Compounder Fund Investors' Letter: First Quarter of 2023

COMPOUNDER FUND
GROWING YOUR WEALTH AND ENRICHING SOCIETY

Note (24 May 2024): Information related to a global stock market index has been redacted from this letter because of intellectual-property restrictions. As such, we believe the S&P 500 is currently sufficient for context about Compounder Fund's performance. This is because the fund's portfolio is heavily weighted toward US stocks. In addition, the S&P 500's return has been higher than a broad collection of global stocks since Compounder Fund's inception, and US stocks have by far the largest market capitalisation among stocks around the world. We will revisit our decision on displaying global stock market returns data in the future if there are significant changes to Compounder Fund's portfolio from a geographic perspective, or if US stocks start lagging their global peers.

Dear investors,

I'm presenting Compounder Fund's 2023 first-quarter investors' letter together with my co-founder Jeremy Chia.

During the quarter, Compounder Fund's overall net-of-fee return for the earliest series of its Class A and Class B shares were both 16.6%. Over the same period, the dividend-adjusted Singapore-dollar returns for the and the S&P 500 were 7.1% and 6.7%, respectively. Tables 1 and 2 below show the returns for Compounder Fund's two share classes (the earliest series for each share class), the , and the S&P 500, since the birth of the fund.

Table 1

Time period	Compounder Fund Class A (after fees)		S&P 500**
2020*	11.2%		14.2%
2021	0.9%		31.2%
2022	-44.1%		-18.7%
Jan 2023	10.6%		4.3%
Feb 2023	-0.8%		-0.1%
Mar 2023	6.2%		2.4%
Q1 2023	16.6%		6.7%
Total return since inception*	-27.0%		30.1%
Annualised return since inception*	-10.9%		10.2%

**Inception date: 13 July 2020*
*** and S&P 500 returns are in Singapore-dollar terms, with dividends reinvested*

Table 2

Time period	Compounder Fund Class B (after fees)		S&P 500**
2020*	6.8%		8.6%
2021	0.9%		31.2%
2022	-44.1%		-18.7%
Jan 2023	10.6%		4.3%
Feb 2023	-0.8%		-0.1%
Mar 2023	6.2%		2.4%
Q1 2023	16.6%		6.7%
Total return since inception*	-29.8%		23.7%
Annualised return since inception*	-13.2%		8.9%

**Inception date: 1 October 2020*
*** and S&P 500 returns are in Singapore-dollar terms, with dividends reinvested*

Jeremy and I are comparing Compounder Fund's performance with the and the S&P 500 to provide an indication of how the fund is faring against a broad group of stocks that are listed across the world and in the USA.

As you know, Compounder Fund's investment mandate is global in nature. This means the fund can invest in any listed stock in the world; it also makes the a

sensible index for context about Compounder Fund's performance. But since most of Compounder Fund's holdings are currently US-listed stocks, it's also important to Jeremy and me that we compare the fund's performance with a prominent US stock market index, in this case, the S&P 500. If Compounder Fund is doing better than the [redacted], comparing the fund's return with the S&P 500 helps us see if the outperformance is simply due to a rising tide in US stocks.

It's been nearly three years since we started investing Compounder Fund's capital on 13 July 2020 and it has been disappointing. The fund's return has not only been negative since its inception, but it has also substantially underperformed both market indices. Compounder Fund's underlying businesses have done well, but their stock prices have mostly not (this divergence is something I've discussed in a number of past letters). The first quarter of 2023 has seen a change in this regard and I have more to say on the topic in the "*Wonderful businesses"* section of this letter.

Jeremy and I are clear that Compounder Fund exists to ultimately produce a positive *and* healthy return over the long run for all of you, and not merely to invest in stocks with growing businesses. **We understand too that discussion about the fund's underlying businesses can ring empty when their stock prices have fared so poorly**, ***especially*** **when most of the holdings had high valuations when we first invested in them (the valuation numbers can be found in our investment theses for the holdings).** But I have repeatedly emphasised, in our past letters, how our stocks' underlying *businesses* have been doing because what ultimately drives a stock's price over the long run is its business performance. Over the short run, stock prices and business fundamentals can diverge wildly, but they tend to converge with the passing of time. This is a concept that I illustrated in detail with Walmart's experience in the 1970s and 1980s in the introductory section of our **2022 fourth-quarter letter** and also with Berkshire Hathaway in the same periods in the "*An unfortunate but necessary disconnect*" section of our **2022 third-quarter letter**.

Times like these are not easy for any of you. We *know*. Charlie Munger - Warren Buffett's long-time right-hand man - was once asked about the lessons he learnt from his investment fund's big losses in 1973 and 1974 (his total loss in that period was 53%). He said:

> "It didn't bother me with my own money, but it made me suffer the tortures of hell as I thought through the loss of morale of the limited partners who had trusted me."

It's the same anguish we feel when we think of you. But at the same time, you have provided us with gentle patience and the space to engage in long-term thinking about stocks - **we're incredibly grateful for this**. With your strong support, Jeremy and I are taking the long-term approach here at Compounder Fund, where the fund's return will come from the underlying business performances of its holdings. I've mentioned in many past letters that you should never underestimate the importance of your role in shaping Compounder Fund's long-term return and I'll like to do so here again. In the "*Investing thoughts: What's our edge?*" section of our **2020 fourth-quarter letter**, I discussed the three sources of investing edge that exist in the stock market and how all of you - Compounder Fund's investors - **play a critical role in helping Jeremy and me produce the behavioural edge**. In what has been a rough period for Compounder Fund over the past two-plus years, you have helped us produce the behavioural edge. ***Thank you.***

Judging our performance

In all our **previous quarterly investors' letters**, I've provided a discussion on how Jeremy and I intend to judge Compounder Fund's performance. If this is the first investor's letter from us that you're seeing, *please* read this section. If this is not your first letter, you can take it as a refresher.

Our target for Compounder Fund is to generate an annual return of 12% or more over the long run (a five- to seven-year period, or longer) for the fund's investors, net of all fees. When Warren Buffett was running an investment fund in the 1950s and 1960s, he shared his thoughts on a suitable time frame to assess the performance of an investment manager:

> "While I much prefer a five-year test, I feel three years is an absolute minimum for judging performance. It is a certainty that we will have years when the partnership performance is poorer, perhaps substantially so, than the [market]. If any three-year or longer period produces poor results, we all should start looking around for other places to have our money. An exception to the latter would be three years covering a speculative explosion in a bull market."

Jeremy and I fully agree with Buffett. **We hope that you, as an investor in Compounder Fund, will judge its performance over a three-year period at the *minimum*.**

It will be very disappointing for the both of us too if Compounder Fund fails to beat the [redacted] and the S&P 500 over a five- to seven-year timeframe. Jeremy and I believe that having a thoughtful investment framework to find Compounders, and the willingness and ability to hold the shares of Compounders for years, will likely lead us to market-beating returns. Do note, however, that we harbour *no* illusion that we're able to beat the indices each month, each quarter, or each year. The willingness comes from our ingrained long-term view towards the market. The ability, though, comes from *your* keen understanding of our investment approach.

Some caution is needed here: **The stock market is volatile**. The returns of Compounder Fund in the future will very likely *not* be smooth - this is just how stocks work. And indeed, we've already experienced significant volatility in the results of Compounder Fund since its inception. If the market falls in the future, you should expect Compounder Fund to decline by a similar magnitude or more. But this will likely only be short-term pain. Jeremy and I believe in the long-term potential of the stock market, and especially in the underlying businesses of the stocks in Compounder Fund's portfolio.

Speaking of volatility, I want to discuss the important concept of the 'destination'. I first heard about it from a friend - an incredibly impressive young investor and person - who in turn learnt about it from Nicholas Sleep, one of the best investors I've read about. After retiring in the mid-2010s and initially wanting to be outside the public eye, Sleep published a collection of his investment letters in 2021 on the **website** of his charitable foundation, I.G.Y (do check out his letters - they're a fantastic read). To illustrate the concept, I will need you to first think about two sequences of returns over a five year period, shown in Table 3:

Table 3

	Year 1	Year 2	Year 3	Year 4	Year 5	Total
Sequence A return	+50%	+28%	+3%	+15%	+5%	**139%**
Sequence B return	+5%	+15%	+3%	+28%	+50%	**139%**

Both sequences result in the same total return - the journey is different, but the destination is the same. Interestingly, even though the end results are identical, we humans tend to prefer Sequence B over Sequence A. This is because Sequence B's return looks better to us compared to Sequence A's, since the former improved over time while the latter deteriorated. As humans, we exhibit natural psychological biases that cause us to favour more recent data.

This is important to note because **when investing in stocks, it's often much easier to know the destination than it is to know the journey**. Jeremy and I have absolutely *no* control over the journey of returns for Compounder Fund - what we have is a great degree of control over the destination. This 'great degree of control' comes from our careful selection of the companies that Compounder Fund owns shares in. And I say 'a great degree of control' and not 'full control' because luck *will* play some role in Compounder Fund's eventual gain. So you should expect Compounder Fund's return - and indeed, that of all stocks - to bounce around wildly in the short term. We've already seen such a bounce happen in an unwanted direction (downwards) but over the long run, Compounder Fund's return should gravitate toward the long term business performances of the companies it owns partial stakes in. There's no guarantee that this gravity will be a strong upward pull though. The direction of the gravitational force will depend on whether our insights - on the abilities of Compounder Fund's companies to grow their businesses at high rates over the long run - turn out to be correct. **In this regard, it's been so far, so good, as I'll discuss in the "*Wonderful businesses*" section of this letter**.

We're fast approaching the three-year mark at Compounder Fund and as I mentioned in the introductory section of this letter, the performance of the fund in terms of stock prices has been nothing but disappointing. The journey so far has been rough on all of us at Compounder Fund, to say the least. But Jeremy and I find solace in the business performances of the fund's holdings and this is what gives us confidence that when Compounder Fund's *stock price* performance is eventually weighed in the fullness of time, a favourable judgement is likely to result.

Portfolio changes

Compounder Fund's **2022 fourth-quarter letter** was published on 12 January 2023. In it, I mentioned a few things: (a) all 50 holdings that were in the fund's portfolio at the time; (b) Tencent's distribution of Meituan shares and our intention for Compounder Fund to retain the distributed shares; and (c) updates on the acquisition of Activision by Microsoft. Since then, there have been no changes to the fund's holdings and Compounder Fund received 560 Meituan shares from Tencent on 24 March 2023, all of which are currently still in the portfolio.

Coming to Microsoft's pending acquisition of Activision, there have been some positive developments. Activision's CEO, Bobby Kotick, sent a publicly-available **email** to staff on 28 March 2023 reiterating his confidence that "the transaction will ultimately be approved." He also shared that Microsoft and Activision's leaders have been meeting with regulators in Europe and the UK and that Microsoft has "proposed thoughtful, generous remedies to address regulators' concerns." On the same day that Kotick emailed Activision's staff, the Japan Fair Trade Commission also approved the deal. Moreover, roughly a week before Kotick sent his email, the UK's regulator, the CMA (Competition and Markets Authority), announced that "the transaction will not result in a substantial lessening of competition in relation to console gaming in the UK." The CMA is still conducting its investigation on the acquisition and will present its final report by 26 April 2023. In our 2022 fourth-quarter letter, I mentioned that the US FTC (Federal Trade Commission) had challenged the deal; there's so far been no material updates on that front.

We have no special insights on the thought processes of the regulatory bodies around the world that are relevant to Microsoft's attempt to acquire Activision. So we're watching how the situation unfolds. As first discussed in Compounder Fund's **2022 first-quarter letter**, Jeremy and I intend for the fund to hold onto its Activision shares and receive the cash from Microsoft if and once the acquisition is completed (but our intention could change depending on developments at both companies and the stock market in general).

As you know, Compounder Fund is able to accept new subscriptions once every quarter with a dealing date that falls on the first business day of each calendar quarter. Jeremy and I have successfully closed Compounder Fund's 10th subscription window since its initial offering period (which ended on 13 July 2020) and raised a net amount of S$0.23 million. This new capital was deployed quickly in the days after the last subscription window's dealing date of 3 April 2023 and we added to five of Compounder Fund's existing holdings (in alphabetical order): Adyen, Datadog, Hingham Institution of Savings, TSMC, and Wise. As of this letter's publication, we have released our investment theses on all the companies that are currently in Compounder Fund's portfolio and they can be **found here**. In the future, if and when we add new companies to the portfolio or completely exit any of the 50 companies, we will be releasing our detailed thoughts for these actions.

In Compounder Fund's **Owner's Manual**, we mentioned that "if Compounder Fund receives new capital from investors, our preference when deploying the capital is to add to our winners and/or invest in new ideas." None of the five existing holdings in the portfolio that we added capital to have seen their stock prices rise strongly after we initially invested in them. But all of them - with perhaps Hingham as the exception - have executed well since our investments and they've produced solid business results as I'll soon touch on later in this section as well as in the "*Wonderful businesses*" section of this letter. Here's how Compounder Fund's portfolio of 50 companies looks like as of 12 April 2023:

Table 4

Company	Weighting	Country/Region of listing	Headquarters
MercadoLibre	6.2%	USA	Argentina
Meta Platforms	4.9%	USA	USA
Tractor Supply	4.4%	USA	USA
Microsoft	4.1%	USA	USA
Costco	3.7%	USA	USA
Netflix	3.5%	USA	USA
Apple	3.5%	USA	USA
Alphabet	3.4%	USA	USA
Amazon	3.4%	USA	USA
Chipotle Mexican Grill	3.3%	USA	USA
Visa	3.0%	USA	USA
Mastercard	3.0%	USA	USA
The Trade Desk	2.9%	USA	USA
ASML	2.8%	USA	Netherlands
Tencent	2.6%	Hong Kong	China
Intuitive Surgical	2.5%	USA	USA
Markel	2.3%	USA	USA
Adobe	2.3%	USA	USA
Shopify	2.1%	USA	Canada
Starbucks	2.1%	USA	USA
Tesla	2.0%	USA	USA
Activision Blizzard	2.0%	USA	USA
DataDog	2.0%	USA	USA
PayPal	1.9%	USA	USA
Etsy	1.9%	USA	USA
Medistim	1.8%	Norway	Norway
Salesforce	1.7%	USA	USA
Veeva Systems	1.7%	USA	USA
Adyen	1.6%	Netherlands	Netherlands
Illumina	1.4%	USA	USA
TSMC	1.4%	USA	Taiwan
Hingham	1.3%	USA	USA
Medpace	1.3%	USA	USA
MongoDB	1.3%	USA	USA
Haidilao	1.1%	Hong Kong	China
Block	1.1%	USA	USA

Table 4 (continued from above)			
Company	**Weighting**	**Country/Region of listing**	**Headquarters**
Meituan	1.0%	Hong Kong	China
Wise	1.0%	UK	UK
DocuSign	0.9%	USA	USA
Okta	0.9%	USA	USA
Wix	0.9%	USA	Israel
Paycom Software	0.7%	USA	USA
Zoom	0.7%	USA	USA
Sea	0.7%	USA	Singapore
dLocal	0.4%	USA	Uruguay
Fiverr	0.4%	USA	Israel
Alteryx	0.2%	USA	USA
Coupang	0.2%	USA	South Korea
Upstart	0.2%	USA	USA
Super Hi	0.1%	Hong Kong	Singapore
Cash	**0.1%**	**-**	**-**

**0.3% of the Block position comes from Block shares that are listed in Australia, but for all intents and purposes, we see the Australia-listed Block shares as being identical to the US-listed variety*

Our additions to Adyen, Datadog, Hingham, TSMC, and Wise in early-April 2023 were made with roughly equal amounts of capital. Adyen, DataDog, and Wise can be categorised in one group with a commonality that the trio have been executing brilliantly business-wise and each carries a decent valuation. Meanwhile, we added to Hingham and TSMC predominantly because they have valuations that look highly attractive to us (although TSMC also produced excellent business results - check out the "*Wonderful businesses"* section of this letter). Let's dive further into all five companies.

Roughly a year has passed since we invested in digital payments services provider Adyen for the first time in April 2022 and the company's business has continued to grow impressively. In the first half of 2022 (Adyen reports its financials every six months), Adyen's net revenue was up by 36.7% to €608.5 million and it produced €316.3 million in free cash flow, representing year-on-year growth of 26.0% and a free cash flow margin of 52.0%. The picture was similar in the second half of 2022, as Adyen's net revenue jumped by 29.7% to €721.6 million. Even though the company's free cash flow for the period inched lower to €312.9 million from €324.6 million a year ago, the free cash flow margin was still excellent at 43.4%. We also applaud Adyen's recent contrarian move in hiring. While technology companies in the West have mostly been cutting headcount in recent months, Adyen has continued to expand its team as talent has become more affordable and the company wants to support its long-term growth plans. Adyen plans to add around 1,200 employees in 2023, building on the 757 it added in the second half of 2022, an increase of nearly 30% from the first half of the year. As of the end of 2022, Adyen had a total of 3,332 employees. Here are relevant comments from Adyen's management that were shared in the company's shareholder letter for the second half of 2022:

> “Amid a backdrop of widespread tech lay-offs and hiring freezes, we consciously grew our team in order to further scale the business. During this time, the labor market proved favorable for reaching our intended hiring speed. While this backdrop supported our headcount goals, it did not dictate them. We did not adjust our plan nor meet quotas because candidates were more widely available.
>
> Rather, we have always been efficient about the number of people required to solve problems. This held true during the initial pandemic years, when we were not distracted by e-commerce or in-store volume fluctuations. Our approach remains the same today. We continue to look beyond short-term changes, and are instead committed to our long-term growth. By staying critical of both the quantity and quality of people we hire, we are building a team that is capable of realizing it.”

It helps too that we managed to add to Adyen at a price-to-free cash flow (P/FCF) ratio of around 71, which is lower than the P/FCF ratio of 101 at our initial investment.

Turning to Datadog, which provides a software platform for companies to monitor and analyse the performance of their technology stack, Table 5 below shows the company’s revenue growth and free cash flow margin dating back to 2020; note the rapid increases in revenue and the improvement in the free cash flow margin to a respectable 20.5% currently. The table also highlights Datadog’s high dollar-based net retention rate and robust customer growth.

Table 5

Time period	Datadog year-on-year revenue growth	Datadog free cash flow margin	Datadog dollar-based net retention rate	Datadog customers
Year 2020	66.3%	13.8%	>130%	14,170
Year 2021	70.5%	24.4%	>130%	18,800
Q1 2022	82.8%	35.8%	>130%	19,800
Q2 2022	73.9%	14.8%	>130%	21,200
Q3 2022	61.4%	15.4%	>130%	22,200
Q4 2022	43.9%	20.5%	>130%	23,200

Source: Datadog earnings updates and annual reports

Datadog's revenue growth rate slowed throughout 2022 as customers sought to optimise their spending on cloud computing services, which included those provided by the company. But Datadog’s pipeline of new customers remains robust and its products remain mission-critical, as evidenced by a high revenue gross retention rate ranging in the mid-to-high 90s percentage range. Furthermore, long-term business trends still appear to be heavily in Datadog’s favour. During Datadog’s earnings conference call for the fourth quarter of 2022, management shared their thoughts on the company’s long-term growth opportunities amid customers’ ongoing optimisation of cloud spending:

> “Although we are seeing customers be more cautious with their cloud usage expansion in the near term, we see no change to the long-term trends towards digital

transformation and cloud migration. We think it's healthy for customers to optimise, and we believe that the ability to correct course and continually align the nature and scale of their applications with their business needs is one of the key benefits of cloud transformation. At Datadog, we have always organised our products and our business around helping customers gain agility and reduce costs, and we do it by enabling stronger business performance and efficient use of their engineering and infrastructure spend. Regardless of near-term macro pressure, we believe it is still early days, and we expect that companies worldwide will continue to grow their next-gen IT footprint to deliver value to their customers."

We added to Datadog at price-to-sales (P/S) and price-to-free cash flow (P/FCF) ratios of around 12 and 59, respectively. These are much better valuations than when we first invested in Datadog in July 2020. Back then, Datadog had a P/S ratio of around 69 and only minimal free cash flow, so the P/FCF ratio was not meaningful.

Back in October 2021, when we first invested in Wise, an international money transfer service provider, we were impressed with many aspects of the company. These included, among other things: (a) the growth in the number of transfers that the company can process instantly; (b) the rapid increase in the company's revenue and processed volume; (c) the progress Wise had made in keeping costs low for customers; and (d) an improving net profit margin. As Table 6 below shows, Wise has continued executing brilliantly on these fronts. As cherry on the cake, our addition to Wise was made at a P/S ratio of 7, which is a significant improvement from the ratio of 23 seen when we first invested in the company.

Table 6

Time period	Wise percentage of instant money transfers	Wise year-on-year growth in transfer volume	Wise year-on-year growth in revenue	Wise customer price at end of period	Wise net profit margin
FY2019	~20%	-	-	0.64%	5.8%
FY2020	~25%	53.9%	70.1%	0.70%	5.0%
FY2021	38%	30.5%	39.1%	0.69%	7.3%
FY2022	49%	40.4%	33.0%	0.61%	5.9%
H1 FY2023	50%	49.1%	55.1%	0.64%	9.4%

Source: Wise earnings updates and annual reports (Wise's financial year ends on 31 March; FY2019 refers to the financial year ended 31 March 2019)

Hingham, an American bank based in the state of Massachusetts, has seen its stock price decline by nearly half from a peak of US$431 reached in January 2022. This has caused its price-to-book (P/B) ratio to fall to 1.2 when we added to it. This valuation looks attractive to us for two reasons. First, it is near a 10-year low, as shown in Figure 1 below, and it is also lower than where it was when we first invested in Hingham in December 2022 (around 1.6 back then). Second, we think the concerns that we see surrounding Hingham today are merely short-term in nature and do not point to any deterioration in the bank's long-term prospects.

Figure 1

Source: Tikr

The first concern is related to the collapse of Silicon Valley Bank in the USA last month due to a bank run that happened with unprecedented speed, and the consequent spread of fear about the survival of banks across the country (I discuss Silicon Valley Bank's predicament in the "*Takeaways from Silicon Valley Bank's collapse*" section of this letter). At a simplified level, banking involves taking in deposits and distributing the capital as loans to borrowers. A bank's assets (what it owns) are the loans it has doled out, and its liabilities (what it owes) are deposits from depositors. When depositors withdraw their deposits, a bank has to return cash to them. Often, depositors can withdraw their deposits at short notice, whereas a bank can't easily convert its loans into ready cash quickly. So when a large group of depositors ask for their money back, it's difficult for a bank to meet the withdrawals - that's when a bank run happens. We think it's unlikely that Hingham will suffer from a bank run. Jeremy and I shared in our **investment thesis** that Hingham has a history of growing its deposits even during the Great Financial Crisis, a period that also saw a massive bank run as I'll soon share in the "*Takeaways from Silicon Valley Bank's collapse*" section of this letter. Moreover, Hingham has, for a long time, offered *full insurance* for its depositors' capital by tapping on both the FDIC (Federal Deposit Insurance Corporation) and Massachusetts Depositors Insurance Fund. This sets Hingham apart from many other banks in the USA that only offer deposits insured up to the FDIC-limit of US$250,000 per depositor.

The second concern involves Hingham's net interest income, which is under pressure due to a rising cost of funding. Short-term interest rates rose rapidly in the USA in 2022 and have continued climbing this year. As interest rates increase, Hingham has to offer higher interest on deposits to retain depositors and borrow more expensive debt from the Federal Home Loan Bank of Boston (FHLB). The rapid rise in short-term rates has left a mark on Hingham's results. For example, in the fourth quarter of 2022, Hingham's net interest income *fell* by 24.1% to US$21.0 million despite a 33.3% increase in total dividend and interest income to US$39.2 million. The culprit was a *10x* jump in total interest expense to US$18.3 million. Hingham released its results for the first quarter of 2023 after we added to it. While

total interest and dividend income was up by 35.0% year-on-year to US$40.7 million, a 1,193.3% surge in total interest expense to US$25.8 million caused net interest income to decline by 47.1% to US$14.9 million. Jeremy and I do not know how long the pressure on Hingham's net interest income will last but it will eventually dissipate. Thus, the more important question for us is whether Hingham can survive until the pressure abates. We have high confidence the bank will; we discussed this in depth in *"The risks involved"* section of our Hingham thesis. A pertinent comment from management in Hingham's annual report for 2022 lends further weight to our view:

> "As we have repeatedly discussed, the most dangerous response to short-term challenges is to make changes that have long-term consequences. We will not add incremental risk, either in our lending or investment operations, and we will continue to make the appropriate investments to support our long-term objectives outlined below."

Then there's TSMC, the preeminent contract-manufacturer of semiconductor chips. In our **investment thesis**, Jeremy and I shared that the most important risk we see with TSMC concerns geopolitics. Specifically, the independence of Taiwan - where the company is based at and where its manufacturing activities are concentrated - is a major point of contention between the territory and China. Complicating things further is the involvement of the USA, which has an incentive to protect Taiwan's sovereignty. TSMC manufactures most of the world's cutting-edge chips. Given the USA and China's increasingly belligerent relationship, the USA's future technological progress and economic growth could face a major setback if China were to seek unification with Taiwan forcefully and restrict the sale of TSMC's chips. We think this geopolitical risk has not diminished since we first invested in TSMC around a year ago in April 2022. In fact, the risk seems to have worsened since then, in our view, as the USA has tightened China's access to advanced semiconductor manufacturing technologies in recent months. Moreover, TSMC's business is under pressure lately. During the company's earnings conference call for the fourth quarter of 2022, management commented:

> "As overall macroeconomic conditions remain weak, we expect our business to be further impacted by continued end market demand softness and customers' further inventory adjustment."

We believe that the challenges outlined above have led to a decline in TSMC's valuation over the past year. As shown in Figure 2 below, its P/E ratio had fallen to 14, which is close to a 10-year low, at the time we added to our position. So the increased risks have presented us with a better valuation. The P/E ratio of 14 also looks like an attractive valuation to us, as we think the long-term prospects for TSMC's business have not diminished. Nothing new we've learnt about the world since we first invested in TSMC suggests that the demand for advanced semiconductor chips will weaken in the years ahead. In fact, TSMC might even enjoy a stronger tailwind than before with the global excitement about recent developments in the field of artificial intelligence (AI), such as the generative AI services introduced by OpenAI over the past few months. The deployment of AI requires powerful chips, and TSMC is the best in the world at manufacturing them.

Figure 2

Source: Tikr

Table 7 below shows the high-level geographical breakdown of Compounder Fund's portfolio as of 12 April 2023:

Table 7

Country/Region	% of Compounder Fund's capital based on country of listing	% of Compounder Fund's capital based on location of headquarters
Argentina	-	6.2%
Canada	-	2.1%
China	-	4.7%
Hong Kong	4.8%	-
Israel	-	1.3%
Netherlands	1.6%	4.4%
Norway	1.8%	1.8%
Singapore	-	0.8%
South Korea	-	0.2%
Taiwan	-	1.4%
UK	1.0%	1.0%
Uruguay	-	0.4%
USA	90.6%	75.4%

Wonderful businesses

Jeremy and I are pleased to report that the companies in Compounder Fund's portfolio have, in aggregate, continued to deliver healthy revenue growth in the fourth quarter of 2022. Table 8 below shows the year-on-year revenue growth rates for all the 50 companies that are currently in Compounder Fund's portfolio (the ones in Table 4) for a few time periods: The whole of 2020 and 2021, and the first, second, third, and fourth quarters of 2022:

Table 8

Company	2020 revenue growth	2021 revenue growth	Q1 2022 revenue growth	Q2 2022 revenue growth	Q3 2022 revenue growth	Q4 2022 revenue growth
Activision Blizzard	24.6%	8.9%	-22.3%	-28.4%	-13.9%	**7.9%**
Adobe	17.3%	18.0%	14.4%	12.7%	10.1%	**9.2%**
Adyen	28.1%	46.4%	36.7%	36.7%	29.7%	**29.7%**
Alphabet	12.8%	41.2%	23.0%	12.6%	6.1%	**1.0%**
Alteryx	18.5%	8.2%	33.0%	50.4%	74.7%	**73.2%**
Amazon	37.6%	21.7%	7.3%	7.2%	14.7%	**8.6%**
Apple	9.9%	28.6%	8.6%	1.9%	8.1%	**-5.5%**
ASML	18.3%	33.1%	-19.0%	35.1%	10.2%	**29.0%**
Block	101.5%	86.0%	-21.7%	-5.9%	17.4%	**14.0%**
Chipotle Mexican Grill	7.1%	26.1%	16.0%	17.0%	13.7%	**11.2%**
Costco	12.8%	17.7%	16.2%	15.0%	8.1%	**6.5%**
Coupang	90.8%	53.8%	21.6%	12.5%	9.8%	**4.9%**
Datadog	66.3%	70.5%	82.8%	73.9%	61.4%	**43.9%**
dLocal	88.4%	134.4%	117.2%	71.6%	63.0%	**55.3%**
DocuSign	49.2%	45.0%	25.5%	21.6%	18.3%	**13.6%**
Etsy	110.9%	35.0%	5.2%	10.6%	11.7%	**12.6%**
Fiverr	77.0%	57.1%	26.9%	13.0%	11.1%	**4.2%**
Haidilao	7.8%	43.7%	-16.6%	-16.6%	-24.9%	**-24.9%**
Hingham	27.4%	20.3%	15.1%	21.0%	5.7%	**-24.1%**
Illumina	-8.6%	39.7%	11.9%	3.2%	0.6%	**-9.6%**
Intuitive Surgical	-2.7%	31.0%	15.1%	4.0%	11.0%	**6.7%**
Markel	17.0%	20.0%	27.0%	19.2%	23.6%	**21.3%**
Mastercard	-9.4%	23.4%	24.4%	21.4%	15.5%	**11.5%**
Medistim	-0.2%	17.7%	13.2%	7.0%	14.1%	**25.8%**
Medpace	7.5%	23.4%	27.3%	26.2%	29.8%	**27.7%**
Meituan	17.7%	56.0%	25.0%	16.4%	28.2%	**21.4%**
Mercado-Libre	73.0%	77.9%	63.1%	52.5%	44.8%	**40.9%**

Table 8 (continued from above)						
Company	**2020 revenue growth**	**2021 revenue growth**	**Q1 2022 revenue growth**	**Q2 2022 revenue growth**	**Q3 2022 revenue growth**	**Q4 2022 revenue growth**
Meta Platforms	21.6%	37.2%	6.6%	-0.9%	-4.5%	**-4.5%**
Microsoft	14.7%	20.6%	18.4%	12.4%	10.6%	**2.0%**
MongoDB	40.0%	48.0%	57.1%	52.8%	47.0%	**35.6%**
Netflix	24.0%	18.8%	9.8%	8.6%	5.9%	**1.9%**
Okta	42.5%	55.6%	65.3%	43.2%	37.2%	**33.2%**
Paycom Software	14.1%	25.4%	29.9%	30.9%	30.4%	**30.0%**
PayPal	20.7%	18.3%	7.5%	9.1%	10.7%	**6.7%**
Salesforce	24.3%	24.7%	24.3%	21.8%	14.2%	**14.4%**
Sea	101.1%	127.5%	64.4%	29.0%	17.4%	**7.1%**
Shopify	85.6%	57.4%	21.7%	15.7%	21.6%	**25.7%**
Starbucks	-14.1%	31.0%	14.5%	8.7%	3.3%	**8.2%**
Super Hi	-5.0%	41.1%	82.3%	82.3%	75.9%	**75.9%**
Tencent Holdings	27.8%	16.2%	0.1%	-3.1%	-1.6%	**0.5%**
Tesla	28.3%	70.7%	80.5%	41.6%	55.9%	**37.2%**
The Trade Desk	26.5%	43.1%	43.5%	34.6%	31.1%	**24.0%**
Tractor Supply	27.2%	19.9%	8.3%	8.4%	8.4%	**20.7%**
TSMC	25.2%	18.5%	35.5%	43.5%	47.9%	**42.8%**
Upstart	42.0%	263.6%	155.6%	17.6%	-31.2%	**-51.8%**
Veeva Systems	32.7%	26.3%	16.5%	17.3%	16.0%	**16.0%**
Visa	-8.7%	18.6%	25.5%	18.7%	18.7%	**12.4%**
Wise	43.9%	32.3%	31.6%	50.5%	59.3%	**50.3%**
Wix	29.9%	29.0%	13.6%	9.4%	8.1%	**6.5%**
Zoom	325.8%	54.6%	12.3%	7.6%	4.9%	**4.3%**

Source: Companies' earnings updates

Here's a table showing the simple averages of the year-on-year revenue growth rates for the fund's holdings for each quarter going back to the first quarter of 2020 (**note the high revenue growth rates for every quarter**):

Table 9

Simple averages for revenue growth from year ago	Compounder Fund current portfolio
Q1 2020	34.4%
Q2 2020	31.7%
Q3 2020	42.6%
Q4 2020	44.1%
2020	37.4%
Q1 2021	54.7%
Q2 2021	77.6%
Q3 2021	38.4%
Q4 2021	34.3%
2021	43.7%
Q1 2022	28.0%
Q2 2022	21.4%
Q3 2022	19.8%
Q4 2022	**16.3%**
2022	**20.4%**

Source: Companies' earnings updates

As I mentioned in the "*Judging our performance"* section of this letter, it's been 'so far, so good' for the business results of Compounder Fund. **The fund's current crop of portfolio companies produced healthy year-on-year revenue growth of 16.3% (this is a simple average) in the fourth quarter of 2022, and this continues from the impressive revenue growth rates seen in prior quarters going back to 2020**. Table 10 below gives perspective on the far-superior growth rates for Compounder Fund's holdings compared to the S&P 500.

Table 10

Simple averages for revenue growth from year ago in a certain quarter	S&P 500	Compounder Fund current portfolio
Q1 2020	Around -2%	34.4%
Q2 2020	Around -10%	31.7%
Q3 2020	Around -2%	42.6%
Q4 2020	Around -0.5%	44.1%
Q1 2021	Around 10%	54.7%
Q2 2021	Around 25%	77.6%
Q3 2021	16.6%	38.4%
Q4 2021	16.1%	34.3%
Q1 2022	13.4%	28.0%
Q2 2022	11.9%	21.4%
Q3 2022	12.1%	19.8%
Q4 2022	**6.9%**	**16.3%**

Source: **Yardeni Research** *for S&P 500 data (data for S&P 500 is as of 21 March 2023; revenue growth rate for Compounder Fund is a simple average of the revenue growth from the fund's holdings)*

In our letter for **2022's fourth quarter**, I mentioned:

> "It's likely that Compounder Fund's holdings will continue to post relatively-slower revenue growth in the next few quarters."

This indeed came to pass. During the fourth quarter of 2022, Compounder Fund's portfolio companies produced an average revenue growth rate of 16.3%. This is a decent growth rate and comfortably exceeds the S&P 500's corresponding revenue growth of 6.9% (great), but it's also a significant deceleration from what was achieved throughout 2021 and 2022 (not great). 2021 provided tough comparisons for the 2022 growth-rates of some of our companies as they had enjoyed a COVID-induced bump in their business fortunes. Moreover, there are signs of a broader economic slowdown that has affected some of our companies. But we're not worried. We invested in the companies that are currently in Compounder Fund's portfolio because their businesses are riding on - or creating - durable and lasting long-term trends. This means they still have massive market opportunities to grow into over the long run (you can read about this in detail in our investment theses for each company).

It's likely that Compounder Fund's holdings will continue to post relatively-slower revenue growth in the next few quarters. But consistent with what I've been sharing in our past quarterly letters, Jeremy and I continue to think there's a high chance that the fund's portfolio companies will, in aggregate, carry on producing pleasing year-on-year revenue growth in the years ahead. **And if these companies can sustain average annual revenue growth of around 20-25% in aggregate for the next five to seven years, *while producing healthy free cash flow* (an important requisite!), we believe it will be exceedingly difficult for Compounder Fund's portfolio to *not* do well over the same timeframe and when measured from the fund's inception**. We're excited to see what the future brings.

Speaking of free cash flow, Compounder Fund's holdings did not manage to strengthen their cash flow muscles in the fourth quarter of 2022. Table 11 below shows the revenue growth for each company that's currently in the portfolio (the 50 companies in Table 4) for the quarter as well as the change in their free cash flow margins for the period. **During the fourth quarter of 2022, the simple-average free cash flow margin for all the fund's current holdings was 14.4%, down significantly from 23.3% a year ago**. It has been a string of quarters where the free cash flow margin has declined on a year-on-year basis (the margin also fell in the second, third, and fourth quarters of 2021, and the first, second and third quarters of 2022). But there are a number of signs for optimism:

- The 14.4% seen in the fourth quarter of 2022 is slightly better than the 13.8% and the 12.4% seen in the third and second quarters, respectively.
- Upstart's free cash flow margin of -175.5% in the fourth quarter of 2022 (vs -5.5% a year ago) dragged down the average significantly. As I first discussed in the **2022 third-quarter letter**, Upstart is currently working through a change in its business model where it's trying to get more long-term funding agreements in place for the loans it's facilitating. In the meantime, it has to utilise its own cash to help fund the loans that are flowing through its platform. But in Upstart's 2022 fourth-quarter earnings conference call, management said the size of the company's loan portfolio (US$1.01 billion at end-2022) has reached their limit and they would not want the

company to fund new loans to a large extent until suitable buyers of existing loans can be found. If Upstart's numbers were removed, the simple-average free cash flow margin for Compounder Fund's current portfolio would be 18.8% in the fourth quarter of 2022, still down from 24.0% from a year ago, but with a significantly smaller gap. It's also worth noting that the simple-average free cash flow margin for the portfolio for the third and second quarters of 2022 would be 15.7% and 13.3%, respectively, when Upstart's numbers are not in the picture.

- 29 companies in the current portfolio saw an improvement in their free cash flow margin in the fourth quarter of 2022 compared to the third quarter.

Given the nature and track records of the companies in Compounder Fund's portfolio, we continue to think that the long-term average free cash flow margin for the current crop of portfolio companies can grow to around 25% eventually and be maintained at that level.

Table 11

Company	**Revenue growth in Q4 2022 from a year ago**	**Free cash flow margin in Q4 2022**	**Free cash flow margin in Q4 2021**
Activision Blizzard	7.9%	47.1%	29.6%
Adobe	9.2%	33.6%	38.5%
Adyen	29.7%	43.4%	58.3%
Alphabet	1.0%	21.0%	24.1%
Alteryx	73.2%	-0.2%	15.3%
Amazon	8.6%	8.4%	2.3%
Apple	-5.5%	25.8%	35.6%
ASML	29.0%	76.0%	122.9%
Block	14.0%	-0.1%	3.9%
Chipotle Mexican Grill	11.2%	11.8%	16.1%
Costco	6.5%	4.2%	-0.6%
Coupang	4.9%	8.6%	-7.3%
Datadog	43.9%	20.5%	32.7%
dLocal	55.3%	-38.1%	47.9%
DocuSign	13.6%	17.1%	12.1%
Etsy	12.6%	35.5%	39.0%
Fiverr	4.2%	11.5%	9.5%
Haidilao	-24.9%	-	-
Hingham	-24.1%	-	-
Illumina	-9.6%	5.4%	17.7%
Intuitive Surgical	6.7%	18.1%	26.9%
Markel	21.3%	-	-
Mastercard	11.5%	47.0%	55.8%
Medistim	25.8%	8.0%	31.5%
Medpace	27.7%	32.3%	20.0%

Company	Revenue growth in Q4 2022 from a year ago	Free cash flow margin in Q4 2022	Free cash flow margin in Q4 2021
Meituan Dianping	21.4%	-	-
Table 11 (continued from above)			
MercadoLibre	40.9%	47.6%	25.6%
Meta Platforms	-4.5%	16.8%	36.2%
Microsoft	2.0%	8.0%	15.0%
MongoDB	35.6%	7.0%	7.0%
Netflix	1.9%	4.2%	-7.4%
Okta	33.2%	14.3%	1.2%
Paycom Software	30.0%	22.6%	18.2%
PayPal	6.7%	19.4%	20.6%
Salesforce	14.4%	30.7%	24.8%
Sea	7.1%	4.9%	-
Shopify	25.7%	14.3%	19.3%
Starbucks	8.2%	12.4%	18.1%
Super Hi International	75.9%	-	-
Tencent Holdings	0.5%	15.9%	23.2%
Tesla	37.2%	5.8%	15.6%
The Trade Desk	24.0%	25.0%	38.2%
Tractor Supply	20.7%	10.2%	0.6%
TSMC	42.8%	24.0%	32.6%
Upstart	-51.8%	-175.5%	-5.5%
Veeva Systems	16.0%	10.5%	10.3%
Visa	12.4%	49.4%	57.5%
Wise	50.3%	-	-
Wix	6.5%	10.9%	2.2%
Zoom	4.3%	16.3%	17.3%
Simple averages	**16.3%**	**14.4%**	**23.3%**

Source: Companies' earnings updates

(As of the publication of this letter, there's no quarterly free cash flow data available for Haidilao, Meituan, Super Hi, and Wise for the fourth quarter of 2022. We did not include free cash flow data for Hingham and Markel because we don't think it's as important for the two companies - Hingham is a **bank** while Markel is predominantly an **insurer and investment holding company**, so we think the book value holds more meaning for them.)

In summary, we are satisfied with the aggregate business performance of Compounder Fund's portfolio holdings.

Near the beginning of this letter, I mentioned that I will have more to share on the business and stock price performances of Compounder Fund's holdings. Table 12 below shows a few

things for the period from 31 December 2022 to 5 April 2023 for the fund's current crop of 50 companies: The change in their trailing revenues-per-share; the change in their trailing P/S (price-to-sales) ratios; and the change in their stock prices. I'm using revenue instead of earnings or cash flow because some of Compounder Fund's holdings are still reinvesting in their businesses for future growth. As a result, they currently are deliberately loss-making, have negative free cash flow, or have low profit and/or free cash flow margins.

Table 12

Company	Trailing revenue per share on 31 Dec 2022	Trailing revenue per share on 5 Apr 2023	P/S ratio on 31 Dec 2022	P/S ratio on 5 Apr 2023	Trailing revenue per share change from 31 Dec 2022 to 5 Apr 2023	P/S ratio change from 31 Dec 2022 to 5 Apr 2023	Stock price change from 31 Dec 2022 to 5 Apr 2023
Activision Blizzard	US$ 9.34	US$ 9.54	8.2	8.9	2.2%	9.1%	11.5%
Adobe	US$ 37.38	US$ 39.13	9.0	9.8	4.7%	8.4%	13.5%
Adyen	€ 37.53	€ 41.17	34.3	34.6	9.7%	0.9%	10.7%
Alphabet	US$ 21.33	US$ 21.49	4.1	4.9	0.8%	17.5%	18.4%
Alteryx	US$ 10.66	US$ 12.49	4.8	4.3	17.1%	-9.6%	5.9%
Amazon	US$ 49.34	US$ 50.44	1.7	2.0	2.2%	17.7%	20.4%
Apple	US$ 24.15	US$ 24.29	5.4	6.7	0.6%	25.3%	26.0%
ASML	€ 49.33	€ 53.19	10.3	11.4	7.8%	10.9%	21.5%
Block	US$ 29.64	US$ 30.28	2.1	2.2	2.2%	5.4%	7.7%
Chipotle	US$ 299.28	US$ 307.7	4.6	5.5	2.8%	19.0%	22.3%
Costco	US$ 519.71	US$ 527.31	0.9	0.9	1.5%	7.3%	8.9%
Coupang	US$ 11.54	US$ 11.66	1.3	1.3	1.1%	5.2%	6.3%
Datadog	US$ 4.87	US$ 5.31	15.1	12.4	9.1%	-17.6%	-10.1%
dLocal	US$ 1.20	US$ 1.34	12.9	9.3	11.2%	-27.9%	-19.8%
DocuSign	US$ 12.15	US$ 12.52	4.6	4.5	3.1%	-2.1%	0.9%
Etsy	US$ 19.50	US$ 20.24	6.1	5.2	3.8%	-15.3%	-12.1%
Fiverr	US$ 9.07	US$ 9.15	3.2	3.7	1.0%	15.7%	16.8%
Haidilao	RMB 6.98	RMB 5.73	2.8	3.1	-17.8%	10.3%	-8.9%
Hingham	US$ 51.20	US$ 48.20	5.4	4.5	-5.9%	-15.7%	-20.6%
Illumina	US$ 29.92	US$ 29.19	6.8	7.9	-2.4%	17.1%	14.2%
Intuitive Surgical	US$ 16.82	US$ 17.11	15.8	15.1	1.7%	-4.4%	-2.8%
Markel	US$ 900.13	US$ 946.38	1.5	1.4	5.1%	-6.3%	-1.5%
Mastercard	US$ 22.21	US$ 22.90	15.6	15.9	3.1%	1.6%	4.8%
Medistim	NOK 25.33	NOK 26.92	9.1	10.5	6.3%	14.9%	22.1%
Medpace	US$ 40.31	US$ 43.36	5.3	4.4	7.6%	-17.2%	-10.9%
Meituan	RMB 34.11	RMB 35.73	4.5	3.3	4.7%	-27.2%	-23.4%
Mercado-	US$ 188.21	US$ 205.26	4.5	6.1	9.1%	35.5%	47.7%

Libre							

Table 12 (continued from above)

Company	Trailing revenue per share on 31 Dec 2022	Trailing revenue per share on 5 Apr 2023	P/S ratio on 31 Dec 2022	P/S ratio on 5 Apr 2023	Trailing revenue per share change from 31 Dec 2022 to 5 Apr 2023	P/S ratio change from 31 Dec 2022 to 5 Apr 2023	Stock price change from 31 Dec 2022 to 5 Apr 2023
Meta Platforms	US$ 43.46	US$ 43.16	2.8	4.9	-0.7%	77.0%	75.7%
Microsoft	US$ 27.13	US$ 27.29	8.8	10.4	0.6%	17.9%	18.6%
MongoDB	US$ 17.41	US$ 18.71	11.3	11.4	7.5%	0.7%	8.3%
Netflix	US$ 69.76	US$ 70.06	4.2	4.9	0.4%	15.6%	16.1%
Okta	US$ 11.00	US$ 11.76	6.2	6.7	6.9%	7.6%	15.0%
Paycom Software	US$ 22.16	US$ 23.64	14.0	12.1	6.7%	-13.7%	-8.0%
PayPal	US$ 23.26	US$ 23.76	3.1	3.1	2.2%	1.2%	3.4%
Salesforce	US$ 30.26	US$ 31.45	4.4	6.2	3.9%	41.8%	47.3%
Sea	US$ 21.88	US$ 22.31	2.4	3.8	1.9%	61.6%	64.7%
Shopify	US$ 4.15	US$ 4.42	8.4	10.2	6.6%	22.2%	30.2%
Starbucks	US$ 27.84	US$ 28.55	3.6	3.7	2.6%	3.1%	5.7%
Super Hi	US$ 0.76	US$ 1.00	1.7	2.4	31.8%	42.3%	88.5%
Tencent	RMB 57.55	RMB 58.2	4.9	5.8	1.1%	19.4%	21.4%
Tesla	US$ 21.59	US$ 23.84	5.7	7.8	10.4%	36.4%	50.6%
The Trade Desk	US$ 3.05	US$ 3.16	14.7	18.6	3.5%	26.4%	30.8%
Tractor Supply	US$ 120.20	US$ 126.66	1.9	1.9	5.4%	-1.1%	4.2%
TSMC	NT 385.70	NT 426.36	5.9	6.4	10.5%	8.8%	21.1%
Upstart	US$ 12.02	US$ 10.18	1.1	1.7	-15.3%	50.1%	27.1%
Veeva Systems	US$ 12.81	US$ 13.27	12.6	13.6	3.6%	7.7%	11.6%
Visa	US$ 13.72	US$ 14.36	15.1	15.9	4.7%	4.9%	9.8%
Wise	£ 0.68	£ 0.75	8.3	7.2	10.8%	-13.5%	-4.2%
Wix	US$ 23.49	US$ 23.93	3.3	4.0	1.9%	23.1%	25.4%
Zoom	US$ 14.24	US$ 14.44	4.8	4.9	1.4%	3.5%	5.0%
Simple average	-	-	**7.0**	**7.4**	**4.0%**	-	-

Source: Companies' earnings updates

What Table 12 highlights: **Compounder Fund's businesses performed well over the past quarter, with average sequential trailing revenue growth of 4.0% and 45 of them experiencing growth in their trailing revenues per share for 5 April 2023 compared to 31 December 2022. On this occasion, many of Compounder Fund's businesses also**

saw their stock prices rise, a consequence of their business growth *and* an increase in their P/S ratios.

This rise in the P/S ratio (from an average of 7.0 to 7.4) is a welcome change from many prior quarters when the stock prices of many of Compounder Fund's holdings fell because of a sharp compression in their P/S ratios despite growth in their businesses. **We think Compounder Fund's holdings now have more-than-reasonable valuations (a continuation of a theme we saw when I wrote our letters for 2022's second, third, and fourth quarters) and this bodes well for the fund's future return**. As of 5 April 2023, the companies currently in Compounder Fund's portfolio **have an average trailing P/S ratio of 7.4, and an average trailing free cash flow margin of 14.2%, which equates to an average P/FCF ratio of 52; the removal of Upstart's numbers - as mentioned earlier, Upstart is in the midst of a major change in its business model - would result in an average trailing P/S ratio, free cash flow margin, and P/FCF ratio of 7.5, 16.5%, and 46, respectively**. If Compounder Fund's companies had an average free cash flow margin of 25% today - around the level we think they could achieve, eventually - **the implied P/FCF ratio on the P/S ratio of 7.4 would be even lower at 30**. For perspective, the implied P/FCF ratio of 30 comes from a group of companies - Compounder Fund's current portfolio - that produced impressive average revenue growth rates of 43.7%, 28.0%, 21.4%, 19.8% and 16.3% for the whole of 2021 and the first, second, third, and fourth quarters of 2022, respectively.

Takeaways from Silicon Valley Bank's collapse

March 2023 was a tumultuous month in the world of finance. On 8 March, Silicon Valley Bank, the 16th largest bank in the USA with US$209 billion in assets at the end of 2022, reported that it would incur a US$1.8 billion loss after it sold some of its assets to meet deposit withdrawals. Just two days later, on 10 March, banking regulators seized control of the bank, marking its effective collapse. It turned out that Silicon Valley Bank, or SVB, had faced US$42 billion in deposit withdrawals, representing nearly a *quarter* of its deposit base at the end of 2022, in just one *day* on 9 March.

SVB had failed because of a classic bank run. As I first described in the "*Portfolio changes*" section of this letter:

> "At a simplified level, banking involves taking in deposits and distributing the capital as loans to borrowers. A bank's assets (what it owns) are the loans it has doled out, and its liabilities (what it owes) are deposits from depositors. When depositors withdraw their deposits, a bank has to return cash to them. Often, depositors can withdraw their deposits at short notice, whereas a bank can't easily convert its loans into ready cash quickly. So when a large group of depositors ask for their money back, it's difficult for a bank to meet the withdrawals - that's when a bank run happens."

When SVB was initially taken over by regulators, there was no guarantee that the bank's depositors would be made whole. Official confirmation that the money of SVB's depositors would be fully protected was only given a few days later. In the leadup to and in the aftermath of SVB's fall, there was a palpable fear among stock market participants that a

systemic bank run could happen within the US banking sector. The Invesco KBW Regional Banking ETF, an exchange-traded fund tracking the KBW Nasdaq Regional Banking Index, which comprises public-listed US regional banks and thrifts, fell by 21% in March 2023. The stock price of First Republic Bank, ranked 14th in America with US$212 billion in assets at the end of 2022, cratered by 89% in the same month. For context, the S&P 500 was up by 3.5%.

SVB was not the only US bank that failed last month. Two other US banks, Silvergate Bank and Signature Bank, did too. There was also contagion beyond the USA. On 19 March, Credit Suisse, a Switzerland-based bank with CHF 531 billion in assets (around US$575 billion) at the end of 2022, was forced by its country's regulators to agree to be acquired by its national peer, UBS, for just over US$3 billion; two days prior, on 17 March, Credit Suisse had a market capitalization of US$8.6 billion. **Going back to the start of 2023, I don't think it was in anyone's predictions for the year that banks of significant size in the USA would fail** (Signature Bank had US$110 billion in assets at the end of 2022) **or that the 167 year-old Credit Suisse would be absorbed by another bank for a relative pittance**. These are a sound reminder of a belief Jeremy and I have about investing that I last shared in the "*Recession, inflation, and interest rates*" section of the **2022 third-quarter letter** (emphasis is added):

> "**[We believe] that bad scenarios inevitably happen from time to time, but we just don't know when.** So what we do is to invest in companies that we think have both bright growth prospects in peaceful conditions and a high likelihood of making it through a crisis either relatively unscathed or in even better shape than before."

For Jeremy and me, the SVB bank run is also an example of an important aspect of how we invest: Why we shun forecasts. SVB's run was different from past bank runs. Jerome Powell, chair of the Federal Reserve, said in a 22 March speech (emphasis is mine):

> "**The speed of the run [on SVB], it's very different from what we've seen in the past** and it does kind of suggest that there's a need for possible regulatory and supervisory changes just because supervision and regulation need to keep up with what's happening in the world."

There are suggestions from observers of financial markets that the run on SVB could happen at such breakneck speed - US$42 billion of deposits, which is nearly a quarter of the bank's deposit base, withdrawn in one *day* - because of the existence of mobile devices and internet banking. I agree. Bank runs of old would have involved people physically waiting in line at bank branches to withdraw their money. Outflow of deposits would thus take a relatively longer time. Now it can happen in the time it takes to tap a smartphone. In 2014, author James Surowiecki reviewed Walter Friedman's book on the folly of economic forecasting titled ***Fortune Tellers***. In his review, Surowiecki wrote (emphasis is mine):

> "**The failure of forecasting is also due to the limits of learning from history. The models forecasters use are all built, to one degree or another, on the notion that historical patterns recur, and that the past can be a guide to the future. The problem is that some of the most economically consequential events are precisely those that haven't happened before**. Think of the oil crisis of the 1970s, or the fall of the Soviet Union, or, most important, China's decision to embrace (in its

> way) capitalism and open itself to the West. Or think of the housing bubble. Many of the forecasting models that the banks relied on assumed that housing prices could never fall, on a national basis, as steeply as they did, because they had never fallen so steeply before. But of course they had also never risen so steeply before, which made the models effectively useless."

There is great truth in something writer Kelly Hayes once said: "Everything feels unprecedented when you haven't engaged with history." SVB's failure can easily feel epochal to some investors, since it was one of the largest banks in America when it fell. But it was actually just 15 years ago, in 2008, when the *largest* bank failure in the USA - a record that still holds - happened. The culprit, Washington Mutual, had US$307 billion in assets at the time. In fact, bank failures are not even a rare occurrence in the USA. From 2001 to the end of March 2023, there have been 563 such incidents. But Hayes' wise quote misses an important fact about life: **Things that have never happened before do happen**. Such is the case when it came to the speed of SVB's bank run. For context, Washington Mutual crumbled after a **total of US$16.7 billion in deposits - less than 10% of its total deposit base - fled over 10 *days***.

Jeremy and I have also seen that unprecedented things do happen with alarming regularity. It was just three years ago, in April 2020, when the price of oil went negative for the first time in history. **When managing Compounder Fund's capital, we have - and always will - keep this in mind. We also know that we are unable to predict what these unprecedented events could look like, but we are sure that they are bound to happen**. To deal with these, we fall back to what I shared earlier in this section from our 2022 third-quarter letter:

> "So what we do is to invest in companies that we think have both bright growth prospects in peaceful conditions and a high likelihood of making it through a crisis [even an unprecedented one] either relatively unscathed or in even better shape than before."

We think such companies look like the ones we have been seeking for Compounder Fund. They are companies with the following traits:

1. Revenues that are small in relation to a large and/or growing market, or revenues that are large in a fast-growing market
2. Strong balance sheets with minimal or reasonable levels of debt
3. Management teams with integrity, capability, and an innovative mindset
4. Revenue streams that are recurring in nature, either through contracts or customer-behaviour
5. A proven ability to grow
6. A high likelihood of generating a strong and growing stream of free cash flow in the future

These traits interplay with each other to produce companies we believe to be antifragile. I last discussed the concept of antifragility in our **2021 second-quarter letter** and I'll bring up the relevant passage again (emphasis is added):

> "Jeremy and I first came across the concept of antifragility - **referring to something that strengthens when exposed to non-lethal stress** - from Nassim Nicholas Taleb's book, *Antifragile…* Antifragility is an important concept for Compounder Fund. Jeremy and I run the fund with the idea that bad things *will* happen from time to time - to economies, industries, and companies - but we just don't know how and when. As such, we are keen to own shares in antifragile companies, the ones which can thrive during chaos. **This is why the strength of a company's balance sheet is an important investment criteria for us - having a strong balance sheet increases the chance that a company can survive or even thrive in rough seas. But a company's antifragility goes beyond its financial numbers. It can also be found in how the company is run**."

It's crucial to learn from history, as Hayes's quote suggests. But it's also important to recognise that the future will not fully resemble the past. Forecasts tend to fail because there are limits to learning from history and this is why we shun forecasts. In a world where unprecedented things can *and do* happen, Jeremy and I are prepared for the unexpected.

House-keeping matters and what's next

Compounder Fund's audit for calendar year 2022 - to be conducted by Baker Tilly - should be wrapped up by the end of the first half of this year. Once the audit report's finalised, Jeremy and I will be sending a digital copy of it to all of Compounder Fund's investors. As a reminder, on 11 May 2022, we sent a digital copy of Compounder Fund's audited financial statements for 2021 to all of the fund's investors. If you did not receive it, or if you joined the fund as an investor after 11 May 2022 and would like a digital copy of the audited 2021 financial statements, please let Jeremy and me know.

As Jeremy and I have shared before, giving back to society is one of the four key pillars of Compounder Fund's mission to "Grow *Your* Wealth & Enrich Society." In the fund's website, we **mentioned** that "we are setting aside at least 10% of every dollar we earn from Compounder Fund in each year for charities of our choice" and that "we will audit our giving." The first audit for our giving, conducted by Baker Tilly, covered the period from November 2019 (when we started building the fund) to December 2021. Subsequent audits are for each calendar year and the audit report for 2022 - again with Baker Tilly as the auditor - was recently completed. As a reminder, all the audit reports for our charitable giving are available on the fund's website **here**. If you are interested to know more about our charitable giving, feel free to reach out!

Another of the key pillars of Compounder Fund's mission involves investor education. To this end, Jeremy and I are running Compounder Fund transparently. We have released the investment theses for all of Compounder Fund's current holdings (for your convenience, all our theses can be **found here**). We will inform you when we publish any new theses.

Compounder Fund's next subscription window will close in the middle of June 2023 and it will have a dealing date on the first business day of July 2023 (which should be 3rd July). If you would like to increase your investment in the fund, please submit the relevant paperwork by the middle of June 2023. Jeremy and I are happy to assist with any queries you may have.

Optimism (as always!)

There are a myriad of important political, social, economic, and healthcare issues that are plaguing our globe today. But Jeremy and I are still long-term optimistic on the stock market. This is because we still see so much potential in humanity. There are more than 8.0 billion individuals in the world **right now**, and the vast majority of people will wake up every morning wanting to improve the world and their own lot in life. *This* is ultimately what fuels the global economy and financial markets. Miscreants and Mother Nature will occasionally wreak havoc but we have faith that humanity can clean it up. To us, investing in stocks is ultimately the same as having faith in the long-term positivity of humanity. We will remain long-term optimistic on stocks so long as we continue to have this faith.

Rich Handler and Brian Friedman, who are the leaders of the investment bank Jeffries, published an open letter earlier this month titled ***Normalcy Returns Faster Than You'd Think After Financial Crises***. The letter started with an apt description of the current state of the financial world:

> "With the end of the first calendar quarter of 2023 complete, once again the financial world feels "on fire." Interest rates are still rising, inflation remains unchecked, two top 20 U.S. banks were put into receivership and auctioned off, and we just witnessed an emergency "shotgun wedding" to protect the world from the imminent demise of a systemically critical global bank."

Suffice to say that there's plenty of mess for society to clean up at the moment. But in the middle of the letter, Handler and Friedman also wrote (emphasis is ours):

> "**Our world always finds a way forward**. In fact, things are usually pretty darn good in a surprisingly short period of time after we avoid [sic] often anticipated the "end of the world."

This harkens to what I mentioned at the start of this section, that "the vast majority of people will wake up every morning wanting to improve the world and their own lot in life." This is how our world finds a way forward each time it's confronted by challenges from mankind's own making or nature's wrath.

The only time Jeremy and I will turn pessimistic on the long-term returns of stocks is when they become wildly overpriced - and we don't think this is the case today. This does *not* mean that stocks are cheap or that stocks won't fall in the months or next year or two ahead (remember, we don't know what the journey will look like). It only means that we think valuations are somewhat reasonable and that investing now will likely lead to a satisfactory outcome, *if* we have a multi-year time horizon and we're invested in fast-growing companies. **With your support, we have both ingredients at Compounder Fund.**

Final words

If you have any questions related to Compounder Fund's administrative matters or our general investment thinking, please know that our email inboxes are always open to you. Thank you again for trusting Jeremy and me with your hard-earned capital. We deeply appreciate your trust and support (especially in difficult times like these), your belief in

Compounder Fund's mission to "Grow *Your* Wealth & Enrich Society," and your understanding of the investing approach that we are taking.

Your deep understanding of our long-term-oriented investment style gives us the space we need to do our work (analysing businesses and their possible long-run futures) to the best of our abilities, for you. **So, thank you all again for being the wonderful investors that you all are. And please, *never* underestimate your importance in helping to shape Compounder Fund's long-run return.**

You can expect to see Compounder Fund's 2023 second-quarter investors' letter in mid-June 2023. Till then, stay safe and take care.

Excelsior,
Chong Ser Jing
Co-founder and Portfolio Manager, Compounder Fund
14 April 2023

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

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