Graham & Doddsville

SPRING 2022

An investment newsletter from the students of Columbia Business School

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Welcome to Graham & Doddsville

Meredith Trivedi, Managing Director of the Heilbrunn Center. Meredith leads the Center, cultivating strong relationships with some of the world´s most experienced value investors and creating numerous learning opportunities for students interested in value investing.

Professor Tano Santos, the Faculty Director of the Heilbrunn Center. The Center sponsors the Value Investing Program, a rigorous academic curriculum for particularly committed students that is taught by some of the industry´s best practitioners. The classes sponsored by the Heilbrunn Center are among the most heavily demanded and highly rated classes at Columbia Business School.

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CSIMA Columbia Student Investment Management Association

We are pleased to bring you the 45th edition of Graham & Doddsville. This student-led investment publication of Columbia Business School (CBS) is co-sponsored by the Heilbrunn Center for Graham & Dodd Investing and the Columbia Student Investment Management Association (CSIMA). In this issue, we were lucky to be joined by three investors who have plied their craft across geographies, asset classes, and market cycles.

We first interviewed **Christopher Lin,** portfolio manager of Fidelity's OTC fund. We discussed Mr. Lin's path to investing, mentors, and what durable growth at a reasonable price means to him. We also discussed his lessons from covering biotech and how probabilistic thinking influences his investing.

Next, we interviewed **Mark Cohen and Raphael Rabin-Havt**, from Stone House Partners. We discussed mentors, deep due diligence, and how to determine what is knowable vs unknowable when researching a potential investment.

Lastly, we interviewed **Fred Liu**, founder of Hayden Capital. We talked through Fred's lessons learned from starting a fund and the importance of relationships in all of business. We also discuss competitive advantage in research and the extent to which information can be truly differentiated in modern markets.

We continue to bring you stock pitches from current CBS students. In this issue, we feature the winner of the 2022 Artisan Investing Challenge, Dickson Pau (KKR).

You can find more in-depth interviews on the *Value Investing with Legends* podcast, hosted by Tano Santos and Michael Mabuoussin, Head of Consilient Research on Counterpoint Global at Morgan Stanley Investment Management and adjunct faculty member at Columbia Business School. Recent interviewees include Lauren Taylor Wolf, Mason Morfit, and Thomas Russo.

We thank our interviewees for contributing their time and insights not only to us, but to the whole investing community.

G&Dsville Editors

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SAVE THE DATE

Value Investing Executive Education

London, Fall 2022
Further Details to Follow

Pictured: Professor Tano Santos

Pictured: Artisan Challenge Winner Dickson Pau ('22) with David Samra ('93)

Pictured: Students and alumni gather at newly opened Kravis Hall for the 2022 Value Investing Artisan Challenge

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Christopher Lin, Fidelity OTC Fund

Christopher Lin, Fidelity Investments

Chris Lin is a portfolio manager in the Equity division at Fidelity Investments. Fidelity Investments is a leading provider of investment management, retirement planning, portfolio guidance, brokerage, benefits outsourcing, and other financial products and services to institutions, financial intermediaries, and individuals.

In this role, Mr. Lin is manager of the Fidelity OTC Portfolio and the Fidelity OTC Commingled Pool.

Prior to assuming his current responsibilities, Mr. Lin served as a research analyst responsible for the coverage of large cap internet stocks. He also previously managed Fidelity Select Computers Portfolio and co-managed Fidelity Select Semiconductors Portfolio, Fidelity Advisor Semiconductors Fund, and Fidelity Stock Selector Mid Cap Fund. He also served as a research analyst and as a research associate covering biotechnology and other health care stocks. He has been in the financial industry since joining Fidelity in 2002.

Mr. Lin earned his bachelor of arts degree, with honors, in economics from Harvard University.

Editor's Note: This interview took place on December 21st, 2021.

Graham and Doddsville (G&D):

Chris, thanks so much for making time to speak with us today. I was hoping we could start by you walking through your background and your path to investing.

Christopher Lin (CL):

Sure. I'm a portfolio manager at Fidelity and I've been running the Fidelity OTC Fund for the past four years.

I was born and raised in San Antonio, Texas, and grew up with a lot of different interests, including competitive swimming. I went to college in Boston, where I studied economics. The interaction between humans and science really caught my attention, and while that's not exactly the same as finance, I started to become very interested in exploring that through the lens of investing.

In 2002, I was at the career fair. I saw Maya Frane, Fidelity's head recruiter at the time, and nobody was talking to her so, I went over and we had about an hour-long chat. Fortunately, she thought that I was worth talking to, invited me for interviews at Fidelity, and hired me to be an intern for the summer of 2002. After that, I was honored to be taken on full-time in 2003 as a biotech and healthcare services analyst. I held that role for about five years and absolutely, positively loved it. My dad is a former professor of biology, so the fit was hand-in-glove for me. My time analyzing the biotech and healthcare services industries really shaped how I think about the world and investing.

In 2008, as part of the rotational program within Fidelity's equity department, I switched gears to cover tech. Then, soon after I started in that role, we saw the entire market completely collapse, and that was an immediate and interesting learning experience. At that time, I covered video games, semiconductors, and semiconductor equipment, and other parts of the supply chain and also ran one of the small semiconductor funds for the next several years. In 2013, I started to cover large-cap internet, taking a close look at a lot of the names that are vilified today in the press, while also running some of Fidelity's tech funds. That brought me to 2017, when I started to run the Fidelity OTC fund.

G&D: Got it. I'm a little surprised that you were the only one who went to go and speak to the Fidelity booth back in 2002. Do you think that was a sign of the times and where the market was?

CL: Absolutely. It was a different world back then. 'Intro to Economics' was the most popular class at the school that I went to, but at that time investment banking was all the rage, and you weren't anybody unless you were going into banking. And so, at the time, the most desired and coveted internships and jobs coming out of school were at Merrill

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Lynch, Bear Stearns, JP Morgan, Morgan Stanley, Bank of America, and Goldman Sachs.

The buy-side was not as popular then. Hedge funds were definitely not as popular then. They were starting to come onto my peers' radars, but there was more of a focus on landing jobs on the sell-side vs. the buy-side.

G&D: Who were your early mentors and investors that you looked up to, whether within Fidelity or externally?

CL: I'll start by saying that, stepping back to when I was an intern, I was interested in investing but I wasn't 100% sure that it would be a lifelong career. I started my internship in the summer of '02 with an exploratory tilt, but within two and a half months, I knew that this was what I wanted to do for a career. I recall feeling very lucky because as a somewhat analytical person, I couldn't think of a better job in the world than doing analysis for a living.

I grew up wanting to be a professional basketball player, but that wasn't really in the cards for me starting when I was seven years old, so I waved bye to that one pretty easily. I also wanted to be a professional musician, but I don't have a musical gene in my body, so that career path also passed me by early on. So after those two, analysis and research in the world of investing was pretty much my dream job.

"[Covering Biotech] forced me to really think probabilistically. I think a lot of people like deterministic thinking, but in reality, stochastic or probabilistic thinking is the way the world works. In biotech, there are so many uncertainties that there's no way you can successfully think deterministically."

In terms of specific mentors, I would say that Joel Tillinghast, who people consider a traditional value investor, was really instrumental in helping me shape the way I view the world. I found his approach to be extremely logical, and it resonated with me a lot. Joel didn't really impose his philosophy upon others, but I was able to learn a lot through his actions. Early on in my career, some people who I consider "Yodas" of Fidelity were Larry Rakers, who ran the Balanced Fund when I was a fledgling analyst at Fidelity, and Victor Thay, who was one of Larry's partners in crime. They were the unofficial mentors - that's my term - for all analysts when I was early in my career at Fidelity.

Unfortunately, Victor passed away back in 2010, which was pretty hard for the entire firm. Lastly, Sonu Kalra has been a mentor for me for my entire career as well. He and I actually ran the Fidelity OTC Fund for a year together to make sure I didn't run the car off the road in 2017.

Externally, I read every book I could find that talked about Warren Buffett when I first started in investing, and I still think that Peter Lynch is one of the best investors who has ever lived.

G&D: That makes sense, and my NBA dreams died when I was about 10 years old as well, so I hear you there. Getting back to your initial experience as an analyst in the biotech and healthcare space, how did that shape your investing approach and what did you take to your next areas of coverage?

CL: It really shaped two things in my approach. First, it forced me to really think probabilistically. I think a lot of people like deterministic thinking, but in reality, stochastic or probabilistic thinking is the way the world works. In biotech, there are so many uncertainties that there's no way you can successfully think deterministically. Understanding that was powerful for me, and it's something that I've tried to instill in a lot of younger analysts, too. So, once in a while, I will

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reread basic probability books to make sure that I'm still up to speed on a lot of the things that might not necessarily be intuitive for most people. It's not the way that we as cave people ever thought explicitly. Instead, we were thinking, "Okay, well, should I stick around and try to hunt this deer when there might be a lion out there?" We could intuit some basic probabilities but we couldn't do so for more complex decisions like investing. We're good at immediate decisions: crossing streets, changing lanes, socializing, things like that, but when it comes to thinking about the long term future, probabilistic thinking isn't natural. Biotech forced me to adopt a new way of thinking, and I found that to be helpful.

The other thing is it taught me to think about causality. I thought about biotech drugs reporting a lot of effects during the testing phases, and my job was to determine whether a certain drug truly caused those effects or not. I started to see cause and effect in random places, and asking myself, "Was that really a cause or an effect? Was it truly a cause or was it completely spurious or just correlated?" So, those are the two things that really shaped the way I not only invest, but also the way I think about the world.

G&D: Definitely. I think a lot of us are aware that the future is a distribution of outcomes. I'm curious how you help younger analysts think probabilistically, and if there's anything that helps train that muscle, because, like you said, instinctively we think deterministically even if we know, rationally, that the world doesn't work that way.

CL: There's no magic formula, but one thing that I do is always go back to base rates. I think this is powerful. When companies come in and say things like, "Yeah, we want to be a $10-billion company in five years." Okay, so what's the base rate for being a $10-billion company in five years from where they are today? It's near zero. Thinking about the base rates and having that sanity check is helpful.

I also like to play the devil's advocate. I do this a lot, actually. I like to test a lot, so even when somebody has a thesis that I agree with-especially when somebody has a thesis I agree with -I will push hard in the opposite direction just to test the soundness of my thinking. That's not just challenging the thesis, but also understanding that the range of outcomes is generally much wider than one thinks.

Like you said, there's a distribution of outcomes, but there's been a lot of empirical research to show that the way that humans perceive that potential distribution is far narrower than the actual distribution.

"One thing that I do is always go back to base rates. I think this is powerful. When companies come in and say things like, "Yeah, we want to be a $10-billion company in five years." Okay, so what's the base rate for being a $10-billion company in five years from where they are today?"

G&D: You've talked about durable growth at a reasonable price being a core tenet or framework for your investing approach. I was hoping you could break down what that means to you, and how you evaluate how long that durability is going to extend into the future.

CL: My investment philosophy is durable growth at a reasonable price, but what on earth does that really mean? It comes down to a few questions: Do people need it? Can anyone else do it or obsolete it? And then, is it a reasonable price? Every investment that I make is in the context of those three questions. If people really need it and no one else can do it, that's pretty durable. So then, the question becomes: what do I need to pay?

Now, obviously, this is a

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simplification and strategy is totally meaningless without good execution. In reality, I think that the best investors really differentiate themselves on execution, not in terms of strategy or philosophy. But if a company can answer those three questions in a positive, yet honest way, then it's one that I'm going to take a look at.

"My investment philosophy is durable growth at a reasonable price, but what on earth does that really mean? It comes down to a few questions: Do people need it? Can anyone else do it or obsolete it? And then, is it a reasonable price? Every investment that I make is in the context of those three questions. If people really need it and no one else can do it, that's pretty durable. So then, the question becomes: what do I need to pay?"

G&D: One piece of that framework that I think is really fascinating is the "Can anyone obsolete it?" question, especially in a world today where there are a few powerful players, especially tech, that have been able to execute and expand into a lot of adjacent markets. When you think about durability, do you need to see proof that someone won't be able to obsolete it? How much evidence of that defensibility, especially in a younger company, do you need to see before you can be comfortable with that piece of the puzzle?

CL: Yeah, it's an astute question. The short answer is no, I do not need to see the proof first. Oftentimes, if you see proof in a fast-moving environment, it's already too late. So, the potential or the motivation or incentive for a large competitor to enter the market is oftentimes enough for me. I'll just give you an example. There was a company that came in one day saying, "We sell these things. And they're super-high margin. And it's great." And the market was going their way. And I just asked them, "What happens if Amazon turns that, say, into an Amazon Basic?"

And that was it. There was no evidence to that at the time. But the product seemed like a prime thing for them to turn into an Amazon Basic, no pun intended. That hypothetical applies to small things that cost a lot like razor blades, right? By the way, it wasn't razor blades, but you know where I'm going.

So, the potential or incentive for another entrant is oftentimes enough for me to think this may be fragile, not durable.

G&D: You've talked about how important primary research is to you and the team, and I was curious what forms that tends to take when looking at a given name?

CL: I would say the heart and soul of my entire process - and probably most portfolio managers' processes - is the research team within the department. A lot of PMs are celebrated individually, but the 150 Fidelity analysts are the differentiating aspect for the firm.

Ultimately, for the Fidelity OTC Fund, I make the decision and I make the call on investments. But that call is totally meaningless at best and totally detrimental at worst without it being informed by our analysts. Fundamental research is by far the biggest input into how I make a decision.

Beyond that, I enjoy conversation and I read a lot. There's approximately a 0% chance that I'm going to buy something without having a conversation on it first, especially with our analysts. They are my first, second, and third most important resource. As part of our research, we also have a lot of qualitative conversations with people who might be users or ecosystem participants in tech.

It could be a developer or a competitor, for

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example. I just did a research call with our analyst with a gentleman who does research at a world-famous biomedical institute just a couple of miles away from our office. I find there is no substitute to having a conversation, and then just flipping over as many rocks as possible. We also go to a lot of trade shows, and I try to read as much as I can, whether the subject matter might be directly related to what I'm looking at or even tangentially related.

G&D: I wanted to shift to the "reasonable price" part of the framework, and how you think about valuation. At what part of the investing process does valuation come into play for you in making a decision?

CL: Sure, and I like the way you asked it, too. The way I've sequenced those three questions that summarize my investment philosophy, with valuation as the third question, is intentional. It's not the first question that I ask, which, by the way, is not inherently the right or wrong approach. It's just my approach. That's the way I look at the world, and the reason for that decision is that in my opinion, the valuation context is more important than the number is.

So, for example, let's just say Microsoft trading at, say, 25 times earnings, is a lot different to me than a commodity E&P energy company trading at 25 times earnings. One is a lot more durable than the other is. And as a result, the multiple (on Microsoft) can be higher. I think of multiples, like an earnings multiple or free cash flow yield, for example, as a measure of durability more than anything else.

> *"The potential or incentive for another entrant is oftentimes enough for me to think this may be fragile, not durable."*

And again, that's why I always ask, "Do people need it? Can anyone else do it?" first. If those questions can be answered in a positive way,then I believe it's durable. If it's not durable then I can't pay a high multiple. So, roughly speaking, you can say a P/E of 10x means that you can think that this earnings stream is going to last for 10 years at the current rate. I say roughly speaking because we're not considering the time value of money, the potential growth, the cost of capital, the return on capital and various other factors here.

I really like NYU Stern Professor Damodaran's philosophy on advanced valuation as a misnomer. Valuation is not advanced. It's how much money you can get out of a company in today's dollars; it shouldn't be that complicated. Warren Buffett says the same thing. Ultimately, I just want to see how much money a company can make, think about what that stream of cash flows is going to look like, and put it into the context of today's dollars.

However, usually the most important input is the assumption of how long it's going to last. That's what I've found, and that's the reason why I talk about my investment philosophy as durable growth at a reasonable price.

G&D: Does keeping the valuation piece last keep you more open to taking a look at things before they're on sale or palatable from a valuation perspective?

CL: That's actually exactly the way I think about it. Let's just say, for example, there's a really expensive stock. And then, if I asked the valuation question first, I might say, "I'm not even going to look at it." But then, what happens if the stock gets cut in half? I haven't even looked at it yet, so I don't know if it's a good value.

Whereas if I ask first, "Hey, tell me about your product or service and why this is going to do something that people need." Okay. "Tell me why nobody else can do it or why it's not able to be disintermediated or obsoleted." Okay. Now, what's the price? Sometimes the answer is, "Oh, that is tough. I can't pay that." But even though it wasn't actionable, it was still a fruitful conversation.

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And then if the price changes, because price and value are two different concepts, I am now on my front foot to think, "Great. I know the story. Bam. I was waiting for it. And now I'm ready to go."

G&D: When valuation isn't a filter in terms of what you decide to research, I would imagine that keeps the universe of what you could choose to dig into pretty large. Is there a structure to how you allocate your time?

CL: I'd say almost all my reading is non-investing-related, and I am a student and a believer in the Steve Jobs school of thought whereby you can see a lot of seemingly distant points that are actually interconnected and interwoven by invisible relationships.

G&D: Is there anything in your process that you currently do that you didn't use to do, or vice versa?

CL: I would say my process has been consistent over the past 20 years, even after I've become a portfolio manager. It's about rolling up the sleeves, going into the trenches with the analysts, seeing if this thing is something that people need, thinking about whether or not anybody else can do it, and then asking myself if this is a fair price to pay or not.

G&D: I was hoping before we move on to some of the things we're seeing in the market today, can you spend a little bit of time talking about your approach to portfolio allocation and position sizing?

CL: Okay. The fund is benched against the NASDAQ, which is fantastic because it's a phenomenal pond to be fishing from. Some of the best business models in the world are heavily weighted in the NASDAQ: Google, Facebook, Microsoft, Apple, Amazon, etc. terms of position sizing and bet sizing, the NASDAQ is not a bad place to start because it's very consistent with the way I think about durable growth at a reasonable price.

"I am a student and a believer in the Steve Jobs school of thought whereby you can see a lot of seemingly distant points that are actually interconnected and interwoven by invisible relationships."

Google's a great example. Do people need it? The last time I checked, people really like information. Can anyone else do it? Google has eight 1B+ user products with powerful network effects. Users love it, publishers love it, and advertisers love it

You can see in the fund that it is one of its biggest positions. In terms of determining position sizing, it's always in the context of durable growth at a reasonable price. I think everybody knows risk-adjusted return, and the level of risk is really important in determining my bet size.

I ask myself, 'how bad could things get?' and the answer to that question matters to me a lot.

G&D: I think that leads into talking about what we've seen in tech in 2021 in terms of the breadth of returns. The NASDAQ is up significantly, but I've seen percentages saying maybe 70% of individual companies within the NASDAQ are down at least 30%-40% from their highs. I'd have to check the numbers. But I'm curious if you have any takeaways from that dynamic, and how that relates to what we just talked about in terms of the downside risk not being beta, but permanent impairment.

CL: You're absolutely right, whereby the NASDAQ was up in 2021, but unfortunately, the end of the year has been painful and a lot of those returns have been highly concentrated. Google was a big outperformer. Amazon, Netflix and Nvidia, Tesla were powerful stocks. But there were more have-nots than haves, at least last year. It's been a narrow market for the NASDAQ, where big blue chip growth names have broadly done far better than smaller

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hypergrowth names have.

I say this loosely because those are not mutually exclusive things. You can have small, super durable companies too, but people like to classify and have taxonomies: growth and value, big and small. I'm not a believer in strict classifications, but that stratification is helpful in understanding how narrow and concentrated the market has been.

G&D: Do you feel like it's a situation now where you're starting to see some of those names that have real durability of growth, but the pricing is now starting to make more sense? Not asking you to name individual names, but are you taking a harder look at things that have been sold off heavily in recent days?

CL: Yes. That's what happens when a lot of these names are cut in half in a very short period of time. There are a lot of great companies that I would have loved to have bought, but I just couldn't get over the price at one point. They're durable growers, and now some those names are a lot cheaper than they used to be.

G&D: I wanted to ask about semiconductors because you've been covering that for a long time, and Nvidia, for example, is a meaningful part of the portfolio and they've gone on an amazing run. Demand is unbelievable. How do you think about durability in a sector that has been more of a cyclical grower historically?

CL: There are two important things: knowing what game you're playing, and having a consistent strategy – in other words, sticking with the game that you're playing. This is much harder to do than people realize. The game that I play is one of longevity and durable growth.

"There are two important things: knowing what game you're playing, and having a consistent strategy – in other words, sticking with the game that you're playing. This is much harder to do than people realize. "

I don't try to time things. I like to have time be my friend and want it to harden my assets over time, but I don't try to predict when something is going to happen or what stock market is going to do. I'm a bottoms-up stock picker.

Nvidia has been a large position in the fund because I am a believer that AI and machine learning are going to be meaningful in terms of computational technology and computer science. Nvidia has the lead on the silicon aspect of it, and a durable one at that. I think that the trend is going to continue to go in its favor, and I don't think that there's really anybody that can do anything about it. That's it. There are going to be cyclical fluctuations all over the place, but my game tells me to stick with a winner until there's meaningful change.

I think it's also important to understand that semiconductors are the foundation for modern society today. There's no internet without semiconductors. There's no SaaS. There's no Netflix. There's no crypto without semiconductors.

As I stepped back and thought about it, I thought that that was going to be important from a long-term perspective. Again, the question is: do the cyclical fluctuations in the short-term get so severe that things are getting overly exuberant or overly despondent? That's reflected in the price that you're willing to pay.

G&D: With the caveat that you're a bottoms-up analyst as opposed to macro-focused investor, semiconductors have become more important geopolitically. Does that factor into how you think about market share durability, and do you need to take the more macro pieces into more consideration for something like semis as opposed to another industry?

CL: I think a lot of people have said this,

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and I would agree, that I'm aware of the macro but it does not determine how I make decisions. It's not what is my main input for investing, but I don't want to have my head in the sand either as macro can significantly impact asset prices

So, I'm aware of it. I've thought about it. I have an opinion on it, but at the same time, to me, it can't be the thesis.

G&D: So, transitioning a bit. One of the portfolio holdings listed for the OTC fund is Reliance Industries. I was curious how that investment came about and if there are any unique considerations that you had when investing in India specifically?

CL: I'll give you the punch line first and then we can backtrack from there. The punch line is that India is about to be the world's largest country by population. I think over the next 10 to 20 years, it has the potential energy to be a rising superpower. That's the context. Reliance Industries is the foundational infrastructure provider for that country, and I think that's a good place to be. So, that's my overarching qualitative assessment.

Let's just dive in a little bit more. It has historically been an energy company, and specifically a world-class oil refinery controlled by a single-family. What they do is important, and they're fantastic at it.

The base business provided a lot of cash flows that funded what is called Reliance Jio, which is the best and I think the largest telecom network in India. The idea of being the largest telecom provider and the largest country in the world is appealing to me.

At one point, it was adding 90% of all incremental 4G subs in India and now has over 400 million telecom subscribers. And just for context, AT&T and Verizon are each at around 100 million, give or take, which gives you a quick sense of the size magnitude.

Again, do people need it? People really like internet service. Can anyone else do it? There are such massive network effects in a telecom infrastructure business.

"The punch line is that India is about to be the world's largest country by population. I think over the next 10 to 20 years, it has the potential energy to be a rising superpower. That's the context. Reliance Industries is the foundational infrastructure provider for that country, and I think that's a good place to be."

Lastly, it trades at a reasonable price given that it has a fundamentally better network than competitors do.

On top of all that, it has become the largest organized retailer in India, Reliance Retail. The vast majority of commerce in India is what we call unorganized (small Mom and Pop stands), which creates massive inefficiencies. Reliance Retail is providing organization.

So, stepping back, to me, the thesis is that they are now the infrastructure provider for what is going to be the largest country in the world.

G&D: Are there any books you've read recently that have particularly resonated, or ones that you come back to again and again that you could share?

CL: I'm pulling up my Kindle list right now, so I'll just go with what I've read recently. I read *Breath* by James Nestor, which is about the science of breathing. That was okay. *Ready Player Two*, I would not recommend. *Ready Player One*, I would highly recommend. I don't know if you've read that or not, but *Ready Player One* is great. You'll finish it in two days.

I just read Andre Agassi's Autobiography *Open*, which I thought was really authentic, and I absolutely loved it. I was motivated because I had a meeting with him

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earlier in the year. I thought that he had a lot of wisdom and a unique perspective.

I also recently read *The Company*, which is a book on the joint-stock company and how that evolved in the mid-1800s.

A really powerful book that I read earlier in the year is *Caste* by Isabel Wilkerson. It's about social and racial justice. Very powerful book, and beautifully written. Sean Gavin, another PM, recommended that to the whole department.

G&D: Do you have any advice for students who are looking to get into investment management, and then once they break-in, what tends to make analysts impactful early on in their careers?

CL: I think that this business naturally selects for people who are intellectually curious. Curiosity is one of the foundational characteristics for people I think who do well in this business, and if you're a learner, the investing business is phenomenal.

I think that people who do well as investors display curiosity, discipline, patience, judgment, stability, and confidence.

Intellectual honesty is very important, as are an absolute hunger to keep learning and willingness to work really hard.

My advice: take time to learn about yourself. I think that's actually harder to do than people think. And then, try to read as much as possible.

G&D: I think some of those are personality traits but a lot of them are ultimately eating your veggies, having those good habits, having that discipline that we've talked about. So, the last question that we have for all our guests is, what do you like to do outside of work, and how do you allocate your free time?

CL: So, my family comes first, second and third. I have a four-year-old daughter and a one-year-old daughter. I also have two dogs who were actually my first kids, and must be the most spoiled dogs in the world. We're a household of six because my dogs are my kids too. That takes up all of my non-working time. It's a total blast. I love being a parent. I learn something new every single day, and I'm surprised every single day, and that's really fun.

Otherwise, I'm a big proponent of health and fitness. I grew up as a swimmer and a water polo player and athlete. I used to do a lot of endurance races. I don't do that anymore, but I still like to swim probably two or three times a week. Unfortunately, I try harder each year, but I go more slowly. And then, I like to read whenever I can. So, that probably sums up my non work life: hanging out with my kids and family, trying to swim or run whenever I can, and then, reading.

G&D: Sounds like a pretty packed 24 hours. Thanks Chris – we have really enjoyed the conversation.

"My advice: take time to learn about yourself. I think that's actually harder to do than people think. And then, try to read as much as possible."

Dickson Pau '22

Dickson is a second-year MBA student at CBS. Prior to business school, he worked at Ascender Capital as a generalist covering Asian small and mid caps. Dickson graduated with First Honors from The Chinese University of Hong Kong with a Bachelor of Business Administration. He interned with T. Rowe Price last summer.

KKR & Co. Inc. (KKR) - Long
2022 Value Investing Program Artisan Challenge (1st Place)

Dickson Pau
CPau22@gsb.columbia.edu

Recommendation

I recommend a long position in KKR & Co. Inc. with a 5-year price target of $128.8, for an IRR of 20%.

Thesis Summary

I believe the Company offers investors an attractive investment opportunity because the market underappreciates (1) **KKR's long-term runway of growth**; (2) **the scale advantage and unique business model of the Company**; and (3) **the stability of earning power in face of interest rate and macro uncertainties**.

Business Description

With more than $470 billion in asset under management, KKR is a leading global investment company that manages multiple alternative asset classes. It generates revenue from three segments: (1) an alternative asset manager that earns a fee and shared profits by managing third-party capital; (2) an investment business with internal capital; and (3) an insurance business, i.e. 60% stake in Global Atlantic.

For (1), revenues of alternative asset managers are mainly categorized into two main sources: (A) Fee-related Revenue; and (B) Realized Performance Income. In 2021, (A) amounted to $3.1 billion and (B) was $2.1 billion.

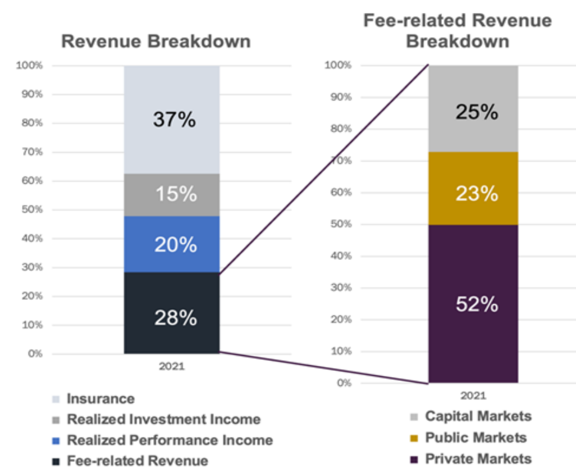
For (2), distributable revenues of the proprietary investing business, i.e. principal activities, come from net realized gains and interest income and dividends. In 2021, KKR made $1.6 billion in realized investment income.

For (3), Global Atlantic revenue in 2021 was $6.5 billion.

Investment Thesis

I. KKR operates in a massive TAM that is growing rapidly

AUM of the global asset management business has grown ***at 7.1% CAGR since 2003***. Passive products and alternatives have taken share from active core products. Alternatives now account for 15% of total asset pool and control more than 40% of the profit pool. It is ***expected to continue to grow at HSD annually***. KKR has taken market share. In 2009, it had $47 billion in AUM, or 0.8% of the alternatives market. After 11 years of ***19% annual organic growth*** and the acquisition of Global Atlantic, it currently has 3% of market share.



II. Industry dynamics strongly favor the largest players.

Three key elements in alternative asset management: (1) **deals**, (2) **capital**, and (3) **talents**. And in all three of them, scale begets scale. ***Better Deals/ Relationships***: The more deals you have done, the more relationships you have created. **Stronger Talents**: Stronger deal pipelines and larger capital base allow top players to attract better talents. ***More Capital***: Fund raising is also relationships dependent. Furthermore, more AUM allows for more resources devoted to fund raising.

III. KKR is well positioned to take advantage of market turbulence

KKR is mostly seen as a leveraged play on the markets, but this view does not paint the complete story.

KKR & Co. Inc. (KKR) - Long
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Market Misperceptions vs Reality

	General Mistaken Views	Fact-based Observations
Alternative asset managers' earnings are tied to market returns	▪ Earnings of alternative asset managers depend on carried interests, which are tied to asset valuations ▪ Earnings are thus tied to market valuations	▪ Asset valuations have no impact on management fees as fees are based on capital invested ▪ KKR has $112 billion in dry powder
Rising interest rates are detrimental to alternative asset managers	▪ Returns will collapse for private equity strategies as costs of debt increase ▪ Demand for alternative asset management services will reduce	▪ KKR has a large credit business (~$200B), which has major floating rate exposure ▪ Rising rates are also positive for Global Atlantic (annuities and life insurance)
KKR's balance sheet strategy makes it riskier than peers	▪ KKR has more of its own capital invested alongside its funds ▪ This creates bigger downside risks to the business for KKR	▪ The funds are operated with leverage ▪ But KKR, the corporation, has minimal leverage, with net debt at $2B and FRE at $2B (net leverage at 1x recurring earnings)

Highly Attractive SOTP Valuation

Fee-related Earnings

- Highly stable income streams after compensation and other operating expenses
- Since 2009, KKR's FREs have compounded at 15%
- Worth 20-25x, for an after-tax yield of 3%+
- 2021 FRE at $2 billion
- Valued at $40-50 billion or $45.4 to $56.7 per adj. share

$69.2 to $80.5 per adj. shares before considering carried interests

Balance Sheet + Global Atlantic

($ in millions, except per share data)	4Q'20	4Q'21
(+) Cash and Short-term Investments	$ 5,961	$ 4,869
(+) Investments	14,992	17,764
(+) Net Unrealized Carried Interest	2,626	4,967
(+) Other Assets	4,199	4,706
(+) Global Atlantic Book Value	–	3,372
(-) Debt Obligations - KKR	4,688	5,836
(-) Debt Obligations - KFN	949	949
(-) Tax Liabilities, Net	486	2,697
(-) Other Liabilities	858	775
(-) Noncontrolling Interests	30	33
(-) Preferred Stock	500	–
Book Value	**$ 20,267**	**$ 25,389**
Book Value Per Adjusted Share	**$ 23.09**	**$ 28.77**

- Cut the values of net unrealized carried interests and other assets in half = adjusted book value at $21B or $23.8 per adj. share
- These two businesses are worth >1x P/B as they have avg. annualized returns of 14%+

Performance Related Earnings

- Least predictable
- LTM realized performance income was $902 million
- Unrealized carried interests increased by $1.3 billion in 2021
- If capitalize realized performance income at 10x = $9 billion of value for incentive fee stream, or $10.2 per adj. shares

SOTP: $79.4 to $90.7 per adj. shares, or 37-56% higher than current stock price

5-Year Projection and Different Scenarios

Base Case: Assume AUM nearly doubles in 5 years, with cash and investments flat. And Global Atlantic (GA) book value compounds at 10% p.a.

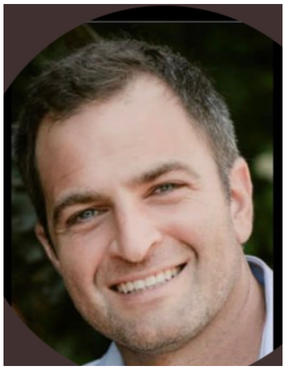
Bear Case: Assume AUM only increase by 35%, with cash and investments as well as GA book value reducing by half.

Bull Case: Assume AUM reaches $1 trillion by 2026, with cash and investments increasing by 50%. GA book value compounds at 12% p.a.

Probability-weighted Price: Base (50%), Bear (20%), Bull (30%)

Figures in $M, except per share	2021	FY26 Base	FY26 Bear	FY26 Bull
KKR AUM	470,556	861,642	639,431	1,012,446
KKR Fee-earning AUM	357,388	651,550	480,251	760,284
Private Market Fee-earning AUM	154,854	286,302	218,071	345,497
Public Market Fee-earning AUM	202,534	365,249	262,180	414,787
Fee-related Earnings	1,970	3,706	2,770	4,196
FRE Multiple		20x	13x	25x
Value of FRE Streams		**74,120**	**41,550**	**104,900**
Realized Performance Earnings	902	972	593	1,216
Performance Earnings Multiple		10x	0x	12x
Value of Perf. Earning Streams		**9,720**	**0**	**14,592**
Balance Sheet Cash & Investments	**22,633**	**22,633**	**11,317**	**33,950**
Global Atlantic Book Value	**3,373**	**5,431**	**1,687**	**5,944**
Average 2026 Target Price ($)		**126.9**	**55.6**	**180.71**
Cumulative Gain/Loss %		145.1%	7.4%	249.1%
IRR (5-year)		**19.6%**	**1.4%**	**28.4%**

Mark Cohen, Stone House Partners



Mark Cohen, Stone House Partners

Raphael Rabin-Havt, Stone House Partners

Mark Cohen is the Founder and Managing Partner of Stone House, which he launched in 2010. Prior to founding Stone House, he was an Investment Analyst at Force Capital Management, LLC. Mark earned a B.S. in Economics from the University of Pennsylvania's Wharton School.

Raphael Rabin-Havt joined Stone House in 2017 as an Investment Analyst. Immediately prior to joining Stone House, Raphael was an Editorial Researcher at the New York Times. From 2011 - 2016, he was the Founder and Managing Member of GP&GM Capital, an investment partnership, and previously was an Associate at Ropes and Gray LLP. Raphael holds a BS from Cornell University and a JD from George Washington University Law School.

Editor's Note: This interview took place on January 11th, 2022.

Graham & Doddsville (G&D): Thanks again, Mark and Raphi, for joining. We're very grateful that you're taking time out of your day to answer some questions for us. To start off, what are your backgrounds and how did you get your starts in investing?

Mark Cohen (MC): For me, I started at a very young age. I remember dialing up AOL, getting on the internet when I was in my early adolescent years, and checking stocks and reading about the companies. And just getting very, very excited by the stock market and how companies work. I was fortunate throughout my college years. I had a mentor who I ended up actually working for after school. His name is Bob Jaffe, at a firm called Force Capital. And even while I was in college, I was doing projects for him during the school year. But during the summers I did investment banking, I worked at Credit Suisse. Most people in my graduating class at Wharton took the path of going into investment banking or consulting right out of college. But I didn't want to be a banker. I knew I wanted to do investing in the public markets. I just found it so interesting that through your hard work and research, you could find things for yourself, where in investment banking you're handed all the inputs. You have to create the inputs or get the inputs yourself in public market investing. And not that there's anything wrong with investment banking, but I like finding and researching. Sometimes my wife calls me an investigative journalist, based on the kind of research that I love to do. And that really was learned at an early age.

My first boss really, really was a huge fan of that. I remember walking in the first day on the job. He basically said, "I don't want you using a Bloomberg Terminal, I don't want you looking at sell side research. I want you out doing your own work and not getting clouded by anything anyone else is writing about the company. I don't want you to have easy access to financials, I want you looking in the SEC filings." And he handed me a corporate credit card and said, "I don't even want you necessarily full time in the office. You should be out making meetings with the companies and going to look at private operators and industries." And right out of school, the first industry I got to look at was the salvage auto auction industry.

That was kind of my first case, I would say, and experience of really digging in and being on the ground full time. I was just going around the country visiting salvage auto auctions. We were researching a company called Copart. That was the first company that I covered at my old firm. And that has something to do with how we started Stone House. I think at the time it was about a $4 stock on a split adjusted basis. And now it's about $125. This is going back to 2004, but that company was one that really left a mark on me. That type of research that we were

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Mark Cohen, Stone House Partners

able to do on that industry and that company in particular, I got to know the founder and chairman, Willis Johnson, very well. And he ended up actually being my first investor in Stone House when I launched this fund in 2010. So that's how we got started here. And we've been going now for almost 12 years. And I'll pass it to Raphi.

Raphael Rabin-Havt (RRH): I've worked with Mark now since 2017. I actually started as a lawyer working at a firm called Ropes & Gray after going to law school but caught the investment bug while in law school. I never actually thought about stocks growing up. My parents never even owned stocks individually. It was something that was not part of my growing up, but it was something I became fascinated with in law school. And so, I tried to pivot into the investment business, and I actually was able to start my own small partnership in 2011 with some family members. Then I wound that down in 2016, and I actually had a short idea that I was looking to size up. I had connected with Mark in 2010 but we reconnected at the end of 2016 when I was trying to convince him to size up my short idea.

MC: I added it to my watch list. Then over the next couple months it was down 80%. So, I said, "Raphi, why don't you just come sit in the office, we'll figure something out."

RRH: Yeah, so I had this funny transition. Because I was actually working for Maureen Dowd at The New York Times during that period too. So, it was kind of this crazy period in my life where I ran down one investment partnership, was working for Maureen Dowd as an editorial researcher, and also pitching Mark a short idea. Now I've been with Mark at Stone House since 2017 and it's been quite a good ride. We go deep, and we work on a few things at a time, and we're quite concentrated. We think about a lot, we learn about a lot, but we don't trade a lot, which I think is really a compelling way to invest.

"I've really come to feeling how much people matter in investment outcomes and how to make sure you're aligned with the right people. Businesses and people, I would say that to us, they're equally important."

G&D: What are some things you look for in a successful investment? And given some of your comments in the past about the importance of free cash flow but also looking for growth opportunities, can you also go over your framework for thinking about value versus growth?

MC: I always think about the famous Buffett quote, where you want to own a business that any idiot can run. But after doing this for 20 years or so, I've really come to feeling how much people matter in investment outcomes and how to make sure you're aligned with the right people. Businesses and people, I would say that to us, they're equally important. We need to have the right business model and the right people for us to get truly excited about it.

In terms of free cash flow, for us, it really comes down to looking out at the free cash flow on a per share basis that we think the company is going to produce. I think that's generally what investing is. You're trying to buy the most future free cash flow and pay the least. The markets are obviously very competitive, and everyone does a lot of great research, but what we try and do is find a situation where there's something that might be changing. There's some reason why we believe that the free cash flow per share is going to be much higher than the market thinks and is not currently being priced into the stock. If you have to think about how we frame our investments, it's around why we think the free cash flow per share in the out-years is going to be higher than what the stock is currently discounting. And I'll let Raphi explain what we

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Mark Cohen, Stone House Partners

do to find and think through that.

RRH: We generally have found the market's very quick to react to earnings news, and very efficient with that, but it's slower to react to when there's a management change, a culture change, a strategy shift, or that kind of thing. We find our best ideas come from those type of moments where there actually is a fundamental change happening at the company, but it's just not the type of news that the market can quickly digest and reprice immediately because it doesn't have the right level of information yet. But this is where we think our work on the research side can lead us to assess the odds correctly in select few situations. I remember one of our previous holdings, Telaria, had this big earnings miss in 2018. And it was related to the part of the business that wasn't that interesting, which was the non-connected TV advertising part of the business. The market cap fell below $100 million. And to us, that's the ideal kind of situation, because what was exciting about Telaria was the connected TV advertising growth and their platform to capture that growth. But the market was getting worried about a one-off event and a part of the business that really wasn't going to be the big driver of free cash flow. That's the kind of ideal situation where we have confidence in the change happening at a company, but the market's obsessing about some old news that's not going to really matter in the future.

"We find our best ideas come from those type of moments where there actually is a fundamental change happening at the company, but it's just not the type of news that the market can quickly digest... But this is where we think our work on the research side can lead us to assess the odds correctly in select few situations."

G&D: One of the most frequent questions from students about getting into investment management is about idea generation. Can you talk some more about other ways you've found names, or other kinds of catalysts you look for to start doing the work?

RRH: For sourcing, it's interesting to think about. Because in this day and age, it's crazy the amount of information that's out there. We will source ideas from anywhere. We don't say, "Well, this person got through an MBA, and therefore, this is the only person to listen to." It can come from anywhere. Ironically, one of our ideas that we've worked on very deeply at one point came from my sister-in-law, and it wasn't because she was talking about investing but she said, "I'm buying all my baby furniture at this store. It's the most amazing store I've ever been to in my life." And to me, I was thinking, wow. She's not even talking about it from an investment perspective, she's just talking about it from a consumer experience, and that's very powerful. So, we will source ideas from anybody. Mark especially has built up a muscle over the last 20 years and then doing Stone House for the last 12. And I've been doing investment in one form or another for a decade. And so, you build up a muscle and a filter and you say, okay, I know what I'm looking for. And then that will allow us to put that on a watch list, and then that watch list forces us to then do all the kind of primary and secondary research. But for the top of the filter, it's amazing how many ideas we come accross. And then there's only a handful of those that make it onto our watch list that then require us to go do the more standard issue research practices. But from the top of the funnel, it's really hard to say there's one thing and that is the way to get it. Because it's really amazing how much is out there these days. It's so different than it was a few years ago.

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MC: The amount of information that's available today versus when I started out, I mean, even that many years ago, it's actually made things very interesting because I think the benefit of doing research today is that there's so much available information that's so easy to find. But it's also a downside because there's so much noise out there. You could be drinking through a fire hose, picking up information that might be irrelevant to the actual thing that you're really trying to figure out, which is the long-term free cash flow per share of the business. But it's just, "Oh, it's a piece of information about a company, I have to know it." And I think filtering has become a very, very important tool to see what really matters. For the type of research we do, we try and have a very good filter, because you can just go crazy. There is an endless amount of research you can do on a company. You can talk to hundreds of people, hundreds of suppliers, and try and look at it every way around it. And you should do that, but there's some diminishing return at some point, we've found. Sometimes, too much information can cloud your brain and make it difficult to think clearly about something. I've seen that happen now where you can worry about every little thing about a company, because it's just so easy to find when some customer had a bad experience and it's all over the internet, and that may be the only thing that everyone's talking about, but that was one customer in one place. It hasn't necessarily impacted the long-term viability of the business.

"...the benefit of doing research today is that there's so much available information that's so easy to find. But it's also a downside because there's so much noise out there. You could be drinking through a fire hose, picking up information that might be irrelevant to the actual thing that you're really trying to figure out, which is the long-term free cash flow per share of the business. ."

RRH: That's something Mark and I try to be very careful of. We don't stop learning, but eventually if you have too much information, you can become overconfident. It's a very dangerous thing in this business, that you think you can know everything. With the amount of information you have, you think, I can't be wrong. So, we don't stop learning, but at the same time, we have to always be aware that we don't want to allow overconfidence to impact our ability to make the right decision.

G&D: Mark, you've been described as a kind of investigative journalist, and Raphi, you've actually been around journalism. Is there a memorable piece of primary research you've undertaken in the past for one of your investments?

MC: The one that had the biggest impact on my career was my research on Copart. I remember I was fresh out of college; I was driving around, it was cold. Some of these auctions would take place in the evening at these cold sites. I'd be bundled up. And I'd try to go meet the owner of the auction that was going on and form a relationship so he would sit down with me and teach me the business: how he competes with Copart, and how the insurance companies were thinking about his business versus a more national chain which Copart was building at the time. And I remember so distinctly when I then got the chance to go meet Willis Johnson, who was the founder and CEO of Copart. His business model was to buy auctions and also build greenfield throughout the United States, and then subsequently internationally. When I walked into his office, he said he was getting calls from these mom-and-

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Mark Cohen, Stone House Partners

pop auctions saying there was this investment banker that was coming out to see them. Because eventually, he would probably end up buying their business because he was a consolidator in the industry. Then they would call Willis and ask, "Oh, who's this banker you had coming out to see me?" And he would have no idea what they were talking about. When I finally met him, and he understood, he saw that that's the type of research that we did on our investments when we want to learn about an industry. And that resonated with him.

> ***"We don't run a concentrated book for the sake of being concentrated… But I think if you look at fortunes over time, they've all been made primarily through concentrating in one asset that has compounded at a very, very high rate over a long period of time."***

RRH: For me, I was going to say one of our first investments that Mark and I worked on together when I started for him in fall 2017. It's a company that's become better known now; a company called PAR Technology. At that point, they had this software business that was quite small in terms of revenue underneath an old school hardware business. They were selling POSs focusing on the the enterprise QSR market. In trying to assess the viability and potential of the software business we would talk to we would talk to POS distributors and CTOs at QSR chains. I think that was helpful for that type of industry where sometimes it's hard because it's just too diverse. But in this industry, there were ways to talk to people to assess the probability of the go-forward success.

G&D: I wanted to ask a little about your portfolio now. You run a very concentrated book. You typically only hold a handful of investments at any given time. Can you talk about the benefits or drawbacks from running a concentrated book?

MC: We don't run a concentrated book for the sake of being concentrated. I think we do it because it makes sense for us and the LPs in the fund. It's not, I would say, an input. But it's an output of our process. I think for many people, running concentrated is a problem because the investor base can't handle it, or the managers can't handle it. But I think if you look at fortunes over time, they've all been made primarily through concentrating in one asset that has compounded at a very, very high rate over a long period of time. And I'm not saying that we're doing that, but I think that is an example of what can happen if you get a concentrated call correctly. Obviously, it can go the other way too. But we've been fortunate enough to gather LPs who have self-selected into Stone House knowing that we are a very concentrated fund, in order to accept potentially higher longer-term results, and are able to withstand the volatility that comes in between. We mark our investments every day. There have been periods now, look at COVID, where we had lots of volatility. You have to do what makes sense to you as the portfolio manager and set yourself up with the right LPs that can handle what you've set out to do. I'm transparent with the portfolio once we build up a position. People understand that, at times, it makes sense not to share when we are building a position. But other times, it makes sense to overcommunicate with your LPs. And they appreciate that, and they've been extremely supportive over time.

RRH: We're lucky enough to have LPs who understand our approach and don't get scared when we encounter volatility, which is inevitable when you own only a handful of stocks.

G&D: So, the volatility is a byproduct of the concentration. But do you ever use it to your advantage when looking for an entry point for something you like?

MC: Yes. I would say

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Mark Cohen, Stone House Partners

we've used it to our advantage over time, especially when markets are dislocated. For one of our LPs, when I speak to him about investing in various funds, he says for Stone House he pays for our conviction. When people see stocks dropping like they did in early 2020 when COVID was setting in, or in other periods of time, it's very easy to cut and run. It's easy to have conviction when things are going up and to the right. But when things go sideways or down quickly, and you don't know what you own, that's when people get in trouble and can really hurt the long-term potential to compound because they've taken permanent capital loss. That's what we try to avoid the most. That's our number one goal. It's to avoid permanent capital loss and then compound at a high rate.

G&D: Jumping back to the investigative research mindset that you take, does that mindset affect what you'll look at and what you'll take a deep dive on? Does it need to be something where you think you can get an edge from doing really differentiated, boots on the ground research?

MC: Absolutely, that's a very good question. I think when people ask us what we will look at and what we won't look at, it's very clear to me. I won't touch anything or think to invest in anything where I need a PhD to understand the business. Whether it's biotech or some industry where you need to have some sort of advanced degree to even understand what the companies do or their edge on patents, things like that, we won't touch. I need to be able to pick up the last few annual reports, understand how the business makes money, understand where it fits into the industry, see the company in action and how a dollar flows through the system, and understand the people behind the business.

G&D: Do you think that that lends itself better to like B2B companies or consumer facing companies? And are there any nuances with what kinds of insights you can get?

RRH: The initial question is interesting because I think it depends on the company, and what type of primary research you do. Like I mentioned the PAR Technology example, that's B2B where you can really effectively survey the industry to get a sense of how well a POS might do. Especially when you're selling into the enterprise and not small individual locations. There's a handful of decision makers that ultimately are going to decide whether to roll out your POS across people with more than 500 units, let's say, so there's only so many. So that's an example where it's very clear to me that type of primary research you can get an assessment and the probabilities of success. But consumer companies

> ***"I need to be able to pick up the last few annual reports, understand how the business makes money, understand where it fits into the industry, see the company in action and how a dollar flows through the system, and understand the people behind the business."***

are more difficult because it's a much broader marketplace of opinions that form ultimately what happens for the company. So, a scenario where we've done work on a consumer brand type company was this company that we learned about from my sister-in-law buying baby furniture. With that, it's obviously completely anecdotal, but it was interesting to me because she was their best kind of consumer, a young mom with a family, with some discretionary income. And for that type of brand, it was very important to have that type of consumer. Ultimately for that stock, it was about understanding the transformation the company was going through, and then understanding the

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Mark Cohen, Stone House Partners

people behind that transformation. The type of work we did that we think really helped us was around understanding the CEO and understanding his motivations and how he looks at the world. Because that was the kind of a situation where we really had to assess the management's capabilities. And we were able to talk to some people who knew him very well, and that gave us some insight. So it depends on the situation. You understand what's actually signal versus noise.

G&D: Going back to your comments on high conviction. Another question that comes up a lot from students who have never been practitioners of investment management is how to know when to pull the trigger? How long does it take you to get to high conviction, or when do you know that you have it right? When do you feel comfortable?

MC: Sometimes we'll watch something and talk about it and learn about it for a very long time before purchasing our first share. Other times, it just stares at us in the face and it's a weekend of nonstop work, and we come in and maybe do something. I would say that it varies to a great extent. And as Raphi said, we built up these muscles over long periods of time studying companies, the market, and people. We have an idea of why something might be interesting.

"Sometimes we'll watch something and talk about it and learn about it for a very long time before purchasing our first share. Other times, it just stares at us in the face and it's a weekend of nonstop work, and we come in and maybe do something."

And then we might try and work only to prove why that idea is wrong. And Raphi's very good at pushing back. We have that very good relationship where I may get excited about something and then he says, "Whoa, whoa, whoa, let's really think about it from different angles." So, we really collaborate on a daily basis like that to build up our conviction to take these meaningful positions.

G&D: I want to ask about some specific stock related questions. This is about one of your current holdings, but this kind of theme has come up already a handful of times regarding other companies. With regards to Scientific Games, it seems like there are different underlying businesses that each have different trends. They have lottery and gaming, and then within gaming they have these super high growth categories like online gambling and sports betting. So, when you think about businesses that have distinct units that are maybe even divergent at times, or seemingly distinct, is that an obstacle, or is that an opportunity in your view?

MC: Well, something that I think is very interesting that we think about a lot is focus. Companies that are focused on a particular segment, product, or service and are doing that better than anyone else in the world. I think Scientific Games has been the world's best and really the inventor of the instant lottery ticket. And they have 75% global market share in that business. Since the overhaul of the board and management that happened over the last couple years, which is a major part of our thesis right now, the company has been headed by a gentleman named Jamie Odell, who's just proven to be an exceptional operator and an exceptional human being in so many regards. His real focus and expertise is on the gaming side of the company. So, he took the opportunity when bids were very strong for very stable assets like the lottery business, to actually unload that business and pay off a substantial portion of the debt that the company was carrying. It's really transforming into a new company as we speak. And I think the deals for the lottery and sports betting businesses are

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going to close soon, and the company will have a minimal amount of leverage and focused only on making great games and supplying them into the casino space, land-based and online. What Jamie noticed was that there was value to extract from selling that very stable lottery company, and also value to be created by focusing on what the team that he has compiled at Scientific Games knows how to do best. They proved that previously at Aristocrat, an Australia based gaming company, and it’s something that I think investors in America haven't seen yet. They can hit escape velocity like their former company Aristocrat did, which is where Jamie, and probably 30 of the top executives in the gaming division, came from. The success that they had at Aristocrat, which I watched over the years competing against Scientific Games, was unprecedented in the industry. And for them to all move over to their former competitor, so now wearing the Scientific Games hat, to us, is an extremely interesting setup. Especially now that the company is solely focused on this, having shed the lottery and sports betting business.

RRH: When we initially invested, it was this diverse set of businesses with a good amount of leverage. And now what's happened, which we're quite excited about, is now they're in the process of closing both the sports betting and lottery deals. So now it's just a much simpler, more focused business with much less leverage on the balance sheet. And with the new team, it's a different company than it's ever been. Even though sports betting is something I know a lot of people get excited about, we were actually quite excited that they sold the sports betting business. We agreed wholeheartedly with that decision. We did not, after our assessment of the sports betting engine they owned, believe they were in an appropriate power position to extract economics there. So, we were quite pleased at the price they were able to receive for that asset. Now the company is just gaming, including land-based and digital. It's not this disparate set of assets that it used to be, which is quite exciting especially given the team.

MC: They went through a long strategic review. There were lots of people who, up until probably Q4 of last year, were very excited about sports betting companies. They were trading at very high multiples. And we've seen what happened to the stocks since then. But one could have made the argument that if Scientific Games sold the business that the market was so excited about, then what would be left? But we think about things on a long-term free cash flow per share basis. And for that business, well, there might have been a lot of hype and excitement around it, but we just didn't see that there was a place in the market for it to earn extraordinary returns over the long term. We thought that companies would begin in-housing this technology and not necessarily let them earn a healthy return, like they had been earning previously. For us, that was a great sign that management understood and was thinking long term about free cash flow, and not just about what's going to please the market in the near term.

> ***“We think about things on a long-term free cash flow per share basis. And for [sports betting], well, there might have been a lot of hype and excitement around it, but we just didn't see that there was a place in the market for it to earn extraordinary returns over the long term.’***

G&D: You mentioned earlier about how you like to be aligned with the right people, and a core part of this Scientific Games thesis is the management team. What do you think are the qualities that make a great CEO and manager?

MC: First and foremost, I think integrity. I think

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they need to be truth tellers. Secondarily, I think obviously having the respect of the team. I remember some of the calls that we did surrounding Jamie when he was coming on board of Scientific Games. I remember on one of our calls, the guy had worked for 25 years in the different aspects of the casino industry and had known about Jamie. And he said the people who work for him would run through walls. He had that type of loyalty and respect of people on his team because they believed in the mission. And that, to us, said a lot about him. Then you have to back it up with results obviously. And his results at Aristocrat were just spectacular. But it comes down to being able to recruit people, having them buy into what you are trying to achieve, and then having alignment around that by being invested right alongside them. That's something that we love about the markets. You can find these opportunities, these teams, and in an instant, become their partner.

RRH: It's funny to think about. We initially cold called Jamie. It was 2018, before he came to Scientific Games. But we were learning about the industry, and then thinking it through there was nobody we'd rather talk to than Jamie given his success at Aristocrat. He took our call and talked to us for two hours, which was amazing. And he just walked us through how he turned around Aristocrat into an amazing gaming business. He walked us through the map and walked us through the strategy. That was just an amazing learning experience. It's quite unique in terms of just being able to talk to such a successful executive and for him to share his thoughts with you just through connecting via a LinkedIn message. And then obviously, we've heard that Jamie's the finest executive, not just in terms of the actions but the belief he inspires and the quality of person he is. Since he's been at Scientific Games, there are all these people that have joined. And when you talk to them, we've talked to a lot of them, they say they joined because they would run through a wall for Jamie. They decide to leave the most successful gaming business in the industry at the midpoint of their career when they're still young executives to work for this guy and, I mean, that obviously is itself a proof point. And then we see what decisions they've made since he's become the chairman of Scientific Games.

> ***"It comes down to being able to recruit people, having them buy into what you are trying to achieve, and then having alignment around that by being invested right alongside them. That's something that we love about the markets. You can find these opportunities, these teams, and in an instant, become their partner."***

G&D: You talked a lot about what you can glean about management from talking to them, talking to employees. Is there any signal in what's available publicly that management is trying to do the right thing for the company? In terms of incentive compensation, or in terms of governance structure, or how the organization is set up. Are there things that you look for, or is it more waiting on that management call or employee calls to get an idea of whether this is a great person running this business?

MC: I'm glad you brought that up. It's much more about actions over words. I've been doing this for so many years, I've come across a lot of very, very, very good salesmen. And unfortunately, over the years, everyone has been sold a story from time to time. From where we sit, trying to assess companies and management teams can be a very dangerous thing. If the person is too good a salesman, you can buy into it. That is something we're always trying to guard

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against, because typically, when you are dealing with CEOs of companies and potentially even founders, they are charismatic, successful people, and they've gotten to where they are because they have been able to do that. So, you always have to ask yourself, am I being sold a story? One of the things that we focus on tremendously is actions, not words, and we try to look at someone's track record. What have they done in different situations that makes them someone you want to partner with now? So, I would say even more so than getting that warm feeling from sitting in a room with them, and hearing them talk about their business, and their plans, and their long-term vision for what they're trying to build, it's about what they have done.

RRH: It's like everything in this business, it's always a combination of things. There are so many charismatic people out there that can tell you all sorts of things. And charismatic people are actually important people. Mark and I have come to appreciate some of the crazy ones that some people might be afraid of. They're so willing to say things that seem outlandish, but that vision, that's the way you can get to some crazy result and inspire people to believe in something crazy. So, we've come to appreciate that, but obviously it's got to be backed up with the numbers at some point. You create this mosaic. Over time, you build up that ability to look and assess a lot of different factors that come into it to, to make the judgment of whether or not what's being said is a realistic possibility.

G&D: How do you avoid going down a path where you're relying on management guidance and a story?

RRH: I think about that a lot. Mark actually had me audit, when I started working for him, a class at Columbia Business School with one of the great investors out there, Tom Tryforos, who teaches one of the executive MBA classes on value investing. What was so great about auditing his class was how much he gets back to the fundamental concept of what he calls economic value add, or effectively earning above your cost of capital. We want to make sure that we don't lose track of the basics of what actually creates value over time. Short-term stocks can trade anywhere, but over the long term, they're going to track that value creation on a per share basis. I think that class was so interesting for me to audit, and I'm so happy Mark had me do it because it was so powerful to reinforce this basic concept that we should all know. But it's so easy to get lost in the noise of the day to forget about what actually over time creates value in a company. And so, Mark and I, when we look at any stock that has a compelling narrative, we make sure we actually understand the economics of the business. And sometimes, we have to admit that it might be an interesting story but we just can't understand the economics, and we have to accept that other people can. We make sure we don't have too big of an ego where we think we have to understand everything. And therefore, when somebody we respect understands and we don't, that we don't end up forcing ourselves into the situation. We try to make sure we always truly understand the core economics of the

“When we look at any stock that has a compelling narrative, we make sure we actually understand the economics of the business. And sometimes, we have to admit that it might be an interesting story but we just can't understand the economics, and we have to accept that other people can. We make sure we don't have too big of an ego where we think we have to understand everything.”

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business, which allows us to avoid hopefully some of the problems you can encounter where you get sold a story without economics that make sense.

MC: And it's a big thing to fight the FOMO where if you just can't get there on the economics but it's going up every day. You have to be happy for those that are making money, and you just won't be participating. But that's fine. There will be other stuff out there to do.

G&D: Going back to when you were setting up your firm. What drove you to leave the established firm you were already at and how did you know it was time to venture out on your own?

MC: I had been there for four years. Everyone has a long-term plan, but it doesn't always work out like that. But I'd always been entrepreneurial. I wanted to get into the investment business in an entrepreneurial way after four years of working at a bigger firm. And I felt like looking out at how things were unfolding, I felt I was at the right age. I didn't have family responsibilities, I didn't have a wife, I didn't have kids. I felt like if I was going to give it a shot, this was going to be the shot. So, basically, I did what every person does when they want to start a new business. Just take a yellow pad and write down everyone you know who could possibly invest. I give this advice to a lot of people who are wanting to start funds right now. The best thing you can do is create a short deck or come up with an idea. Find your own investment idea that you think at that time is super compelling. What I found is that anyone will take a meeting for an idea. When you approach people and say, "I want to talk to you about my new fund I'm starting." It's like, "Ah, another fund. Who needs another fund?" But I remember when I got started, I was focused on a number of companies after I left my job, and I was thinking about what type of portfolio I was going to build out, and what type of companies I would invest in on day one. And one of the companies that I was researching was Jack in the Box. I remember being out on the West Coast and seeing Jack in the Box, and someone had recently filed that he owned 5% of the company himself and that caught my eye. I started doing work on it and they were going through this transformation, selling their company owned stores and real estate, and then buying back stock. They also had Qdoba, which is like Chipotle, growing inside it. There was just an interesting value dynamic going on there. And that was my pitch. I actually created a deck based on that investment. And I went out to every person that I wrote down on the list with that in mind. I said, "I want to come pitch you an investment idea, not my fund." And we ended up talking about the fund, but I said, "This would be an example of something I would buy, the first thing I would buy." Willis Johnson was the first person who came into the fund, but I actually didn't pitch him that stock. It was more just talking about my work on Copart with him. And he got to know me well over the years. But other people, I did pitch Jack in the Box, and I had that PowerPoint deck that I was running around New York City with. I remember like it was yesterday. One person would introduce me to another person, and that was really the start of how I got going. But I think starting out with just a few hundred thousand dollars, starting a fund is a daunting thing to do. I think the other thing that I would say is people overcomplicate things sometimes. They need the big office space. They need the high-priced lawyers. They need all that. At the end of the day, I said I'm going to run this with the least amount of operating costs possible,

"I give this advice to a lot of people who are wanting to start funds right now. The best thing you can do is create a short deck or come up with an idea."

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and just try and stay in business. So, it was just me for the first couple years, and we had very low overhead. I think that's what initially allowed us to stay in business. Although we have had some periods of volatility, overall the return has been very good. For us, it has always been about focusing on the long term.

G&D: And last question for both of you. What do you like to do outside of work?

MC: Well, Raphi and I both have young kids. I have three, Raphi has two.

RRH: My hobbies now, outside of spending time with my family. Tennis and chess.

MC: Family, home life, that really just absorbs me when I'm not in the office.

G&D: Well, thank you guys. I really appreciate you giving us so much time and walking us through your story.

Fred Liu, Hayden Capital

Fred Liu, Hayden

Fred Liu is the Founder and Portfolio Manager of Hayden. Fred holds a B.S. in finance and international business from the Leonard N. Stern School of Business at New York University and is also a Chartered Financial Analyst. Fred founded Hayden in 2014. He previously worked at New Street Research and at J.P. Morgan as a Research Analyst on its Small Cap Equity Fund.

Editor's Note: This interview took place in December, 2021.

Graham & Doddsville (G&D):

Good afternoon, Fred. Thank you for having me. Why don't we just start off. It'd be great to just hear an intro of your background and your life before investing.

Fred Liu (FL):

So my parents came from China in the late 80s, and I was born here in the U.S. I grew up in Cincinnati, Ohio, so I'm a Midwestern boy. I got into investing really when I was 11 years old. I really have to credit my dad for this as he gave me 15 shares of Walmart for Christmas one year. I distinctly remember bragging to friends on school bus that, "I own a piece of Walmart." And every time we walked into a Walmart, he'd actually explain to me "Hey, you own that door or that shelf or whatever." I thought that was super cool. I always loved business and making a buck. I worked ever since I was very young and because hooked on investing ever since my dad gave me those shares.

I went the complete opposite direction of probably what I should have at first. I started day trading. Obviously, day trading is high adrenaline and fun way to lose a lot of money, and that's basically what I did over course of the summer. When I was 13 years old, I was listening to CNBC playing the after hours earnings pops. I started with $3,000 bucks that I had saved up from birthdays and Christmases and made my way down to $5. As I lost more and more money, I started going into penny stocks, trying to make that back. I've done the whole gamut. From that experience, I completely understand where some of these Reddit guys are coming from today.

After that experience, I thought, "There's got to be a better way to invest." I went to the library and picked up the first books that stare at you in the face in the investing section. That included "The Warren Buffett Way" and a couple other Warren Buffet books. I probably read every book that I could on investing over a period of several years. By the time I was 15, I knew that I wanted to be an investor. Growing up in Cincinnati in Ohio, there just aren't that many opportunities to work as an investor so I tried to come out to the East Coast whenever I could.

I actually spent a summer at Columbia when I was still in high school, taking valuation courses and falling in love with New York. I did a banking internship in Philadelphia when I was in high school too. I just knew that I wanted to be in New York for the apprenticeship atmosphere that it would allow. Unfortunately, Columbia doesn't have an undergrad business school. So, I applied early decision to NYU, and got in. While at NYU, I had a bunch of great internship experiences while there. Afterwards I was lucky enough to make my way to J.P. Morgan Asset Management.

And so, I worked for one fund there. We ran roughly $5 billion. It was a team of five, six of us. We were just looking for great companies to invest in. It was a great place to cut my teeth. I think though that as investors, we're all artists in some sense. The way that you invest has to match your personality well. I think that everyone reaches a stage in their career where they've learned the techniques and the tools that they need from their apprenticeship type of role, from the great masters that they apprentice under. But

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after that, they want to create their own investment process and style - something that's tailored to their unique personalities and how they innately think and in the types of companies that they're fascinated by. That's when the magic really happens. And I always knew that I wanted to do that. The end goal was always very clear to me – it was just a question of how and when.

Hayden has been something that's been in the works for a long time. The name Hayden comes from my freshman year dorm at NYU. I registered the Hayden Capital domain in 2013 years before I launched to outside partners. I worked for a year at a firm called New Street where I cut my teeth and taught me how to do primary research. And then we launched Hayden to outside partners at the beginning of 2016.

G&D:

So you mentioned Warren Buffet. Who are a few of the other big name investors that really sparked your interest in investing?

FL:

I mean, everyone. The reason I named it, Hayden Capital after my freshman dorm Hayden Hall at NYU is because I was a freshman in 2008. There was just complete turmoil going on around us. Luckily, as a freshman I had four years until graduation so I wasn't too worried about job prospects. But it was an interesting time to witness and to study many, many different styles investing. I didn't necessarily have a defined investment philosophy up until that point. I studied everyone from the Quants, to Deep Value guys, to Buffet, Klarman. The Ira Sohn and other investment conference presentations were just starting to become public and being public via the internet. I spent that period learning from everyone that I could, self-studying, and reverse engineering their ideas.

G&D:

So now moving on to Hayden Capital. It'd be great to hear the origin story of the initial launch including how you initially raised capital.

FL:

I think there's two ways career paths in this industry if you want to launch. You can either start off once you have a phenomenal reputation in this industry. Say you're the CIO at a large firm or a co-CIO, or what have you. You may want to spin out and launch your own firm and name on the door. You're probably later in your career, with maybe 20, 25 years of experience. You have decades long relationships with different allocators. And you probably performed superbly and have an amazing track record, which allows you to go launch with the support of these long-held relationships. This would enable you to launch with a large amount of assets on day one. But that's not where I came from.

"I think that everyone reaches a stage in their career where they've learned the techniques and the tools that they need from their apprenticeship type of role, from the great masters that they apprentice under. But after that, they want to create their own investment process and style - something that's tailored to their unique personalities and how they innately think and in the types of companies that they're fascinated by. That's when the magic really happens. "

I started with between $1-2 million bucks, all friends and family

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capital. All of these were personal relationships of mine. I thought, "I can either wait 20 years in my career to launch when I'm more established and have more relationships and go build this work of art, or I can launch earlier when I lack the relationships but have ample amounts of time." I was just 25 years old at the time, but just after a couple years of experience on Wall Street, I could already see clearly the flaws in this industry and the structural reason why so few investment firms are able to manage a strategy like Hayden's.

I've interviewed with a lot of hedge funds during those first few years, and while they may have been interviewing me, I was also interviewing them and studying how and why they launched their investment firms. Through the interview processes, through interviewing a lot of these managers, what I found was a lot of funds structurally just aren't set up to invest in 10 year type of durations. They may understand that's where the alpha is. And I truly believe that there is an equity yield curve out there similar to the fixed income markets and the longer duration you go, the more you should be rewarded for those longer duration investments. Obviously the longer duration to go, the more volatile it is. Many others funds aren't set up to invest in that way. They may understand the alpha is there, but the structure of the industry and the incentives of most of institutional allocators, who could be early investors, just doesn't support that.

And a lot of managers because they're desperate for capital on day one, they accept everyone who comes in the door. What I've seen from personal experience, is that they don't select their partners very well. Often times the reason investment management firm fails and the average duration of a hedge fund is less than five years is because of this mistake. It's not usually because of performance. It may be because there's a period of bad performance, but that's not the death kneel. What kills funds is your partners have a different expectation around volatility or returns than you do, and more importantly, you didn't do a good job explaining and setting expectations upfront, and around the period it takes to generate returns. Thus, partners would withdraw at the wrong times and lose confidence. Therefore, it's ultimately a communication and expectations setting problem.

It comes down to building the foundation of your firm very robustly. What a lot of people try to do is fill that foundation with every single dollar that they can to come in. They know the foundation is shaky – but when you're desperate for capital and have large operational cost structure with a yearly burn, what else are you going to do? But they then try make up for it, by reinforcing this foundation with legal contracts, lockups, what have you. In my view, that's putting a bandaid on the problem, not fixing the root problem. It's not something that I ever wanted do even philosophically. My rationale, was that if we can reverse the issue, and be very selective with our foundation first, then we can create a win-win situation. That's why we try to diligence and get to know our partners as well as we can, to ensure there's a philosophical fit too and they have a clear understanding of what to expect from this relationship.

As long as that's in place, we should then have respect and mutual trust for our partners, since we trust them enough to allow them in the first place, right? If that's the starting point, then they have every right to see their portfolios on a real-time basis and how their money is managed. They should have daily liquidity and access to their capital, since we trust them to behave appropriately. And by being radically transparent, they can continue to build their trust with us and see that we're actually doing

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what we said we would. This is the basis for why we consciously chose to go with a separately managed accounts structure.

I always thought that was the right thing to do for our partners. It's their money. This is a relationship based business, and so every time we accept a new partner, we're essentially entering into a long term marriage. Once you make that decision, you should make every effort to treat that marriage well.

And I also said, "If a partner wants to leave us at anytime, that's completely fine too." We never want someone leaving with a bad taste in their mouth because we tried to lock up their money and say, "We know better than you and we're going to make your money back before you can withdraw." That's just not the right way of approaching things. Not all marriages work out, and it's better to know early on if it's not a good fit, so no lasting damage is done for either party. There can be a differing of philosophies, but still mutual respect for one another. And in this relationship driven industry, those relationships that didn't work out may actually result in referrals down the line too.

So I launched with that mentality. I saw the structural business flaw in our industry. The piece that I lacked was personal brand and long-tenured allocator relationships, but I believed that I could basically build those relationships and iterate as I went.

"This is a relationship based business, and so every time we accept a new partner, we're essentially entering into a long term marriage. Once you make that decision, you should make every effort to treat that marriage well."

Initially, the portfolio was a little bit more diversified than it is today. I looked at a lot of industrials when I was at JP Morgan and so initially our portfolio was filled with some industrials names as well. Over time, what I realized is that if we truly are investing with 10 year horizons, I needed to find companies that think in that that timeframe as well. We had to find great entrepreneurs that are willing to iterate in an ever-changing world. Where we found that generally was within the tech sector, in particularly the consumer internet sector. On top of that, I just thought the consumer tech sector had the alpha and was the most interesting part of the market. There is perpetually a lot of businesses that flame out and die off while also having a lot of businesses that endure for 20 to 30 years. That discrepancy of potential outcomes is what creates an interesting fishing pond, and where we can add the most value.

The market generally values these consumer tech businesses conservatively in the early stages, since the the range of outcomes are wide and uncertain. And the market hates uncertainty. But in many cases, with deep research you can gain confidence that the expected value might be very high despite the wide range of potential outcomes. So I thought that if we could get better information, if we could have different insights than others, then we could actually generate alpha there. I started Hayden with just friends and family capital and we probably didn't get our first real outside investor for a year and a half, two years. And at the same time, like I said, I had realized the issue with running a strategy like this was always around communication. Why it's hard to run a portfolio in this manner, stems from setting the wrong expectations for your LPs or not curating your foundational base of partners well enough. And my solution to this was, "We're going to do everything publicly and

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transparently."

I believe in today's markets, much of the information, or the "what" is really no longer an edge, especially in the sectors that we operate in. All the data lives online. You can web scrape. You can use alternative data. There are many ways to get the datapoints outside a company's filings. But while these datapoints will tell you how the business operates today and how it has operated historically, it doesn't tell you anything about the future. You have to understand the "why". So I thought that we could add value by basically talking to people and extracting information out of people's heads around the strategy and the "why". Why is a company going in a certain strategic direction? Why are they entering a certain geography? What's the internal thinking behind launching a new product?

Companies may not even know what the end game looks like, it might just be an experiment. If a company itself doesn't know, you as an investor probably won't know. But at least you understand the rationale why and what KPIs you should be tracking in order to gauge whether whatever product is going to be successful in the company's eyes. If you can gauge that a product is a success, that means the Company is likely going to plow more money into it and spend more on customer acquisition. And then you can run the math objectively, on whether you think that's a good capital allocation decision or not. We've invested in that manner since, and iterated on that process over the last five years or so.

"I believe in today's markets, much of the information, or the "what" is really no longer an edge, especially in the sectors that we operate in. All the data lives online. You can web scrape. You can use alternative data. There are many ways to get the datapoints outside a company's filings. But while these datapoints will tell you how the business operates today and how it has operated historically, it doesn't tell you anything about the future. You have to understand the why."

G&D:

As you mentioned, you initially had been more investing in industrials businesses that you're familiar with from your time as an analyst. Are there any other major evolutions in terms of the strategy, whether that is maybe looking at companies that are more expensive by traditional metrics or outside of the U.S.?

FL:

Not necessarily. Like I said, our portfolio was a little bit more diversified, we had more holdings. But the actual fishing pool that we were fishing in never really changed. I would actually say that circle of competence has maybe narrowed a little bit in the initial years from fewer industrials names, into more centered around ecommerce. But it was always in the U.S. and in Asia, because that's just where my personal background is. It's what I understand culturally.

Honestly, I also think some of the best entrepreneurs are coming from these two regions. If you think about things that change within a business, the only things that really don't change, especially within the tech sector, is the founders and the cultures that they instill. Culture is really important because once you reach a thousand people inside of your company, the founder doesn't necessarily know every single person and certainly can't have that many personal relationships. So

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institutional culture curates and points everyone towards one common goal, moving the company in a common direction.

At the end of the day, corporations are just collections of people that are trying to achieve a common goal. I find the best entrepreneurs are those that are able to motivate the troops and instill the best culture within each role. Therefore, that's where I focus a lot of my research. On the process side, I've evolved somewhat and become better, at least I would hope so. In the early days what I lacked was a network of relationships, but what's beautiful is the ability to build that quickly by sharing information with the world. We have a Twitter profile, we share our research, we share our letters in order to start a conversation.

Every time we publish on something that might be a little bit controversial, people proactively reach out including very, very smart people. Some of the top leaders in the space have reached out in the past, which is really interesting. This refines my own thinking over time. In addition, whenever I travel, I'll publish something like "Hey, I'm traveling to X, Y, and Z city." I get a lot of cold emails too, from people. Some of them are extremely smart and experts in their own domains. Speaking with them has enabled me to pick up new ideas from them. I've been able to do that more and more over the last few years because of the benefits of an ever expanding network. And I think that has helped with our process too in terms of again, understanding the why behind some of these decisions.

G&D:

It would be great to discuss quickly your idea generation process. Is there any degree to which you generate ideas systematically? How do you go from say 100 ideas to a few that actually become investments?

FL:

I don't think there's that many great ideas out there honestly. I think usually with a particular company, it's a gut feel. It's like when you're going on a date with someone, you can usually tell within the first few minutes whether that person is right and there's something special there or not. In the case of public markets, you don't have to wait until the hour is over to go get up and leave table - you can stop researching an idea after five minutes. I think generally after an hour or two, you can have certain hypotheses and a theory about what's going to make this an investable idea. And the next step is to see if you're right or wrong on that, or maybe you even find an "X factor" going on in the company that's actually even more attractive than you had initially hoped. I think you can find out very quickly whether something is in your circle of competence or not.

"I think there's credit to that, through having joint research. You're seeing a lot of smaller shops launched today and people often say like, "How the heck can you launch with only couple million in assets? And how do you have the resources to out-compete?" It's by having great friends in the industry through Twitter and whatnot. It's basically like a decentralized research organization, which is amazing. And it's all for free."

But the real work is the next four months in terms of trying to disprove that initial gut feel. This is the next 20 dates, after that rose-tinted honeymoon period in the relationship. But

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in terms of idea generation and how that initial idea comes across your table, that's serendipitous. I've asked that question since back when I was an intern. No one has a coherent scientific quantitative answer, especially for what we do. If you're a Deep Value statistically cheap type of investor sure, you can screen for ideas based on valuation metrics.

But for what we do, a lot of our businesses, we're trying to catch inflection points in a sense. Going from early adopter phase to mainstream phase, or some acceleration within the revenue growth. Historical financials may not fully capture what's about to happen with this company. A lot of it is just being very aware of what's going on in the world. Cultural changes, societal shifts, looking for big industry wide tailwinds within certain geographies, finding products that customers really love and keeping your ears open.

Oftentimes customers may love a product and a Company may have millions of users, but Wall Street is skeptical of the business model. Those are the best because the real world was telling you something is working here and investors are skeptical. And so, that's the secret right there. One example of this is I was in Paris last week and came across an app called Sunday. Even before COVID, the way a lot of restaurants in China worked, especially quick service and less service oriented restaurants, basically have a QR code on the table.

What's different about this QR code from the one's you see in American restaurants is that when you scan it, not only does the menu pops up but you can order directly from that menu exactly what you want. It's like adding items to your shopping cart online. You click it, it gets sent to the kitchen, the kitchen prepares it, the server brings your food to your table. When you're ready to pay, you pay on the same screen on your phone, and you walk out. There's no touch points with a waiter, neither bringing you a check nor giving you a menu. It's better for the industry. Number one, you reduce labor costs.

The average orders are somewhere between 20 and 30% larger as well. Because when you can instantly something to your order, it's like "Oh, I'm still hungry, I want to add another dish." Or "This was really good, I want to add another one." People increase their checks without having to go flag down a waiter. It reduces friction. I thought this was a genius business model, a win-win for the restaurant and the customer, and I didn't understand why that didn't exist in the West yet.

So I had been thinking about this for a couple years. Even during COVID I was telling friends, "Watch QR codes, it's going to start to take off." They didn't quite take off to the degree that I thought. In the U.S., you use a QR code and it still brings up PDF menu. What good is that for? In France, I noticed that a lot of restaurants were using a app or POS system called Sunday. A waiter often still brings you the menu but at the end when you want to check out, there's a QR code on your table. You scan the QR code which is already linked to the POS system. You just hit check out, link your credit card, and walk out.

So, I came back to the US and this idea was already formulating in my head. I started doing research on Sunday. Unfortunately it's still private. They raised a $5 million seed round in April of this year. Got a hundred million in September, turns out Coatue had led both rounds. So lucky for them. But that's like one small example of how I search for ideas and how it's a little bit serendipitous.

There's a little bit of preparation mentally beforehand, I already knew kind of what was interesting. And then I came across the right opportunity in a different geography. It's just in this case, it wasn't

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actionable. And they're coming to the U.S. by the way. That's what the 100 million raise is for.

G&D:

I'll keep my eyes open. So it sounds like a lot of it is taking your experiences, the knowledge you have about the world itself and then applying it to businesses that are essentially productizing the insights that you have. Do you ever work backwards and try to look at a company and try to understand why it's doing well?

FL:

Yeah. Sometimes you'll see a company growing 100, 200, 300% year after year. And you may not have come across it before. You don't know, you don't understand the cultural shift that's going on with the consumer base. That's probably a flag for you to dig in, because the real world again is adopting this product at a very rapid pace. And so, yeah, that can teach you something about the macro from a bottoms up perspective.

Like Afterpay was one of those, right? I'm 31 years old. I'm probably too old even for a buy now pay later product. I have three credit cards in my wallet. I didn't quite understand why younger generations were adopting this, but I knew that was a fact that they were. And so, at that point what I did was go back and do a lot of research in terms of why are younger generations starting to avoid debt more and more? What was the cultural spurring of that? A lot of people point to the 2009 financial crisis and a lot of younger kids at the time watched their parents struggle because of taking on too much debt. As they grew up, they had a very strong aversion to debt. And this whole ethos that banks are evil and banks are charging interest, and want you to get into debt so they can make more money. There was this cultural shift that I wasn't aware of before I initially came across Afterpay and saw their traction. So yeah, the idea generation process works both ways.

G&D:

Okay. Interesting. To that point, it'd be great to discuss the Afterpay thesis. I believe that was one of your largest positions and of course you were in there relatively early. So it would be great to hear about the evolution of that thesis, how you initially came across the idea. And of course, maybe you could quickly talk about Afterpay's performance for you as an investment.

FL:

Yeah. So this is also similar to a lot of our good ideas. Have you ever read Common Stocks and Uncommon Profits? Common stocks and uncommon profits is Phil Fisher's most famous book, written in the 1960s. He has a page where he talks about how four-fifths of his ideas in his portfolio came from friends, but five-sixths of his profits came from those ideas. Which meant that his friends' ideas were better than his own. And I think there's credit to that, through having joint research. You're seeing a lot of smaller shops launched today and people often say like, "How the heck can you launch with only couple million in assets? And how do you have the resources to out-compete?" It's by having great friends in the industry through Twitter and whatnot. It's basically like a decentralized research organization, which is amazing. And it's all for free.

Afterpay came about through one of my friends. I had heard about it for years, he was invested in it when it was just an Australian business. It had always been on our list of companies to do some research on. Then I started seeing some traction in the U.S. as well. They were expanding into the U.S.. There were, if I remember correctly about 3 million customers in Australia about a million or so customers in the U.S. at that time. And so, U.S, was still a much smaller business.

U.S. Consumers also weren't using it as

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frequently. They were only using it a couple times a year while Australian consumers were using it in the high teens per year. So the GMV on the Australian business was obviously multiples larger than the American business. But the bet was basically that the U.S. consumers and merchants would react and find value in this product similar to how consumers and merchants in the Australia market had found value. And obviously the U.S. market is 10 times larger than the Australian business. So if US consumers eventually reached Australian levels of penetration and usage frequency, this was going to be a huge business. Far more than what the markets were valuing at the time – which was just the Australian business by itself. We did a lot of work around it at that point in trying to understand BNPL, why a US consumer or merchant would find value in it.

BNPL at a cursory glance seems like a commoditized product, like just a feature inside of a website. Some of Afterpay's competitors truly are just a feature inside of a website. Those businesses will probably get disrupted away. Afterpay was special because they were trying to create a brand themselves. If an online fashion merchants actually puts the Afterpay logo on their website they see an uplift – that's how strong the brand is. They're able to sit at the top of the purchasing funnel, rather than the bottom, once someone has already decided to checkout. And BNPL is special among payment options because you can't wait to display it until checkout when someone has already decided exactly what items they want to buy.

"…if you have a certain amount of confidence in terms of what the short term future looks like, maybe you are able to pay a little more than other investors in the market because for instance, you have a better understanding of the underlying unit economics. Essentially, you can see the underlying profitability in a certain business that's not widely appreciated by the market."

The only way you get the KPI uplifts, which includes 25% larger baskets and double the traffic conversion rate, and free traffic from the Afterpay app, is if the customer knows beforehand that they can use Afterpay at checkout. That encourages them to add more things to the cart. Which also is why going after the fashion category and more female dominated, discovery-oriented categories was so important.

Because with fashion, you don't necessarily know what you want before you walk into those stores or visit the website. You browse, you discover and you try to see what's interesting versus say electronics or other more male dominated categories. For those, people know exactly what they want to buy. They want to buy an iPhone so they go and find the cheapest price. Whether you offer Afterpay or not it doesn't matter because you're still going to buy the same phone. And offering BNPL is not going to encourage you to buy two phones at the end of the day.

So on the fashion side, it was just understanding how merchants were rapidly adopting this product. Previously, we had heard it would take six months to convince a brand to launch a BNPL product. But at the time we were hearing for instance, after doing some cursory channel checks, that it was more like six weeks because there was a FOMO cycle going on. For a lot of fashion brands out there, there's not true,

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tangible differentiation, if that makes sense. Why is this dress better than another dress?

Because a lot of fashion is commoditized at a certain level, if your competitor is using Afterpay then they're stealing your market share – which lights a fire under you to adopt Afterpay for your own store. You're not necessarily going to go with the fourth player just because they are a couple basis points cheaper. You're going to match a competitor and do exactly what they're doing. Especially you're your margins are 50%, like in fashion, getting higher conversion rates, basket sizes is far more valuable than saving a couple points on fees. And so, what this meant was Afterpay was basically able to scale quicker because of this FOMO effect among the brands.

On the consumer side, a lot of younger consumers are just avoiding credit cards in general. Trying to understand that process was difficult. Heck like I said, even I'm too old. And so, going on YouTube and listening to the interviews with some early Afterpay users, 18 to 25 year olds and hearing in their own words why Afterpay is better, how Afterpay helps manage their cashflow, how they don't trust themselves to not go into overdraft fees. And so they want a third party company to help them manage that as well. To be like a parent almost, to guarantee they don't get into trouble with spiraling interest.

Afterpay's claim to fame is that you never get charged interest. Or even if you do pay a late fee, they basically shut you off after one late payment. And the late fee is a fixed dollar amount and not a percentage of variable cost. Understanding both sides was really, really crucial. So we got lucky with timing because we started doing research on this right before COVID, and I worked with my friend at Farrer Wealth. He helped with a lot of the research as well.

G&D:

And when was this?

FL:

This was late 2019 into early 2020. And so, we started looking at it when it was, I believe it was trading at $40 AUD when we started getting interested. It was around $13 billion on a market cap basis around that time, but we watched the stock decline because of COVID down to eight bucks at the bottom. Unfortunately we hadn't finished our research at that point so we caught it on the way back up. We started buying in the 20s.

Another theme for us, which is basically the Australian business was already super profitable. They were generating 30, 40% margins. They already kind of gave you a blueprint for what this business looks like at scale. They were rapidly acquiring customers in the U.S., spending a lot of money on influencers and partnering with brands. In order for the business model to work, they had to go after national brands in order to gain trust with consumers. Let's say you go to Fenty Beauty or Sephora and you partner with them first. As a customer, I've never heard of Afterpay before. I'm not going to go use some random, buy now pay later website that I've never heard of before because I don't trust them with my hard earned money, I'm afraid they're not legitimate somehow.

But if I go to Sephora's website and I see the Afterpay logo, plastered over every single item description page, not just at checkout but all over the website then I might think "Maybe this is a legitimate company." Then I go to Fenty, same case, right? I see it over and over again. And I think to myself, "If a large brand trusts this, then it's probably legitimate. They probably did some vetting." Then you start testing it out. That's how consumers get introduced to the Afterpay ecosystem.

Now the thing is because these large national

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brands have strong negotiating power. They know the value scale brings to buy now pay later product so you're basically going to break even from the large national brands. For this entire industry the very rough math is that a 3% take rate is break even level. As a BNPL company, you are dealing with 1% for operational cost, 1% for bad debt, 1% for cost of funding. That's generally how it shapes out. So to make money, you charge these merchants between 3% and 6%. The larger the brand is, the closer they are to that 3% level, in which case the buy now pay later company is breaking even but you're leveraging the national brand's trust with their customers and acquiring all these customers. The statistic, if I remember right, is that about 50% of Afterpay customers make their first Afterpay purchase at one of these national brands, and only once they get comfortable use it at the SMEs.

So initially, you're going to be losing money, especially if you're scaling that new market much more rapidly than the core market. That's where Afterpay was at that point in time. In order to get comfortable with the investment, you had to dive under the hood a little bit, look at that unit economics on both the Australian business and separately the U.S. business to really understand what was going on. But if you understood the Australian business, because they provided a blueprint for this, you knew that once they reached a certain scale and branded trust within the market, they were going to start to acquire small and medium sized fashion brands next.

These smaller brands, you're able to charge 5% or 6% because you provide a lot more value to them. You provide them traffic, you help encourage your customers to order more from these certain brands, you provide more touch points with a consumer because with a six week loan, you have a customer interaction every single time they pay it. They may get an email from Afterpay that basically says, "I'm reminding you of that brand that you ordered from before, now we have a special deal for Afterpay customers, do you want to shop again?" This is instead of just a one time touchpoint. So we knew this was the playbook, which is why we were comfortable with the loss making economics of Afterpay at the time.

Because we knew that as long as they continued to scale each incremental merchant got them closer and closer to profitability. In terms of bad debt, its absolutely true that there may be periods of elevated chargeoffs. The only way to really prove that out was to go through a recession type of period because it's a newer business model. You're betting how are consumers going to react in a recessionary type of environment, right? You can look at historical case studies, you can look at past recessions, you can look at 2009. But each generation is a little bit different in terms of how consumers behave with their money. So you can't necessarily prove that out.

But what we saw, even when COVID began, was Afterpay's short duration loans enabled them to adjust their risk model quickly. That's different from longer duration consumer installment loans which have a harder time readjusting their risk costs because they have to wait for old loans to roll off before redeploying capital. With Afterpay, the average duration of a loan is 3 weeks with total duration of six weeks. So they readjusted the risk models and actually saw losses go down during COVID.

And also because of the loyalty to the brand, people were actively calling in to Afterpay customer service and saying, "Hey, I know I'm going to miss my next payment, but I love this product so much, is there something we can do to work it out?" If you hate your bank, you're never going to call customer service and warn that you're going to miss a payment.

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Afterpay has a true brand around it, true fans. And this goes back to understanding what's happening in the real world outside of Wall Street. Because if you went on Afterpay at the time, they had Facebook fan pages with 300,000 people talking about how much they love this product. I can't see anyone saying that about Bank of America. No one's writing on a Facebook fan page about Bank of America.

G&D:

Got it. That's really interesting. Maybe we could quickly give you a chance to do a victory lab. How's the Afterpay investment going for you?

FL:

It's done decently. It's actually decent for us because we wanted a 10x on it, at least that's what we were looking for. I think Square bought it at a pretty cheap price, given how early the company still is. There’s still so much runway left for this company. So that's what I mean by decent.

I was getting off a flight from Mexico when I saw the news that Square was acquiring them and trust me, my first reaction wasn't happy. Because I know that Afterpay has a ton more potential ahead of it. They have barely penetrated the U.S. and they have only penetrated a couple categories, fashion, cosmetics, beauty. There's so much more that they can do and they are so far away from reaching the scale in the US of their Australian business. I think under the Square umbrella, they're still going to do phenomenally. And they're going to continue to have the same drive that they did before, but it's a little bit diluted inside Square. We don't get pure exposure to why we bought this. I think Square is still a great business but not as great in my opinion as Afterpay standalone.

G&D:

Sure. That's interesting. Maybe moving on to another investment. I think you just published an investment in Coinbase. One of the first things that comes to mind is clearly there's been a pretty pronounced value investing imprint on your investing philosophy. And I think a lot of folks within the value community are skeptical of pretty much everything crypto. Notably Seth Klarman, and Buffett more or less saying that crypto is a sham. It'd be really interesting to hear how maybe your point of disagreement with them or how you view the crypto space, and how you went about analyzing Coinbase?

FL:

I would say number one, don't necessarily always take your idols words as gospel. Even Buffet changes his mind. Call it 20 years ago, he was highly against tech and now he's pretty heavily invested in tech through Apple and through some of his lieutenants’ portfolios and whatnot. So I wouldn't necessarily say that their opinions don’t make an impact on my own. What I would say in terms of Coinbase is that value investing as a discipline is around price discipline. It's about not paying up for things that are unpredictable or unsure about in the future.

But if you have a certain amount of confidence in terms of what the short term future looks like, maybe you are able to pay a little more than other investors in the market because for instance, you have a better understanding of the underlying unit economics. Essentially, you can see the underlying profitability in a certain business that's not widely appreciated by the market. Depending on where you shake out on the debate as to whether or not crypto has a real world use case or not will determine whether you're interested in Coinbase.

We think that eventually there will be real world utility, but the problem is that right now we're entering a phase from early adopter to mainstream. So going from say, 100 million crypto users to a billion users. The next 900

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million customers are going to be very different than the early adopter first 100 million. So that's what we're playing for. In order to get the next 900 million you need real world use cases. So like your uncle Joe at Thanksgiving who knows nothing about crypto or technology, but he needs to complete some real world use case and needs to go buy a token in order to do that. Where is he going to go do that?

He's probably going to go to the easiest to use fiat on-ramp that's regulated and trusted by 10,000 of the world's leading institutions, in an easy to use way that can connect directly with his bank account. And he can just complete that transaction without having to hop through multiple different sites. If you understand today's decentralized nature, call it the MetaMask route. You probably have to hop through several different steps. You first have to use a fiat on-ramp. Then you have to transfer your money onto MetaMask. Then you have to convert it on some decentralized exchange. It's a cumbersome user experience. And oh, that decentralized exchange is recording the transaction on the blockchain, so your gas fees might be even larger than your total transaction amount – given that mainstream consumers typically transact $100 or $200 at a time, and likely less over time if it's used increasingly for transactions rather than price speculation.

"I would say number one, don't necessarily always take your idols words as gospel. Even Buffet changes his mind. Call it 20 years ago, [Warren Buffett] was highly against tech and now he's pretty heavily invested in tech through Apple and through some of his lieutenants' portfolios and whatnot. "

I think the first early adopter phase was about technological innovation and capabilities within the product. The next phase is about usability and about the user experience and simplifying that for your average mainstream user. Given all this, given that we believe that there will be real world use cases – for example, venture funding has gone up three times, year over year into this space - we're optimistic on eventually crossing the chasm in mainstream adoption. The raw ingredients are there. The capital that venture investors are investing is essentially capital to go run experiments. The number of startups has gone up about seven to eight times as well. The biggest criticism right now is that crypto is a kind of a walled garden. That it's just users transacting among themselves, it's a derivative of crypto itself – speculative trading – that's the biggest use case today. But it's not necessarily touching the real world.

I think this next phase with all these experiments and startups is going to bring real world utility. We don't know what exactly that looks like yet so it's still very early. But again, if that does happen, we're going to be at an inflection point and this market is going to go from a 2 trillion market cap to 10 to 15 over time. It's going to be a multibagger for us. We believe Coinbase is the best positioned to go capture this tailwind. Now, given all of this optimism that we have, what's interesting about Coinbase stock, is that it is trading like a deep value name in some sense. It is trading at five time sales where its highly profitable with 50-60% margins.

So you're looking at 10 to 12 times earnings, despite our projections that they're going to grow at least at a 50% CAGR over time if we're correct. That's pretty attractive in my book. Now, the controversy and what the market is unsure of and why it's

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priced that way that it is largely related to volumes. Most of Coinbase's business is still an exchange and that's about trading volumes. Trading volumes are inherently unpredictable. Imagine if your entire trading volume was based off of the Wall Street Bets sub reddit. That would be very, very, unpredictable. So if you look at Wall Street estimates, the sell side is demonstrating how lazy they can be. They're flatlining revenue at 7 billion for the next couple years. Flat is just wrong - make a call. You either believe volumes are inflated and crypto will lose interest and volumes will fall dramatically. Or we will enter mainstream adoption, and volumes will go up multiple-fold.

It's either going to be cut in half and we're going to a speculative environment, like 2017 where it's still a walled garden and people are just day trading among themselves. There's still going to be some volumes, but it's not going to be the type of volumes that we'd expect if it went into the mainstream. Or make a call that it's going to go up multiple times. It's one or the other, it's not going to flatline at 7 billion. That just kinds of shows you that people out there are unsure of what the future looks like and they don't know how to make a call on that and don't want to stick their necks out. Which by the way, also says something about the incentives of this industry.

And so, even if you looked at the initiation reports, when they went public back in April. The initiations, some of these guys were predicting like 3 billion of revenue for full year. We're in Q4 right now. They're likely going to do about 7.5-8 billion of revenue this year total, so the street was off by half. That shows you how inefficient this stock is. A lot of people out there cannot or do not want to own anything related to crypto because it may be a generational thing as well. There's a lot of older PMs out there who just don't understand why anyone would use this technology just like the buy now pay later example.

They may be adverse to it. I've personally have spoken to a lot of funds in New York. And analysts will tell me, "I could never pitch this to my PM". There's no real short case on it, besides worries about fee compression or volumes declining – but I think the stock is currently pricing that in at 10 times earnings. And we take a different view on those, by the way. I haven't heard of another coherent short case. All I've heard is we just can't touch it. So that leaves the stock a little bit under followed despite its 50 to 60 billion dollar market cap out there.

So that's really the difference in terms of expectations or perception in the stock. That's where your alpha comes from because we're expecting multiple fold growth over the next few years whereas the street is pricing it as if it's just going to flatline.

G&D:

Okay. It might be interesting to talk about an investment that you've learned from?

FL:

Zooplus was one of them. Anyone who wants to take a look at our postmortem can read our letter from last summer when I sold Zooplus, and then also this past quarter where I talked about our experience with it. They got bought at like four times where we sold it. There was a bidding war going on among private equity firms out there for it. Anyone who's interested can take a look at that. But the general lesson learned is you don't want to pull teeth with people. Life is too short and investing is too hard already to be adversarial with someone and to try to convince the management team or the CEO to do something that they don't want to do naturally.

I truly think that they had the opportunity to be the Chewy of Europe. And if you look at when we invested back in

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2016, Zooplus and Chewy were the exact same size in terms of revenues - each about a billion dollars or so. Chewy is a $25 billion business. Zooplus when we sold it was barely over a billion. I think private equity saw the opportunity in terms of changing the culture and enacting the changes we've been advocating for.

But that's something that we aren't able to do at Hayden as a public fund. And especially because we're not activists and that's not where I want to spend my energy. I don't think it's a good use of my time either. But I think that's the biggest lesson, we spent three and a half years on that investment. We didn't necessarily lose money on it, but it was an opportunity cost in terms of time and effort spent. So I think that's probably the biggest lesson here. Your career is super long, it's 30, 40 years, pick where you spend your time wisely. Because we could have found some other investment that makes us multiple times our money.

G&D:

Awesome. Okay. It'd be great to hear some advice you have for any students that are looking to enter investment management.

FL:

Two things that are probably really related - network your ass off number one. That's what B school's for. It's not for drinking and partying, it's for networking – although you could argue you can do both at the same time. You have two years to go do that. I wish I did this a little bit better when I was in school too, building a personal brand because the best roles in this industry are not publicized. You're not going to find it through some career website, it's all through word of mouth.

So you need to think about how can I be top of mind when someone is looking for someone to fill this role. How can I build a connection with this person? How can this person already think of me as being the smartest in this space? So you need to think about how to create a personal brand. And with the internet today and everything being public - you see some of the top investors in the world actively engaging on Twitter for instance. You didn't see that 10 years ago. It's a much more transparent and accessible world today.

What I recommend is be on Twitter, start a Substack. Talk about what you really love and know deeply about. Over time, people will recognize that, and talented people will start to follow you. You'll probably even get inbounds in terms of people who want to connect, then you'll probably get consulting roles or internships with some of these funds. And then word gets out that you're the smartest person on X, Y, and Z companies. And then whoever is looking to fill a role in that space is going to reach out to you proactively. You always want to be in a position of leverage. You don't want to be in a position where you are begging for a job. You need to be in position where everyone knows that you're the smartest person and people are clamoring to get you into their seat. And again, that doesn't come through an auction mechanism like a career recruiting event. That comes up through personal relationships.

G&D:

That's interesting. I think you touched on this earlier, but any advice you'd give to anyone who's looking to launch their own fund?

FL:

Yeah. It depends what model you want choose. I think anyone who's interested should probably read our Q4 2020 letter from February this year. I talk about a lot of this business is you're either a businessman or a craftsman. A businessman basically goes out, understands the market and what customers are demanding as a product and then goes and creates that product to

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go fulfill this need. You're going to make a lot more money that way, you're going to cater to a lot more customers because you already know there's existing demand out there and you probably went after the product that had the largest amount of demand.

You're probably going to over time build a huge asset management firm if you follow that mentality well. The problem is that as an investor, you probably will never be as good as the craftsmen because the product that you created was never something that was unique to yourself. It was never something that you truly 100% believed in, or would invest like with your personal capital. It was created to serve the majority of the market. And you essentially become a CEO of an asset management firm and start managing people, rather than being in the research weeds, and really doing what you love, which is investing.

I firmly believe that the best investment firms, I don't mean in terms of AUM or revenue, I mean truly investors and thinkers, are craftsmen at their core. They truly believe in a certain product. There's thousands of ways to go make money in the public markets. I'm not saying any of them are wrong, it's just you have to find that one style that fits your own personality. It's similar to art. There's many forms of art out there, but each artist typically finds their own style and what they love to do. And that's when the magic happens. So decide what path you want to take, that's number one. Because how you build that business is going to be very different.

The craftsmen goes and builds a product for themselves, one that is a 100% reflection of themselves. And then they go out to the world and say "Here is what I'm building, here's why I'm building it, here's my vision for it". Anyone who's interested will come and find you. It's a slower growth, slower path, but it's probably more enjoyable on a personal level. And many investors out there, I think businessmen who create these investment firms, if you don't necessarily love 100% the product that you're creating, it's going to be stressful, it's going to be a drain on your time. And you may want to exit the business after you've made a lot of money, whether that's five years, 10 years, what have you. If you're a phenomenal investor it's not going to take you that long. That's the point that a lot of people convert to family offices. So to be honest, the great businessmen also don't stay in the game very long in this industry, out of conscious choice.

The craftsmen has duration. It benefits their LPs too. The right LPs who build a very, very strong foundation, create joy for this manager to go invest in this style and give them the runway, even though it may be very volatile. This manager's going to love what they do so they're going to be in business for the next 30 years. If this manager is one of the best investors in the world, the LPs get to go along that journey for a 30 year type of period. Versus in the businessman case, it might be a much shorter duration because they're going to close soon as they make enough money. Even from an allocator standpoint, you should understand who you are allocating to and what the mentality of the investor is too. 30 years of compounding at high rates vs. 5 years is a very big difference.

Similar to my advice previously, network your ass off. Information is commoditized nowadays, especially if you're investing in tech or consumer businesses. There's so many alt data firms out there and stocks will move more on alt data releases more so than even earnings. You have to go beyond that. Again, you have to understand the "why". Alt data only tells you what is happening today and what has happened in the past, it doesn't tell you what's going to happen in the future. So you have to understand what are the KPIs that are most

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important for thinking about certain strategies. Only then, can you predict what comes next.

And none of this information comes in a 10-K. It's not even going to be said on the earnings call. It's going to come from talking to middle level managers, former employees, other people in the industry about what direction is the industry moving? How are competitors thinking about certain KPIs and what are they managing for? "Why" are they managing for this? When you understand that, then you can put the puzzle pieces together and see the future a little bit more clearly as data releases happen. You have context for the data that's coming up. That just comes from talking to a lot of people, a lot of coffee chats and having some really smart friends.

G&D:

Got it. Terrific. Then finally, it'd great to hear about what you do outside of work, any of your non- investing related passions or hobbies that you have. Favorite restaurants even.

FL:

I think my favorite thing is just trying new things in general. And typically that takes the form of eating and travel. Even in New York there's probably more restaurants opening up and churning than I could ever go to. So it's very, very rare that I'll actually go to the same restaurant twice. There's probably just a handful that I go to frequently.

"Similar to my advice previously, network your ass off. Information is commoditized nowadays, especially if you're investing in tech or consumer businesses. There's so many alt data firms out there and stocks will move more on alt data releases more so than even earnings. You have to go beyond that. Again, you have to understand the why."

When I was growing up in the Midwest, it wasn't very diverse. And so, I grew up watching a lot of Anthony Bourdain and Andrew Zimmerman travel shows. What I loved was basically over time, you understand food is a way to understand the culture and the history of a certain set of people. But you also understand that people in general, no matter how different their life experiences, generally want the same things. Human beings as a race, across different geographies are generally more alike than not. Food is just like one expression of that, which is why I love travel too.

I love being exposed and pushing the boundaries of my own knowledge and my own assumptions, and to understand different cultures and how different people do different things while meeting the same core needs and universal society needs. Everyone wants the same things whether that's family, love, enough wealth to take care of those around them, some sort of self fulfillment in life. What's beautiful about travel is, and I paraphrase, "The future is already here but just not evenly distributed." When you travel, you get to find the corners of the world where the future is already here. That can also provide investment insights for us at Hayden too.

G&D:

Yeah. That's really interesting. Terrific. Thank you so much your time Fred.

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