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CAPITAL MANAGEMENT

2021 ANNUAL PARTNERSHIP LETTER

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Survivor & Thriver Fund, LP

2021 Annual Letter
(edited for SEC compliance, 2024)

Dear Partner,

Two thousand and twenty-one was a disappointing year for performance but an excellent year in terms of progress for our portfolio companies overall. For the full year the fund was down 16.5% net to investors compared to a gain of 27.5% for the S&P 500 including dividends.

Long-time investors in the fund can remember past periods when our positioning was completely at odds with conventional market wisdom. Those periods of discomfort were followed by the best performing quarters and years in our history. This is not a prediction for returns next quarter or year but the selloff in many of our names feels overdone.

In 2021 most of holdings exceeded our expectations in terms of business progress which is all we can ask for. There were also areas of disappointment where I had overestimated the resiliency of growth against COVID headwinds. Lastly, we made an opportunistic investment in a private company called Blockfolio that was sold to the private crypto exchange FTX. Blockfolio shareholders like us now own rights to a minimum amount of FTX stock and tokens with further upside based on an earn-out over the next two years. I am learning more about FTX it might be the fastest growing business I have ever seen.

The current narrative around inflation and interest rate hikes has caused huge swaths of the market to become uninvestable almost overnight. This speaks to asset managers being asset managers and not business investors — "when bonds move x then (*all*) equities must move y" or "if a Democrat wins the presidency sell defense stocks".

Our objective is to own a basket of businesses that we think will adapt and thrive even in a higher rate environment. As a fund comprised of multi-generational family capital, we benefit disproportionately from holding companies driven to become more relevant, essential, efficient, and valuable over the next decade.

The best the investment opportunities are born in periods of uncertainty. This is when investors with a reasonable timeframe can differentiate between business quality and volatility. Our North Star for navigating investment decisions is a simple 4-part criteria that we call the *Survivor & Thriver Company Criteria*. This approach provides two important advantages:

First, allows us to focus on a range of future outcomes of a stock based on where the underlying business is headed. We invest when we think the business risk is mispriced for reasons we can understand.

Second, our framework allows us to operate outside of the market's peripheral vision and helps prevent mindlessly selling stocks because the market says to do so. It also allows us to identify mistakes based on a business thesis not coming to fruition.

Selected Portfolio Update

I am excited about the trajectory of our portfolio entering 2022. The recent selloff has allowed us to re-think and re-underwrite the risk/reward of each position compared to wish-list ideas that have also come down in price.

The Partnership's top five positions are Indivior, Spotify, Amazon, Roku, and an unnamed starter position. In total the fund has 11 holdings including a small investment in Turkey via Talas Capital.

Spotify has become one of the more contrarian positions in our portfolio as Wall Street continues to ignore improvements in gross profit, revenue, user growth and cash flow. Similar to Netflix a decade ago, Starbucks in 1990s, Nike in the early 1980s, and McDonalds in the early 1970s, Spotify is under-earning as it invests heavily in a consumer category that is still in its infancy. We think Spotify is on a glidepath to future margin expansion and user monetization that could justify the stock being worth $600 to $750 per share within five years.[1]

Spotify has been in our portfolio since late 2018 / early 2019 and the return so far has lagged the S&P 500.[2] We continue to own the stock because in our view, the valuation has not caught up with the underlying business performance.

In March of 2018 Spotify laid out its long-term goals in a pre-IPO Investor Day Presentation. Management has executed on these goals especially in the foundational areas that matter for value creation such as growing engagement per user, completing the global footprint, improving search and discovery tools, and delivering far more value to subscribers than it charges.

Spotify users have doubled to 406 million since we first bought the stock. Even if user growth slows to 15% annually, Spotify will reach one billion users within six years.[3] More importantly, the number of hours consumed on the platform in the last three years has gone from roughly 50 billion to 121 billion.[4] Spotify users are spending more time on the platform every year and we think this trend will continue as more podcast content and audio books are added.

We think streaming audio could also become a customer acquisition tool for building and monetizing audiences.

[1] JDP estimates
[2] Capital IQ
[3] JDP estimate
[4] Spotify 2021 20F filing

Spotify is leveraging its dominate position to become a mission-critical partner for music labels and creator content owners to begin to close the gap between audio and video monetization.

The monetization of premium users has improved both in terms of gross margin expansion and gross profit. Premium gross profit has nearly doubled to €2,474 billion while margins have improved to 29% with scale.[5]

We think Spotify could deliver gross margins of 35-40% by 2026 driven by advertising and search-discovery tools which could unlock €3 to €5 billion in operating income without using outside capital.[6] Longer term there are multiple paths for Spotify to win if they can be successful adding businesses on top of music.

Last August I discussed Spotify in a three-part interview with Sleepwell Capital and Tilman Versch the Good Investing podcast.

Spotify Interview Part 1

Spotify Interview Part 2

Spotify Interview Part 3

INDIVIOR

"I don't think the general public really understands the scope of the epidemic. If you look in individual counties' data and in all of 2020, three times more people died in San Francisco [of drug overdoses] than they died of COVID." --Konrad Leo Franco, PhD Candidate and Researcher, California Health Policy Strategies

Indivior PLC (INDV.L) has been in our portfolio for almost three years and been one of the more successful investments in our history. We acquired Indivior for a valuation of less than the cash on the balance sheet during a period of extreme pessimism for the company. A lawsuit filed by the Department of Justice over marketing practices was believed to have a high potential of bankrupting the company. The lawsuit has now been settled far below the worst-case scenario that had been priced in the stock.[7]

Despite the recent runup we still think the stock is cheap at 6x 2022 EV/EBITDA and strong net cash position.[8] In early 2021 an activist fund joined INDV's board, and we thought it was likely the company would sell itself. Our updated view is that the company might remain public after executing surprisingly well on its growth initiatives. The re-opening of treatment centers closed during COVID, combined with a spike in opioid use during the pandemic has helped INDV

[5] Spotify SEC filings
[6] JDP estimates
[7] JDP research/opinion
[8] JDP research, Capital IQ

expand faster in 2021 than expected. Additionally, the company's new buyback program and exploring a dual US-London listing might create more value for shareholders than selling the company today.

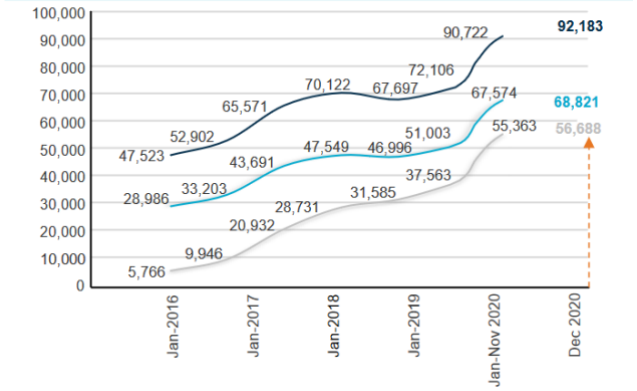
The growing Treatment Gap for opioid addiction

Indivior estimates that more than 3 million Americans and 16 million people worldwide are addicted to opioids. The market for opioid addiction is accelerating as the street drug Fentanyl is driving up addiction rates, particularly during COVID lockdowns.

Indivior is uniquely positioned as the only FDA approved injectable opioid treatment in the U.S.[9] A large part of the opioid addicts cannot be relied on to take daily medication or show up to routine doctors appointments. As such, the Sublocade injectable depot is orders of magnitude more effective for regulating addiction than drugs like methadone that simply treats withdraw symptoms.

Centers for Disease Control and Prevention, National Center for Health Statistics

Figure 1: Rapid increase in synthetic opioid deaths through lockdowns



Although we do not have definitive statistics on the economic status of US opioid addicts, we know that many are low income and often are in-and-out of prison for drug use. Indivior estimates that 65% of opioid addicts flow though the criminal justice system each year.

This has led to growing political will to reduce the "treatment gap" or the opioid addiction rate in US prisons versus treatment which is a unique tailwind for INDV's flagship drug Sublocade. Indivior targets a Sublocade peak patient penetration of 180,000 per year (6% of users), from 29,000 per year run-rate currently (or 1% of users) which is modest relative to the addressable market. Indivior's entrenched sales force within the highly fragmented government Organized Health Systems (OHS) that approve Medicaid programs is also an overlooked advantage. Indivior's heavy investment over the years in integrating their salespeople into the fabric of OHS organizations is not easy to replicate and opens up the opportunity to sell other addiction-treatment drugs in the company's pipeline.

[9] Indivior investor filings

Although taxpayer funded treatment of opioid addiction might never close the treatment gap, Sublocade's 80% sobriety success rate provides a floor in market share that should allow the company to achieve its revenue target of $1 billion for this flagship drug while on patent.[10]

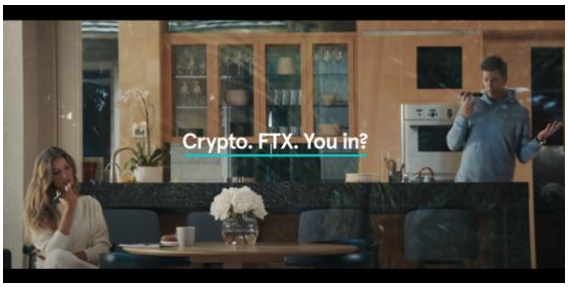
FTX

Through a small investment in privately held Blockfolio we now own stock in FTX. FTX is one of the largest and fastest growing derivative exchange businesses for trading crypto assets. FTX pioneered an efficient way to cross-collateralize any crypto asset such currencies, tokens, tokenized-stocks on a global scale.

We have decided to create a side pocket for our FTX position in order to protect the current investors from being diluted by new investors coming into the fund. Capital contributed or redeemed after December 1, 2021, will not be dilutive to your pro-rata ownership of FTX. Any distributions from the FTX investment will show up in your Survivor & Thriver Fund, LP capital account.

Based on the most recent fundraising round FTX is valued at $32 billion. On paper the combined, our FTX stock and token we received has seen enormous appreciation. Our hope is that FTX will be able to go public within a few years.

Click to view: Tom Brady and Gisele FTX commercial: You In?



Futures vs Spot market

FTX's model is different from exchanges like Coinbase which primarly facilitates ownership and delivery of the underlying asset (think Schwab or eTrade). FTX also offers spot trading but has built a best-in-class futures business that allows trading any crypto asset without needing to take delivery of the underlying asset (think trading corn, soy, coffee, pork belly futures vs buying the underlying commodity).

The crypto futures market is estimated to be 4x or 5x larger than the spot market in daily volume but is mostly outside the US due to regulatory constraints.[11]

[10] JDP estimates, Indivior investor relations
[11] JDP research

FTX's acquisition of LedgerX last year positions the company to gain regulatory approval to expand its non-US futures offering in the US.

In an excellent interview last year with Patrick O'Shaughnessy, founder Sam Brankman-Fried mentions that he thinks there is a $25 billion opportunity in US derivatives trading volume that is wide open today. Sam also discusses the opportunities for FTX to build new marketplaces and banking rails of its current exchange business.

Roku

In January 2021 we cut our Roku position after a strong rally in order manage the position size as a percentage of fund assets.

Roku has since declined to 2019 price levels while gross profit is on pace to be 5 times higher in 2022 than 2019.[12] In the short two years we have owned the stock, platform revenue per subscriber (ARPU) is up 77% from $23.14 to $41.[13] The bearish sentiment around supply chain issues holding back TV sales and advertising spend in certain consumer product categories is painful but has helped Roku gain share. Roku now controls ~40% of US TV streaming hours and less than 20% of linear TV advertising has followed the consumer to connected TV.[14]

We think Roku can achieve ARPU of $120+ by 2026 which could drive substantial cash flow growth.

Highlights from Roku's 2021 FY Shareholder Letter

- US active account base surpassed the US video subscribers of all the cable companies combined
- Platform revenue increased 80% YoY to $2.28 billion
- Roku is the number one TV streaming platform in the US, Canada and Mexico by hours streamed
- The Roku operating system remained the number one selling Smart TV operating system in the US representing 1 in 3 Smart TVs sold
- In 2021 streamed hours increased by 14.4 billion hours to 73.2 billion hours
- The company ended 2021 with $2.1 billion in cash on the balance sheet and no debt

[12] JDP estimates, Roku investor relations
[13] Roku investor relations
[14] JDP estimates, Roku investor relations

Arbitraging performance-driven advertising and budget-conscious content

The backdrop of our Roku thesis is that connected TV (CTV) is the gatekeeper to the living room which is one of the more under-monetized consumer categories in our opinion.

Growing consumer engagement with The Roku Channel allows Roku to serve ads to subscribers who get access to 225+ channels of Free Ad Supported Television. Price-sensitive subscribers will continue spending more time watching free TV as the content value proposition narrows compared to second tier and third tier subscription content apps. This allows Roku to arbitrage the growing spread between lower-budget content costs and ad pricing that rises with expected returns for advertisers. As the targetability and measurability of CTV advertising improves, the more advertisers will earn and the more they will spend with Roku.

The addressable market for CTV advertising is still tiny and loosely defined because the mass adoption of streaming TV is a recent phenomenon. We think that connected TV advertising will become many times larger than cable TV advertising which is estimated to be $200 billion globally in 2022[15] because it is interactive, targeted, and measurable. The operating system that runs a Roku smart TV are the rails for consuming and purchasing content subscriptions, content on-demand, and advertising anything that can be embedded within ad-supported content.

Despite trimming the position, we remain invested because we think the company has years of growth runway in front it. We think Roku's current market cap of around $16 billion today undervalues future earning power.

Roku Subscribers and ARPU

	2015	2016	2017	2018	2019	2020	2021	2026
Subscribers (m)	9.2	13.4	19.3	27	19.3	51.2	57	82
(Change %)		*45.6%*	*44%*	*39.9%*	*71.4%*	*165.2%*	*11.3%*	
CAGR estimate*								*8%*
ARPU / Annually	$6.48	$9.28	$13.78	$17.95	$23.14	$28.76	$41	$125
(Change%)		*43.2%*	*48.4%*	*30.2%*	*28.9%*	*24.2%*	*46%*	
CAGR estimate*								*25%*
ARPU / Monthly	$0.54	$0.77	$1.15	$1.50	$1.93	$2.40	$3.40	$10.4

*Company filings, JDP estimates

Over time we think ad-supported streaming models will become standard and embraced by publishers trying to play catch up with Netflix and build subscription-based models that only work at mega-scale.

Roku's ability to help publishers build and monetize large audiences with less pressure on content costs becomes more compelling as the value proposition rises for advertisers. Roku points to recent case studies where consumer brands like Home Chef earned 2.5x return on ad

[15] Dentsu Ad Spend Report, 2022

spend and a 21% sales lift among new buyers exposed to a CTV campaign. As return-on-advertising spend improves it will be easier for sub scale content apps to shift to ad-based models and allow platforms like Roku to monetize their inventory.

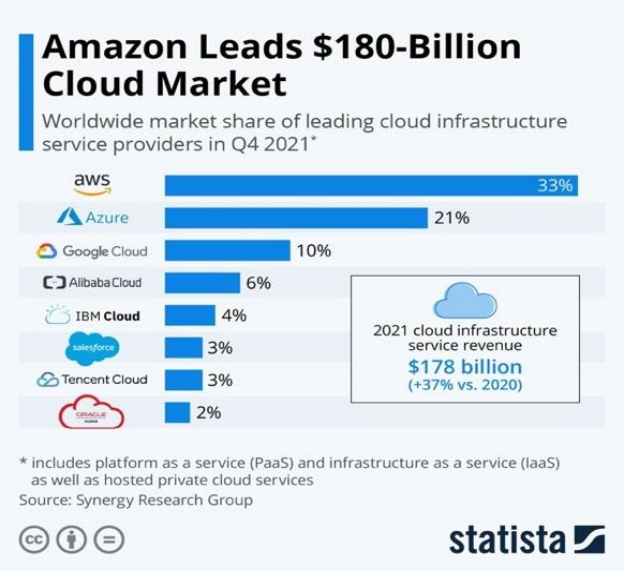
amazon

The Partnership added to Amazon at price of $3,200 per share on the simple thesis that at the current equity value of $1.6 trillion you are buying AWS and getting the rest of Amazon for between $200 to $300 billion dollars based on current revenue and operating earnings.[16]

Dan Loeb from Third Point recently pointed out that he sees "$1 trillion of untapped value" as the market is failing to recognize the full value of Amazon's two disparate businesses: core e-commerce operations and Amazon Web Services. We think "$1 billion of trapped value" is conservative but possibly more realistic if the conglomerate discount is never fully closed.

AWS is the most important infrastructure business in cloud computing globally with $71 billion in run rate annual revenue growing at 40% annually (4Q '21) at massive scale. As a consumption-based business AWS will benefit from new workloads across cloud computing as they grow and evolve. AWS is on track to reach $100+ billion in revenue within a few years, if that were to happen, we could see a standalone AWS worth $2+ trillion.[17]

The longer we study Amazon the more it is clear that the barrier to compete with either AWS or ecommerce infrastructure is enormous and growing.



[16] JDP estimates and research
[17] JDP estimates

What about Amazon's other businesses that you are getting for $200 to $300 billion?

- The #2 retailer globally by volume,
- A logistics business that is close to being larger than UPS and Fedex,
- The #1 online marketplace in terms of merchandise volume,
- The #3 advertising business globally behind Google and Facebook,
- 200 million Amazon Prime members,
- One of the largest streaming entertainment businesses globally,
- Amazon Style and the largest apparel retailer in the US,
- Amazon Healthcare,
- Alexa, and several other large initiatives that are rich with long-term optionality such as commercial EVs and the investment in Rivian Automotive, leading warehouse robotic technology, and satellite/space initiatives

Despite Amazon's mega cap status, we think the stock fits our return goals of 15% to 25% annualized over a 5-year period.

In December 2021 we initiated a position in Digital Turbine (NASDAQ: APPS). APPS is a mobile advertising platform for the Android operating system that facilitates app downloads and customer acquisition for app publishers on smartphones globally.

We were attracted to APPS's small market cap in relation to the growing importance of its position within the Android smartphone advertising supply chain. Digital Turbine is growing revenue 30% to 40% annually, is profitable, and growing EBITDA at nearly double the rate of revenue.[18] Management is targeting $1 billion of EBITDA within a few years, and we think this is possible to achieve with internally generated cash flow.

Digital Turbine operates as a 3-sided marketplace where consumers benefit from customizing their mobile applications, advertisers get an efficient means to acquire users, and Telcom / smartphone OEMs add a recurring stream of cash flow through a revenue share in monetizing app downloads.

Digital Turbine's SingleTap technology enables smartphone users to instantly install an app to their Android device with a "single tap." This creates a bypass from the noise of an app store environment, and dramatically increases conversions. The company's product and network create adtech supply chain arbitrage because it can more efficiently get smartphone users to download and use applications than other platforms.

The recently announced strategic partnership with Google has added credibility to Digital Turbine's technology and contracts with 40 smartphone OEMs, relationships with 45,000 app

[18] Digital Turbine earnings presentations, JDP estimates

publishers, and a 1.5+ billion user reach today. APPS's marketplace is an excellent tool for publishers and advertisers to reach non-Apple smartphone users with a one-stop-shop solution.

Looking forward

I found this recent quote from Eric Markowitz from Worm Capital to be very insightful and excellent summary of the investment environment today:

"Humans are biologically wired to stay within the herd for safety. But what if the herd is heading towards a cliff? In this environment, I increasingly believe what feels safe in the short-term (i.e. "cheap" legacy business models) may prove to be the riskiest assets over the long-term."

Over the last decade we have been through several downturns, all scary, and all eventually passed like a bad storm in the night. Past examples include the late 2011 "double dip recession" fears, 2012 Eurozone "financial contagion" fears due to Portugal, Italy, Greece, and Spain (PIGS) county defaults, December 2018 Fed tightening (Taper Tantrum), COVID, and now, rising interest rates.

Think about the number of smart managers that panic-sold Berkshire Hathaway for $45,000 in early 2000 (up 10x since), Nike at $11 in 2008 (up 12x+ since), Netflix for $8 in 2012 (up 48x since), Hermes for $210 in 2012 (up 5.7x since, before dividends) and Domino's Pizza for $248 in late 2018 during the last Taper Tantrum (up 75% since, before dividends). How do *we* avoid similar mistakes?

The feeling of uncertainty is the "one constant" in investing and that never goes away.

Mistakes are part of investing, and we will continue to make them. My hope is that our investment process and unusual time horizon offers just enough of advantage that our winners are able to make up for the losers.

The prices of several of our holdings are approaching COVID-low prices despite having grown much larger and benefiting from secular tailwinds that that we believe to be durable.[19]

We are fortunate to be in a position to be fully invested when many others cannot be. More than 90% of my family's net worth is invested alongside yours. I believe deeply in our investment process and am confident in the value that our businesses are creating.

YouTube channel

We plan to resume the quarterly videos in 2022 but with a renewed focus on reviewing key takeaways from selected portfolio companies. Questions are still welcome, but we will pause

[19] JDP research and opinion

from the practice of taking pre-video polls. If you would like to ask a question about anything you see in a video, please send me an email.

Adding capital

New and existing investors can add capital at the end of each month. The minimum investment for US taxable investors is $250,000 and $500,000 for non-US taxable. Forms are available in Investor Portal area of the website.

Thank you for your continued support.

Sincerely,

Jeremy Deal