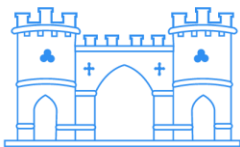


**TOLLYMORE**  
INVESTMENT PARTNERS

A letter to partners, December 2020



Dear partners,

£1 invested in Tollymore at inception was worth £3.58 on 31 December 2020, after expenses but before fees paid to Tollymore. Over the same period £1 invested in the MSCI All Country World Index would have generated a return of 87p. Around three quarters of this benchmark outperformance would have accrued to those invested at inception. Tollymore has generated returns of 28% per annum net of all fees and expenses<sup>1</sup>.

| GBP        | Tollymore (gross) | Tollymore (net) | MSCI ACWI |
|------------|-------------------|-----------------|-----------|
| 2016       | 35.2%             | 31.4%           | 26.6%     |
| 2017       | 16.6%             | 14.4%           | 13.3%     |
| 2018       | 3.5%              | 2.5%            | (4.6%)    |
| 2019       | 17.2%             | 15.0%           | 21.4%     |
| 2020       | 86.9%             | 77.1%           | 12.7%     |
| Cumulative | 257.5%            | 213.5%          | 87.3%     |
| Annualised | 31.6%             | 27.9%           | 14.5%     |

## Operating systems and shortened supply chains

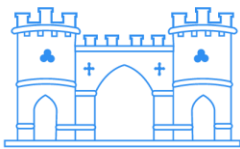
Our investments are a product of a bottom-up organic investment process, and an examination, one by one, of each company's investment merits. We are deliberately not limiting our investment universe by restricting what we can look at. We do not create rules relating to the business models, economic characteristics or geographic end markets our holdings companies must possess. We have a simple research process requiring our companies to meet high hurdles for business quality as we define it. Having said this, we can make broad observations about the features of the businesses we own. Two features have stood out to us in the context of our preference for businesses with symbiotic value chains<sup>2</sup>: operating systems and shrinking supply chains.

Value chain symbiosis cannot be achieved while one component's profits are another component's losses. Operating systems create value for multiple parts of a value chain. By helping one component, they can simultaneously create value for another. For example, retail operating systems such as Shopify allow sellers to focus on doing what they love – delighting customers by creating amazing products. Everything else, including website design and hosting, payments, inventory management and fulfilment is taken care of through a single counterparty relationship. By levelling the playing field with larger merchants such operating systems allow

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<sup>1</sup> Inception 12 May 2016. Source: MSCI, Interactive Brokers, managed account performance in GBP, unaudited, net of all expenses, 1% management fee and 10% incentive fee in excess of a 5% hurdle, as of 31 Dec 2020.

<sup>2</sup> A symbiotic value chain is one in which multiple stakeholders participate in a company's value creation; success is shared with customers, employees and owners through thoughtful and transparent incentives.



smaller retailers to access larger markets. Customers benefit from better choice, superior products and lower prices.

There are two limitations of Shopify as an operating system for retail. The first is its lack of B2C brand (which of course is its appeal to brands seeking DTC routes to market) and by extension its inability to help sellers reach the large majority of customers shopping in multi-brand environments. This is both a demand aggregation and a marketing efficiency shortcoming. And the second is its inability to help sellers sell *offline*, still the mode through which three quarters of commerce is conducted. These limitations inhibit Shopify's ability to optimise an end-to-end customer experience.

This letter discusses why we think two of our holding companies are uniquely positioned to become operating systems of their respective fields. In so doing we believe they can create vastly more value than they consume via highly compelling supplier and customer propositions. Before we proceed to some detailed case studies of retail operating systems, a brief note on shrinking supply chains. When the value created by a linear supply chain is shared amongst fewer components, win-win outcomes are more achievable. We will discuss shrinking supply chains in our March 2021 letter to partners, with a focus on the conditions under which shortening the supply chain can lead to substantial value creation for owners, suppliers and customers, again using case studies of companies we own as well as those in which we decided not to invest.

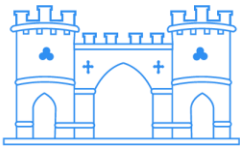
The appendix to the letter is a transcript of an interview we did with Good Investing TV, in which we discussed our business quality criteria, investing in companies with emerging moats, the determinants of antifragility within Tollymore, as well the individual investment cases for two of our holdings.

### Operating systems: Next plc and Farfetch Ltd

Our most recent investment has quietly but purposefully been building the means to be the operating system of multi-brand, omnichannel retail in the UK and beyond. We acquired an interest in **Next plc (NXT:LN)** for £66 per share last quarter.

Next is a multi-geography, multi-brand, omnichannel retail business. The company sells own-branded NEXT products, as well as c. 1,000 third party brands via Next's online aggregation business LABEL, a £500mn business in the UK. Next has 6mn UK online customers and 2mn overseas online customers. Since 2019 Next has also provided customers access to partner brands' products stocked in those brands' own warehouses ('Platform Plus'). This has broadened the range of third-party brands offered. Online sales are routed through Next's own website and app, as well as brand.com websites. The store network is an important part of the online value chain; *half of online orders are collected from Next stores, and 80% of returns are processed through the stores.*

Next offers nextpay, a credit facility for UK online customers, and next3step, a credit account which allows customers to spread the cost of orders over three months interest free. Next's



£1bn+ lending book is not just a sales enabler/friction reduction tool but is also highly profitable (60-70% return on equity).

Under 'Total Platform' Next makes its warehouses, call centres, distribution networks, customer relationships, marketing engine and lending business available to third party brands, including next day delivery services and store collections and returns. Next also builds and operates brand.com, all in return for a 39% commission on brand partner sales.

Next has a forty-year business history of innovation and successful strategic pivots including pioneering out of town stores when competitors remain focused on the high street, expanding apparel categories from adult wear to children's clothes and homewares, and expanding beyond own-label online to a multi-brand marketplace, and now becoming the operating system for third party brands via Total Platform. Throughout this period Next has earned consistently high operating margins in the high teens, three to four times higher than high street market leader Marks & Spencer, or online pure plays ASOS and Zalando. One can see how continued progress in widening Next's SKU variety advantage might drive increasingly attractive basket economics and higher customer loyalty.

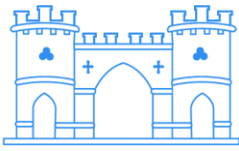
The value created by Next over the last fifteen years against a backdrop of the rapid proliferation of ecommerce pure plays, supermarkets' success in penetrating the UK discount apparel market and declining high street footfall, has been commendable; free cash flow per share has compounded in the mid to high teens. One could have bought the business for £4bn 15 years ago. Since then, Next would have paid the owner roughly that amount in dividends, and today the business could be sold in the public markets for more than double this purchase price.

**Distinctively positioned to be the operating system of multi-brand omnichannel retail.**

Today, Next is perhaps uniquely positioned to invest in and benefit from delighted customers and suppliers. The strength of the supplier proposition strengthens the consumer proposition and vice versa. This positions Next well to create more value than it consumes.

Online shopping has two characteristics that distinguish it from traditional brick and mortar retailing: (1) product choice: customers can now access products from all over the world, vs. a few physical shopping locations; and (2) convenience: customers can now have goods shipped directly to their door.

We can clearly observe the increases in online penetration of retail sales across the world. But as the retail industry is divided between largely pure play online players, and largely physical retailers, it may be difficult to ascribe relative value to these two propositions. Next is perhaps the only scaled multichannel home and clothing retailer in the UK. The behaviour of its customers is therefore instructive; half of online orders are delivered to Next stores. This might suggest that SKU variety is the most valuable advantage that online shopping has over brick and mortar. But there is another reason: for many, delivery to store is more convenient. In Northern Ireland, delivery is free, yet 28% of orders are still delivered to stores. This would suggest that over half of customers picking up in store are doing so due to convenience rather than cost.



Then there are returns. Rather than attempt to suppress returns rates, Next has embraced the customer's right to return unwanted items. Again, the stores play an important role in providing an efficient returns process. In some categories of online apparel sales return rates are as high as 50%. And for Next 80% of returns are conducted through stores.

The store network is part of the distribution infrastructure; store stock operates as an online reserve. Stock can be delivered from store to home when there is no warehouse inventory, or stock can be moved from store A to store B for collection by the customer. This omnichannel aspect of the customer proposition may be more defensible than crude subsidised shipping strategies. And the ability to collect in store is more valuable in the context of a multi-brand shopping service – *there are not many places in which one can shop across many different stores and pick up once in one convenient location.*

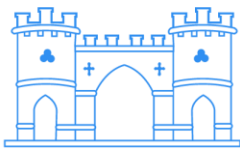
Two conclusions might reasonably be drawn from this observation. The first is that online penetration has some way to go before it stabilises, as product choice is a more sustainable advantage vs. offline than home delivery. The second is that retailers with a physical store footprint may, by avoiding the material costs of last mile delivery, be best positioned to offer the most valuable consumer proposition and the most profitable route to market for third party brands.

The supplier proposition is the provision of the most profitable route to market. The internet has lowered the barriers to entry for brands seeking market access by removing the upfront cash commitment associated with retail stores and lowering the operating leverage of such businesses. And e-commerce platforms such as Shopify have reduced these barriers further by turning yet more fixed costs into variable expenses for online brands. But given that 80% of retail shopping takes place in multi-brand environments, brands can access many more customers by trading on aggregation marketplaces such as Next.

Our assumption that the multi-brand omnichannel shopping proposition is valuable is supported by most customers choosing to pick up and return in store and most customers shopping in multiband (online and offline) environments. In addition, many of the world's most successful pure play ecommerce businesses, such as Amazon, Alibaba, JD.com, Wayfair and Farfetch have been investing in the integration of offline and online shopping experiences.

If we accept this consumer preference for shopping in multi-brand environments, and the sustainable product choice advantage of online, it seems that two categories of sellers will find it hard to generate and retain value for owners. The first is established physical retailers, and the second is brand.com destinations lacking the brand equity required to stand alone and compete for the 20% of consumers shopping in such places.

Next's traditional business falls in to the first high risk category: a high street retailer with burdensome fixed cash obligations such as operating leases and wages. Next's investments in next.co.uk over the last 20 years are evidence of customer-centricity. But its more recent efforts to help competing brands increase their addressable markets and safeguard their own businesses against the more level playing field in an online world seem to be particularly forward



looking. And necessary. Since 2014 Next has featured third party brands alongside its own Next and Lipsy brands through its online platform LABEL. The first order implication of this move has been to increase competition with, and potentially cannibalise sales of, Next's higher margin own brands.

But in the words of CEO Simon Wolfson *"There is nowhere to hide on the internet, one way or another our customers will find the brands they want. If they can find what they want on our website they are more likely to come back to us, furthering our ambition to be our customers' first choice for clothing and homeware online."*

Since the introduction of Platform Plus two years ago, the number of third-party brands available on the Next platform has doubled to 1,000, and Next's active online customer growth has accelerated from mid to high single digit rates to mid-twenties in calendar 2019 and 2020, despite the larger base. More recently, visits to next.co.uk have more than trebled since the first lockdown in the UK at the end of March 2020. This is the highest growth rate amongst established ecommerce peers such as H&M, Zara and Asos.

LABEL was originally a wholesale business model, but today more than half of this business is done on a commission basis. This may increase as the rate of growth of brands paying a take rate is three times those selling wholesale. LABEL represents just c. 13% of total Next sales currently.

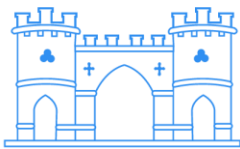
In return for a flat all-inclusive 39% take rate brands receive the following benefits: 8mn active customers, growing c. 25% pa.; price control – Next is a full price retailer – 15% of sales are on markdown, vs. the industry average of 35-40%; Next day delivery network including returns and collections from stores; and a large-scale consumer lending proposition.

The timing of LABEL's quiet but notable business progress is fortuitous; it positions Next to gain from the COVID lockdown-induced restructuring of the UK apparel industry. Cross-shop between Next and retailers in company voluntary arrangements or administration such as Debenhams and Arcadia Group is high. These retailers represent a tenth of UK market capacity, vs. Next at c.7%, including LABEL.

In addition to the omnichannel distribution advantage, but much more nascent, is the opportunity to use online information about consumer shopping habits and preferences to optimise in store inventory and customer service. In store collection and returns also drives footfall and therefore incremental selling opportunities.

### **Avenues for highly accretive internal reinvestment**

The economics of online capacity growth are attractive. The current book value of Next's online warehouse and distribution plant and machinery assets carries annual depreciation of c. £20mn, 1% of online sales. Next is halfway through a six-year warehouse and logistics investment programme costing £300mn; this will increase annual online sales capacity by £1.7bn. So, 18p of investment is increasing annual sales capacity by £1. And the principal growth driver of online, the LABEL aggregation business, carries no inventory and enjoys negative working capital.



Next's multi-brand offering is exploiting historic distribution and marketing investments. Next is leveraging existing assets to expand into close adjacencies. And as the scale of the business increases, so too does the utility and value of Next Unlimited, which offers unlimited free home delivery to customers for £20 per year.

The LABEL penetration opportunity is vast. LABEL sales still represent just 1% of the UK apparel market, vs. 6% for the NEXT brand alone. Sales per LABEL brand are also still less than £1mn pa. Given the strength of the LABEL proposition in a world in which consumers overwhelmingly prefer to shop in multi-brand environments, engines of business growth may include adding more brands, the expansion of product ranges for each brand that are available on LABEL, and extensions into adjacent categories such as Beauty and Home. LABEL still sells mostly apparel; home and beauty together are just 15% of revenues. The online penetration of beauty products is still less than 10% in the UK, but the high value, small size and low returns rate of beauty products make them well suited for online sales. Homeware online penetration is c. 15%, around half of the proportion of apparel and footwear sold online.

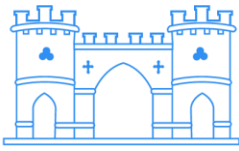
Manufacturing is a nascent growth opportunity. Retail operating systems can further integrate themselves into retail value chains by reorganising their partners' supply chains; that is, by connecting merchants with manufacturers. Next sees an opportunity to leverage its sourcing experience to create and distribute partner brands' products. In 2020 it signed such licencing agreements with Ted Baker, Oasis, Joules and Scion Living. These opportunities, and the economic terms underpinning them, may only improve for Next given the COVID-induced failures of large retailers.

Online business models enable geographic expansion. As rent is replaced with digital marketing dollars, Next's online assets have allowed the company to profitably enter new regions, unencumbered by the customer density required to economically justify physical store investments. Online sales of c. £600mn are growing 25%+ pa as Next adds >1mn new overseas customers per year. NEXT brand accounts for c. 85% of overseas revenue and has been growing 20% pa. However, after initially modest take up, LABEL brands have started to exhibit meaningful growth, +c. 70% yoy as the range of brands has increased substantially.

This overseas growth is valuable. Digital marketing spend has been doubling annually, with sound return on investment; the business is generating £1.53 in incremental orders within the first year for every £1 spent on digital marketing. Assuming a 40% gross profit margin implies a 20-month gross profit payback on each £1 spent on marketing. Overseas customers spend 20% more each year on average; a customer spending £100 in year one spends >£350 p.a. in year seven. Despite the attractive unit economics on digital marketing initiatives, almost 90% of new customers are still acquired organically.

Total Platform is the most nascent, and potentially most valuable opportunity. The LABEL leadership team is responsible for developing client relationships for Total Platform, leveraging pre-existing relationships with LABEL partners. Next's first Total Platform customer was Childsplay Clothing, which sells luxury childrenswear. While [www.childsplayclothing.co.uk](http://www.childsplayclothing.co.uk) looks like an independent brand, part of the Total Platform proposition is to reduce friction of





signing up to a new website. Next account owners can sign in using their Next login credentials and Next credit customers can pay using nextpay.

Next's CEO summarised his thoughts on the prospects for Total Platform as follows:

*"Total Platform is potentially a very exciting business because what it does is it takes a partner brand and it allows them to plug in to 20 years' worth of investment that NEXT has made in its web systems, its marketing, its online warehousing, its distribution, whether that distribution be through couriers, through NEXT stores, through overseas networks, it plugs them into our call centres and gives them our credit offer. And that integration allows them to have a much more powerful and robust presence both in terms of U.K. online presence, their online presence overseas where they can tap into all the work that we have done to develop 70 different international websites for our business. We can put their product into those countries on websites that are translated, that deal in local currency and it takes specialist forms of local tender types, for example, cash on delivery in Russia.*

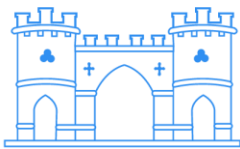
*They also have the advantage, if they want it, of being able to deliver their stock through our stores. We know that 50% of our orders are picked up in our stores. So, we think, the use of NEXT stores as a post office is actually a very powerful marketing tool, even more powerful as an easy way to return stock."*

Next's brand aggregation business LABEL has made this possible. Next has been delivering LABEL stock from hundreds of third-party brands into its own warehouse for six years. To integrate that stock into Next's system, it is given a single unique identifier. This identifier allows Next to know who bought returned items and how they bought them so that customers can be refunded accurately, regardless of whether returned online or in a Next or brand partner store. Contrast the alternative available to brand.com seeking to grow sales profitability via outsourcing aspects of the value chain independently. A new website built from scratch needs to be integrated into the seller's warehouses, credit systems, customer account systems and call centres.

The cornerstone of the Total Platform proposition is the reduction of business risk facilitated by swapping fixed costs for a single commission structure. A commission structure which aligns the interests of Next and the partner brand. 2020, perhaps more than any year in recent history, may have brought the benefits of such a cost structure into sharp focus for retailers mandated to shut their doors all over the globe. And even in times of rapid growth, Total Platform eliminates the growing pains of step-ups in fixed costs and major capital investment projects to expand capacity and customer support. In this way Next's vertical integration can lower partner brands' capital intensity. The utility of business resilience is particularly high in the volatile fashion industry.

AS Next scales this business, the proposition becomes increasingly compelling due to the size difference between Next and the partner brands. A 50% step change in call centre or warehouse capacity for a partner brand might be achieved by a mere 1% increase in Next's volumes. In addition, Next's longstanding reputation, physical high street presence and high customer





satisfaction may serve to lower Next's costs of customer acquisition and retention vs. third party brand partners, particularly smaller and emerging brands for whom Next's Total Platform proposition may be especially compelling. It also allows newer and emerging brands to focus on what they find interesting – designing and creating great products, and delighting customers, rather than the unseen, but crucial, components of a retail supply chain, such as data security, call centres or warehousing.

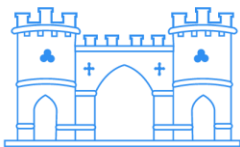
Capital will be increasingly directed to servicing online demand. Management forecasts modestly lower capex over the next five years vs. the previous five. But warehouse and systems capital requirements are set to rise dramatically with store capex falling to levels commensurate with maintaining, rather than expanding, the store estate.

So, what kind of returns can these internal investments generate? 18p of capacity investment is increasing annual sales capacity by £1, and the operating margin on online business is running at c. 18%. Incremental returns of c. 100% are attractive indeed. Of course, this fully loads the operating expense base into the new profit pools generated from these investments. If we use the group gross margin of 40%, incremental returns are north of 200%. Achievable rates are likely between these two percentages; the point is that incremental returns are very high, and capital can be reinvested at substantially above opportunity cost levels. Next currently earns returns on non-lending capital employed of more than 100%.

As for increasing the lending book, this too is valuable. Next uses group borrowings which cost 3-4% to lend to customers at a rate of 24%. Next generates almost £300mn in revenue pa from its £1.2bn lending book. Assuming its current 85% debt funding mix, it earns c. 70% RoEs in this business. The low cost of servicing this business is due to that fact that it serves existing retail customers, three quarters of whom have been shopping with Next for more than five years.

Now for the bad news. We hope the priorities for the use of cash in this business will change. For 15 years Next has been repurchasing shares and issuing special dividends due to a limitation on the amount of capital that can be internally deployed into value accretive projects. Today, Next can use that capital to help smaller, more capital constrained brands with a higher funding cost, and in so doing become the operating system of multi-brand, omnichannel retail. For many publicly quoted UK businesses, capital allocation agendas are set by a low-quality institutional investor base requiring sustained annual dividends to satisfy their marketing-led investment remits.

Prior to 2019, Next's preference for returning excess cash to shareholders was a result of its inability to deploy capital profitably in overseas markets. But two years ago, that changed. The company is getting better at targeting those customers who will like Next's clothes. And Next has found distribution partners capable of delivering high quality service at attractive unit economics. The result is that from 2019 Next has been earning supernormal incremental returns on investments in these areas; c.100% IRR for UK digital marketing campaigns and almost 400% for Overseas campaigns. Extraordinary circumstances such as these provide the perfect opportunity to reset the capital allocation agenda and really lean into the online opportunity that few others are so well positioned to exploit.



Scale is a more important driver of success in online vs. offline business models, especially for working capital light marketplace models. Scale drives advertising efficiencies: large scale, reputable retailers will win Google and Facebook auctions with lower bids due to better quality scores – that is, high customer satisfaction and strong brands increase click through rates. Scale also lowers shipping costs via volume discounts on last mile delivery. Scale begets scale; this is responsible for the winner take most market structures of most online categories.

Unfortunately comments from management such as “We recognise the importance of providing our shareholders with consistent and reliable dividend returns” and “We remain committed to paying dividends to our shareholders once the crisis has passed and do not anticipate any long-term change to our dividend policy” may mean that catering the existing shareholder register inhibits total EVA that can be generated by the company over the long term.

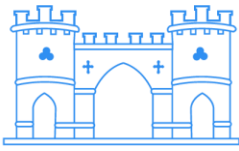
Given highly able management and the huge optionality embedded in this business; that is, the opportunity to become the operating system of multi brand, omnichannel retail, why pay dividends and buy back shares? The IRR on these activities is likely to be low compared to internal business investments that could lead to quite extraordinary industry dominance. This may be particularly true at this juncture, in such a period of competitor distress and disarray.

See for example the considerable business progress of Farfetch, progress that accelerated in moments of maximum stress, such as 2009 and 2020. That company’s capital allocation agenda is designed to widen a set of unfair business advantages so that their assets become increasingly hard to replicate. It is this type of anti-fragility that we see with Next. A company whose competitive position has been strengthened by COVID-induced retail business failures and accelerated online shopping habits.

Perhaps we have misappraised this opportunity. Or perhaps capital allocation choices at Next are governed by factors other than simply long-term business value compounding. Presupposing directionally right analysis of Next’s opportunities for value accretive investments, capital returns to shareholders could diminish the value of optionality embedded in Next’s equity price. Dividends are typically paid by businesses caught on the wrong side of time. Next could be a special business for the future.

Next’s market cap was £8.5bn when we acquired our interest; the quoted value of the enterprise including finance receivables was £9.5bn, vs. FY20 EBITDA of £1.1bn, or 8.5x EV/EBITDA. In FY20 Next generated £6 in FCF per share; we paid a 9% yield for our shares. Of the c. £800mn Next generates in FCF, around £130-140mn is spent on sales and marketing. We estimate Next comfortably generates more than £1bn p.a. in pre-tax owner earnings, a 12% yield to current price available to equity owners.

This valuation, which anticipates no growth or value neutral reinvestments, together with Next’s outstanding track record of economic progression and shareholder value creation amidst a challenged industry backdrop, mitigate against substantial loss of capital for equity owners. Meanwhile Next may be uniquely placed to leverage existing assets to exploit optionality and



become the operating system of multichannel omnichannel apparel, beauty and homeware. And to do so on terms that are extremely valuable to owners, customers and sellers alike.

One of Tollymore's largest holdings, **Farfetch (FTCH)**, is a global luxury digital marketplace for brands, retailers, and consumers. The marketplace connects 2.5mn active consumers in 200 countries to 1.3k sellers across 50 countries, including 500 direct brand e-concessions. FTCH is the biggest online destination for luxury in the world.

The consumer proposition is predominantly range of merchandise and curation of supply. But also localised websites, multilingual customer support and same day delivery in 18 major cities. Accessibility to global products is evidenced by consistently >90% of transactions being cross-border. Shopping for luxury products via FTCH's website or app enables customers to search by designer, category or keyword, is available in multiple languages and accepts multiple payment methods.

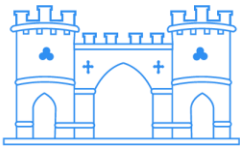
80% of products sold online are in a multi-brand environment. This is evident in brands' historic willingness to have e-concessions in department stores – that is where the footfall is. But the value of a fashion marketplace goes beyond choice. As a marketplace, rather than an inventory-owning retailer, FTCH can better curate products for consumers. FTCH can more rapidly test and iterate messaging, content and SKUs; purchasing inventory would slow this down. A large SKU count also makes it easier to satisfy consumers' desire for 'newness' via daily product additions and the ability to offer new/more extravagant products without inventory risk.

A compelling supplier proposition seems to be evidenced by: the large number and strong growth of brands and boutiques on the platform; that 98% of retailers have done so exclusively; and FTCH has retained all top 100 retailers and all but one top 100 brands over the last five years despite strong supply growth.

What are the reasons for this? Access to 2.5mn customers across the globe, on a fully managed basis; that is, everything from content creation to last mile delivery. An online offering helps brands reach new audiences, increase visibility, and expand their presence into new geographical locations without the need to invest in retail infrastructure.

The price for this is a 30% take rate to FTCH. This is high by the standards of marketplace business models. But it seems to economically be a better deal for brands, no longer required to pay the retailer margin. Under traditional linear industry economics, a product costing \$20 may sell for \$100. The retailer typically keeps most of the \$80 mark-up, perhaps around two thirds of it. The brand margin is therefore c. 25%. For a brand selling directly on FTCH, this might double to 50%, what is left after the product cost and FTCH's 30% take rate are deducted from the retail price. Brands can achieve incremental sales by making their inventory available to a global luxury audience without increasing their invested capital or diminishing their returns on capital.

Brands have full control over visual representation and pricing. FTCH allows access to a targeted luxury customer base, mitigating potential concerns around brand dilution. Increasingly FTCH is overcoming challenges faced by emerging brands such as brand exposure and limited reach.



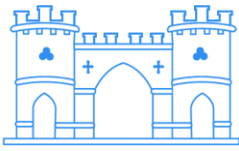
FTCH's marketplace offers a place alongside leading luxury brands, lending credibility to the emerging brand and providing access to luxury consumers, who, in turn, are attracted by the opportunity to discover under-the-radar, exclusive, emerging brands. This potential flywheel has opened because of FTCH's purchase of New Guards Group, a brand incubator. The market reacted to this acquisition by cutting the stock in half, a price decline that piqued our initial interest. The NGG acquisition helps FTCH to provide more choice, including exclusive products from emerging brands. That is, to drive engagement through limited supply.

Like Next plc, Farfetch is embracing the omnichannel advantage. But unlike Next, FTCH's distribution is largely decentralised and offline sales are made via partners' stores. FTCH has c. \$5bn of inventory available to its customers, which has two channels. For the online channel FTCH represents most online sales for sellers. There is also a compelling *offline* advantage to being on the FTCH platform: you become a distribution partner. That is, FTCH will distribute through those fashion boutiques that are on their platform, sending footfall into the stores, creating offline selling opportunities not available to non-FTCH partners.

Customer orders are directed to a boutique based on proximity, cost of delivery and fulfilment record. This model is scaling successfully due to the absence of strong local incumbents. FTCH has not needed to build supply and demand in each market; the distributed model arises from the value of SKU range. It is also resilient: 85% of SKUs are available from multiple sellers within FTCH's supplier network. FTCH can therefore tap supply from wherever it is. However, it is more expensive than centralised logistics, in which multiple items ordered on the FTCH website arrive in one box when processed through a Fulfilment by Farfetch facility. FTCH has six Fulfilment by Farfetch warehouses, which are 3PL and therefore have no associated capex obligation. The main 10-20% of SKUs are available in these centralised warehouses.

The high take rate is supported by high gross profit products and a fragmented supply base characterised by family-controlled companies seeking to protect brand integrity. In addition, there are some more subtle characteristics of the luxury fashion industry that may be creating special unit economics. Typically, ecommerce marketplaces grow scale and compete partly on price. This is not how to build a sustainable ecosystem in the luxury industry, in which decisions are a function of emotion, personal identity and scarcity. This translates to a \$600 AOV, a 30% take rate, and mature cohorts delivering > \$100 per order contribution/55% order contribution margin. LTV to CAC payback of fewer than six months makes investing to grow the active customer base by 50% each year the right capital allocation choice. Finding luxury customers is a costly endeavour, but when they are found there is an immediate payback on CAC. FTCH has run promotions in the past, but today seems to be increasingly focused on increasing the loyalty and therefore value of the customer base and allowing the brand full control over price setting. This seems consistent with sustainable value creation vs. ephemeral but expensive revenue support.

Is this a symbiotic value chain? That is, is there a non-zero-sumness to the sharing of value creation in which suppliers, customers and owners enjoy win-win-win dynamics? It is not immediately obvious FTCH passes this test. The superior economics of FTCH to brands may result in pressure to disintermediate boutiques. There seems to be a clearly compelling



proposition for brands and consumers, but the proposition for retailers seems to be less clear. In particular, the margin that needs to be surrendered (and ceded to brands) by being on FTCH's platform vs. the traditional linear industry model. In return for this margin dilution the retailer receives a range of valuable services such as access to a global luxury audience (which also increases the probability of full price sell through), data insights, logistics, outsourced customer service, and the omnichannel offline footfall described earlier. But given the opportunity for the brand to disintermediate the boutique and take all the margin, why would a retailer happily sign up for this, and what sustains their future in the value chain under a marketplace model?

More brands seem to be bypassing retail partners and exploring a direct-to-consumer model. The reasons: larger profit margins and stronger customer relationships/insight. Brands have increased in FTCH's mix, now 50:50, a trend which management expects to continue.

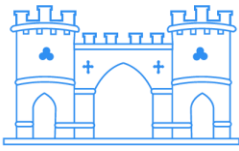
One aspect of value chain symbiosis is FTCH's supply chain capabilities provided to platform partners, such as content creation and global fulfilment, integrating global logistics partners in a single interface. Thus, as with Next plc, there are interesting comparisons to both Amazon and Shopify here.

The following anecdote, from Frederic Court of Felix Capital, FTCH's earliest VC investors, suggests the presence of a non-zero-sum value chain:

*"I am often asked for anecdotes about Farfetch and the story so far, there are many special moments but here is one that resonated particularly strongly when it happened, at one of the company's "Gatherings". José had pioneered the event early in the life of the company, to cement the relationship with our key partners, and create a stronger sense of community, gathering all the boutique owners and brands to Porto or London, once or twice a year for a couple of days (hundreds of people connecting). This was a great opportunity to meet many boutiques and brand owners, to explain the development of the Farfetch platform, and get feedback from users. A couple of years into the investment, one of the first boutique owners to have worked with Farfetch (and still a partner to this date) came to me at a Gathering and said: "thank you, for investing in Farfetch and saving my store". Without Farfetch his store would have closed because of the recession and he was grateful that we had funded Farfetch, which ended up rescuing his business from the recession. This was an emotional moment illustrating how critical the platform had been for many boutiques at difficult times, reinforcing the mission of the company, and all its stakeholders, to connect fashion lovers and make those products more accessible".*

### **Unfair advantages are numerous and growing.**

Network effects are two sided and global. More brands and boutiques on the marketplace increase the choices available to consumers, and more consumers increases the potential sales for sellers. The network effects are global. That is, the total global SKU variety is a factor in the consumer proposition, and the total luxury consumer base is a relevant factor in determining value to a seller. This makes these global network effects more difficult for entrants to overcome via clustering strategies. Consumers prefer to shop in a multi-brand environment, and FTCH



offers more brands to consumers than any other luxury destination. In addition, the economics of distributing via FTCH are more appealing to brands than retail, which typically will take half of the retail price as a gross profit, vs. FTCH's 30% take rate. Finally, they retain control over how their products are presented and priced with FTCH vs. a multi-brand retailer. The appeal of control is particularly strong in luxury because in times of depressed cyclical demand, retailers will seek to unload stock via discounting which erodes luxury brand value. Luxury brands therefore seeking to complement their brand.com presence with a multi-brand channel find FTCH to be the most appealing option. As more brands make this choice FTCH's multi-brand proposition strengthens. Recent evidence supports the notion that this advantage is widening: FTCH's top 10 brands, which includes Gucci, Prada and Fendi, have more than doubled their direct stock on FTCH yoy. And on the demand side active customers are increasing >50% yoy.

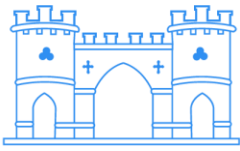
Fragmented supply increases value of a marketplace: 19 of the 20 largest luxury fashion brands by revenue are in Europe yet address global demand. Large brands access demand by building expansive networks of directly operated stores and through department stores. Emerging brands typically have no route to the global market. They rely on wholesale distribution through a network of independent fashion boutiques. As a result, luxury fashion inventory, from both larger and smaller brands, is distributed across a highly fragmented network of luxury sellers. FTCH has c. \$5bn of third-party inventory (not owned but available for sale) sitting in thousands of stores across the >50 countries from which supply is sourced, leading to multiple combinations of shipping routes and logistics providers. The e-concession model means that the same warehouses that serve brand.com serve FTCH. This happens with 500 concessions and FTCH taps directly into the brand's inventory without acquiring it. Thus, some of the acceleration in revenue that FTCH has recently experienced was a result of these brands prioritising their direct-to-consumer sales.

Established partner relationships are hard to dislodge. In seeking to preserve brand integrity, luxury brands have historically been reluctant to partner with an online retailer. FTCH has developed relationships with the leading luxury families to overcome this reluctance by, for example, allowing control over visual representation and pricing. As a result, these brands have agreed to partner with FTCH on an exclusive basis – 80% of items listed are exclusive to FTCH – and FTCH has 8x the number of SKUs of its nearest competitor. It is now likely much more difficult for a new entrant prise these relationships away.

FTCH is the only scaled luxury marketplace. However, it faces competition from technology companies enabling ecommerce e.g. Shopify; online luxury retailers which hold inventory and ship from centralised warehouses, such as YNAP.com; and multichannel retailers. Richemont, the owner of YNAP, removed YNAP founder and CEO Federico Marchetti in March 2020 amidst reported frustration in YNAP's lack of profits. With seeming competitive disarray, FTCH continues to invest ever increasing dollars at widening its business model advantage.

There is another subtle but significant advantage of marketplace over retail: FTCH's marketplace model confers an important and widening advantage vs. linear retail peers. FTCH's technology is integrated with the stockpiles of its sellers. FTCH therefore has access to data from traffic and





sales not only made through the FTCH platform, but also offline in its boutique and brand partners' stores. This information can be used to make FTCH's services more valuable to more engaged consumers, but also to provide aggregated feedback to sellers.

Like Next, Farfetch is investing in further integrating itself into the luxury value chain through Farfetch Platform Solutions (FPS), a white label ecommerce offering. On the front end, FPS creates global websites, apps or WeChat stores. Back end services allow retailers and brands to synchronize their websites with in-store and warehouse inventory, both from mono-brand stores and other suppliers in their distribution network and facilitate in-store pick-up and consumer returns. Layered on top are services such as marketing, localisation, production and warehousing. These white label solutions are being provided for Harrods in the UK and 20 other clients.

Also like Next, FTCH is demonstrating anti-fragile business qualities. FTCH's boutique suppliers have faced mandated retail store closures due to COVID 19 restrictions, and have suffered from a material decline in tourists, particularly from China. FTCH's revenue growth accelerated in 2Q20 as these boutique partners sought to access luxury fashion consumers across the globe. COVID has helped to increase demand too: FTCH saw a spike in app downloads in the first quarter, especially in China in which app downloads more than doubled yoy. Chinese consumers represent more than one third of luxury consumption, of which typically 70% is made while traveling. That is \$70 bn of personal luxury goods purchased by Chinese nationals while traveling outside Mainland China. Demand, which, with all else being equal, seems to have been repatriated online with huge drops in international travel in 2020. Likewise, FTCH's FPS customers, such as Harrods, were able to continue serving customers during lockdowns.

### **Expect high reinvestment rates and incremental returns.**

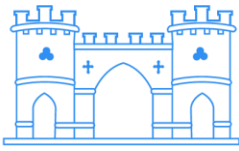
FTCH has a large, growing addressable market driven by online penetration, opportunities to carry adjacent products, exceptional unit economics and evidence of operating leverage.

Luxury fashion transactions are increasingly online. Over the last decade online penetration of luxury sales was c. 2% and has grown 20-25% pa. According to Bain online now accounts for 12% of the global \$330bn luxury sales market, with customers increasingly influenced and enabled by digital channels, including in their physical purchases. 75% of luxury transactions were influenced by the online channel, and almost a quarter of purchases were digitally enabled. Bain expects online to become the number one channel with 28-30% market share by 2025.

Bain expects the global luxury market to be worth >€350bn by 2025, driven by growth in Chinese consumers, online channel and consumers younger than 45. This might imply a >\$30bn online commission pool, c. 85x FTCH's revenues. FTCH's current share of the global market for personal luxury goods is c. 0.3% of the estimated total addressable market.

FTCH has the right model for industry domination. FTCH does not compete with any other large luxury marketplace. Its competitors are online brand ecommerce, omnichannel multi-brand stores and online multi-brand retailers. Jose Neves is playing for winner take all: *"I believe a*





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*single company will orchestrate this revolution in the conversion of offline and online luxury retail because, even if multiple retail-tech vendors emerge, the new technology will have to be adopted both by retailers and consumers. We believe consumers will always gravitate to one single app, forcing vendors to gravitate to one single platform, most likely a platform that has already built consumer-side critical mass and benefits the entire ecosystem. This all translates into a potential \$450 billion addressable market for Farfetch, which, as the operating system for luxury, we want to transform, empowering individuality for consumers, curators and creators of fashion."*

Despite a clear understanding of FTCH's advantages, attractive unit economics and long runway for demand generation investments, management does not have a 'growth at all costs' mindset. Jose and Jordan have frequently reiterated their focus on protecting margins and strongly growing the profitability of the business, which they expect to be EBITDA break even this year. So far, the demonstrable operating leverage in the business lends credibility to these ideals.

Despite more than quadrupling in value since we originally acquired shares at \$14, the rates of returns we expect to earn on our ownership remain high. An estimated \$500mn of owner earnings are being invested into demand generation efforts that are yielding materials ROIs. Assuming a three-year customer lifetime and one order per year would imply incremental returns north of 30% and an IRR on the equity of \$20bn north of 20%. Assuming a five-year customer lifetime and one order per year would imply incremental returns north of 50% and an IRR on the equity of around 40%.

The quoted price remains inconsistent with the deep reality. FTCH has a large and growing addressable market, a differentiated business model, high barriers to profitable participation, a win-win value chain, great unit economics and a capable, aligned leader.

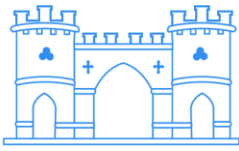
Thank you for your partnership,

With my best wishes.

Mark



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## Appendix: Interview with Good Investing TV

The following transcript is from Tollymore's interview with Good Investing TV in September 2020, which is available to watch [here](#).

**Tilman Versch 00:05**

*Hello everyone! Welcome back to our livestream session. This time I'm very happy to have Mark Walker of Tollymore here. Hello, Mark! How are you doing today?*

**Mark Walker 00:18**

*Hi Tilman, I'm really good. Thank you for inviting me.*

**Tilman Versch 00:22**

*You are located in London, right?*

**Mark Walker 00:26**

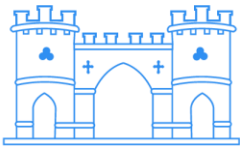
*Yes, my offices are in London. But I actually just moved my family out of London to a place called Kent, which is just outside. Because we decided that a global pandemic wasn't really stressful enough for us. So, we decided to move house at the same time to spice things up a little bit. So, I'm actually located at my house in Kent at the moment. But our offices are located in the centre of London.*

**Tilman Versch 00:53**

*Brexit is also a topic we should discuss during our live stream. I also want to say "Hello" to all of our viewers. As always, you are welcome to drop your questions into the chat box so I can pick them up and pose them to Mark during our livestream. Mark, before I show the disclaimer, I want to give you a question you can think about for a moment. The question is: What is good investment for you? You have some time to think about that and for everyone else, you can again enjoy the disclaimer. You can find it below in the links section. The main message is: "Do your own work, this is no investment advice. We are having a qualified conversation. You always have to do your own research and that is also the interesting part". So, without further ado, what is your answer, Mark?*

**Mark Walker 01:56**

*Well, first of all, thanks again, Tilman, for asking me to have this conversation. I think what you do is in a clear spirit of intellectual generosity. I've had this uneasy sense of embarrassment at being part of an industry that I've felt for quite a long time now has really done a pretty bad job for its customers, which are the owners of capital. What you and people like you are doing in a very value-added way is to shine a light on those individuals, those investors, those managers, that community that are trying to forge a different path, which in many ways is non-institutional. They are trying to think carefully and thoughtfully about how to set themselves up to create*



*value over time. And so, this light that you are shining on them and the support that you are giving them is very, very valuable. Because there are lots of barriers to small thoughtful managers becoming sustainable. So, I just want to thank you on behalf of the community for that work that you are doing.*

**Tilman Versch** 03:20

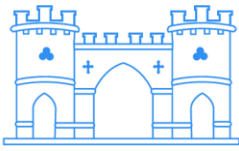
*Thank you. Thank you as well for coming here and sharing your insights and your wisdom.*

*The qualities of a good investment*

**Mark Walker** 03:26

*So, what makes a good investment? That is a huge question. I think that it's helpful to understand what Tollymore's central philosophy is. It's also instructive at the outset to clarify that I don't think that there is anything unique or exotic about this philosophy and I certainly don't consider it a source of edge. It's a philosophy that has three principles.*

- 1. One is that we are trying to exploit a time arbitrage over time in the public markets with a very simple goal of maximizing intrinsic value of a group of assets over a long period of time. What that typically involves and the reason why that is through a mechanism of public equity investing rather than private business ownership is that we can buy securities from sellers who are selling for non-fundamental reasons. Because they have not set themselves up, they don't have an ecosystem that's consistent with executing a long-term strategy. The obvious examples might be because they have misaligned LPs or they have short investment horizons because of all manner of constraints on their ability to make good decisions. And so, we want to buy the securities from those people.*
- 2. Secondly, the implementation of that philosophy, the goal of maximizing intrinsic value of a group of companies is predominantly through ownership of companies that can compound their own values through their own efforts over the long run. That necessitates a level of self-awareness and recognition that we might not be that great at actually managing a portfolio, but if we can pick the businesses that can do the work for us, that is a less labour-intensive and more efficacious route to a good outcome.*
- 3. The third aspect of our philosophy, our goal is to maximize intrinsic value of a group of companies. If our goal is to be in this IRR hall of fame, it's absolutely imperative that we understand and cater for how we permanently lose money. And so, there is a risk framework that informs what we are and what we are not, that is from two angles that we consider permanent loss of capital to be a potential outcome. One is through the holding companies themselves and we look for businesses that have a number of lasting unfair advantages, that is that they can protect and hopefully grow their enterprise value over time. Secondly, we look for those companies who are appropriately capitalized so that that intrinsic value growth over time accrues to owners rather than lenders. Finally, we are trying to acquire those businesses at prices, which means that our IRR as an equity*



*owner of the business is at least as good as the intrinsic value compounding of the company.*

*That is the overall philosophy, but as we might discuss, my experience to date has led me to believe that there is a sort of lollapalooza of institutional constraint to just executing that philosophy, even if the rhetoric of long-term investing is well-understood and well-versed. You asked, "What makes the best investments?" Well, we've made a distinction over time in obvious versus non-obvious business excellence. Frankly, we've done a pretty poor job of generating acceptable results by investing in obvious excellence. Principally because that excellence is generally reflected in asset prices. What I find is that it is often these kinds of multiple small, mispriced insights that compound to form a business which is very defensible and very difficult to replicate. The discovery of those multiple small insights really requires a bottom-up organic idiosyncratic investment process.*

*What I find is that it is often these kinds of multiple small, mispriced insights that over time compound to form a business which is very defensible and very difficult to replicate. The discovery of those multiple small insights really requires a bottom-up organic idiosyncratic investment process.*

*Those opportunities are really what is missed by some investors who label themselves as quality managers, because they are inappropriately attaching labels such as 'network effects' or 'platforms' or 'recurring revenues' or 'SaaS' or 'working from home stocks' or whatever the heuristic of the day might be. And so, what's really crucial to us in unearthing these non-obvious moats is a first principles approach to understanding business characteristics and unit economics and the description in a first principles way in our research which leads us to conclusion of whether or not this business is of high or low quality along the vectors we use to define that. That is much broader than simply competitive positioning, for example.*

### ***Long-term investing***

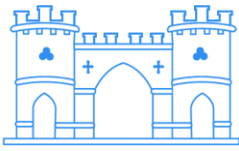
***Tilman Versch 09:05***

*You mentioned the word 'long-term'. How do you use it in your practical approach in investing? What is long-term for you?*

***Mark Walker 09:15***

*One of the things I talked about was that we have a risk framework which means that long-term is a risk mitigant, because it allows us to focus on those businesses that are very high quality and be reasonably agnostic as to over which period of time the value is created and we can be very patient for long-term holders of companies to realize that value. One implication of that is that we for example don't short securities.*

*I think that having an unlimited downside and uncapped upside is inconsistent with our ability or our willingness to take a view, which in some cases is very well beyond five years. I think if you are a short seller and you consider that a business is worth zero, effectively, then you need to be*



*right on a horizon which is shorter than five years if you are willing to accept an opportunity that cost of capital which we are willing to accept. In fact, if Tollymore's historical results are your opportunity cost, then that is much shorter. If you are trying to achieve an outcome that is 50% lower than the current price, again your horizon maybe turns into 18 or 24 months. To us, that is a very labour-intensive and hard thing to do. We've learned over time to try not to disrupt the positive fundamental business progress of the companies that we own. That has also then informed the source of capital that we have used to average down in businesses whose quarter prices aren't doing so well over time.*

***Origin of the name Tollymore***

***Tilman Versch 11:12***

*What is the history of Tollymore and what is the meaning of the castle you have behind you?*

***Mark Walker 11:19***

*I grew up in Belfast in Northern Ireland and Tollymore is a forest that our extended family spent a lot of time growing up in. It's a really beautiful place, it's at the foot of the Mourne Mountains in Northern Ireland and overlooks the Irish sea. It's a place that is at the tip of the hat from me to my heritage. It's something that holds very happy memories for me. There is no real clever association with the business of investment management.*

***Tollymore's success in 2020***

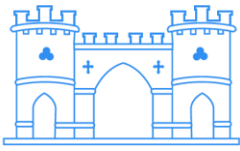
***Tilman Versch 12:05***

*There doesn't need to be! You did a good performance until 2020. When I looked in your fact sheets and letters, I saw this performance; it was good. But in 2020, your performance was even better. What happened for you this year?*

***Mark Walker 12:26***

*While being very cognizant of trying to extrapolate or interpret short-term results in this way, I'd say 2020 has been a really important year for Tollymore. Because what our investors are doing is underwriting my business judgment and underwriting my investment judgment. But they are fully aware that the business of investing, the process of investment learning is never finished. We are hopefully on a treadmill forever, as long as our mental and physical capacity allows us to do so. And so, this is a period of rapid learning for a lot of people, I think. While Tollymore has had a consistent investment philosophy and a process, that helps us to govern our behaviour on a day-to-day basis in a manner that is consistent with that philosophy. I'm very aware that that is something that needs to evolve over time.*

*Investment decisions that we have made over time have evolved and the sources of investment results have evolved. Some examples, I think that earlier this year was the most volatile market in history. Clearly, it was quite a stressful time, but it was a really comforting time for me, because I've worked quite hard over the last few years for Tollymore to be one of these very*



*defensible non-replicable anti-fragile businesses in which I seek to invest. Some of the ways that I have sought to do that were to think about incentives within Tollymore. I think about the components of Tollymore's ecosystem, which include the physical working environment, the working partners that we involve ourselves with and our investment partners, our LPs. And so, I've tried to create a set of LPs who are very temperamentally aligned with the objectives. They are very unconventional by the standards of institutional active asset management. They have the capacity to certainly think and hopefully act in a counter-cyclical way. I talked before about an investment philosophy not being exotic or unique, but what I've observed in my more institutional experience prior to Tollymore is that there are so many constraints in large institutional active money managers. Whether that is the imperative to grow assets, whether that is the division of labour between portfolio managers and analysts, whether is specialization according to sectors or geographies, whether that is internal incentives and bonus structures, whether that is lack of insider ownership, whether that is misaligned LPs; there are just so many that prohibit the ability to make sensible decisions.*

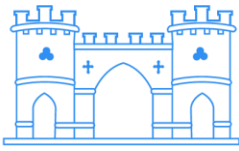
*One example is that in the face of quoted price volatility, as firm managers, have we set ourselves up? Do we have an ecosystem that allows us to either acknowledge our ignorance and the fact that we actually don't know what we think we know about this investment opportunity? Or does it allow us to recognize that we do know, and that the quoted price decline presents an opportunity to improve our IRR by lowering our cost basis and we can exercise conviction?*

*In March and April this year, as you might imagine, we frankly didn't need to look outside of the portfolio for distressed investment opportunities. Because there were plenty within the portfolio from which to pick. Some of our businesses were down 65-75% in a period of 4-5 weeks. A huge source of comfort to me was that our capacity was appropriate for the strategy. This is a capacity constrained mandate. Our investment partners are willing and able to think and act counter cyclically and able to not only not redeem but to step up to the plate and lean in. And so, what I realized was a real shame of asset managers; when they bend to the overwhelming incentive to grow assets, an incredibly scalable business model, what that leads to is when we have these retrospectively seemingly gifts, these opportunities to acquire businesses at lower prices, they are constrained from doing so for non-fundamental reasons because of liquidity or because they can't be a certain size of a company. When you have a portfolio, the positions in which are dictated by non-fundamental reasons outside of simply investment merits, you are doing a disservice to your investment partners. So that was very instructive.*

*One of the other ways in which a portfolio has evolved is that some of the biggest holdings of the portfolio are there for different reasons. One is there because we aggressively averaged down in this period. Another is there because it has done very, very well.*

*Tollymore is a concentrated portfolio and has a global remit. I think the natural implication of that is that we are a fully invested mandate. That's great for me, because frankly I'm unable and therefore unwilling to use cash as a mechanism to time markets. And I don't have to, because of a small portfolio of assets and a big opportunity set. But what that means is that when it comes to averaging down into certain businesses, we don't have cash with which to fund that activity. And*





*so, we need to decide between essentially cutting our winners or cutting our losers. I think increasingly we've been more comfortable with avoiding the disruption of fundamental business progress of the companies that frankly deserve to be larger portions of our portfolio and forcing us to choose between the losing investments that are eroding value; those that deserve our capital and those that don't. I think that some of the businesses have done very well. Some of the businesses are still 50-60% off their previous prices from the start of the year and they remain very core positions for us.*

***How to recognize good businesses***

***Tilman Versch 19:43***

*That's an interesting insight. You're investing globally and this is a bit of a challenge to boil down to the best ideas. What are your steps to boil down to the good businesses and the anti-fragile businesses you mentioned?*

***Mark Walker 20:04***

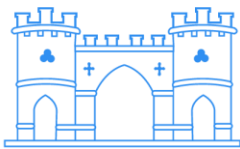
*The opportunity set is global. We're not global investors in the sense that we are trying to identify thematic changes or geographic opportunities from a top-down level and using that as a source of idea generation. As I said before, I think that it's really important that opportunities are discovered in a way that some might consider haphazard and because it's very serendipitous in nature. What we're not doing is finding ideas according to a systematic quantitative method such as screening. One of the reasons I've described, if you are looking for these businesses that are high quality according to our vectors of quality and you are screening over a period of time, what you are finding is obvious excellence and that is unlikely to be undervalued. But more broadly, the problem that we have with screens is that those who use screens cynically – coming back to this imperative to raise capital – are doing so partly to make the investment merits of their organisation more marketable in an institutional sense.*

*Institutional investors are typically – and rightly so – trying to understand the repeatability of a process to allow them to underwrite it. It seems that by showing a kind of quantitative or proprietary idea generation funnel you're helping allocators of capital to take tick that box of repeatability.*

*Our process is serendipitous in nature and it's really driven by energetic and passionate engagement with written and verbal materials and conversations with management and our peers and engagement with reports and transcripts and filings. If that is energetic and it is a highly motivated endeavour and if you are passionate and reasonably competent, it's a perfectly adequate way to uncover investment opportunities. Our issue has never really been that dearth of investment ideas. What we are trying to do and what we think should be repeatable is the judgment with which you interrogate that idea. That again comes down to what your incentives are and how you are resourcing the investment process.*

*Are you resourcing the investment process with a large highly pedigreed investment team? Because that is the way you raise assets. Or are you resourcing in a way that is most efficacious*





*and likely to do the greatest good for your existing cohort of investors? People in the industry have debated over the merits of screening. They will suggest that screens will, just simply by fishing in that pond, improve your chances of success because that pond will outperform in itself. My argument is that it may well have done so in the past, but there is no real guarantee that it will continue to do so in the future. Particularly when the screen is predicated on any kind of style factor type of investing, such as growth or GARP or value as value is typically understood. Especially considering these changing business models of the future versus the past.*

*If you look at our portfolio, there are a lot of companies that screen really badly there and some of our largest positions screen really badly. That's because the reported financials of the business poorly reflect the economic reality or the economic prospects of the company because of accounting convention or because of businesses in transition or simply because of high levels of internal reinvestment opportunities. And so, we attempt to sort of disaggregate between owner earnings and reported free cash flow, for example.*

#### **Criteria for high-quality businesses**

**Tilman Versch 24:42**

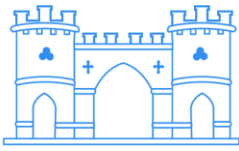
*What makes you kill an idea and what makes you like or love a company that you want to hold it for years?*

**Mark Walker 24:51**

*The bar is high in that we have a research process that gathers hopefully objective information, data, strands of logic which are designed to support or refute a contention that a certain vector of quality is high or low. So again, these are not proprietary or rocket science. A lot of them can really be found in The Warren Buffett Way:*

- *Is this business simple?*
- *Is it appropriately financed?*
- *Is the stewardship adequate or good?*
- *Is the competitive positioning of the business strong?*
- *Does it have avenues for internal redeployment?*
- *Does it have very value creative rates of return?*

*And so, we are collecting this information and trying to score in a pretty unquantitative but very qualitative way whether we think this is a high-quality business among these vectors. An idea will be killed if it becomes clear that this is not a high-quality business along these vectors. But if it passes those hurdles and we are very excited about the quality of the company and its prospects for internal capital and the excellence of its stewardship etc., we will assess the valuation from multiple angles. But oftentimes, through a lens of a prospective IRR to equity*



*owners which starts with an understanding of what the owner earnings yield of the business is and what the reinvestment rate and the incremental returns likely to earn are and that triangulation helps to get a rough idea of whether the IRR is really high or really low, for example. So, if we get this business that is screening to be a very exceptionally high IRR, that may be because of the reason I talked about before, which is that these cumulative mispriced insights are adding up into a business quality and opportunity is substantially undervalued.*

***Alignment of interest***

***Tilman Versch 27:10***

*Interesting. How are you aligned with your investors?*

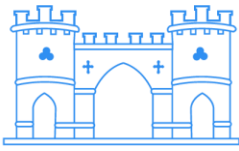
***Mark Walker 27:20***

*Richard Lawrence of Overlook has this phrase he refers to: 'Outlawing greed', which is a major competitive advantage in this industry but a path not really taken. I think if you can set up a set of investor incentives that allow you to outlaw greed and focus on returns above asset growth, you've taken a large step of the way there. And so, the way in which we've thought about that is to be very rigorous and disciplined about the investment partners that we take on.*

*We want a very small number of partners over time. I think everybody talks about the value of relationships in life but rarely actually implements that understanding and sacrifices it a lot of the time for rapid wealth accumulation and then wonders why they're not happy, given that sacrifice they've made.*

*The majority of my capital is invested alongside investment partners. Currently, Tollymore's economics for me imply that I will accumulate more capital from the compounding of my ownership of funds under management than from any fees that Tollymore has paid me. And then we have a set of fee structures that have been stress-tested under a range of scenarios to ensure that under reasonable circumstances investors receive not just the majority of the return over time but a majority of the alpha over time, a majority of the excess return over whatever reasonable benchmark they may decide. We have different fee structures; some with fixed hurdles and some with benchmark hurdles that investors have chosen. And so, if you look at our cumulative results, to date investors have received around almost three-quarters of the excess return over the benchmark over time. One of the things I've been thinking about more since the March and April period of 2020 is really "What is the appropriate capacity of the strategy?"*

*One of the ways to engender alignment is that you err on the side of caution and you close the capacity of your strategy comfortably below what you think the ultimate capacity of the strategy is. It's our intention to close the capacity to external investors and then to periodically allow existing investment partners to add if and when appropriate, if we have other periods of severe dislocation like March and April.*



### *How to invest in companies with emerging moats*

**Tilman Versch** 30:38

*We have a first question coming from the chat. If you have more questions, please send them in. The question is: Do you invest in businesses in the process of building a moat but not there yet? For pre-moat companies, historical numbers that you find in a screen look junky but the future could be very bright. What is your take on this question?*

**Mark Walker** 31:02

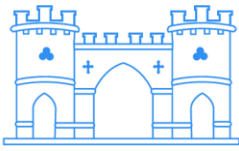
*I think it's completely consistent with what I was saying about obvious and non-obvious excellence. If I look at the contributors to Tollymore's results and the detractors from Tollymore's results, the major contributors are from businesses which at first sight are written off as low-quality businesses. That is usually due to a faulty heuristic and an inability or unwillingness to interrogate the business quality from first principles.*

*So, for example, many investors have written off Trupanion as an insurance company. The heuristic associated with insurance companies is that they are capital intensive, mature businesses with limited opportunities to internally redeploy capital and constrained addressable markets. I think that heuristic has led to a really outsized investment opportunity. If you think about the components of that company's value chain and how they cumulatively manifest in this really phenomenal business, you can avoid that heuristic.*

*Likewise, one of our largest holding, Gym Group, is an old economy operationally geared financially leveraged business selling discretionary services with very high churn. In a world enamoured with high multiple sales, SaaS companies and Big Tech, you could succumb to being a victim of this potential bubble in buzzwords by becoming overly enamoured with these labels if you are not interrogating from first principles what a good business is and what a poor business is. Those types of opportunities have contributed strongly.*

*We have done badly in two main areas. One is we have identified obvious excellence and we've become enamoured by this beautiful financial history going back 10-30 years of extraordinary super normal - consistent, super normal profit generation. The second area is in what is often called legacy moat type companies.*

*Back to our goal; our goal is to maximize the intrinsic value of a group of assets. There are two ways of doing it, one is that you buy assets at very strong discounts to current intrinsic value. That necessitates a re-rating of the asset or a turnaround of its fundamental prospects. Potentially, that re-rating needs to be accompanied by a catalyst and that's a very labour-intensive method of generating acceptable results. When you're trying to identify a catalyst, I think that those catalysts are readily identifiable to most people. Therefore, it's unlikely that there's a big gap between price and value or a big gap between likely future results and expectations. And so, we've been poor at picking those deeply discounted legacy businesses despite our contention at the time that they were extraordinarily discounted.*



*By the way, we are not investing in businesses that fail to meet our objective qualitative criteria for quality. These are all extremely high-quality businesses, but they generally have limited opportunities to reinvest capital and internally grow their own assets. Over time, the results have been more and more driven by these businesses that at first sight – to answer the questioner's question – don't have a moat that is widening but it's not obviously huge, because there is no eloquent way of describing it because it's not an economy of scale or it's not a switching cost or whatever moat label you wish to use.*

### **Reasons to invest in Gym Group**

**Tilman Versch 35:31**

*You already mentioned two names: Trupanion and Gym Group. Can you tell us a bit more why you like these companies and why you invested in both? Also, how you managed your feelings because on one side, Trupanion is a huge winner, this year as well. Gym Group is getting squeezed and is one of the Covid losers, if you could call it like that. How do you manage to stick to both and how do you manage the loser and winner side?*

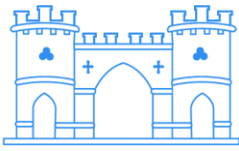
**Mark Walker 36:10**

*Gym is a business that has a large position because we bought a lot more and it's my view that our final purchases in March and April were purchased at IRRs of 60-70% and the owner earnings yields are at 35-40%.*

*Even pro-Covid, Gym is a good example of this very serendipitous idea of generation process. It was really discovered initially as a consumer experience where having been a member of a mid-tier large multi-site gym in the UK for a decade, I suddenly started seeing that mid-tier gyms started closing down and these low-cost gyms from Gym Group and a business called Pure Gym started opening up sites increasingly. When I just looked very roughly at the profitability profile of these mid-tier private equity owned gyms and the low-cost gyms, it was very striking that these low-cost gyms were incredibly more profitable and their super normal profits were off the charts compared to mid-tier gyms. But their prices were 60-70% lower.*

*Having joined those gyms, it became clear to me that it was actually a superior proposition, it was a more enjoyable experience and the question then becomes "As a potential business owner, is this sustainable?" If you think about the positioning of the incumbent in this industry, what can the mid-tier gyms do? It's my view, looking at their margin profile, that they could cut their prices 10-15% before they become loss-making at EBITDA level in a capital-intensive industry. And so, their competitive response has been really muted, there have been some small efforts to launch low-cost alternatives that have been quickly wound down.*

*The source of the low-cost gym's super normal profits is that there is a margin superiority which is a function of lower labour intensity because there are only one or two employees per gym and there is an asset turn advantage which is facilitated by a few things.*



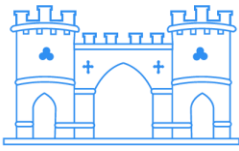
1. *One is that they don't have any wet facilities, so they don't have any saunas or steam rooms or swimming pools. They don't have any general coffee or greeting areas which improves the density of their site usage; their site utilization is improved. Another factor that improves their asset turns is because of the labour intensity and the technological tools they are using to admit people into the gym, they can open 24/7.*
2. *So, their assets are used more efficiently. The 24/7 capability is also expanding the addressable market to those gym users who are shift workers or taxi drivers or previously didn't have access to gyms that constrained opening hours.*
3. *They also addressed the other barriers to gym participation, which are around cost and people not being able to afford to pay 40-50 pounds a month for a gym and people are not signed into contracts with low-cost.*

*It's my view in a nutshell that this is a business with very, very high owner earnings as a percentage of its market cap there were substantially all being reinvested in projects that I felt were earning 20+% cash on cash returns in capital. Again, in this investment universe, these are unconventional sources of a company's competitive advantage. But Gym is also a really good example of a business that is almost a holy grail of public equity ownership, because it's a business that has been steadily compounding its economic value and its owner earnings over time. But there's a very volatile public equity associated with it.*

*So, since our ownership, it's basically doubled and halved twice and now it's 60% below again. So, it's below our original cost but it has contributed positively to our cumulative results because our average purchase price is lower than our cost price and it's been at a larger position in the portfolio when the stock has been beaten up. It presented a great opportunity in March and April, because in many ways the market very efficiently and aggressively recognized the shortcomings of this business model in a world where people are instructed not to leave their house, in a world where governments are telling gyms to close down. So, it's a business where its revenues literally go to zero. They're not selling services with any kind of pent up demand phenomenon and they have a very high fixed cost base. It took some back-of-the-envelope additional work to re-underwrite our ownership of the company through a lens of liquidity first. My view was that this was a business that was just absolutely not going out of business.*

*Actually, their capacity to flourish at the other side of this is really, really attractive for a number of reasons.*

- *One is that their relationship with their landlords is likely to improve because of the dearth of retail or restaurants seeking leases.*
- *The other is that most gyms are either local authority gyms owned by the government who have been heavily subsidizing whenever there is a funding crisis or they are mom-and-pop fragmented highly levered single sites with weaker relationships with real estate landlords.*



- *Finally, the recessionary or cautionary conditions that Covid is and is likely to continue to confer could well accelerate this migration to low-cost gyms that don't tie people into contracts.*

*So, in a nutshell, you've got this capital cycle potential outcome where capacity is exiting and demand is increasing. If you believe that they have the liquidity and balance sheet to survive a period of extended lockdowns – back to one of your earlier questions: "What is long term?" – this is a classic time arbitrage opportunity where their results are likely to look pretty horrible for a while. But to my mind, they're one of the best capitalized players in the industry and their prospects for incremental returns of capital have probably gone up over time. I'll just pause there without diving into Trupanion. But if you have any questions, we can talk about it.*

### ***Gym Group in a post-Covid world***

***Tilman Versch 44:07***

*Yeah, there were two questions coming up. One is: Do you see Gym Group as a winner in a post-Covid world and do you see any other winners in the fitness space as well? Another question was: Do people's habits change? People get used to train outside the gym and after Covid, there is a high chance they won't come back to gyms, so this might be a problem for Gym Group.*

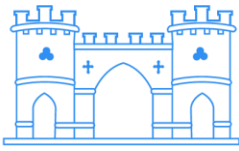
***Mark Walker 44:47***

*Other winners, the other main low-cost operator is Pure Gym, which is a private business. I think that you may well have this sort of barbell evolution where there's low-cost and then there are premium gyms where people really, really want that swimming pool or that tennis court or that boxing ring.*

*I think that there are potential parallels to be drawn with low-cost airlines or supermarkets where these propositions are initially low-cost and then they simply become the mainstream. I think the proposition gap between mid-tier and low-cost is so substantial that the market share opportunity is very clear. And as I said before, there is a market share opportunity driving volume and there is also an addressable market expansion opportunity, driving volume of a third of customers. Every year, new customers for Gym and Pure Gym have never used a gym before. Because they're addressing these barriers. That addresses a little bit this challenge of a structural change where people train at home. But I'll come back to that.*

*So, the other winner I think is likely to be Pure Gym. What you see is that Pure Gym and Gym are really accounting for the vast majority of new gyms and new members in the UK. The evidence so far since gyms have opened is that very quickly, gym memberships and visitors are returning to almost pre-Covid levels. I'm more comfortable betting on things that are likely to remain reasonably unchanged rather than calling a structural inflection in human behaviour. I think that Gym's share price reflects either an anticipation that the business will not survive and lacks the liquidity; I think that's absolutely very comfortably refutable. Or that people just aren't going to visit gyms anymore. I think the evidence so far does not support that and I think the logic also doesn't support it.*





*As a user, my experience has been pretty consistent with other people's experience when gyms close down. Which is that I switch to an app, which by the way was offered in partnership with Gym Group and I used that app to try and train at home. At the start I was very enamoured with the experience, I thought it was a very high production quality experience. But after 3-4 weeks, despite having this huge library of exercise classes and different trainers and so forth, I basically became a bit bored. Unless you have the capital and the space and the time and the willingness to set up a fully functioning gym with all manner of equipment and unless you are permanently willing to forego the social experience involved in training with other people and using that a source of inspiration, I think it's unlikely that people won't return to gyms. Potentially, the addressable market doesn't grow as quickly as it was growing before but I think for the reasons I've articulated that the market share opportunity is larger than what it was before.*

*And so, I think you have a future in which Gym's competitors are very distressed. You've seen that in high-profile bankruptcies over the globe and in some cases, you've seen low-cost business models in continental Europe, such as McFit, acquiring those assets. I think Gym Group as the best capitalized business in the sector certainly has on its radar opportunities to acquire those businesses. It also has on its radar potential premium site acquisitions that were previously not meeting its return invested capital hurdles. But now, because of the real estate situation, it will be able to contribute to profitable site growth.*

**Tilman Versch 49:29**

*I think there's also a certain desire to go back out again after Covid is over, because everybody is frustrated being at home.*

**Mark Walker 49:40**

*Yeah, it's just the value of having a long-term lens. In this case, I don't even think it needs to be that long-term. If you just think "What is the likelihood that in another 18 months Gym is not somewhere around its previous level of utilization and unit economics, if not in a better position?" The business today is 25% owner earnings yield, reinvesting all of that at 20% returns in capital.*

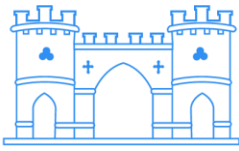
**Tilman Versch 50:16**

*Interesting opportunity. Shall we switch to Trupanion?*

**Mark Walker 50:22**

*Sure.*





***Reasons to invest in Trupanion***

***Tilman Versch 50:27***

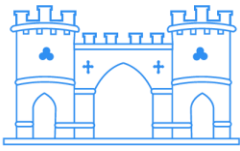
*What do you like about the company? And I still have this question open: Is it easier to keep a loser or to keep the winner?*

***Mark Walker 50:43***

*My temperament is such that I've been historically very comfortable averaging down into situations where I felt that the opportunity to improve my investors' investment results presented itself. I've had mixed success in doing that and sometimes I've been guilty of being a proverbial boiling frog and being very slow to recognize structural deterioration. Either structural deterioration the business or my ignorance or misunderstanding of the businesses' prospects over time.*

*I'm trying to be more cautious and slower to average down. I think Gym was just really an exceptional opportunity to do that in March and April. The corollary of that is that I've been slower to cut profitable investments if those companies are demonstrating a level of execution and fundamental economic earnings progress that justifies that. I think with Trupanion we have lowered our position size. I think when we first acquired the shares a couple of years ago, this was really a business that I felt was valued to not grow and I felt that the growth opportunity was extraordinary. Essentially in the last couple of years, the stock has tripled and the owner earnings of the business have also compounded quite strongly. But the current multiple of stockholder equity implies a sustainable growth rate of 7-8%. That re-rating of the stock will typically not cause us to exit investments but it may be a trigger to very occasionally and sensibly power back our ownership if the owner earnings yield decline is a reason for the lower perspective IRR.*

*To go back and use Trupanion as an example of some of the things we talked about today, Trupanion basically offers medical insurance to pets; cats and dogs in North America. As I've said before, if you're a quality business investor and you apply this heuristic that insurance companies are low-quality generally and they should be valued at low single-digit multiples of the book, as a long-only investor you'll quickly dispense this is a potential opportunity. If you are a long/short manager, you might be very interested in this business as a short. I think Trupanion is one of the most shorted companies we own. It's less now, but it still has a very high short interest. I've described the reasons why we don't short securities, but I think it's useful to understand the short seller agenda that I described earlier to examine the insights that we believe we have about a company. The points of contention that bears on this company have and why we think that through our lens is very long-term long investor, they don't really make sense to us – and I'm cognizant of the behavioural risks associated with what I'm about to do – it's not my business to be overly defensive and get into arguments about whether a company is investable or not. But when you understand the reasons for the short interest in the business and you disagree through a research process, which is bottom-up and hopefully objective in nature, it can lend some conviction to your view which allows you to know what to do when the quota price changes.*

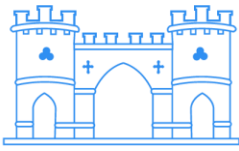


*One of the things that it's been argued by people who dislike Trupanion as an investment is that the provision of medical insurance to cats and dogs that is distributed via vets has endemic to it, an adverse selection issue: if you're selling to animals in the vet, you are selling to sick animals and that affects your risk pool and that will cause a rate spiral and that will cause an affordability issue for your customers. Trupanion is the only pet insurance operator distributing its insurance via vet relationships. Other competitors to Trupanion rely more readily on online marketing to acquire customers. It strikes me as logical that if you are Googling for 'pet insurance' there may be something wrong with your pet if that's your first interaction with an insurance product. Whereas if you, like Trupanion, are focused on puppies and kittens – animals in the very early stages of their life when they first visit the vet in the first few months of their existence – I think that your propensity to have an adverse selection problem is much lower.*

*One of the other issues in this world where net retention ratios of comfortably above 100% seem to be the holy grail of investing in sustainable enterprises, a business that has an implied churn of 16-17% a year seems like a low-quality business with a customer retention and problem which increases the cost of doing business. Trupanion expresses its churn in on a monthly basis which is 98-99%. This implies this annual churn of around 17%. That can really be explained by two phenomena.*

*One is that the customers who churn early, which is most of the churn, are those that are under the misperception that pre-existing conditions are covered. Once they realize that there's no coverage for such pre-existing conditions, they churn off. Clearly, that is an opportunity for Trupanion and they can do better in educating their customers by that lack of coverage. But normalizing for that factor, you have a churn level that is then predominantly explained by the average life of a pet. I generally think that Trupanion – given its business model – does a reasonable job of keeping its customers. Like Gym, Trupanion is this holy grail of investing in many ways because it is a business demonstrating very consistent strong positive fundamental progress but whose quoted equity is extremely volatile. Trupanion has never reported a quarter of revenues that was not higher than the previous quarter in its 10 years of financials. That isn't because they have phenomenal executors in a challenging business, it's the result of a recurring revenue model and a very high and underpenetrated addressable market. I think the last bone of contention for short sellers is two-pronged.*

*One is that the CEO and founder of Trupanion is overly promotional and disingenuous in his characterization of the business and how it makes money and how they think about allocating capital internally. I've specifically read their arguments that contend that the CEO has compared Trupanion to SaaS business models in order to try and get this very high SaaS multiple. I haven't seen that anywhere, what I have seen is that in his shareholder letters he specifically said that this is not like a SaaS company because it has a high cost of doing business. It has a high cost of sales and a low gross margin. But he has used comparisons to companies like Netflix because of the recurring revenue element and the growth of its key assets is around 30% and gross margins are both around 30%. But because he is not describing this business in traditional insurance terms, I don't think that this characterization is disingenuous and that leads to where we are in valuation which you've mentioned before, which is that if you have a heuristic that this*



*is an ex-growth insurance company, you will be very excited about potentially shorting this company. But as I've described before, I think that despite a quite strong re-rating of the asset, is pricing in a level of growth of 7-8% sustainably? Because on an owner earnings basis, if Trupanion stops reinvesting internally to acquire new pets, the ROI of this business would be in the order of 40-50%. What it's doing with all those owner-earnings is directing them to invest in new pets with investment returns which are 4-5 times any reasonable opportunity cost of investing. So those are the reasons why it remains this core investment for us.*

### **Consolidation of industries post-Covid**

**Tilman Versch** 01:02:16

*Those are good rates for sure. There is another question from the chat: Do you expect a consolidation of certain industries after Covid? It's a broader question, but referring to Gym?*

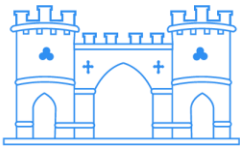
**Mark Walker** 01:02:31

*We don't really think in this thematic way of "Let's think thematically about Covid or the US selection or Brexit and carve out winners and losers and try and invest according to those paradigms". But specifically with Gym, as I've outlined, I think it makes sense that a number of competitors are not going to be in great shape to compete, like the local authority gyms; around 35-40% of them still haven't reopened. Those gyms are charging 35-40 pounds a month. Gym is charging 18 pounds a month and reinvesting substantially in their gyms. So, I think that value proposition is going to maintain and as I said, I think that it's very reasonable that capacity will exit and demand will continue to increase.*

*On the broader point, you mentioned Brexit before as well, I have no special insight into inferring consequences of macroeconomic or geopolitical events. I think that what this year has shown and has reiterated is that it is unknown unknowns that in aggregate move markets. Unknown unknowns are impossible to forecast. When it comes to known unknowns, I think the market generally does a reasonable job of pricing expectations in an aggregate way.*

*Therefore, I think that trying to predict the future and trying to predict the evolution of known unknowns is also a low ROI exercise. So, it comes back to "What can you do?" I think all you can really do is own these companies that you think have business resilience and are led by adaptable innovative managers and owners and to lead through crises. One of the things that we look for and talk about or recognize in some of the companies we own – Trupanion is a good example as well – is symbiotic value chains.*

*I've been quite dismissive of most ESG-programs and the value that can really be created by the quantification of an ESG-checklist and the employment of consultants to help formulate ESG-checklists and really the business of long-term sustainable investing should satisfy a reasonable ESG-agenda. One of the ways to do that is through a symbiotic value chain, through a shared mission which goes beyond profit maximization. If customers, if employees, if owners of the company are united in a shared objective, the ironic consequence of that shared mission is*



*usually profit maximization over a long period of time. And so, the internal micro-economic examination of Trupanion's value chain is an interesting insight in itself.*

*If you consider what a 70% loss ratio implies for the customer proposition, it implies that the customer is paying a 43% mark-up on every dollar of premium. The customer seeking an ROI on this, he is going to find that very unconvincing. But of course, customers are not seeking an ROI, they don't want their pets to be sick or unhealthy. There is an asymmetry in the value chain that is as follows: Pet owners don't have access to the aggregate information of an insurance company that the insurance company is using to accurately underwrite policies. That is a barrier to self-funding the medical requirements of their pets. Even if they had access to that aggregate information, they still don't know if their pet is on the lucky or unlucky side of that distribution. The value of 43% mark-up is actually very high to them. And by the way, Trupanion's competitors have 50% loss ratios, so their 100% mark-ups are even less unconvincing as a value proposition. There are other components to the value chain that I think combined form what is a very resilient and anti-fragile business. One of them is that the founder, Darryl Rawlings, has a very transparently communicated formula for sharing enterprise value growth between employees and owners of the company. And all of the employees are owners of the company and lots of employees are customers of the company because they basically all own pets as well.*

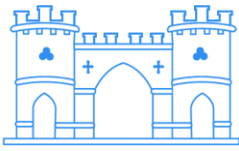
*So that's a form of symbiosis and then finally, Trupanion has this software product called Trupanion Express. That is installed in a number of their vet partners and that allows Trupanion to directly pay claims within minutes or seconds of a claim being made. This is a really interesting development, because to me, it really cements this idea of symbiosis, it really cements this idea of win-win-win. This is a great evolution for Trupanion, because it allows them to have access to data from other insurance policies provided by other insurers that allows them to more accurately price their products and it's great for the vet because the vet can suggest and implement plan A treatment options and it reduces economic euthanasia, which is sometimes a function of the customer's inability to fund out of pocket expenses. And also, for the vet, there's a direct financial impact, which is that the credit card fees are saved, which can be 15-20% of their profits.*

*But it's also interesting to understand that vets' careers are intrinsically motivated and mission-driven. They earn a fraction of what medical practitioners like doctors and surgeons in the human field earn. So those are cumulative series of observations about the value chain. I think in times of uncertainty or in times of distress the value chain is united by this common mission or objective.*

### ***Gym Group prices versus mid-tier gyms***

***Tilman Versch 01:11:01***

*Interesting. In the chat, there is a former customer or maybe I could also say a short seller of Gym Group, I'm not sure. His comments are a bit critical because he's also mentioning that they don't charge 18 pounds per month but they are charging 22 pounds in the bigger cities and 15 pounds in the outskirts locations. He's also having critiques with the person who is fitting the*



*gyms. It is the brother of the founder and that's a critical point for him. Do you want to react on this or is this getting too deep for you?*

**Mark Walker 01:11:43**

*All I would say is that the point about pricing is that their average price is 17 pounds in ARPU. They are the lowest cost national gym chain. Whether or not they are charging 18 or 25 pounds, they are not charging the 45 pounds that the mid-tier gyms are charging for their inferior experience. If you look at net promoter scores or customer feedback for gyms, it's generally terrible. For Gym it is reasonable. It's not stand-out phenomenal. The negative feedback is usually associated with gym members leaving and being charged and being difficult to cancel their memberships. For example, for gym members who are tied into contracts. So, it's not a business that is universally extremely highly regarded by all of its customers. But I think that its relative appreciation is pretty good.*

**Tilman Versch 01:13:06**

*Thank you. We are coming to an end with our livestream. At the end, do you want to mention one point we haven't discussed yet that might be interesting for the viewers and that describes you, Tollymore or your view on investing in a good way?*

**Mark Walker 01:13:29**

*Sorry, what do you want me to say?*

**Final notes from Mark**

**Tilman Versch 01:13:32**

*You have the opportunity to add something we haven't discussed. If you have a point that comes to your mind that is interesting for the viewers, adds value and gives insights, that might be interesting.*

**Mark Walker 01:13:45**

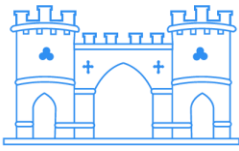
*Tollymore at the minute is a one-man band.*

**Tilman Versch 01:13:54**

*I know the feeling!*

**Mark Walker 01:13:57**

*Exactly! There are shortcomings, there are pros and cons of that. There is an obvious shortcoming in potentially the intellectual robustness of a process if you aren't sharing the work with people who are incentivized exactly the same way as you. I think that is a clear and obvious shortcoming. I think there are lots of shortcomings of growing teams relating to generally complexity of organizational decision-making that are under-appreciated and not often*



*discussed. And so, at the minute I attempt to plug the intellectual robustness gap by being part of an intellectually generous community and having people like you to champion my efforts and to bring this community together. It's a really important safeguard against that risk for me and there have been ideas that have come into my fold as a function of these types of relationships, so I welcome people to reach out to you and reach out to me with feedback, with questions or with observations or challenges, bearing in mind the respective contexts and lenses through which we are trying to judge investment merits of companies. We can play a small but valuable part in trying to create value in a very institutionally focused active management industry.*

**Tilman Versch** 01:15:42

*Thank you very much for your insights and sharing your ideas. Thank you also to our audience for being with us and raising critical questions, that's always helpful because critique makes progress. Finally, I want to send you a "Hi" from Dennis Hong. He will be on here in three weeks. He is sending you a nice "Hi" and I'm saying goodbye to everyone who watched the stream and wish you a good night or day, wherever you are.*

**Mark Walker** 01:16:14

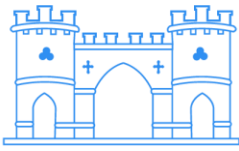
*Thanks, Tilman. Thanks everyone, I appreciate the time!*

**Tilman Versch** 01:16:18

*Bye!*

**Mark Walker** 01:16:19

*Take care, bye bye.*



**TOLLYMORE**  
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