

KIG INVESTMENT MANAGEMENT, L.L.C.

260 Crandon Boulevard, Ste #32 PMB 63
Key Biscayne, FL 33149
Tel: 617-938-3443

March 18th, 2021

KIG Investment Partnership, L.P. 2020 Letter

<u>Trailing returns</u>	<u>KIG Investment Partnership, L.P.</u>
One year	68.7%
Two years	69.6%
Three years	84.7%
Four years	135.9%
Five years	125.4%
Six years	87.3%
Seven years	170.0%
Since inception (February 1 st , 2013)	306.6%
Annualized since inception	19.4%

The figures above are net of all costs and fees under the founding partners' terms and 2020 figures are yet to be audited¹. We are fully invested with 95% of KIG's capital in four businesses.

Thicker Than Blood

*"I know water that's thicker than blood
That's deeper than love with my friends
People come and some people go
And some people ride to the end*

*When I am blind, in my mind
I swear they be my rescue, my lifeline
I don't know what I'd do if I, if I'd survive
My brothers and my sisters in my life, yeah*

*I know some people, they would die for me
We run together, they're my family
When I get up they gon' be high with me
I'll say forever my family*

*My family
I'll say forever my family..."*

– The Chainsmokers and Kygo, *Family*

¹ Founding LPs pay a 2% fixed management fee and no performance fee. Other investors pay a 1% management fee and a 20% performance fee over a 6% hurdle rate. In that case, trailing returns are 271.1% since inception or 18.0% annualized.

“How do you see me adding value?”, asked a candidate to join KIG in a recent interview. “I can think of specific parts of our process where you will help us right away. That, however, is not really how I think about it. At KIG there is no formal roles. There are no limits to the impact you might have over time. If you feel confident enough, you should aim to take full ownership and become the main partner of the firm. If that happens it means you will be adding more value than me; it means we all win,” I replied.

For the first six years KIG was a one-person team. Not anymore. In February 2020 Marcos Sacerdote joined the team straight out of college. Last month Lucas Sacerdote joined KIG also from college. This month Mariano Ocantos, who worked at Brown Brothers Harriman and Amazon, joined as our COO. Also, we continue interviewing new candidates.

You might have noticed the last name of some team members. Make no mistake, nepotism is frowned upon at KIG. Marcos and Lucas are not just my nephews; they are also ambitious and capable young professionals. Keep in mind, both at my previous employer and at KIG I interviewed hundreds and hundreds of candidates their age. I have a hard time thinking of candidates that compare favorably to them. They have been learning about investing since their mid-teens and at 23 and 21 years old, respectively, they are way ahead where I was at their age. Finally, they are excited as I am about KIG recruiting investment professionals without the Sacerdote last name that will compete with all of us.

Throughout the year we also partnered with a number of old-time friends who know KIG well and are selectively introducing us to likeminded LPs. We want every partner to think and act like business owners. While KIG had its share of significant drawdowns in market valuation – just like every concentrated fund would –, after seven years we have yet to receive our first call from a nervous LP asking for explanations. Its only with such privilege that one can take rewarding decisions under pressure. For instance, we were able to buy more shares of Wayfair and Carvana last year at incredibly attractive valuations. The point is we have one of the best investor bases in the world and no intentions whatsoever to give up one of our strongest competitive advantages.

Team members and most of our new partners introducing new LPs share something in common: a human connection with me that goes back many years, if not decades. They are first interested in their fellow human being, and only at a distant second place, interested in their professional colleague.

For instance, Mariano and I became friends in college. Later, we spent many years in Boston where we got to know each other’s families, had offices close to each other, and got together during lunch breaks to play speed chess. We have known each other for more than twenty years and only in the last three years or so we started exploring the possibility of working together. We went back and forth before both agreed to move forward. None of this affected our friendship; that always came first. I am confident Mariano will be a fantastic addition to our team. The same could be said about pretty much every new partner in this new KIG ecosystem. This is powerful stuff.

This team will add an important layer of robustness to both the emotional energy and processes required to take KIG where we want to go. This is closer than ever to our businesses and our management teams which in turn will allow us to concentrate our capital when the opportunity is right. The goal is to do this while making sure that our learning and underwriting processes always continue running at full speed.

It is important to mention that I have been a crucial part of building a team before and, it is fair to add, in a very successful manner. I have a clear vision of where KIG’s culture, processes, and mentality

should be within a few years. I am excited to be part of a team effort again!

Transcendence, the Ultimate Goal

“Michael Jordan helped create a different way people thought about the African American athlete, a different way people saw athletics as part of the entertainment business... Michael Jordan and the Bulls changed the culture...”

– Barack Obama in *The Last Dance*, a documentary on Michael Jordan and the Chicago Bulls

Some BIG mistakes of omission...

Over these first seven years at KIG I made a number of mistakes of commission that had a significant impact in our performance. We are talking positions 10% or larger in size as a percentage of our allocated capital on any given year. That is a lot of pain to endure. As costly as these mistakes were, they are small compared to the costs of my mistakes of omission.

Consider for instance missing out on Shopify. This is a company I was talking to soon after their IPO. I was impressed with Tobi Lutke, their people, and their vision. Its stock was trading at less than \$30. Fast forward to today and the stock is up more than 40x just five years later to more than \$1,200. Why did I pass? It is never that simple but, in a nutshell, I did not like they were constantly raising capital. Or in other words: I used a stupid heuristic instead of thinking carefully through the opportunity. Shopify, of course, is far from the only mistake of omission I committed over the last seven years.

...and some important mistakes of commission...

In the past we have talked plenty about many of them. The most recent was my far from brilliant investment made in 2018 in GTT, a telecommunication company that is likely to file for bankruptcy soon. My mistake here was on many fronts but I could simplify by pointing to its highly levered balance sheet. What need is there to take this kind of risks? None really.

Over the years most of my mistakes of commission had at least one of the following characteristics: 1) a leveraged balance sheet; 2) they were on the wrong side of disruption; and/or 3) an unimpressive management team. While not as nearly as juicy as the potential upside from avoiding some large mistakes of omission, I think there is also significant low hanging fruit to grab on this front.

...lead us to our new focus

So where does all this take us? Can we monetize these lessons? I think so.

When discussing the book *Being Wrong* written by Kathryn Schultz with the entire team, Marcos asked an interesting question: *“What hurt more, the mistakes of commission on Metro or GTT or the mistakes of omission on Shopify?”* I immediately laughed, as it became evident to me that the first ones hurt way more – even though the latter cost us at least 10x as much!

This reminded me of a Jerry Seinfeld joke. It goes something like this. Of course, I am going to butcher it: *“Pain is a lot of information in a short period of time. Think about how much it hurts when you hit your little toe against the leg of your bed in the middle of the night. You just found out the bed leg*

was there but the key reason it is so painful is because you found out the leg was there all of a sudden. One moment you had no clue, next moment you were very well informed.”

Mistakes of omission, on the other hand, are not anywhere as painful because they usually give us many years before we fully comprehend them. That is not to say that they are not incredibly costly. It is precisely because this pain comes in small doses over a long period of time that investors have a hard time correcting their approach. In our case we kept investing too much of our capital in companies that did not have a real shot at greatness.

We were not aiming well enough. Our previous focus was quality; a valuable and noble focus indeed but not nearly as precise for the goals we have in mind for KIG. If you read KIG’s past annual letters you will read the term *exceptional companies* over and over again. This exceptionality was defined mostly by the quality of businesses’ processes and services/products. Moving forward we intend to refocus towards companies that aim to transcend.

What typically differentiates these businesses is having the ability to scale at a completely different level, capture a truly ginormous opportunity, and have a deep impact in the world. This is not entirely new to KIG. For instance, our sizable investment in Ocado over the years was not far from this new focus. Ocado is changing the grocery industry all over the world. While at my previous employer, I lead an important investment focused on Amazon. KIG also made a small investment in Amazon a few years back².

Just like quality, potential to transcend is an intangible concept that can be incredibly granular. There is all this depth to dissect. For instance, is the business bringing a new skillset to the business world? Can the business scale in a sustainable way for a long period of time? How will the business change our lives? Is this business thinking about their industry in a completely original way? Are the external elements in the world ready for this transformation to occur? Does management possess this steadfast focus on greatness? Will the business be remembered in two hundred years? These are tough questions, often about an unknowable. The fact that these questions and answers are there, unknowable as they might be, are further prove that there is indeed an edge to be gained by focusing our time and energy in a business’ potential to transcend.

KIG is in an excellent position to invest in this direction because: 1) our previous focus on quality has trained us well dissecting abstract concepts; 2) like quality, potential to transcend tends to add margin of safety to the fundamentals of a business; and 3) KIG’s base of investors has proven over and over again that is well prepared to take volatility.

Businesses that aim to transcend typically do not have quality as their primary focus. Addressing opportunity in a completely original fashion, they often do not have any real competitors. This means they don’t need an extreme level of quality to differentiate themselves which in turn means they have spare energy to use on other important fronts. This allows them to grow at a faster pace. With the right

² Amazon, by addressing some of the largest business opportunities in the world, epitomizes this new focus. This was especially true ten years or so ago when I first focused on the company. Ideally, we want to identify these characteristics and invest in these businesses before the meaningful change takes place.

flywheel in place, quality does improve as they scale and eventually arrives to a very high level as well. It is often a much more natural way to evolve than one that is obsessively focused on quality.

When too much energy is focused on a single direction, it often comes at a cost. For instance, the documentary film *Jiro Dreams of Sushi* shows the radical obsession of a three Michelin stars Tokyo restauranter to produce the best sushi in the world day in and day out. It is beautiful to witness the passion Jiro brings to his craft. At the end, however, one cannot help to think that aiming for such pinnacle of quality also explains why Jiro has only one restaurant with ten counter seats.

KIG stands for Keep It Going. I am grateful for all these years that helped us understand that focusing on businesses that aim to transcend is our way to Keep it Going. As important, the path was a healthy one. Focusing on quality for the past seven years was a great way to develop our soul. Just like building a team, focusing on businesses aiming to transcend was right in front of me all along.

Letting Go

"I'll never forget sitting in the living room with my brother, sister and mom as my dad tearfully told us his travel company was not going to make it. After that, I always associated bankruptcy with overexpansion. I think that's why after my first restaurant, it took me 10 years to open a second one.

Now I realize, despite whatever emotional issues led me to go slowly, I gave myself a real gift. I was able to take a deep dive into the skills of being a restaurateur in a way that I never would have done had I lacked that patience.

It's easy to think running a business has to be a sprint. If I've learned anything at all, it's that if you're lucky enough to lead a healthy, long life, there's time.

During those first 10 years, I learned the value of allowing a business to develop its soul. Soul happens almost as slowly as it takes for a baseball glove to break in; you have to play catch for a really long time."

– Danny Meyer, founder of Union Square Hospitality Group and Shake Shack

Why build a team now? Why change focus now? As I mentioned before, these obvious decisions were sitting right in front of me all along. The question therefore should be, what took me so long?!

Recently a limited partner and I were talking about an excellent CEO we both knew very well. This CEO is a world class executioner but has a hard time looking beyond executing at a high-level day in and day out. Important capital allocation and strategic decisions, for instance, are missing. The discussion was whether this CEO would have been in an even better place today if exposed to these skillsets when younger. In a way, the conversation was also about ambition for greatness.

This limited partner and I are both great admirers of David Hawkins's book *Letting Go*. There, Hawkins explains that the vast majority of us go through our lives doing the impossible to avoid connecting with our "negative" feelings – guilts, angers, fears, shame, etc. We are not aware but ignoring, reprieving, or suppressing feelings – resisting them – takes an incredible amount of energy away from our biological systems. Not to mention that unprocessed feelings can easily manage our lives from our subconscious – we are not free! He goes on to explain we resist these "negative" feelings to such a

large extent that we subconsciously – and tragically – start looking at death as an escape as we grow old. Hawkins message is simple: stop resisting these “negative” feelings³. Simple, does not mean easy.

Today, barriers to do things have less to do with information and more with awareness. I always say that there are three steps when mastering a concept: knowing about it, understanding it, and internalizing it. The last step requires a visceral connection. Take for instance, one of the greatest athletes of all times: Michael Jordan. The documentary *The Last Dance* shows how he competed at his fullest every day and in the process discovered an energy between his inner self and his craft that kept surprising everyone. Letting this energy flow must have taken an incredible amount of courage – over and over again.

Going back to the conversation with my limited partner, we both agreed that for this CEO it was not just about mentoring some business skills. Learning the technical skillset is the easy part; having the awareness to internalize it and use it prudently is a completely different story.

It takes tremendous courage to venture into unknown territory. The same courage it takes to connect with our “negative” feelings. Uncertainty, unknown places, potential missteps inevitably brings up all sorts of feelings. Not everyone knows how to or wants to flow with them. As important, it is only by connecting with one’s feelings that one can tell if a new venture feels right or not. Without this inner connection we lose touch with the external elements – think winds which are both threats and opportunities. Without this inner connection, navigating uncharted territory becomes a risky proposition.

This limited partner and I were talking about this other CEO but we could as easily been talking about me. Why all these changes now? Something clicked, something became more visceral. I can now *Let Go* the old KIG. I can’t wait to see where this new KIG will takes us.

Closing Remarks

The fund is open to new capital.

We acknowledge the frothiness in the general market, especially in US growth / tech. In fact, we sold most of our holdings in our businesses that belong to these sectors as each of their market capitalization’s implied valuations that were way too expensive for us.

The businesses in our portfolio remain valued at very attractive valuations. We think about valuation in three big buckets: a range where we are buyers, a large range where we hold tight to our shares and don’t even come close to consider selling, and a range where we become sellers. About 75% of our portfolio is in the buying range with the other 25% barely entering the holding range. We believe our businesses should do quite well for us over the next five to ten years.

³ It is “negative” with inverted commas because of course there is nothing negative about any feeling. Feelings are not good or bad in themselves; it is what we decide to do with them what makes us better or worse human beings. In any case, the problem is that it is precisely because of these negative associations that most of us cannot do this. In other words, to connect with these feelings and fully process them, we must first internalize that there is nothing bad about them.

Thank you again for all your patience and support. Never forget, you play a critical role at making KIG possible.

Sincerely,

Matias Sacerdote