Q2 2019 Investor Letter | *July 23, 2019*

Dear Investor,

Results for the quarter ended June 30th, 2019 appear below with comparable results for the S&P 500.

Bonsai Partners Historical Returns Summary

	YTD 2019	2018	Since Inception
Bonsai Gross Return	50.1%	-17.9%	30.9%
Bonsai Net Return	46.9%	-18.1%	27.7%
S&P 500 Return	4.3%	-8.6%	7.7%

Performance data shown represents past performance. Past performance is not indicative of future results. The period October 22, 2018, to April 30, 2021, presents time-weighted returns of a representative Bonsai Partners, LLC ("Bonsai") managed account with the same strategy and risk profile as Bonsai Partners Fund, LP, (the "Fund") which launched on May 1, 2021. Results from May 1, 2021, reflect the time-weighted returns of Class A shares of the Fund.

Gross returns from October 2018 to April 2021 include transaction and commission fees. Gross returns from May 2021 to the present include transaction and commission fees and fund operating expenses, such as administrative and audit fees but do not include management or performance fees. Net returns reflect the gross returns (as described) reduced by a 1.0% management fee and a 10.0% performance fee above a 6.0% cumulative compounding hurdle.

All performance figures are calculated internally by Bonsai Partners and are therefore estimated, unaudited, and subject to adjustment. The investment return and principal value of an investment with the Fund will fluctuate so that an investment, when redeemed, may be worth more or less than its original cost. Actual performance for a particular investor may be lower or higher than quoted performance due to different fee structures, share classes, beginning periods, capital additions or withdrawals, or individual compliance related mandates. Please refer to important additional disclosures at the end of this letter.

Performance Update

I want to begin by repeating something I wrote earlier:

> *"Please, do not offer me too much credit (or discredit) for a single quarter, or even a single year's results. You will need at least a couple of years to know how we're doing."*

While we had good results this quarter, a ~50% return for any portfolio over a three month time period is unusual, and I don't expect we'll repeat that any time soon. In short, I'm pleased but not satisfied, but we have a long way to go.

Like prior quarters, it's been difficult to identify many attractive new opportunities, but I was still able to extend our streak of adding a new investment to our portfolio – marking three quarters in a row. Since we began, we've made three purchases and no sales.

To me, one trade per quarter is plenty. We're not trying to maximize the number of buy/sell decisions we make; we're trying to do the opposite. Selling a position is not a victory, and often it happens because we found something else that's better or we realized we made a mistake in the first place. Further, each time we sell we have to pay transaction costs, taxes, and we lose the interest-free loan the government offers us (we can compound the taxes owed on our capital gains until we sell).

My prediction: the fewer sell decisions you notice over time, the higher our long term performance will be. That said, I intend to make trades as necessary, but it isn't my goal to show you the five new positions I've bought and sold each quarter. It's not possible for anyone to deeply understand five new companies in a given quarter. Even a single new idea takes months of work and preparation to have a decent understanding.

During the second quarter we made our third investment in a Hong Kong listed company called **Travelsky Technologies**. While the U.S.-China trade war created volatility in the Asian markets, this allowed us to acquire part of a great business at a reasonable price. I have been watching and learning about Travelsky for months, and I waited for a reasonable time to get involved.

I want to take a moment to thank Ziqiao Wang who worked with me on Travelsky from late 2018 through mid-2019. As a Mandarin speaker, Ziqiao helped me sleep better at night by confirming that the filings I've been reading in English are in fact the same as what is presented to Chinese investors. Ziqiao also helped bridge the gap between Bonsai and their investor relations department who only conducts calls in Mandarin. His ability to augment our research by looking at Chinese documents and speaking with Chinese sources was invaluable.

While I've long wanted to make a China based investment, I didn't want to be operating at an information disadvantage, which is typically the case for westerners looking in Asia. I'm confident we've minimized this issue as much as possible, and in the process, uncovered a number of deep insights into this business that offers a different kind of information advantage over local investors.

I outline the full rationale of our investment in Travelsky later in this letter. Travelsky now represents a 12.5% position in our portfolio, which is the "smallest investment" we've made. As stated in prior letters, I believe it's less risky to own a small number of companies that I understand deeply, than to own many companies I know little about.

In summary, we continue to move ahead with our strategy and believe we're headed in the right direction. I hope to find more compelling opportunities to intelligently deploy our capital over the coming quarters.

Portfolio Update

Our portfolio grew from two to three positions during the quarter. Below I provide an update on our two existing positions: **Aspen Aerogels** and **Redbubble**, as well as share the rationale for our investment in our newest position: **Travelsky Technologies**.

Aspen Aerogels (NYSE: ASPN):

our position in Aspen Aerogels appreciated 185% in the second quarter. As our largest position, this was a welcome development that drove the majority of our returns in the period.

Since our initial purchase in late October, it would be an understatement to say that Aspen shares have been volatile. As of the end of Q2, we are above our cost basis by approximately 80% over an 8 month holding period. While I believe there's more upside to Aspen, we may experience more volatility first before we get there.

Aspen enjoyed some positive developments during the quarter. Most notably, the company announced a large project win that improved the trajectory of their business for the foreseeable future. Aspen won a large contract in Thailand to supply their Cryogel insulation for a large liquid natural gas (LNG) receiving terminal being built for PTT Public Company Limited. This deal will generate $35 to $40 million dollars of revenue for Aspen through 2020, which is quite meaningful if you consider last year's total revenue of ~$105 million. Since Aspen's end markets already started improving, this added fuel to the fire.

In addition to revenue, the PTT project offers Aspen even more balance sheet flexibility as they negotiated favorable payment terms from PTT. The combination of this deal and the $5 million pre-payment they received last quarter from BASF put to rest the two biggest overhangs that remained on the stock: 1) their balance sheet position and 2) proof that the company is back on a multi-year growth trajectory.

If you recall, the Aspen business has a significant amount of fixed costs, so any revenue realized above their ~$110 million revenue break-even point offers high profit margins, causing profits to appear rather quickly.

Aspen will go from a chronically money losing business to one that generates a reasonable amount of profits in 2020. I expect next year Aspen will generate $15 to $20 million of adjusted EBITDA, compared to their current market capitalization of ~$175 million. Even after Aspen's 225% share price increase year-to-date, the company still trades for less than 9-times adjusted EBITDA at the high end of my estimate. For a company in growth mode with a unique technology and a long runway, that is still pretty reasonable.

In addition, Aspen has other shots on goal. First, the company has the ability to expand their relationship with BASF in building materials (the largest insulation market), and second, it's possible for Aspen to expand into the high growth battery market through a new partnership; which is one of their 2019 goals.

In short, despite the share price appreciation we've seen, I'm still enthusiastic about our Aspen investment, and expect execution and potential new market expansion over the next 1-2 years to drive additional upside.

Redbubble (ASX: RBL):

Redbubble was far less exciting for us during the second quarter. Although core Redbubble sales grew 15% and total Redbubble revenue grew 40% including the acquisition of TeePublic, the company continues to take flak from analysts while they lap lingering core organic search headwinds caused by a Google algorithm change. Redbubble will finally lap these headwinds in October this year, and I hope this will remove the overhang that holds the company back.

That said, the core Redbubble thesis continues to make sense to me. More and more consumers want to buy products that express who they are, and artists continue to seek ways to better monetize the work that's sitting on their hard drives. Redbubble's two-sided marketplace is an enviable business model, and their valuation remains compelling at these levels. All we can do now is be patient.

Our position in Redbubble has depreciated approximately -10% from our cost basis, but I don't think we've made a mistake in our decision to buy it, it's just a matter of timing. We were a bit early (hopefully that doesn't become a theme), but I hope to have more positive developments to share about Redbubble over the next few quarters.

New Investment: Travelsky Technologies (HKEX: 0696)

Overview:

Travelsky represents the third investment I've made for the Bonsai portfolio. As a company, Travelsky is based out of Beijing and its shares trade on the Hong Kong Stock Exchange. Although I've been eager to make a China based investment for some time, I've found it difficult to gain conviction due to the language barrier, trust barrier, cultural barrier, and elevated valuations for high quality companies.

Travelsky is somewhat unique because it threads the needle on many of my concerns due to the way it's structured. First, like all other Hong Kong listed companies, Travelsky's filings and earnings calls are in English. Second, the company is a “state-owned enterprise” (SOE) which means that it is controlled by the Chinese government, and third, their major customers are also key shareholders.

Initially, the idea of investing in an SOE seemed unappealing. However, over time I’ve come to believe it has made me more comfortable with the business. Knowing that there is government oversight gives me more confidence that the numbers I see are real and that my interests have some alignment with the Chinese government. In addition, since Travelsky’s key customers (the major Chinese airlines) are also key stakeholders and directors of the company, this further aligns economic interests through the value chain. Said differently, there are structural safety nets within Travelsky that keep the business operating in a fair and reasonable way.

Unlike other Chinese SOEs which are typically asset-heavy, have large debt burdens and low returns on invested capital, Travelsky is different. Travelsky is the only software/IT focused SOE, and as a result, their business offers high returns on invested capital, is asset-lite, and has a fortress balance sheet.

In terms of valuation, I noticed an opportunity to own Travelsky at an attractive price. This happened for a few reasons. First, for Travelsky’s full year 2018 results, the company reported anemic earnings growth due to a one-time step-up in their cost base. This mainly occurred because the company is building out a larger new headquarters. With this build out, they have also been re-architecting their technology infrastructure.

Second, Travelsky’s monthly reported passenger traffic growth was weaker than expected in March and April. Although the company historically enjoyed passenger growth of +10%, in these months Travelsky reported growth that dipped into the 3% to 4% range. This slowdown was due to a combination of factors including the grounding of Boeing’s 737 MAX planes, weak economic sentiment in China, and the monthly idiosyncrasies associated with the timing of the Chinese New Year holiday.

These hiccups and newly stoked concerns over a China-U.S. trade war caused Travelsky’s stock price to decline around -30% during the past few months, at which point it made sense to take a position.

Why I Like it –Secular Trends

I'm excited about Travelsky over the long term because Travelsky sits at the intersection of two major demographic shifts: 1) Growth of per capita income in China and 2) the increasing percentage of incomes that shift to travel related expenses when income levels rise.

Travelsky's business acts like a toll road that collects a fee every time someone travels by air in China. This is an ideal business to take advantage of this opportunity: they are not only in the right place, they also have the right model.

Today, the average person in China flies approximately 0.5 times per year, compared to 2.5 times in the United States. If China achieves just 1.0 flight per person per year, that is still a doubling of today's traffic volumes. It's expected that over the next ten years, China will surpass the United States as the largest aviation market. These demographic shifts are a massive tailwind that Travelsky will enjoy for many years to come.

Travelsky's Business:

Travelsky is the leading provider of information technology solutions for China's aviation industry. To put that in plain English, Travelsky develops and maintains systems that allow passengers to reserve seats, book tickets, and board flights.

Travelsky's software is used by virtually all Chinese airlines, and their solutions are tightly integrated into the operations of each of these businesses. One former Travelsky employee I spoke with described their technology as "the beating heart an airline, often impossible to remove without killing the patient."

Travelsky's solutions include reservation systems, passenger boarding systems, ticket distribution systems and accounting services. The company is the Chinese analogue to Amadeus IT Group in Europe or Sabre Corporation in the United States.

Nearly every time a passenger books a flight through a Chinese airline, Travelsky earns approximately $0.80 (USD) for a domestic flight and up to $5.00 for an international flight. As Chinese airline passenger volumes increase, so will Travelsky's revenues and profits.

While I typically avoid companies that experience significant government intervention, the Chinese government has actually created a more rational and sustainable business than what we see in their western counterparts. Like Travelsky, Amadeus and Sabre have very strong business models, which have allowed them to increase the prices that airlines pay to an unsustainable level. In my view, these developments have made Amadeus and Sabre vulnerable to technology disruption in the form of an emerging IATA standard called NDC (new distribution capability). This capability allows an airline to bypass Sabre or Amadeus's distribution business to avoid paying these fees. While Travelsky earns ~$0.80 per fare to provide their full suite of services to an airline (reservations, ticket distribution, and airport processing), Amadeus or Sabre earns between $4 to $15 dollars per fare just for the distribution service. Airlines are low margin businesses, and these rents that Amadeus and Sabre have extracted are a significant point of contention.

Coming back to Travelsky, since the government helped set the price for Travelsky's services at a far lower rate, and the airlines are also Travelsky shareholders, the airlines aren't nearly as bothered by the cost, especially while their passenger growth continues to be strong.

In this circumstance, the government acted like a benevolent parent between two rival siblings to create a more sustainable, long-lasting arrangement. While I'm not a huge fan of government intervention, this lower price strategy is quite favorable for long-term shareholders, as these lower prices increase Travelsky's stickiness with their customers and lowers the chance of their customers would want to switch.

While it may sound like I'm describing Travelsky as a cheap, low-margin provider compared to Amadeus or Sabre, do note that Travelsky's profit margins are already excellent. Travelsky enjoys a 30-35% operating margin today and since the cost of processing an additional ticket is low, their margins will continue to expand as their volumes grow.

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Another appealing feature about Travelsky is that their business requires little additional capital to grow; the business expands without having to spend much on additional assets or sales and marketing campaigns. The Chinese government has clearly articulated their long term ambitions to become an aerospace power, and they have pushed forward the expansion of new airports and plane fleets. This in itself increases the availability of more affordable flights in more locations, and ultimately, more tickets sold. Travelsky benefits from these growth efforts without having to spend much of their own cash.

I expect that Travelsky will continue to grow its profits at a compounded annual rate of 10% to 15% per year. Since the company doesn't have to reinvest much in growth, they pay out ~1/3 of their profits as a dividend, which allows us to earn an annual coupon while we let them compound our capital at an attractive rate. At our cost basis, last year's dividend payout represents a ~2.0% yield, which is roughly the same amount we would earn from U.S. treasuries, except our coupon isn't fixed: it will grow as Travelsky grows.

Although there might be some turbulence in store for the Chinese economy in the future, the long term trajectory of Chinese airline traffic is clear – many more passengers will be going through Travelsky's systems, and Travelsky will be earning far more in profits than they do today.

I don't like broadcasting price targets, but I believe that over a multi-year period Travelsky should be worth meaningfully more than what we purchased it for.

In summary, Travelsky is a sticky business with favorable growth prospects and an attractive business model. It was available to us at a very reasonable price (approximately 15x 2019 earnings, excluding cash), and when the opportunity presented itself, I jumped at the chance to own it. Hopefully we'll own it for a long time.

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Concluding Thoughts

As always, thank you for your partnership.

If you have any questions or comments, please don't hesitate to call or email me.

Fondly,

Andrew

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Disclaimer:

Bonsai Partners, LLC ("Bonsai") is the investment manager of Bonsai Partners Fund, LP (the "Fund").

This letter has been updated from its original version. Disclaimers were revised to reflect current standards and clarifications for the intended audience. Certain visual elements, formatting and brand identifiers have been refreshed to align with our current branding. These changes do not alter the core message of the original letter.

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