GreenWood Investors LLC

Global - Collaborative - Builders

Sunday, May 10, 2020

**Confessions**

Dear GreenWood Investor:

Reporting our performance this quarter feels quite a bit like the same experience I had preparing for my first confession as a young Catholic. Our performance, which has not been great in recent years, was truly terrible - a record new low for me since starting to manage the portfolio. I do not take this continued underperformance lightly, and if you would permit me, I'd like to confess in a rather longer quarterly letter than normal, some of what went into this historically undesirable result for us. And I'd also like to explain why in some ways, it's the best thing that could have happened to us.

Psychologists over the past century have largely identified two separate voices in our own heads. Daniel Kahneman calls these two minds System 1 and System 2. System 1 is what ancient Greeks and Buddha called the ego, it is the rapid-firing and emotional part of our brains, which is largely housed in the amygdala and the limbic system. System 2 is the slow, deliberate part of our minds that can handle complexity, and is inherently very creative. It is housed in the pre-frontal cortex, a segment of the brain that is unusually developed in humans over other mammals. In talking about the two separate parts of our minds, brilliant psychologist Carl Jung explained the great benefit that confession has brought to people throughout the ages. Confession admits and embraces the behavior patterns of System 1, which often leave us red-cheeked and embarrassed. As Jung wrote in *Modern Man in Search of a Soul*, "There appears to be a conscience in mankind which severely punishes the man who does not somehow and at some time, at whatever cost to his pride, cease to defend and assert himself and instead confess himself fallible and human."

While investing requires a humble approach, our recent results are indeed humbling, and reflect the decidedly fallible parts of our nature. They also reflect my previous cavalier disregard for System 1 thinking, which actually proved to be harmful to us, rather than helpful.

*Exhibit 1: GreenWood's Composite Performance[1] vs. MSCI ACWI All Cap (Net)*

| | Traditional | Global Micro | Global Micro Fund | MSCI |
|---|---|---|---|---|
| 8/1/08-12/31/08 | -10.9% | | | -33.9% |
| 2009 | 155.3% | | | 36.6% |
| 2010 | 28.5% | | | 14.5% |
| 2011 | -1.0% | | | -8.0% |
| 2012 | -5.6% | | | 16.4% |
| 2013 | 14.2% | 18.0% | | 23.6% |
| 2014 | 0.1% | 2.0% | -2.8% | 3.8% |
| 2015 | 11.2% | 11.8% | 11.2% | -2.2% |
| 2016 | -2.5% | -1.0% | -1.5% | 8.4% |
| 2017 | 27.0% | 25.1% | 25.0% | 24.0% |
| 2018 | -2.1% | -2.1% | -3.1% | -10.2% |
| 2019 | 6.9% | 5.4% | 6.8% | 26.3% |
| YTD April 2020 | -22.9% | -19.6% | -25.6% | -14.0% |
| Cumulative | 247.5% | 38.3% | 2.5% | 82.3% |
| Annual Compounded Rate | 11.2% | 4.5% | 0.4% | 5.2% |

System 1 is the passionate, angry, greedy, and fearful parts of our minds. The amygdala, which is largely our survival mechanism, serves to keep us alive. It got mankind from 400,000 BC to 4,000 BC. But after civilizations arose in the ancient middle east, System 2 thinking was the value driver. It is the cooperative, collaborative, generous part of our mind. It enables teamwork, complex and structured thinking, and infinite creative possibility. It is the source of value creation throughout these last millennia. This is why, as Carl Jung asserted, self-restraint was one of the earliest celebrated virtues of society. It wasn't the System 2 self that needed restraint, it was the System 1 ego. But Mr. Market is only capable of System 1 thinking. My constant attempt to quiet System 1 through meditation, has built up this disregard for Mr. Market, the very counter-party that determines our fate on a short-term basis. As Jung asserted,

[1] Represents GreenWood's Traditional & Global Micro Composites. Performance prior to January 2011 represent the returns generated by the manager prior to founding GreenWood Investors, using the same strategy. GreenWood Investors LLC claims compliance with the Global Investment Performance Standards (GIPS®) and a GIPS-compliant presentation is available on our website (click here for access). **Past performance is no guarantee of future results.**

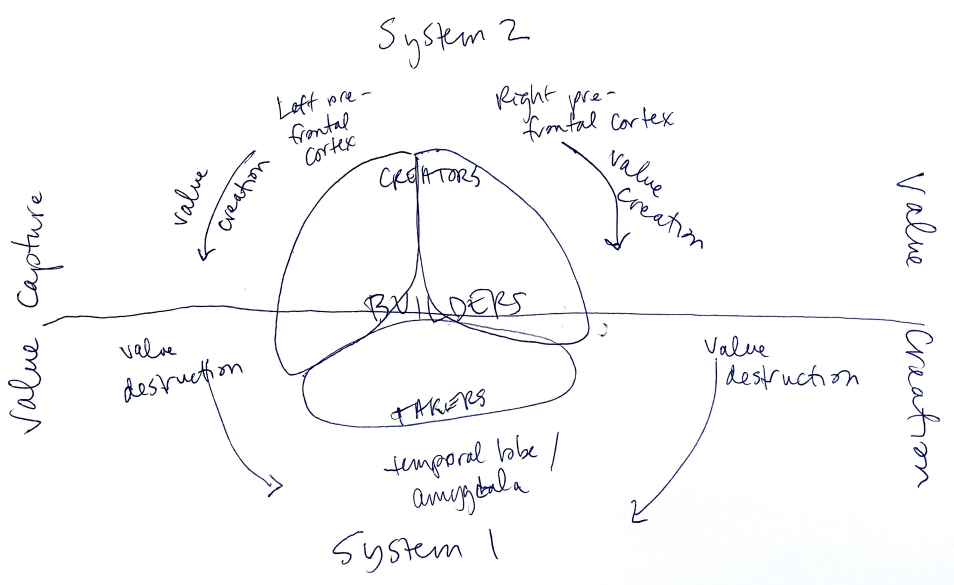
claiming ownership of this part of our minds is key to the process of healing. So in that vein, I have a few more confessions.

**The Book**

For the past few years, I've been using runs, chores and office commutes as opportunities to listen to research for a book I'm working on, *The Builders.* It's a historical and psychological look at some of the most impactful value creators of all time. While macro-economists like to look at centuries of data to inform their thinking on where we are in the arc of history, this project is a micro-economic and psychological analysis of the biggest builders over the past three millennia.

Perhaps the most interesting outcome of that research was the realization that while the originator of value creation has been a highly developed pre-frontal cortex, or the home of System 2, all major commercial value creators also had a very strong System 1, or at least keen understanding of its methods, tricks and behaviors. Many of them understand System 1 so well that the products or services they create catch the world by fire, or rather by involuntary reactions of System 1. System 1, or the ego, doesn't think before it acts. It wants immediate gratification. While many of these products or services either are a hook, line, and sinker to consumers' limbic systems, in many other cases, they invite their customers into System 2 stimulation. One of the brilliant, possibly accidental, virtues of Private Equity and Venture Capital, is that these funds can mark their funds to model as opposed to the whims of System 1. While this lack of volatility is a complete illusion, it saves its limited partners the pain of constantly being subjected to the amygdala. System 1 is not a fun place to hang out, as the evergreen scowl on President Trump's face bears witness.

*Exhibit 2: Original Diagram of the Psychology of Value Creation*




So in my cavalier disregard for Mr. Market's or System 1's views, I was actually ignoring a theory which my own research has been able to unearth. The most impactful value creators are masters of *both* Systems 1 & 2. To be fair, the insight only came in early January, but this entire social dialogue that the "ego is the enemy" that has taken hold has not served us well. Quite frankly, I'd rather be empathetic to the needs of Mr. Market, and not keep "pushing rocks uphill."

**Accelerating Our Framework Evolution**

As Chris and I were chatting about portfolio construction in the context of our ranking framework in early February, he articulated that too much of our portfolio had tough stock market narratives. Too many companies, it seemed, had managers swimming upstream. I'm not sure what I looked like to him, but internally, it was as if I had seen a ghost. He was exactly right. My penchant to puzzle-solve complex situations, and my contrarian nature had naturally attracted me to deeply out of favor transformations where we had a very different view of the world than Mr. Market's. This is the "hedgehog" approach that psychologist Phil Tetlock talks about. But while hedgehogs hit home-runs, they are less reliable in hitting steady singles every time they bat.

I immediately agreed with Chris and we evolved our framework that very afternoon. As a result, we are no longer allowing an extreme outlier in one area of our framework, which ranks companies on three continuums: value - quality

- behavioral, to over-ride a terrible ranking in the other two criteria. The second evolution to the framework has been abandoning the 3, 6, 12-month roadmap of the market's vs. the fundamental views. Instead, we now select three major concerns of Mr. Market's, assess the fundamental reality of such drivers and make probability-adjusted estimates of the likely progression of those drivers. We also have added three probability-adjusted narrative inflection points, or developments which can cause a sudden and forceful shift in the market narrative.

System 1 is inherently unpredictable. It's sort of like a child that falls. If there's no blood, and you maintain a smile, maybe you can avoid the tantrum. Maybe they'll be laughing 60 seconds after crying. The evolution of that is unpredictable, but we can at least understand what System 1 cares about, and where those inflection points may be.

We were getting there with our entire portfolio, and then the Covid-19 (C-19) market turmoil hit prior to us selling down some companies that had a low likelihood of reaching an inflection beyond the narrative of "pushing the rock up the hill." It didn't mean we were paralyzed by the turmoil. Rather, it was almost refreshing for us. While it was both a frustration and a great opportunity, fundamentals didn't matter during the C-19 selloff. That meant these "rocks uphill" companies sold off with equal vigor to companies that are managed by Builders with better narratives. The funny thing about the selloff is that while Mr. Market did a great job differentiating between industry and market sectors, it did a very poor job distinguishing between good managers and administrators, or companies with a debt or a cash position. Frankly, in a world where the MBA "optimization" processes are no longer relevant, I trust managers who actually embody their business more than I trust the MBAs. I trust cash over debt. I trust organic growth over financial engineering. Mr. Market still hasn't differentiated between these dichotomies, and owner-operators and family-controlled businesses have still managed to underperform the market by over 10-points so far this year.

These are the people we feel most comfortable with, and who have generated the most significant long-term outperformance. The recent market drawdown and underperformance of this class of ~2k companies (with a market capitalization over $1 billion) has been historic. These managers have a large amount of skin in the game. They don't give quarterly guidance. They use less cash for acquisitions, buybacks and dividends. They have lower profit margins, but significantly faster revenue, employee and fixed asset growth despite carrying lower debt levels. In the white paper I'm working on with my friend Ehren Stanhope, we will publish our findings on their behaviors, which unsurprisingly run counter to so many of their peers who are largely compensated in stock options by a board with no share ownership (after all, they need "independence").

When Mr. Market failed to differentiate, and in fact, penalized this class of companies, we moved quickly. We added five new long positions, three of which are founder-led, and the other two of which have very good management teams with significant skin in the game. Four of these five businesses are net beneficiaries of the current pandemic environment, despite them selling off more than global markets in the beginning of the panic.

I confess we went into the crisis with a larger-than-normal gross long positioning in our fund, which is clearly reflected in the performance. It was because we were so enthusiastic about the year ahead at our coinvestment, or CTT Correios de Portugal (CTT). With deep gratitude to an anchor investor, we started investing in this company in early 2018, and have managed to buy over 8.5% of shares today. We had a playbook of drivers that we believed would deliver very substantial value to the company, and in early 2019, we sought a board seat to help secure execution over these initiatives. We wanted to wait to publicly talk about CTT until we were more advanced in executing these strategic priorities for the company. But, as our very large weighting in the fund suggested, and our funds' overall heavier gross long exposure show, we think the year ahead, the company's 500th year in operation, will be one of the most transformational in its long history. It's a good time to discuss what we've been working on in Portugal.

**CTT - Committed to Deliver**

As a constructivist investor, we took an opposite approach to a traditional activist in the American markets, which typically argue for a leveraged recapitalization of the company. The traditional activist re-arranges the capital structure to favor shareholders in the short-term, and often leaves a long-term bill that will be brutally painful to pay one day down the road (most likely by the creditors). In hindsight though, it would have made sense for our playbook to include a few "quick wins" that would have led to more immediate performance for our investors, who have patiently waited for our more transformational efforts to bear fruit. We could have planned a better roadmap for *both* System 1 and System 2, but we don't think we'll have to wait much longer.

After we took a large position in CTT Correios de Portugal (CTT), the postal carrier of the country, we were welcomed on the board last year. The very meeting we were voted in, we abstained from the vote on the company's dividend payment. Rather than payout all the cash from the company, which is basically admitting defeat, we saw a lot of potential for growth in the core business, as well as many peripheral areas where the brand could be extended.

Over the prior year, I had developed a relationship with many other large shareholders of the company, during which I got to know João Bento. Through too many conversations to count, we shared ideas for the company and its diverse business activities. When CTT's former CEO decided to retire, João serendipitously had his 100-point plan ready to go. He hit the ground running in late May 2019. He has refreshed some of the executives at the company, and more importantly, created a bench of ~40 direct reports, nearly all of whom I've met and impress me with their work ethic. Since last summer, João and these able executives have been laying the groundwork for a return to growth at our company, and a robust return at that. Rather than a centralized structure reminiscent of a government-controlled entity, this team and its collaborative approach has already completely redefined the purpose of the company and its relationship with customers.

How can a postal company, a melting ice cube, return to growth? Well, while mail is reported as a large portion of the company's revenue, only a quarter of the overall revenue last year was tied to ordinary transactional mail (the secularly declining kind being eaten by the internet), and it will clearly be lower this year. Surely that will be going away over the medium term. Two major parts of that reported segment, registered mail and international mail don't face the same underlying digitalization headwinds. In fact, the company's international mail is largely being driven by soft parcels coming in from China, as Chinese e-commerce companies were the first to arrive in Portugal.

The company's ubiquitous network that touches nearly every house and business almost every day is a fantastic delivery mechanism for the clear bull market in parcels, particularly e-commerce-driven parcels. Express networks are not properly set up for the last mile outside of highly urban areas. That's why postal companies largely win the last mile of e-commerce. It's a business that's somewhat similar to a cement company, local market share matters heavily. As we all learned in geometry, when a truck's delivery radius shrinks by half, as its market share doubles, the total area driven is reduced by ~75%. That means market share conveys a very significant cost advantage. And while CTT is not a sexy business, it's almost as boring as it gets, it is highly durable. It's one reason why challenger mail delivery companies in the past always failed. But now that mail is disappearing, it's not guaranteed the postal carriers win e-commerce. There are two separate networks anddelivery methods. Mail routes have been traditionally fixed, while express & parcels routes are typically more dynamic. We have a great challenge, but also a great opportunity, to try and converge these two networks into one. Already, around 70% of the company's parcels are being delivered by postmen, and frankly, the word postman should really be parcel-man today. The bag or van has mostly parcels in it.

As already mentioned, this year is the company's 500th anniversary, and as a new board member told me when I met her last year, "you need to know something, everyone in Portugal has a piece of CTT in their hearts. We all have ownership over it." It was a symphony to my ears, as she mentioned the key skin in the game trigger that drives highly favorable outcomes no matter what business or industry we're in. It's no surprise that the largest telecom in the country was once a segment of the company. Just a few years ago the company launched its own bank, which we estimate has taken almost half of all new accounts in the country since being opened. It has the highest customer satisfaction, and with a labor and physical footprint around one tenth of its competitors, it will have a permanent cost advantage versus peers.

Investors have given this bank, with a balance sheet of €212 million in equity, a zero or negative valuation in the market. We don't share their pessimism, and originally wanted to help underwrite an IPO to allow a spin off of the bank. Unfortunately, investor appetite for European banks over the past 18 months has collapsed to a state of revulsion. Still, the bank is accelerating growth plans to become more like a fin-tech than a bank, and we're encouraged by the strong growth in profitability and significant revenue coming from non-interest income. That's not because the bank charges aggressive commissions to its customers, in fact it's the opposite. But the bank handles a very considerable portion of the payments in the country, which is no surprise that when fin-tech Revolut wanted to partner with a local bank, as an experiment with cash top-up of payment cards, it chose us. We believe there will be many more partnerships in the payments arena. We are excited about an acceleration in the non-interest income, no matter what happens to the pervasive negative rates in Europe. The value of the bank is not very concerning to us, though it has been to the market. We're in the very early stages of working on something to help alleviate investor stress there. But it's certainly not worthless, despite Mr. Market giving it such an appraisal.

We are much further along in optimizing another under-appreciated asset within the company, the significant real estate portfolio throughout the country. Because the company is centralizing its distribution centers, in order to more fully automate tasks, a very large number of logistics centers will be left vacant over the course of the next year or two. While the portfolio is quite diverse, some of these are fairly well-located assets, and can be repurposed to a higher-value mission. As CEO João Bento disclosed on the last quarter's call, the value of this portfolio today is over €200 million, and we believe there will be incremental value-add as we work with a real estate manager to unlock the considerable value in this portfolio. Thus, combined with the bank, and even if we take a major haircut to the bank's value, the stock with just over a €300 million market cap today and a €32 million net cash position, means the company's current enterprise value is deeply negative. So investors today are getting paid to take a core business which before the coronavirus, was on track to hit over €90 million in EBITDA in 2020, even after the new lease expenses and banking income are removed.

Mr. Market is also worried about the company's deteriorated regulatory relationship, which last year accelerated the loss-making status of the regulated universal mail service. GreenWood estimates that this contract is loss-making at the EBITDA line, and including depreciation, which is roughly equal to maintenance capital expenditures, lost nearly €20 million. That is the definition of unsustainable. In early March, I had the chance to meet with Portuguese Economy Minister Pedro Siza Vieira and confirmed that at least this large shareholder is committed to keeping the universal service, as the government wishes, but only under a sustainable contract. The current contract, which was abruptly changed in January of 2018, carries with it a deep negative net present value.

One of the first things that João Bento did as the CEO of the company was to restore this relationship with the government. We were in strong alignment that the satisfaction one of our most important customers was of the utmost importance. We took steps to re-open unprofitable locations that were controversially closed, and started to vigorously defend our renewed focus on quality of service. We're encouraged that recent public statements made by the government acknowledge the flexibility needed for us to manage our network as this great business shift is occurring. GreenWood estimates that CTT is the only major postal carrier in the developed world that doesn't take subsidies from the government in order to maintain universal service, despite the very rigorous regulatory conditions extending to the Azores and Madeira. We don't need subsidies. In fact, we'd be happy with a breakeven universal service, as it is a key strategic asset that gives us a considerable local competitive advantage. The old unprofitable contract expires this year and we look forward to making the universal service more sustainable.

The biggest concern we had prior to C-19, was that e-commerce in the country was failing to scale like in other European countries. Portugal's parcels per capita, largely driven by an even greater e-commerce under-penetration, is one third of Spain's, 1/5 of France's and 1/12 of the UK. We have the benefit of being able to learn from other postal carriers' mistakes as e-commerce scaled in their countries. And if we manage the network transition correctly, we will win that business with the best price points and highest quality in the industry. Lastyear, the company's on-time delivery performance was, substandard to say the least. Amazon will not launch Prime in an environment where consumers aren't getting their parcels by the guaranteed delivery date, which in Europe, is quite a bit more rigorous than what Americans enjoy.

While the Coronavirus has dramatically affected the company's business customers, which were previously roughly two-thirds of the parcel customers, C-19 has brought e-commerce to Portugal in the most accelerated way. The company has taken a leadership position in developing e-commerce in the country. While the operations team still needs to adjust to the incredibly rapid shift in delivery mix, as now at least two-thirds of the parcels are coming from e-commerce, this major progress has propelled our parcels business to breaking company records almost every day that goes by, even measuring against Black Friday.

The notable quality laggard was previously the company's tiny Spanish business, with a market share of less than 4% in this highly fragmented market, and which had been losing money every year since CTT acquired it in 2004. When I joined the board last May, just after the company lost Amazon as a Spanish customer, the company was at the final consideration point to acquire another company in the country as a quick fix to this perennial pain point. Yet, through our conversations with competitors and former industry executives, we learned that not only was this purchase price extremely high, nearly all of the EBITDA of the business was generated by "fines" lobbied against their supplier partners. Hardly a highly conscious business, in our opinion. While I'll never know which direction they were leaning towards, we successfully led an effort to vote this down. But I knew it was incumbent upon me to help figure out a solution for this division.

Enter GreenWood's collaborative investor network, where a friend in Madrid had eventually gotten me in touch with Manuel Molins, who I met the day after this merger was voted down. Manuel built SEUR into a market leader in the country, and then did it again with Correos Express. After the socialist government in the country replaced the company's executives with political cronies, we had the absolute gift of being able to ask Manuel to perform a career hat trick. He very rapidly devised a plan to turn the business model on its head, quite literally doing the opposite of the former managers, who I think are actually very smart. But when you're the extreme underdog, sometimes the most intelligent thing to do is the most counter-intuitive one. We are seeing some early very strong green shoots emerging from Manuel's efforts. Over the past few weeks, the company has continued hitting all-time throughput records, even prior to our new distribution facilities coming online in Madrid and Barcelona. Manuel was able to capture an incredible bench of managers from his former employers, and they've committed to turning around a €9 million loss last year into an operational profit by the end of next year. It's quite an aggressive target, but Manuel is already performing ahead of plan from a revenue perspective. Once his cost optimization efforts start bearing fruit this summer, we are encouraged a division that brought the company's probability down by almost 10% last year will turn into a major source of incremental profit growth. The total investment we will make to deliver profitability in 2022 is less than a fifth of the considered acquisition, which was going to struggle to get us to the same result. But the payoff is slower than a "quick win" that we believe the market would have cheered.

A healthy Spanish business is also key for cross-border market share capture, which last year was an embarrassing low-single-digit. The two countries' tracking systems didn't properly talk to each other, so on-time performance was lackluster, to say the least. This is also being fixed, so that as Manuel makes progress in Spain, we also expect a virtuous effect on the Portuguese business.

Perhaps the most frustrating part of the coronavirus is how it's very much impacted small businesses. We love a true underdog story, but unfortunately, as the market has accurately reflected, the largest five digital companies in the world are eating the stock market index, and seemingly the world. Not in Portugal. Through CTT's efforts, which have seen major new business initiatives being launched every week, the company has successfully brought an incredibly wide range of Portuguese businesses online. Through the partnership with local retail champion Sonae, our dott.pt platform has seen gross merchandise value at least quintuple, and continues to generate impressive marketplace figures still less than one year from its launch. Yet CTT's initiatives have gone so much further. The new Shopify-like service, where we help local retailers launch their online storefront, handle the payments and delivery, and even fulfillment at times, already has nearly 1,000 customers in the process of launching their online presence, a mere dozen weeks after launching this full-order-cycle service. While Amazon has struggled with inventory and fulfillment capability on the Iberian peninsula, local businesses have had the opportunity to capture the significant portion of the population that is experiencing their first online order in their lives. Our prior concern about e-commerce failing to penetrate in the country has very rapidly vanished.

Quite remarkably, and almost overnight, this very capable team of executives is turning us into *the* back-end of e-commerce in the country. That was always our goal for the core business, but we thought it would take years, not months to achieve. While we feel confident we can develop separate pathways for the company's under-utilized real estate and bank businesses, the core business needed to tie its sails to the tailwinds coming from e-commerce. The same digitization headwinds that are eliminating the need to receive a statement in the mail have a much greater impact to requiring distributed last mile delivery of a wide array of products.

Yet this requires a completely flexible network, which we don't totally have today. It's perhaps my greatest near-term focus to ensure our executives have the best resources in the world in order to profitably manage this transition in the business. CTT is one of the only major businesses in the country to not use the government payroll assistance program thus far, and the company remains focused on helping the country through this unprecedented time. There is still room for improvement, and as the company grabs a very substantial share of the country's e-commerce, much of which it has helped create, it will create some friction in the delivery network. Still, early signs point to encouraging trends, as April's parcel volumes, which overshot the robust month of December in total volumes, brought with it an over 60% reduction in shipments missing the original intended delivery window. That's far better than what consumers are experiencing in the United States, which is a substantial lengthening in delivery timetables.

Thus, while C-19 will certainly bring choppiness in some of the company's business lines and profitability in the second quarter, and perhaps beyond, we are so encouraged by the substantial progress the company is making towards this goal of becoming *the* e-commerce back-end in the country. Not only will this secure healthy revenue growth for us, as we are not going to stop until the core business revenue is growing by double-digits, but CTT is giving the underdogs a chance to not only survive, but thrive. And that has to be a goal worth pursuing on its own.

The most important thing for us as investors, and for the company's mission, is customer satisfaction. The company's great efforts to keep the country running through this time have strengthened the goodwill towards the company's brand. Quite coincidentally, the company's recent evolution in its purpose statement, "a nossa entrega é total" (translated to mean "committed to deliver") has been backed by signification actions in recent weeks and months. All of the investments in IT systems to enable delivery notifications and dynamic route configuration, as well as more centralized and modern automated sorting equipment, will help CTT work to continuously improve the quality of service. As most of the Portuguese population experiences their first online delivery of medicine or groceries, the first impression will always be the strongest. It's very important to us that the first experience is a great one. The convenience of online ordering, will hopefully allow e-commerce to stick when the other former two-thirds of the parcels business comes roaring back.

**A More Conscious Sustainability**

It's still remarkable to me how few investors track customer satisfaction and Net Promotor Scores (NPS). Tens of trillions of dollars are pouring into ESG-focused investments (environmental, social, governance), which many investors often characterize as "sustainable." Yet much of this capital is missing the two most important aspects of the sustainability of a business: the customers and the employees. Customers are the only reason a business exists. The companies that myopically focus on happy customers actually evoke those customers to feel as if they too have a stake in the business. Happy stakeholders add to the durability and competitive advantages of a business. Yet, NPS measures are typically overlooked by investors as this satisfaction doesn't immediately translate into profits.

Our analysis of companies that have significant insider ownership suggest that founders and family-controlled businesses do not optimize for profit margins, but for business growth. At the same time, we acknowledge the timeless aphorism that "revenue is vanity, profit is sanity and cash-flow is reality." Still, this customer-centric approach contrasts starkly with the over half of major US businesses that are optimized to "beat" the quarterly guidance. This quota-focused business model demoralizes a workforce, as numbers are quite a bit harder to become passionate about, particularly as opposed to a company mission. Let me underline this point with an example of one of the recent additions to our portfolio.

One company that appeared to have a fairly pronounced mismatch between valuation and NPS is Peloton (PTON), which we added during the coronavirus crisis sell-off. When I first mentioned the company to Chris, he thought I was referring to a possible short candidate. Yet with a NPS of 91, the second highest in the world, I respected the power of the emerging ecosystem of this company, which has similar characteristics to most luxury businesses. It sells its stationary bikes and treadmills for about 10x the cheapest competitive offerings, yet it still manages to save its 2.6 million subscribers significant sums of cash every month. Because the value of Peloton lies in the millions of hours of content, as well as live exercise classes, the monthly subscription fee of $39 is dwarfed by the monthly bills of boutique fitness studio goers, which number over 30 million in the United States, and who pay over $30 *per class* for their endorphin rush. Peloton gives these subscribers unlimited classes per month for just $39, or for digital subscribers, for just $13.

The company's mission is to inspire its community to exercise more and engage with their exercise equipment at an accelerating rate. It has had great success in actually building bike and treadmill utilization over the years after purchase. This is in stark contrast to most gyms and exercise equipment which see a permanent decline in utilization after the initial honeymoon period. Despite the company, which is founder-led, being a significant beneficiary to the current pandemic, as all gyms and fitness studios remain closed, the stock was cut nearly in half in the prior three months when we had purchased our position. As the company articulated on its earnings call this week, it added record new customers to its ecosystem while also recording a record low in subscriber churn. The company's myopic focus on increasing exercises per month and customer satisfaction allow it to build the largest, most convenient and best-valued exercise-oriented community in the world. There is now an unprecedented 7-8 week waiting list to join this rapidly growing community. We discussed the business at length in a note, which is now available on our website.

**Recent Actions & Performance**

While we went into the crisis with a heavier long position than we normally would have, we didn't let it hold us back from taking advantage of the opportunities we saw. During the past few months, as we added new long positions, or simply added to high conviction investments we held prior to C-19, we also added three short positions. These securities have limited upside in a normalized economy, while carrying significant downside exposure if the pandemic lasts longer than just a few months. So we actually have been able to *lower* our net exposure to ~60% in our fund and in accounts where we can short, while not missing any of the market upside. We have modestly outperformed the market from the bottom, and this outperformance is actually led by only a handful of our positions, driven by key catalysts unfolding. Every single one of our long positions has narrative inflection points approaching in the next 2-12 months.

The economicnormalization could take many forms. Just like our analysis of investment positions, we have approached the current pandemic with a range of various outcomes. In the extreme bear, geopolitical tensions rise to levels where we see a cyber conflict between China and the Western World. We sincerely hope it doesn't happen, but are positioned to be ready for it. In our base bear scenario, the virus continues to mutate, this time into more lethal variations, and the world remains in some kind of lock-down mode for over the next 12 months. In our base bull, the economy starts normalizing late this year as treatments and testing become more thoroughly available. In the extreme bull scenario, somewhere between 80-90% of infected patients are asymptomatic and the R0 of ~5.7 allows herd immunity to be established over the summer. The surprising thing about these ranges of scenarios, we find evidence daily that nearly all four scenarios are playing out. Upon any economic normalization, the unprecedented government and central bank intervention in the global economy could cause a "melt up," scenario in equity markets. Thus, while we've positioned the fund in a much more defensive posture today, we've not left out any material upside in the normalization scenario.

While I was personally getting worried that GreenWood was failing to reach its mission of at least 15% absolute performance and 7.5% annual outperformance in recent years, the valuations that the crisis has allowed us to purchase securities at has actually made me increasingly optimistic we'll come roaring back from this setback. My own period of most pronounced outperformance was in the years following a period with valuations very similar to the ones we enjoy today. At the low, and still, even to this day, we own core positions where the market is giving very attractive and growing assets a zero or negative valuation. As we saw much commentary when oil was trading at negative price points, that many investors would love to get paid for taking oil, these companies have a similar pay-off while allowing them to avoid taking physical delivery of the black liquid that just keeps coming.

I must confess, while it's not something any institutional investor would want to hear, we're not going to keep this firm open if we can't manage to hit the hurdles we've set for ourselves. We must outperform meaningfully over the long-term to justify the amount of time we pour into getting this right. If we can't, we'll all move on. While underperformance is a sad story, it pales in comparison to under-utilized talent. If we can't serve in this capacity, I'm confident we'll find better ways to serve. Yet, as we recently discussed regarding Bolloré, we know that the best time to coinvest with a manager with the long-term track record that Vincent has, is exactly a time like this. He has recently gone through a period of fairly significant underperformance. This is not for a lack of intelligent decisions, as his takeover of Vivendi and capital invested into his African port collection have created two incredibly valuable, but undervalued assets. System 1 has given this African ports collection a negative valuation in recent weeks, and we are paying a discounted price to own Universal Music Group (UMG) while getting Canal+, a stake in Telecom Italia, African ports, a global logistics business and the only commercial solid state battery maker in the world for free. As he bucks the recent social anxiety over buybacks and repurchases shares almost every day, we continue to support Vincent Bolloré.

The events of the March market panic happened so quickly, we couldn't publish research concurrently with all of these actions taken, but we are finally starting to catch up. We stayed in frequent communication with our investors about the portfolio actions throughout the quarter, as actions speak louder than words during periods of great volatility.

While we reserve most of our research for investors with skin in the game, as it aligns information with intention, we also want to be as helpful as possible to other friends who may be experiencing the same befuddling whims of System 1, or Mr. Market, by publicly posting research on some of our favorite names. We recently added research on Rolls-Royce, TripAdvisor, Peloton, Exor, and Telecom Italia on our public research page. While the page requires a registration to access the notes, don't worry, we never send marketing emails. The registration is only to help us deepen our collaborative diligence efforts, which continue to help us upgrade the quality of the research and idea generation. This collaboration has helped lead to fundamental improvements at CTT.

In addition to the public research, in January we posted our investor-day conversation with MEI Pharma CEO Dan Gold on his novel approach to creating value in biotech. Despite MEIP stock ramping recently, as it struck a partnership to develop its key lead drug, the enterprise value has actually declined while the stock has rallied. It has grown to be one of our larger positions. Because only a few companies have led our portfolio from the pits of hell earlier in March, many of them, a painfully high number of them, remain around their lowest levels in decades, if not all-time records in some cases. There are varying reasons for this ongoing underperformance, whether it be factor exposure to Italy, small-cap, or value, but we see many of these companies as survivors, and eventually thrivers, in the post-covid world. And so we believe we are well prepared for any C-19 scenario that we have been able to imagine. We have more downside protection today, but more upside possibilities than we've ever had.

Kveta, Chris and I have all taken whatever cash we have economized through this period of non-traveling and deployed it into the fund, as we all have a very high conviction in the opportunity set. Our portfolio now has more insider or founder-led businesses than ever before. Balance sheets are largely at net cash positions, for certain in the areas that are sensitive to the economy, and the portfolio has more North American exposure than it's had in a while. Serendipitously, the bottoms-up method of selecting securities that have very favorable value, quality and behavioral characteristics has actually led to a much more diverse geographical, sector and capitalization mix of securities than we've had in the past. This wasn't the result of a macroeconomic forecast, though we are happy to limit single-factor or single-geography exposures to 20% or less of our net exposure. This is a period where unknown unknowns are going to be much more common.

We're incredibly grateful our largest and highest conviction investment was deemed an essential service. Not only is CTT an essential service, but with e-commerce bringing forward business initiatives that we used to think would take years to materialize, the core business is quite a bit more exciting today than it was even just a few months ago while the stock is clearly much cheaper. And we don't believe real estate investor appetite has been impacted by the recent pandemic, as logistics infrastructure in the country is more critical than ever before. Even in a bearish C-19 scenario, the company is poised to thrive.

Now that insiders (board members and management) own over 20% of the business, we have the possibility to be included in the venerable group of Builders that outperform the market by at least 6% a year over the long-term. Let's just say that starting with a negative EV, a clean balance sheet and improving cash-flow, we're aiming for quite a bit higher than 6% outperformance. We need to reach a $1 billion market cap before we get included in the data set our forthcoming white paper covers, and we won't rest until our fair value well surpasses that key threshold. We believe our actual fair value is quite close to these levels today and are focused both on collapsing this discount as well as accelerating the compound growth rate of that intrinsic value.

Your satisfaction is paramount to us, which is why we've disclosed retention metrics and it's a key KPI for us to track our progress. With a retention rate of over 100%, you continue to stun me with your commitment to our efforts, and just like CTT, we are committed to deliver. But let's be honest, while customer retention is very important, the most important driver is performance. We had wavered in recent years, and failed to generate alpha in this late cycle market. But now, with the moves we've seen, the investments we've added, and the low-upside shorts we've added, we're more encouraged than ever that we can perform in the ensuing months, quarters, and years ahead, no matter what we face. Thank you for your continued trust.

Annuit cœptis,

Steven Wood, CFA