comes from a very wealthy background to begin with and now has hundreds of millions through his ownership in Carvana; still, has his eyes set on the big prize and is fully committed to it. I also liked his intellectual honesty. I heard him multiple times answer difficult questions with a simple and straightforward *"I don't know"* and is focused on surrounding himself with the best people he can find. Finally, he is very creative, something that shows up in the multiple ways Carvana is doing things differently from competitors.

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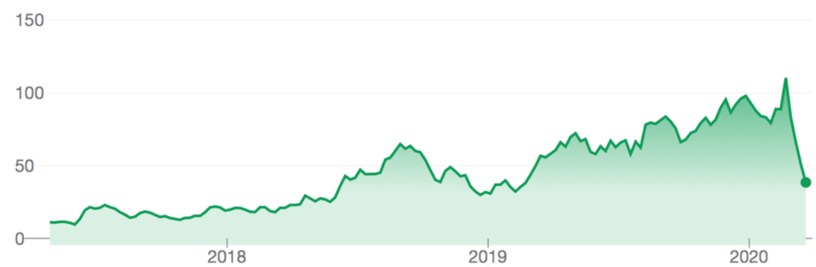
[2] We became friends since and we often exchange ideas about business and life. A few years ago, he sent me a message saying, *"You have to look into this business"* and a link to a video of CEO Ernie Garcia explaining Carvana's business model similar to the following video, https://www.youtube.com/watch?time_continue=8&v=UPlyCJXhHjQ&feature=emb_logo

Carvana's stock price volatility as an example: a -50% return or a 100% (or higher) bounce back within a year is very common when investing in exceptional businesses that are investing aggressively



As important, the Carvana team is staying humble. After one of my visits I sent them a letter explaining the importance of creating a culture of frugality early on. I shared the story of how Jeff Bezos himself saved electricity at Amazon by removing light bulbs from vending machines. I also included a copy of *Memos From the Chairman* by Alan Greenberg – a collection of his memos at Bear Stearns where he continuously reminded employees to save on everything including paper clips! A few months later I received a thank you email from Carvana explaining how my feedback helped them come up with an additional value for Carvana's culture: Stay Scrappy. While I believe the company has a very bright future, I sold about 50% of our shares at recent highs when its market capitalization was approximately equal to four times revenues.

Going back to the conversation with my friend, I said to him: *"I would argue that thinking about a -50% return or the 100% bounce back is not for me. You were the one that suggested reading about Nick Saban and his philosophy of 'not looking at the score'*[3]*. Thinking about this kind of 'short term' performance would be analogous to playing while looking at the score. I rather keep my sight in learning and growing to become the best businessman / investor I can be. In my opinion, owning just a few exceptional businesses is the most conducive approach to learning as much as possible about my businesses, acting as a business owner, and becoming the best investor I can be."*

Closing Remarks

The fund is open to new capital. The Coronavirus will certainly have an impact on our businesses' earnings. While it is impossible to predict both the depth and duration of this impact, I believe our businesses' valuations are now offering a very attractive entry point for the long-term investor.

As many of you know, 2019 was a difficult year for me. Every year I praise limited partners for the critical role they play at KIG. This has never been more evident than in the past twelve months. The encouragement and support I received from my partners – in so many different ways! – were truly

[3] Nicholas Lou Saban Jr. is an American football coach who has been the head football coach at the University of Alabama since 2007. He is considered by many to be the greatest coach in college football history. In *How Good Do You Want to Be?* Saban does a great job at articulating how to stay focused. Regarding the perils of thinking too short term he says, *"'Don't look at the scoreboard" is one of my philosophies, and we asked our players to dominate their opponent for sixty minutes"*. Regarding the perils of thinking too long term he says, *"Every time you think of winning the national championship – stop. Instead, think of what you have to do to dominate your opponent for sixty minutes."*

amazing. I am more convinced than ever when I say that KIG's biggest asset is that it is a true partnership. It is a huge privilege to be able to do what I love doing surrounded by such caring people; a privilege that I do not take for granted. Thank you again for your trust and patience.

Sincerely,

Matias Sacerdote