Vision Capital Annual Investor’s Letter: 2022

VISION CAPITAL

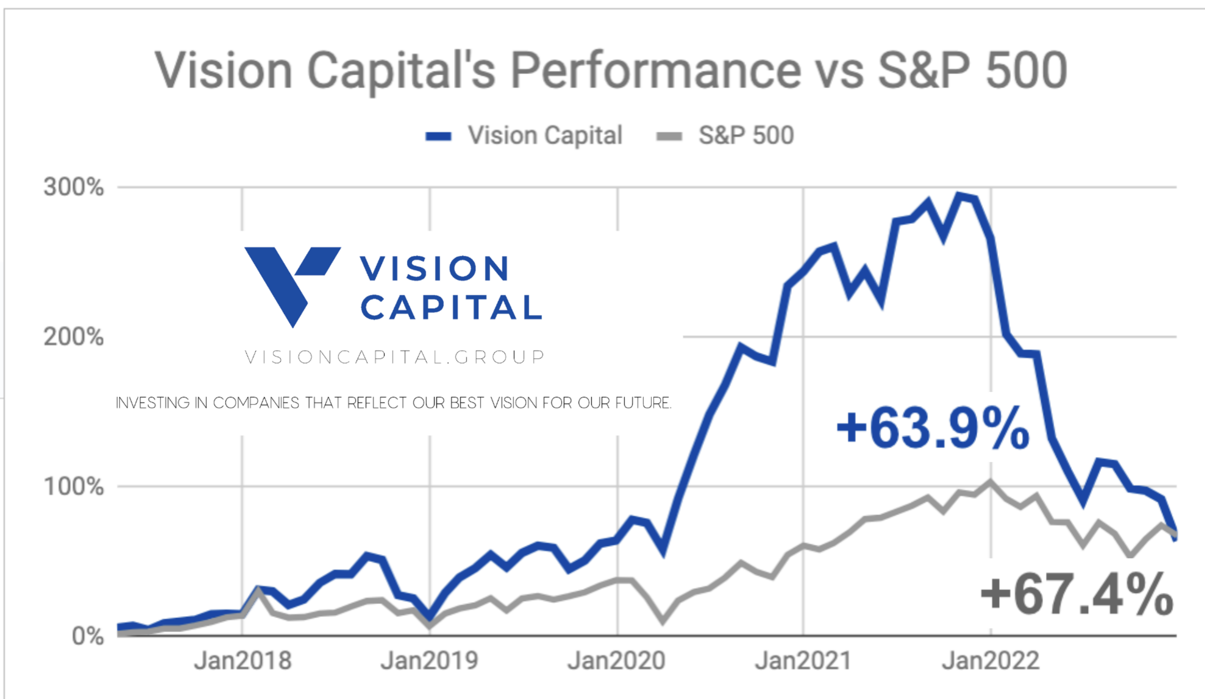
VISIONCAPITAL.GROUP

INVESTING IN COMPANIES THAT REFLECT OUR BEST VISION FOR OUR FUTURE.

Dear Investors (to myself as the single LP),

We welcome you to **Vision Capital’s 2022 annual investor letter**.

For 2022, Vision Capital returned -54.3% versus the S&P 500’s -19.3%. Since inception on 24 March 2017, it has returned +63.9% versus the S&P 500’s +67.4%, and the MSCI World’s +41.0%. The chart and table below details our performance thus far.



Source: Vision Capital, as of 30Dec22 unaudited broker statements, since Inception 24Mar17

Cumulative Returns	Vision Capital	S&P 500	Excess
YTD	**- 54.3%**	- 19.3%	**- 35.0%**
1Y	**- 54.3%**	- 19.3%	**- 35.0%**
2Y	**- 51.3%**	+ 2.4%	**- 53.7%**
3Y	**+ 2.0%**	+ 19.2%	**- 17.2%**
Since Inception	**+ 63.9%**	+ 67.4%	**- 3.5%**

Annual Returns	Vision Capital	S&P 500	Excess
2017	**+ 15.0%**	+ 14.0%	**+ 1.0%**
2018	**- 1.7%**	- 6.3%	**+ 4.5%**
2019	**+ 45.3%**	+ 28.7%	**+ 16.6%**
2020	**+ 109.5%**	+ 16.4%	**+ 93.2%**
2021	**+ 6.5%**	+ 27.0%	**- 20.5%**
2022	**- 54.3%**	- 19.3%	**- 35.0%**

Inception 24 Mar 2017, as of 30 Dec 2022, updated monthly

Global Mandate. Vision Capital's investment mandate continues to be global in nature, and we can invest in any of the accessible publicly listed companies in the world. But since the majority of our holdings continue to be largely US-listed stocks (~94% as of 31 Dec 2022), it's also important to us that we compare our performance with a prominent US stock market index, in this case, the S&P 500, rather than the MSCI World, a more global stock market index.

2022 underperformance. 2022 was another disappointing year of being down -54.3%, which largely continued from Oct 2021. This was after 2020 where we experienced +109.5% of pulled forward portfolio outperformance, and largely due to a rapid increase in valuation multiples. It benefited a large batch of our holdings almost indiscriminately. However in 2021, most of the companies saw normalizing and softening demand, with more scrutiny and longer customer decision cycles, and significantly tougher comps. Thus the market corrected lower, not unexpectedly, and unsurprisingly our portfolio also underperformed much more than the market.

Judging our performance. We do ask that we continue to be judged on at least a 3-5 year time frame at the minimum. It would be very disappointing if Vision Capital fails to beat the S&P 500 over a longer time frame. We do believe that if we have a strong analytical and investment framework and thoughtful philosophy to find growing durable compounders, coupled with a strong behavioral advantage of the willingness to hold and keep adding to them for years, which is more likely to lead us to market-beating returns.

Occasional underperformance. We know that as much as we like to keep beating the market each year and throughout, underperformance is never welcome, but it is nonetheless inevitable. We are not aware of any investment strategy that will consistently outperform every year, and under every type of market condition. As much as we like, there will be periods of underperformance, especially when Mr Markets throws his tantrums, depressing short-term valuation multiples, and through late 2021, and especially 2022, was one such year.

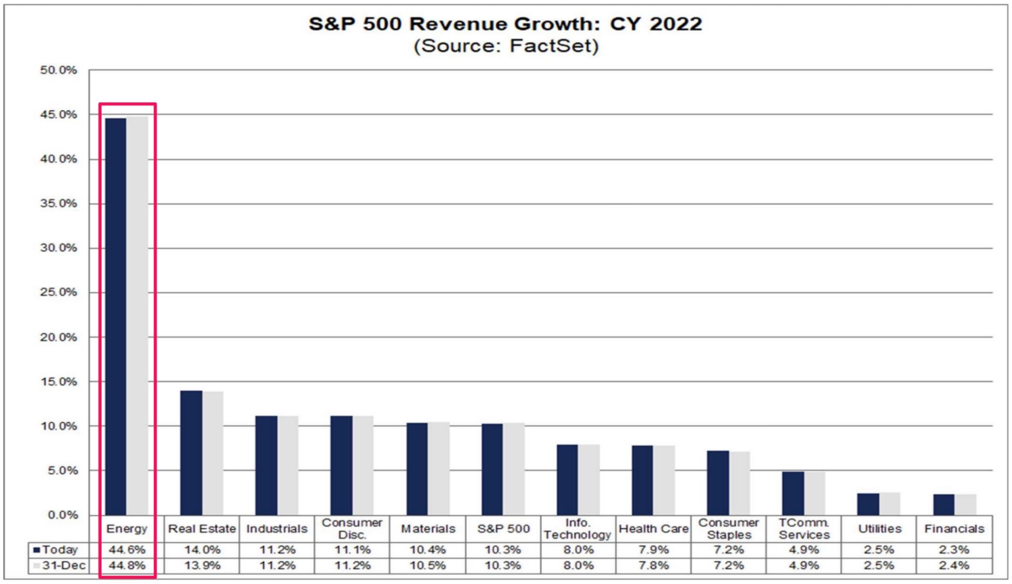
Down just like most. Unless one owned only energy stocks (which benefited from high oil prices) or was a perfect trader, every other long-only investor would likely have had a significant down year in 2022. We are not traders, and rotating between companies and sectors depending on how the economy is going to do each year is not what we do, nor what we are good at. We do not promise smooth upward returns or aim to achieve that. Frequent market timing only serves to increase our transaction costs, and the likelihood of us making a mistake, particularly of missing the winners and the good days (not the worst days), which truly matters.

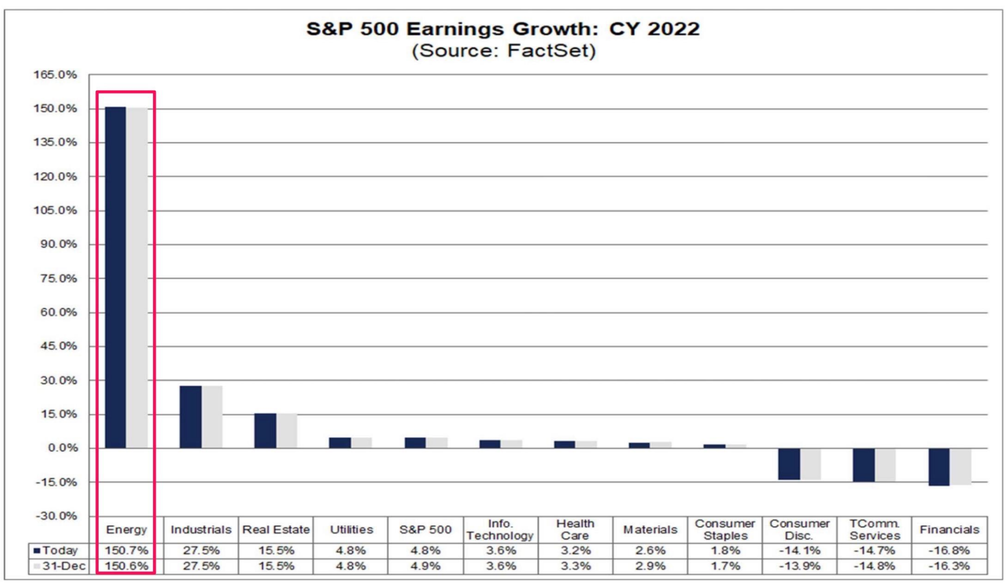
Performance of S&P 500 Sectors in 2022	
S&P 500	**-18.1%**
Energy	**65.7%**
Utilities	1.6%
Consumer Staples	-0.6%
Health Care	-2.0%
Industrials	-5.5%
Financials	-10.5%
Materials	-12.3%
Real Estate	-26.1%
Information Technology	-28.2%
Consumer Discretionary	-37.0%
Communication Services	-38.9%

Source: Novel Investor

Energy sector had a strong rebound in 2022. The energy sector saw significantly higher revenue and earnings growth in FY2022 alongside higher oil prices, after suffering from significant declines in revenues and profits in 2020/21 due to lower oil prices.

It is a firm reminder that investing in energy related stocks is cyclical and one has to consistently perfect market time, to achieve strong returns. We don't and are not good at it, thus we do not own any energy stocks. Now with lower oil prices and if it does continue to drop further, it remains to be seen if energy stocks would remain the darling in 2023 and beyond, it is highly unlikely that we would expect it to repeat, but we never know for sure.





Source: [Factset (13 Jan 2022)]

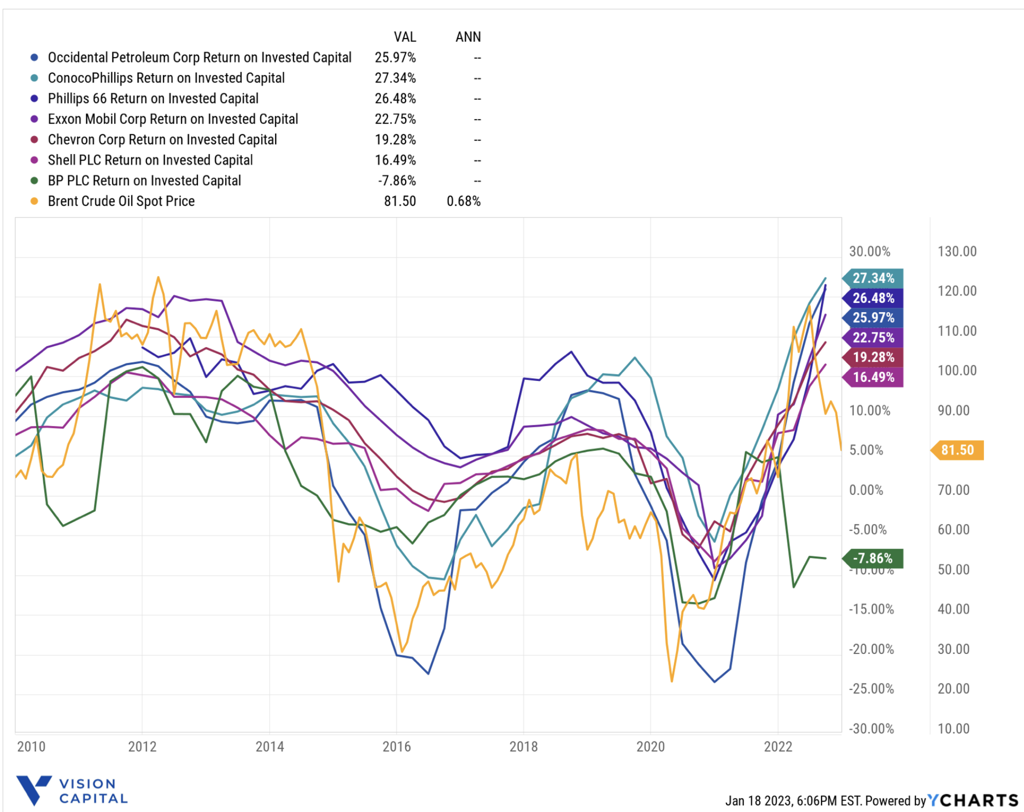
Why do we not invest in energy-related companies? Energy is extremely cyclical. Higher oil prices represent a shift of wealth from oil consumers to oil producers. Its revenues tend to have a high correlation with oil prices, along-side operating leverage and profit margins as well.

However, most of the time, they are actually poorer value generating companies with largely lower ROIC <15% versus other industry sectors. Thus it is no surprise why the energy sector has tended to underperform. Frequently ROIC only becomes higher temporarily due to elevated oil prices. With already lower oil prices, it remains to be seen if revenues, profits and ROIC will again turn back lower.

They currently seem to trade cheap at PE and P/CF of ~8.3X and ~9.4X, but if E and CF does turn back lower, if prices stay the same, the multiples will become higher, and multiples could well revalue lower, taking prices back lower.

Enough talk of energy and oil already. Hopefully the discussion gives you a sense of how we bring historical perspectives and context into our investing decisions. Let's move on to the other things that we are more passionate about.

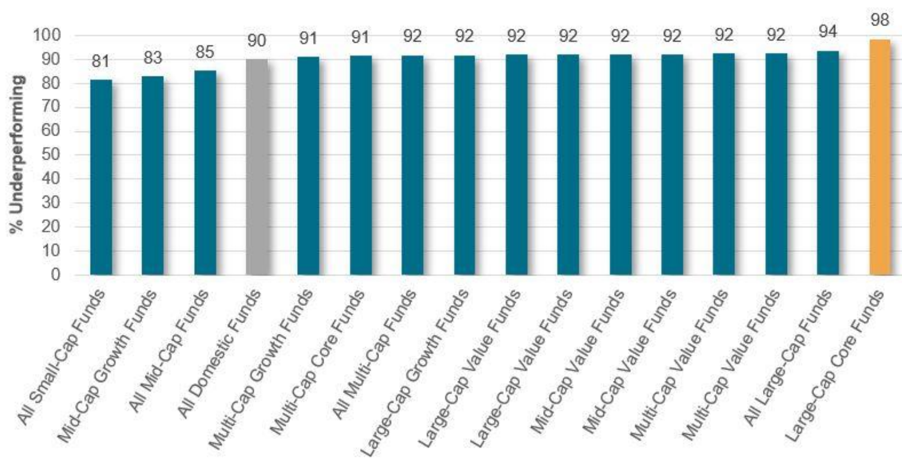
The Cyclicality of Oil Companies ROIC with Oil Prices



Staying in the game. The 2022 market decline was a firm reminder that investing is truly about staying in the game, to never ever be wiped out, or be significantly impaired, and to allow one to keep playing, and compounding. It really is to have longevity, to be patient, and to allow time, the exponent to really shine through eventually.

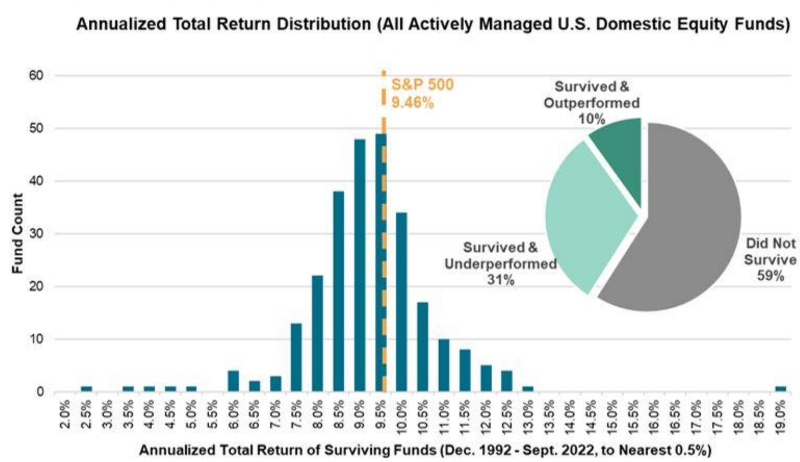
Investing is a Tough sport. Looking at actively managed US equity mutual funds over 30 years, collectively across all categories, 90% underperformed the S&P 500. And for those who survived and outperformed, they were in the top 10%. We don't aim to be in the top 10% every year, we aim to be in the top 10% after decades. Investing is a tough sport, if one is built right to survive and outperform over the long-run, eventually one does get to the top. We discussed this in our 2021 letter as well.

Exhibit 1: Active Equity Funds versus the S&P 500



Sources: S&P Dow Jones Indices LLC, CRSP, Lipper. Data from Dec. 31, 1992, to Sept. 30, 2022, as compared to the S&P 500 total return in USD. For details on the methodology applied, see S&P DJI's SPIVA U.S. Scorecard. Past performance is no guarantee of future results. Chart is provided for illustrative purposes.

Exhibit 2: Distribution of Active Fund Returns



Sources: S&P Dow Jones Indices LLC, CRSP, Lipper. Data from Dec. 31, 1992, to Sept. 30, 2022, as compared to the S&P 500 total return in USD. For details on the methodology applied, see S&P DJI's SPIVA U.S. Scorecard. Past performance is no guarantee of future results. Chart is provided for illustrative purposes.

Source: S&P Dow Jones Indices (SPIVA)

Avoiding being exposed to significant left tail risk. Two key reflections come to mind in 2022. We employed zero margin/leverage, and sold zero options (and continued to do so), thus avoiding unlimited downside especially in a market of large selloffs.

Avoiding being highly concentrated <10 stocks. Separately, we also avoided our portfolio being highly concentrated (of <10-15 stocks). Thus we were not as negatively impacted by certain specific stock selloffs, many of whom were down significantly from -80 to -90%+ from the highs, many of whom were impacted by poor business execution. Such a large drawdown, which would have made it very difficult for the portfolio to recover from. Diversification for us is really trying to mitigate unknowable events that could take us out of the game, and we want to avoid it at all costs. As one of my favorite quotes from Mark Twain goes, "What gets us into trouble is not what we don't know. It's what we know for sure that just ain't so." Too often we think we know for sure, but more often than not, we never really know.

Diversification, not concentration. We seek to own 30-50+ companies over the long-term, higher than most typical investors. It is because most deep value investors tend to own highly idiosyncratic investments, which tend to have lower correlation, they can own lesser stocks, typically <10-15. That said, we don't think there is a magic number for everyone, we think it should be at least 15-20. But it ultimately depends on the investing strategy and the manager itself. For us, we tend to own the best-in-class businesses who are top dogs in certain industry niches riding long-term tailwinds, across different geographies. Seeing the examples below would make it more obvious as to the rationale of our strategy. Diversification, not concentration is also what allows us to really let our winners run (discussed in our 2021 letter). We diversify to really reduce the risk of being wiped out of the game, so we can increase our exposure to highly asymmetric payoffs/returns, which Vision Capital then effectively becomes a long portfolio of "very long-dated call options".

Thematic Concentration. For example, in E-Commerce (~23%), we own Amazon, MercardoLibre, Shopify, JD.com, Sea Limited, Coupang, Fiverr, Airbnb, & Meituan. In Payments (~19%), we own Visa, Mastercard, PayPal, Block, Adyen, Wise, DLocal, Nu Holdings, StoneCo and PagSeguro. In SaaS/Software (~14%), we have Adobe, Atlassian, Datadog, Elastic, Hubspot, Salesforce, Microsoft, Monday,com, MongoDB, Okta, Palantir, Paycom, ServiceNow, Veeva, Workday, Zoom, ZoomInfo. In Advertising (~13%), we have The Trade Desk, Alphabet, Meta, and Tencent. In SaaS/Cybersecurity (~3%), we have Zscaler, CrowdStrike, CloudFlare and SentinelOne.

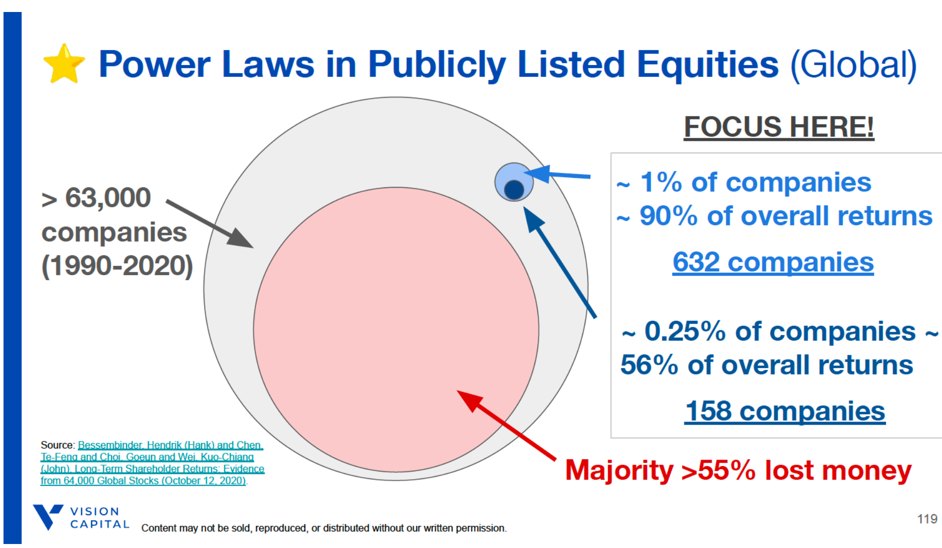
We think you should be able to get the drift by now. By thinking in blocks / mini-portfolios, because of the somewhat higher correlation between a number of these companies, we are actually quite highly concentrated on an industry level (13% - 23% across 4 largest sectors), but less so at an individual company level (largest positions being 8%+, <10%).

Seemingly very diversified but still fairly concentrated. Despite having a large number of 64 holdings, Pareto Principles (80/20 rule) do continue to largely apply for us as well. Our top 25 and 35 positions account for ~80% and ~90% of the overall portfolio (versus ~30 and ~40 for ~80% and ~90% of the portfolio in 2021). The increase in concentration was largely due to two factors. The first was the large number of indiscriminate drawdowns across most of our holdings, as the market shifted more towards energy and value. This reduced the gains and position of some of the multi-baggers/larger outsized winners relative to the overall portfolio. Second, the continued intentional reduction in number of holdings (~7.8% turnover for 2022 vs ~2% in 2021) also contributed, though we believe this was of far less significance, as all if not most of the exited positions were not top 20 / 30 positions.

Concentration as a process, not a strategy. Because of the highly asymmetric payoffs (limited downside, unlimited upside) of owning strong businesses resulting in multi-baggers that keep compounding over a long duration of time, the positive skew can result in power laws, where a few long-term outsized winners typically account for the majority of the returns. This continues to be the case for us, but the attribution varies significantly year to year, depending on how much the winners go up or down (especially in 2023). We believe that if we do it right, our portfolio should look like the chart below (like it did at the end of 2021), and it should become even more pronounced in the many years and decades to come, albeit with the occasional compressions like in 2022. If it is going to be the next multibagger, a little is all we need, if not, a little is all we want.

Source: [Vision Investing: How We Beat Wall Street & You Can, Too!]

Power Laws exist in publicly listed stocks. ~1% of companies (i.e. 632 companies) accounted for ~90% of overall returns, and ~0.25% (i.e. 158 companies) accounted for ~56% of overall returns, whilst the majority >55% lost money. The majority of companies are not where we seek to invest, and we are really only seeking to be fishing in a very small pond of companies that truly matter. We think that is probably at best about 100-200+ companies worldwide that would meet our criteria. We have been selectively, and will continue to be even more so in the coming years.



Source: [Vision Investing Cohort 1 Presentation Slides]

Stronger companies will emerge. These challenging times will differentiate the companies that could still keep growing and were able to manage their capital allocation better, and strong management, from the weaker ones. A number of our portfolio companies were also reinvesting (i.e. higher capital expenditures) which resulted in currently depressed FCFs. It is my expectation that 2023 and beyond could well differentiate the long-term structural winners, away from the seemingly short-term winners who had weaker products/services, business models and unit economics.

Strategy remains unchanged. Our investing strategy (mission and principles below) continues to be refined, and focuses on the (1) business growth of quality, durable and growing compounders (where we have higher control and higher probability) with strong sustainable and durable long-term competitive advantages, and are continuing to reinvest at high rates of return (i.e. ROIC), and (2) ideally not paying up too much excessively for them.

VISION CAPITAL

Mission: To invest in companies that reflect our best vision for our future, changing and shaping the world for the better.

Vision Capital's Ten Core Investment Principles:

1. **Horizon:** We are dedicated to a **long-term investment approach** driven by **bottom-up business fundamentals**, focused only on publicly listed equities. We seek to hold our investments for at least 3-5 years, if not 7-10 years or more.

2. **Diversification:** We strive to maintain a **high-conviction diversified portfolio** of at **least 25 investments**, which could increase with time. **Diversification**, not concentration, **keeps us in the game, allowing us to hold & not trim our winners**.

3. **Vision Investing:** We seek to invest in **top dog and growing disruptive companies** that bring innovative solutions into their fields that are or can be **either monopolies or oligopolies**. We **prefer founder-led and owned** businesses with **large total addressable markets**, supported by **long-term structural/secular tailwinds**, with **strong competitive advantages** (particularly **network effects**), **scalable business models with strong unit economics**, **recurring and growing revenues**, **improving profitability, strong reinvestment opportunities and financially strong**. The chosen businesses should be highly durable and enduring, and **must be changing and shaping the world for the better.** We tend to avoid turnarounds, cyclicals, complicated companies, lackluster businesses in deteriorating industries.

4. **North Star:** Where revenues, profits and free cash flows go, the stock price eventually flows. We are long-term business focused investors, and we know that in the long-term, it is **ultimately revenue, profits and free cash flows that drive returns, not valuation multiples.**

5. **Excellence:** **Find excellence, buy excellence, hold excellence, add to excellence and sell mediocrity**, that's how we invest. We buy far more than we sell, and if we ever sell, it is because the fundamentals have deteriorated rapidly beyond our thesis.

6. **Price Volatility:** We **do not focus on the day-to-day gyrations** of the stock market, and our **investment performance is measured over the course of years and decades**, not in days, weeks, months, or even quarters.

7. **Cash & Opportunity:** We have **no requirement to be fully invested** at all times. We **embrace price volatilities** (not business volatility), and **see market sell-offs as normal** (10-40% in any given year) **as wonderful opportunities to add more** (not sell). We are especially opportunistic, when others are fearful. We generally keep **5-20% of the portfolio in cash**, this will allow us to capitalize on opportunities and **add to our highest convictions** during declines.

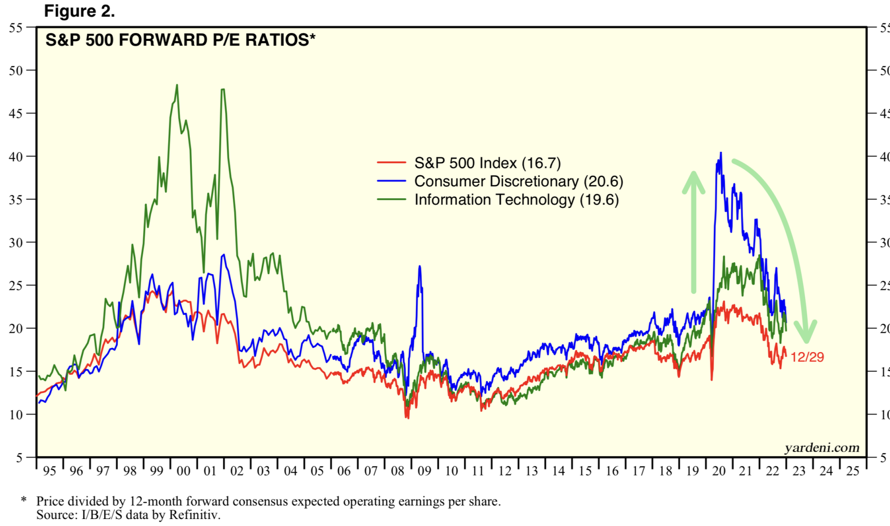
8. **Asymmetric Outcomes:** We are relentlessly focused on investing in our winners. But we know that **we will get it wrong sometimes**, and we **will have losers.** We expect our overall **outperformance** to be driven largely by the **disproportionate multibagger gains from our winners** that **will outweigh the losses from our losers combined**.

9. **Simplicity:** We **will not employ any form of leverage, short-selling, FX hedging, speculative/short-term trading nor the use of any derivatives and options**. Not doing these ensures that we will never be wiped out. Being able to stay in the game, and not being taken out of it, is half the battle won and provides **longevity & durability.**

10. **Skin in the game:** We are owner-operators. A **significant portion of our net worth is invested**. We will return capital should the scale or our size impede our strategy execution and/or returns or when prevailing opportunities no longer make financial sense.

Normalization of Mr Market's over-excitement. In hindsight, Mr Market was clearly on steroids in 2020 as valuation multiples reached all-time highs towards Oct/Nov 2021. The subsequent retracement/normalization of valuation multiples from late 2021 and throughout 2022 back to long-term averages (or arguably even lower towards historical lows) is in retrospect kind of obvious, at least in terms of direction, not magnitude. That is an important lesson for us, and should be for most investors. We still believe that it is okay to pay up for good companies, but not excessively such that future returns are unlikely to be good.

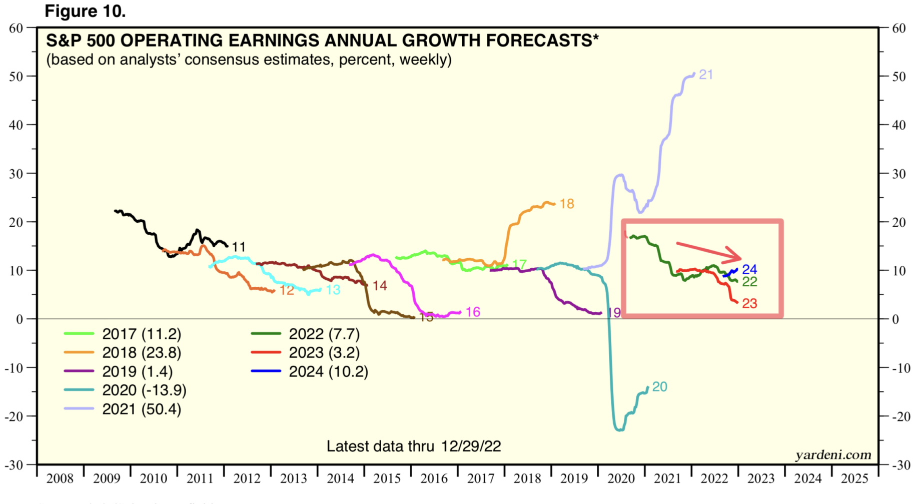
Figure 2.



Source: [Yardeni Research (4 Jan 2023)]

Near-term Forecasts are bearish. Near-term, intra-year price movements are really largely more due to the change in expectations. Earnings growth is expected to slow down and stay weak, and we won't be surprised if prices continue to stay weak near-term. Instead we prefer to ask ourselves if the businesses we own will continue to grow longer-term, and if the near-term slower pace of growth is more temporary, or if they are pointing to signs of a longer-term structural decline. Always important to differentiate between the price narrative from the business narrative. Don't let the price narrative drive the business narrative, instead let the business narrative drive the price narrative.

Figure 10.

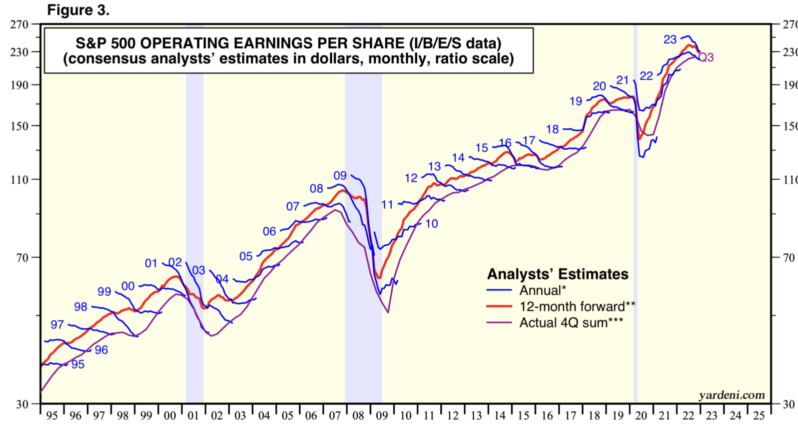


Source: [Yardeni Research (4 Jan 2023)]

Focused more on the destination than the journey. We prefer to be approximately right focusing on the likelihood of the longer-term path, than to focus our energies on short-term predictions (i.e. squiggles), and be spending all of our energy and attention trading and market timing our entry and exits, and be absolutely wrong over the long-term. Prefer to be focused about what the business would eventually could do, where its revenues and earrings could eventually be, its business growth path, than its price chart path. That is why we do not make any short-term stock market predictions, as they are most likely to be wrong. Focus on the long-term path, don't get lost in the earnings squiggles that are most likely going to be wrong anyways. Have expectations, don't make predictions.

S&P 500 Earnings Squiggles (Monthly)

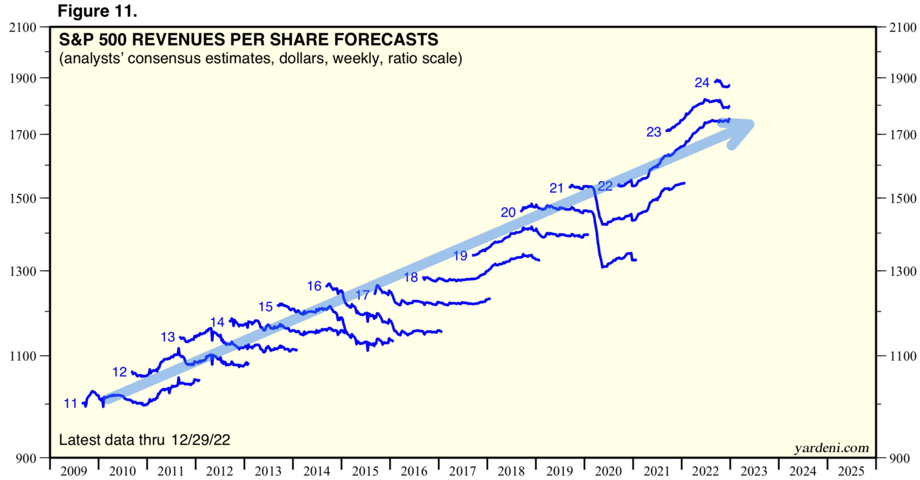
Figure 3.



* "Squiggles" span 25 months from February to February.
** Time-weighted average of consensus operating earnings estimates for current and next years.
*** Actual 4Q sum from I/B/E/S data by Refinitiv.
Note: Shaded areas denote recessions according to the National Bureau of Economic Research.
Source: I/B/E/S data by Refinitiv.

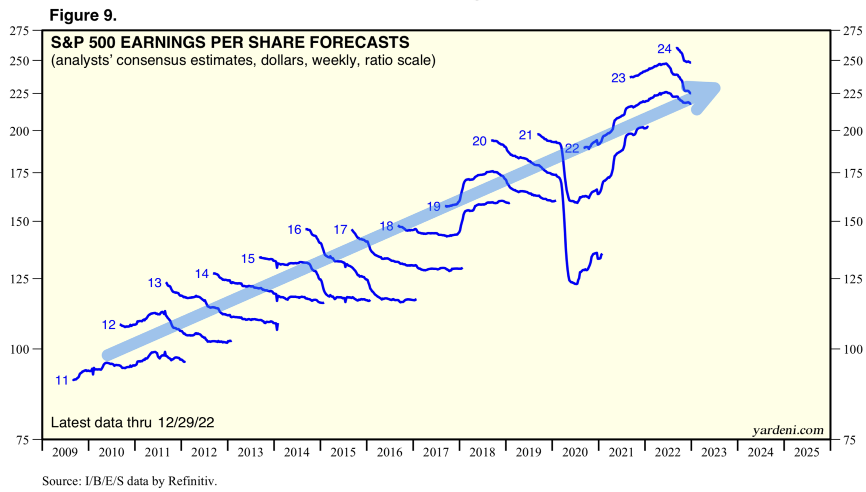
Revenues

Figure 11.



Source: I/B/E/S data by Refinitiv.

Earnings



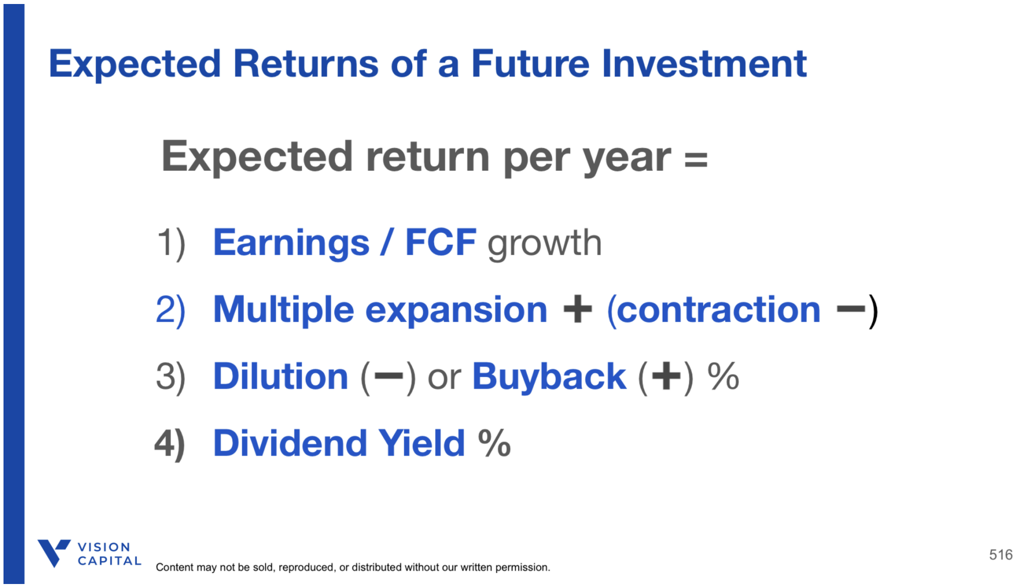
Source: [Yardeni Research (4 Jan 2023)]

Being focused on what we own. We prefer to own businesses that we know are likely to keep growing revenues, improving or maintain profit and FCF margins, that are reinvesting at high ROIC versus cost of capital, rather than to fret over short-term noise. That's not our expertise, to try and market time vs near-term expectations, and we want to avoid it at all costs.

Continuing to add capital. As long-term buyers of stocks, we continue to welcome lower prices and the attractive opportunities Mr Market continues to present us from time to time, and especially in the last few months and in the present. Correspondingly, we have taken the advantage of lower prices throughout 2022, and especially much more in H2 2022, deploying significant amounts of fresh capital (~14% of ending portfolio value through 2022) into our highest conviction ideas.

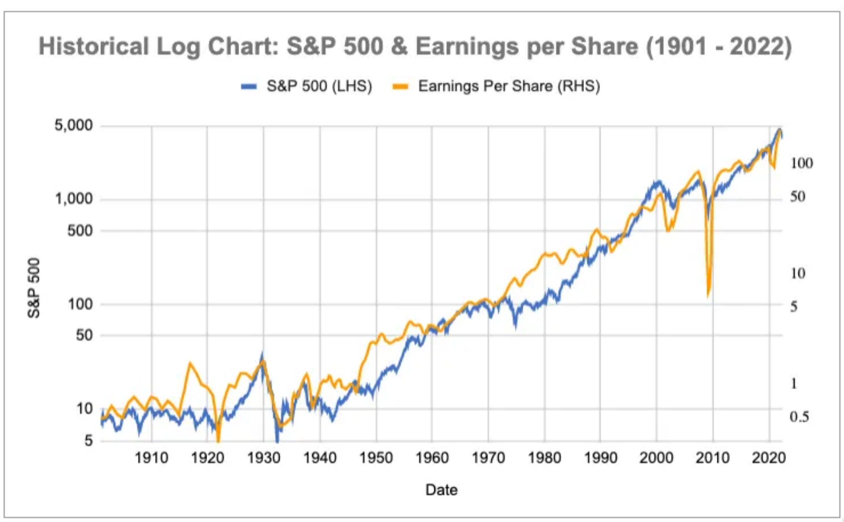
Remain focused on the north star of what drives long-term stock returns. In our minds, the drivers of long-term stock returns stem from 4 key factors (our four-legged stool): (1) growth of earnings / free cash flows (+) (driven by growth of topline revenue and margins), (2) change in relative valuation multiples (+/-) (which we have almost zero control), (3) stock buybacks (+) / dilution (-), and (4) dividends (+) (we tend to not to favor, because of high withholding taxes and that most tend also to be slower growth, have far fewer reinvestment opportunities, and are in the maturing stage of their company life cycle.

Below is what we shared with our students in our first batch of our investing course, Vision Investing back in December 2022.



Source: [Vision Investing Cohort 1 Presentation Slides]

As our favorite saying goes, where revenues, earnings and cash flow, eventually the stock price flows. That's what eventually drives long-term stock market returns. That's the biggest investing secret lying in plain sight. When you have a portfolio of companies whose aggregate earnings keep growing over the years, so will your portfolio's market value eventually.

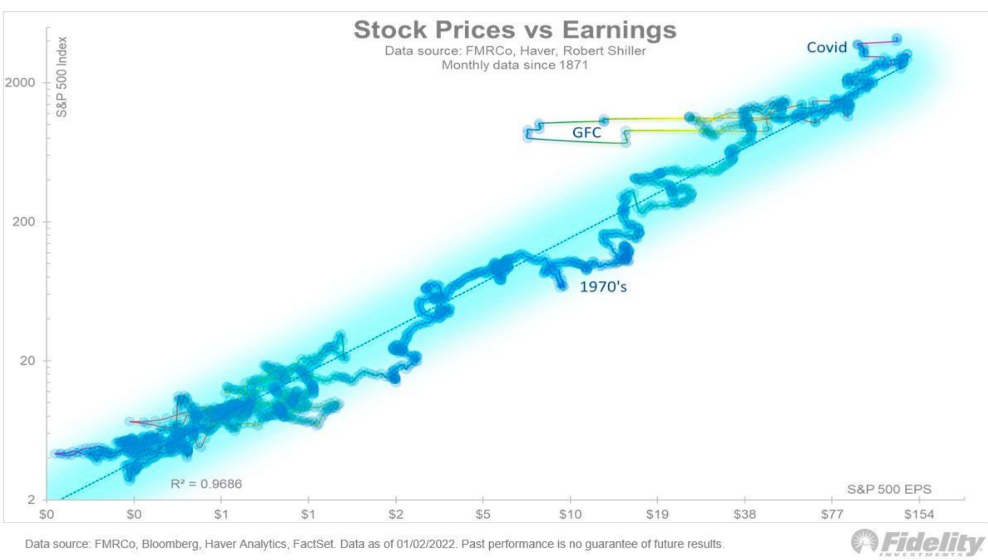


Source: [Vision Capital calculations]

Normalization of Valuation Multiples. We continue to remain long-term optimistic on stocks. We don't think stocks are overpriced in terms of valuation multiples. Instead we think they actually currently look quite cheap, and present some very attractive long-term investment opportunities for the right companies that can reinvest through and end up becoming even stronger at the end of it all. That said, stocks can continue to fall further in the near-term, in the coming months or through this year still, or it can bounce hard, we have absolutely no idea what the market will do.

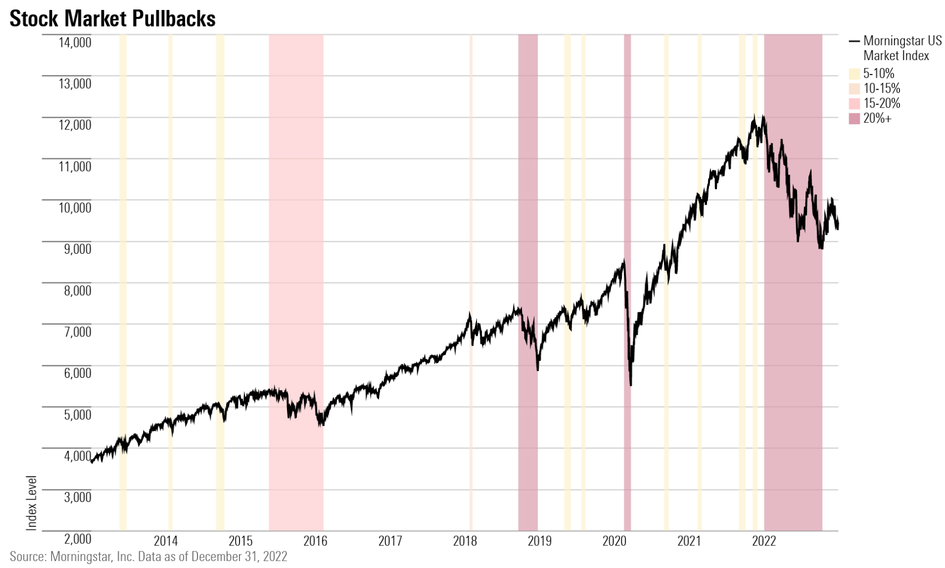
Future returns look more attractive. With the normalization of valuation multiples back towards the lower end of long-term averages, our portfolio should be expected to earn at least the returns of the businesses, i.e. earnings/FCF growth (simple average TTM Rev +34%, Free Cash Flow ("FCF") Margin 21%, Rule of 40 at 55), adjusting for dilution/buybacks, and adding dividends (if any) even if multiples remain unchanged. Should valuations instead trend back higher, this could add additional upside to our future returns.

The journey is not going to be smooth. There will be a lot of ups and downs, and sometimes the market can even go sideways for a while. Sometimes Mr Market will like something more, and others less, but one thing for sure is that he always comes back to the ones that keep doing well over time. We remain unperturbed, and continue to remain focused on what the long-term drivers of businesses and stock market returns are. Stocks are not lottery tickets, and they represent a partial ownership of actual businesses. As Benjamin Graham said, Mr Market is a voting machine in the short-term, but a weighing machine over the long-term. We only prefer to focus our energy and time on the latter.



Source: [Jurrien Timmer, Fidelity]

Market Declines are very normal. Since we started the portfolio back in March 2017, we have experienced our 3rd broad market decline of 20% over the last 5 years at a far higher historical frequency (typically once every 3-5 years). Each time, we underperformed more each time, declining 40% and more. We assure you that our short-term performance will tend to be more volatile. Thus this decline is not the first one for us, the only difference is that it is for much longer. One thing we can guarantee you is that there will always be market declines, the only question is when and by how much.



Source: [Morningstar]

Avoiding permanent loss of capital. However the true risk of investing to us, really is the permanent loss of capital. We do not run our portfolio as though we are playing a Russian Roulette (revolver with one bullet in the chamber, spinning and shooting the gun at one's head), by trying to get supernormal returns by underwriting risks that kill when it does come. Because black swans are actually frequent, and they will appear. We do not think our portfolio is structured to be significantly exposed to this left tail risk (unless the world comes to an end, which honestly all the wealth in the bank would not matter).

Differentiate slower temporary growth from long-term structural decline. While some of the businesses are experiencing somewhat weaker sales conversion in the near-term, leading to slower revenue growth, as purse strings of businesses and individuals tighten, it is crucial for us as capital allocators to differentiate if its more short-term temporary or long-term structural. Like for many of the SaaS companies, it is crucial to differentiate which are more mission critical, the must- have, versus the good-to-have, that the businesses cannot do without.

For example, Tesla could well likely see slower demand in the coming few quarters (with price cuts to encourage sales, though initial signals are still bear watching on the exact rationale of the price cuts, the upcoming earnings call should provide more insights).

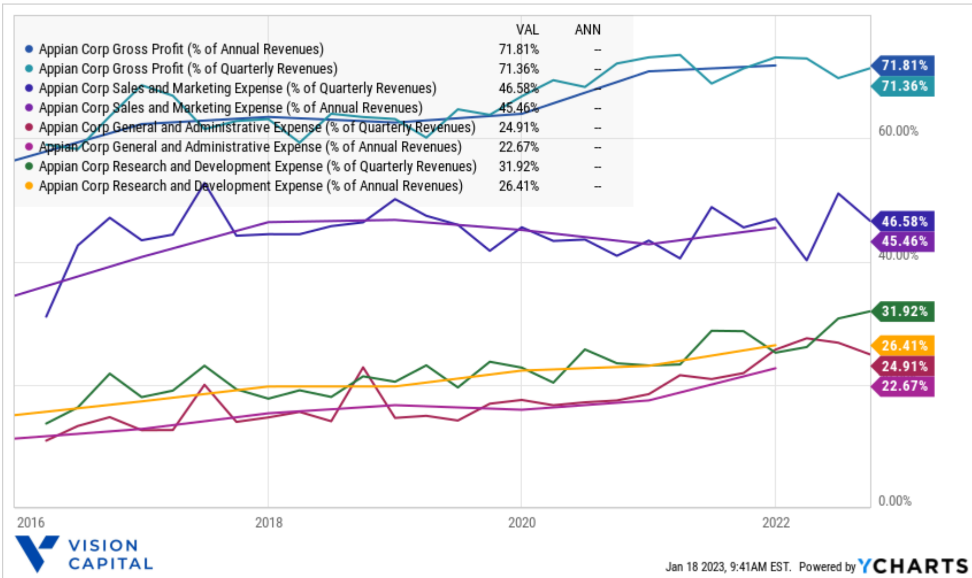
However, the shift from ICE to EV is a multi-decade shift, and there will be times when demand is slower and others when demand is faster. We certainly did not expect smooth sailing revenue growth. The key is to hold them through these “tough” times, rather than to time and trade them through such expectations. We are not a short-term trader of businesses, but a long-term owner of them. So we really do prefer to hold them for as long as we can, the especially good ones.

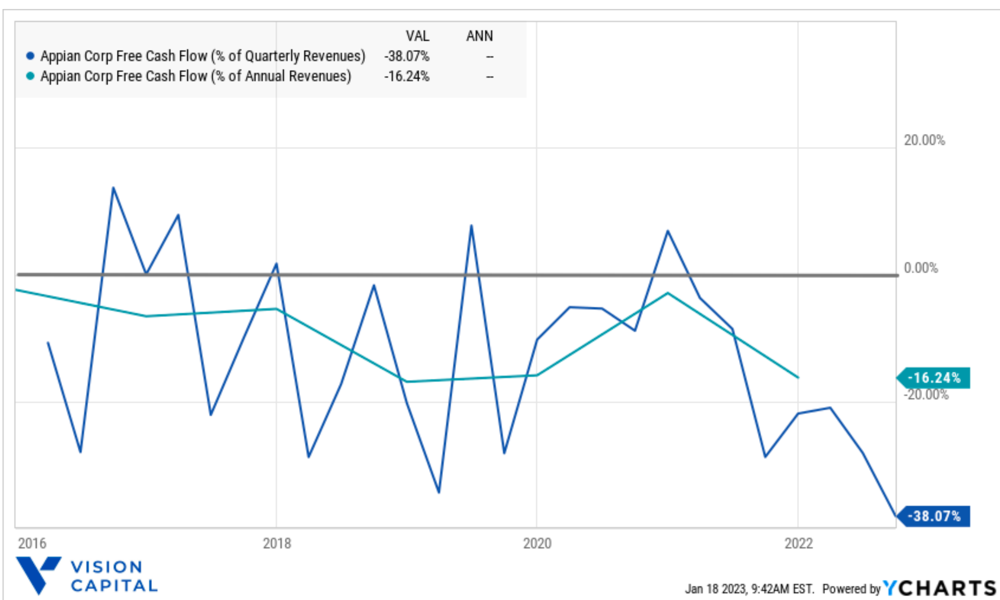
Weeding out the weaker companies. We took the opportunity in 2022 to continue to intentionally reduce the number of holdings significantly from the peak of 84 towards 64 and expect to continue to do so towards 50 throughout 2023. A number of these companies largely did not perform as expected, and we do think that we could have better tightened our investing selection framework on some of the smaller starter positions especially during 2020. Thankfully it wasn’t a significant portion of the incremental capital.

We exited a total of 25 positions, and they are Guardant Health, PacBio, Novocure, Teladoc, Lemonade, BigCommerce, Grab, Uber, Crispr, Editas, Intellia, Zendesk (acquired), Match Group, Unity Software, Dropbox, Roku, Appian, Alibaba, Twilio, Docusign, UiPath, Etsy and Pinterest, Danimer Scientific, and Coupa Software (acquired). We generally prefer to minimize our portfolio turnover, our overall full exits amounted to ~7.8%, a little higher than usual, but still significantly lower versus most active funds (40-80%+).

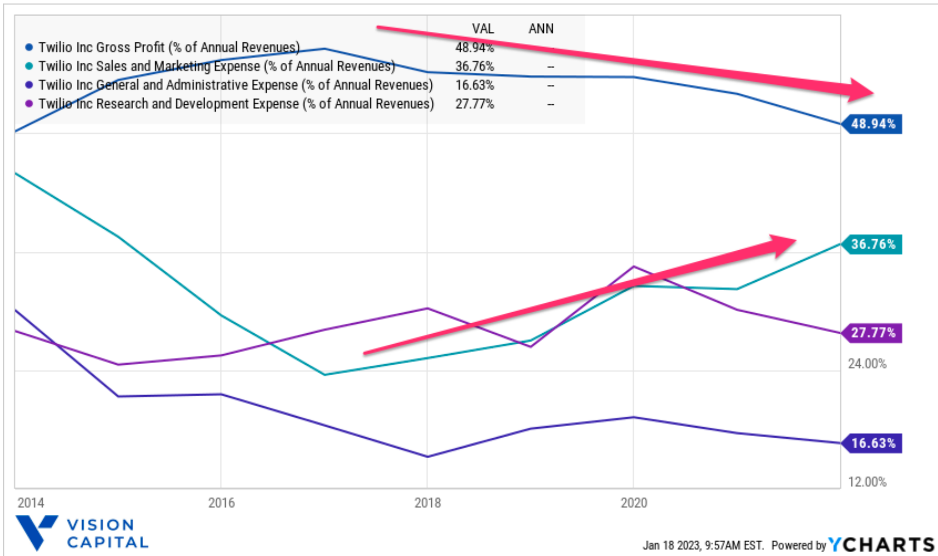
Alibaba, a deteriorating business. Alibaba continues to be a largely China e-commerce play, but it has been losing market share of GMV from 71% in 2018 to 50%. With Pinduoduo and JD to hold market share, whereas Alibaba is expected to continue to keep losing share, moving lower towards 40% in 2024 with slowing growth. This is in stark contrast to the emerging short-form video players, Douyin and Kuaishou winning more market share and growing faster. Alicloud’s revenue growth rates have decelerated from 60% to 10%, and adjusted EBITA margins have remained low 1-2%. Although it is trading cheap at 12X EV/FCF, its revenue growth profile going forward looks to be much lower 5-10%+ CAGR for the next 3-5 years, we remain unconvinced that it is as strong a quality business as when we first bought it.

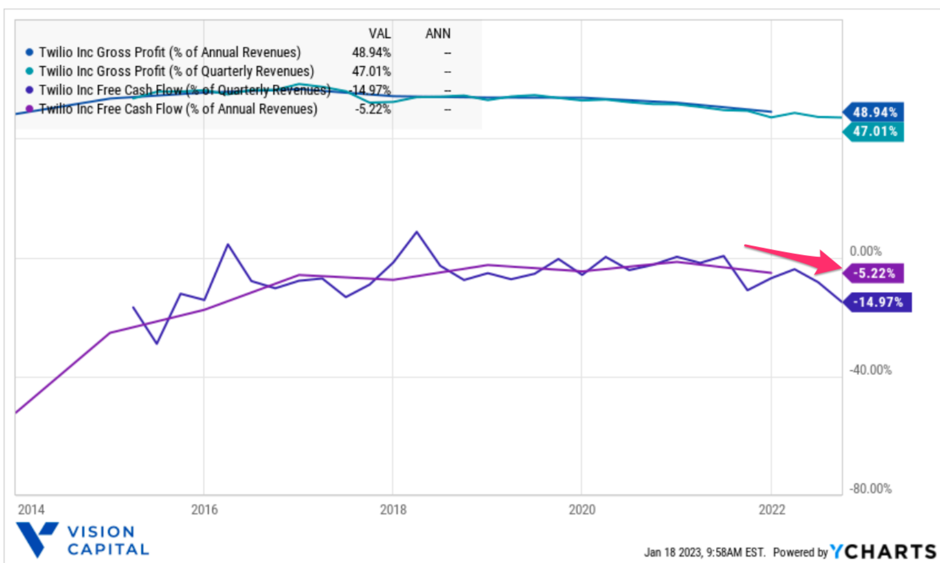
No longer confident in Appian. Appian’s technical leadership has been deteriorating, moving from a leader in Gartner’s Magic Quadrant for Enterprise Low-Code Application Platforms in Aug 2019 to a Challenger/Visionary in August 2021/2022. Despite its shift to an increasing higher gross profit margin (90%) subscription business (~70% of revenues), and higher gross margins from 56% in 2016 to 71% in 2022, R&D margins have been steadily increasing from 13% to 31%, G&A from 11% to 22%, whilst S&M margins holding steady around 45%. With cloud subscription revenue retention rates sustained at 116%+, we have much lower confidence that Appian can grow fast enough >25%, more likely <20%, and not be able to generate substantial free cash flows, alongside 4%+ dilution, to generate sufficiently adequate returns, and hence the exit.





Significantly lowered confidence in Twilio. For example, with Twilio's faster than expected decelerating organic growth from 50% in 2Q21 to 33% in 2Q22, slowing dollar-based net expansion from 135% in 2Q21 to 123% in 2Q22, declining gross profit margin from 56%+ in 2018 to 48%+ in 2022, versus S&M margins of 30%+, R&D margins of 28%+ and G&A margins of 13%+, we no longer feel confident in Twilio getting to a path of being strongly FCF positive of best-in-class SaaS, >15-20%. In addition, with the persistently high dilution arising from stock-based compensation (~15%), we do not see a likely scenario where Twilio will provide sufficiently adequate returns for us, hence our exit.





If it is not, a little is all we want. A good thing is that for most of our exits, they were initiated as small starter positions and were never added subsequently as the business did not do as well as we would have liked. Thus most were not even our top 20-30 positions. With the significant decline in confidence, we had to exit our stakes in the businesses. Thus even with the exits where we got it wrong, it really did not hurt the overall portfolio as turnover at 7.8%, still remains very low (<10%).

Tracking our Sell decisions. Tracking our 45 position exits (41 full/ 4 partial) over the last 5 years, 32 (~71%) continued to further underperform -26% since, and -27% relative to the S&P 500. We managed to exit earlier in advance of further large declines, Wirecard (-100%), Carvana (-97%), Baozun (-80%), Guardant Health (-75%), Fastly (-74%), Nano-X (-70%), iQiyi (-69%), Teladoc (-62%), amongst many others. If we had to list one that we should not have trimmed/sold on hindsight, it would probably be Arista Networks. Its demand rebounded strongly thanks to the cloud titans, and continues to gain market share against Cisco. It was one where we trimmed our position at the end 2020, because it was too large relative to what we were overall comfortable with, and wanted higher allocation to other holdings.

Raising the bar on additions. We added significantly fewer new positions in 2022, only 4. And they were Palantir, Nu Holdings, Monday.com, and SentinelOne. We continue to track a small number of very high quality companies on our watchlist that we could add in 2023.

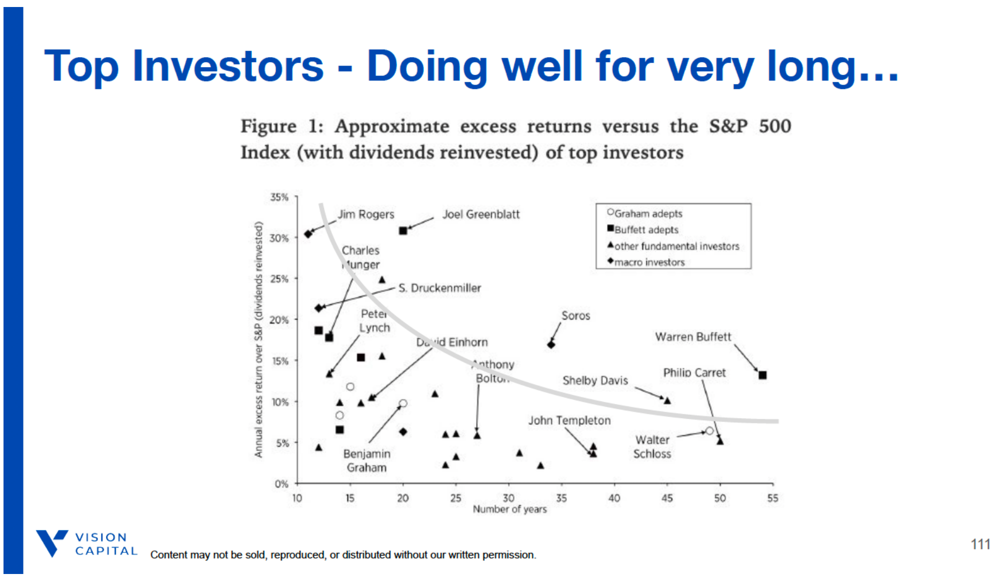
Nu Holdings (or NuBank) caught our eye during its Dec 2021 IPO, as one of the few FinTechs with strong unit economics (reminded us of Alibaba's Ant Financial) as Brazil's dominant NeoBank. However, we thought that the valuations were excessive, and we were not able to achieve decent returns no matter how bullish we were. After monitoring for a number of quarters of its continued strong execution and growth, the indiscriminate market selloff in 2022 finally provided an opportunity for us to enter into a larger than usual starter position.

For Palantir, we became more convinced that it had few to no competitors with its unique high value product offering, and was becoming extremely mission critical to its customers, evidenced by the long contract duration (3.5 years) and higher ARPUs (top 20 $43.5mil) clearly evident of the high amount of customer value it delivered, and hence customers were willing to pay. However the high stock-based compensation had always deterred us, but our deeper analytical work provided us greater comfort that dilution will likely be much lower going forward, and the lower prices provided an attractive entry for us to enter into a larger than usual starter position as well.

Our belief in eventual outperformance. If the companies in our portfolio can sustain average annual revenue growth of greater than 25% CAGR for the next 5-7 years, while producing healthy Free Cash Flow growth even after low single digit dilution, we do believe it is difficult for us to not outperform the S&P 500 over time (long-term 7-9% CAGR).

Generating alpha. How we think of our own alpha generation is that when the broad market declines, we tend to underperform much more than the market, but when the broad market rises, we tend to significantly outperform the market by a much larger fold. We have done so over a number of times with the types of businesses we own. Eventually we will let the durability of growth of our portfolio businesses speak for themselves.

A Marathon, not a Sprint. I will turn 40 this year in 2023. After investing for over 5 years with our own capital, I do hope to continue investing for the next 30-40+ years, and hopefully even 50+ years for as long as I can. To be one of the world's greatest investors, it is not just about doing well for a very short period of time, but to be able to do well for a very long time, and that's why Warren Buffett is up there amongst the very best. I will be heading up to Omaha, Nebraska for the 2023 Berkshire Hathaway AGM this year, if you would like to catch-up, let me know.



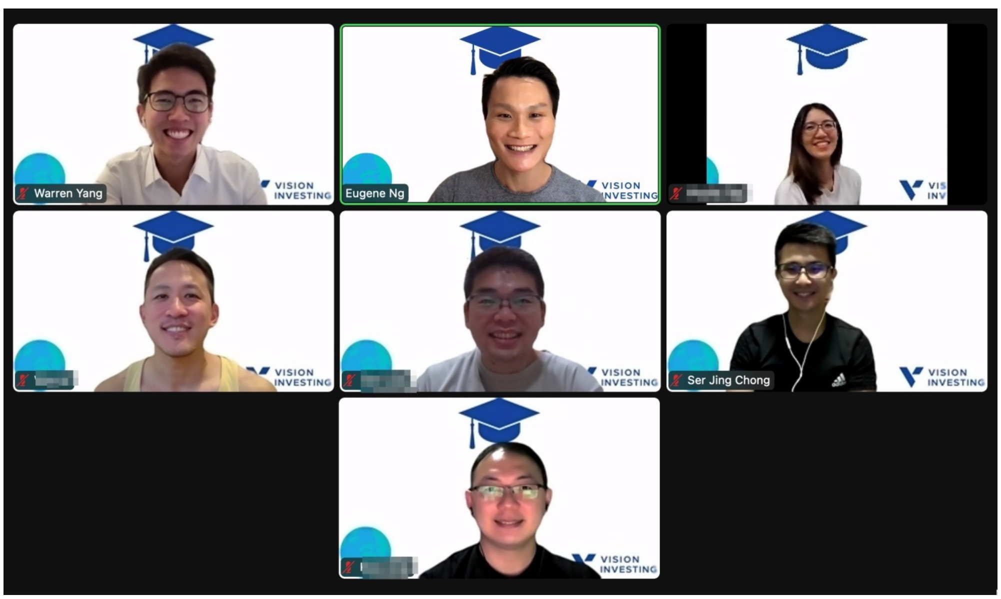
Source: [Vision Investing Cohort 1 Presentation Slides]

Giving back - [Vision Investing]. We had always wanted to give back, not just in monetary benefits but also with a positive impact on people's lives. Time is the most precious resource we have, and by teaching investing the right way, we together as a collective can invest better and hopefully help to change the world for the better.

We will be donating 50% of all net course proceeds to start a Giving Back Fund to be invested in exactly the same philosophy and framework, of which 10% of the annual investment gains will be donated in perpetuity to philanthropic causes. For the first cohort, we decided to commit 100% of the net proceeds, and topped up further to start the Giving Back Fund at a decent size. It might be small now, but hopefully with many years of continuous addition (with even bigger cohorts) and after decades of compounding, it can become a force to help others in need.

We have taken advantage of very attractive valuations recently and have fully invested the capital in 20 companies, and to be accountable, we will also be sharing publicly the performance of the Giving Back Fund going forward as well. We will be spending time to also identify the right long-term impactful philanthropic causes for us to support as well. If you have any to highly recommend and why, do let us know!

After 300+ hours of preparation, 700+ slides, and over 18 hrs of teaching, over 6 sessions, we completed our first ever cohort and Vision Investing graduates! We shared [14 of our key takeaways] here from this experience. Big thanks to our first ever intern, Warren Yang, my good friend and guest judge, [Chong Ser Jing] of [The Compounder Fund] and the ever helpful Thomas Chua for the help!



Right LPs. The right partners matter. Thank you for trusting us with your hard-earned capital, always giving us even more to invest for you when prices fall, and never taking it away when prices are at all time highs. We deeply appreciate the faith, trust and support in us, especially in difficult times like the last two years, and your deep understanding of our long-term investing approach and philosophy that we do here at Vision Capital. Thank you once again for being wonderful patient investors, and playing a significant role in allowing us to maintain our behavioral edge. As always, we look forward to making yours and our portfolio reflect our best vision of the future, changing and shaping the world for the better.

Excelsior,
Eugene Ng
Founder & Chief Investment Officer, Vision Capital
21 January 2023

P.S.: You can find all of our **past investors' letters here**.

Disclaimer

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