**Bonsai Partners**

# Q1 2021 Investor Letter | *May 12, 2021*

Dear Investor,

For the three months ended March 31st, 2021, the Bonsai Partners portfolio declined -0.6% gross, and -0.8% net of fees and expenses. The S&P 500 Total Return Index increased 6.2% over this same period.

At the end of the quarter, gross exposure was 70.1%, with 29.9% held in cash. This cash balance reflects the timing of a position sale at the end of the quarter. This is temporary and I discuss further in the portfolio review section below.

### Bonsai Partners Historical Returns Summary

| | YTD 2021 | 2020 | 2019 | 2018 | Since Inception | Annualized *Since Inception* |
|---|---|---|---|---|---|---|
| **Bonsai Gross Return** | -0.6% | 275.3% | 60.6% | -17.9% | 381.6% | 90.4% |
| **Bonsai Net Return** | -0.8% | 247.0% | 56.4% | -18.1% | 340.8% | 83.6% |
| **S&P 500 Return** | 6.2% | 18.4% | 31.5% | -8.6% | 51.0% | 18.4% |

*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.*

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# Launch of Bonsai Partners Fund

As you already know, over the past months much of my time has been devoted to the preparation and launch of the Bonsai Partners Fund. This unfortunately led to a delay in the release of this letter and its limited scope.

That said, I am pleased to announce the launch of the Bonsai Partners Fund on May 1st, 2021. While setting up the fund required significant upfront investment, it will pay dividends every year going forward. Adopting a fund structure improves Bonsai's operational backbone, increases simplicity, and allows me to devote more time and attention to the portfolio.

The group of new partners that joined the fund on May 1st is an outstanding collection of individuals from diverse backgrounds who understand what Bonsai stands for. I am very excited about the opportunities ahead.

Years ago, when Bonsai was just an idea, launching a fund was one of my long-term aspirations. Looking back now, launching the fund is not only an important step forward but also a satisfying milestone to reach.

Over the coming years, my focus will be devoted to 1) continuous improvement of the research process, 2) upgrading the quality and positioning of our portfolio, and 3) increasing the robustness of Bonsai's operation.

# Position Update

**Redbubble (ASX: RBL)**

Redbubble is a three-sided marketplace connecting digital designs to customers looking to express themselves. The company's shares declined -9.2% during the quarter.

In February, Redbubble presented its quarterly and half-year results ending December 31st, the first earnings call for newly appointed CEO Michael Ilcynski. Mike is an impressive executive who helped scale Seek.com.au into the leading job marketplace in the ANZ region. His experience scaling a digital marketplace is what Redbubble needs.

The half-year period's performance was impressive, generating nearly $50m (AUD) of EBITDA, implying a low-teens EBITDA margin. Importantly, these results offer a window into the favorable underlying economics of the business as it scales.

Despite what I considered an impressive quarter, other investors weren't as keen on the results and management's commentary as I was. Significant focus was placed on the quarter-over-quarter decline in gross margin as well as the increase in marketing spend for the Christmas holiday. Similarly, investors were concerned by management's cautious view related to lapping the high-growth periods of the past year.

What was clear from the earnings call and subsequent conversations was that the new CEO needed to articulate his medium-term strategy for growing the business. At the time of writing, Mike has since laid out this vision, and I believe it focuses on the right steps to improve Redbubble's foundations and drive sustainable growth over the coming years. However, in a similar fashion to February's results, the market didn't share my enthusiasm for this plan, leading to another share price decline after the strategy announcement. Investors were concerned about the decision to reduce near-term profitability in exchange for sustainable long-term growth and building an industry-leading brand. **I couldn't disagree more with this view**. This second share price decline isn't yet reflected in our performance, and it will show up in the next quarter's results unless there's a meaningful change before then.

2021 will likely be a transition year for most e-commerce companies who benefitted from the pandemic, creating uncertainty for investors in businesses like Redbubble. Although it's easy to confuse uncertainty with risk, the two are not the same. Redbubble faces significant uncertainty due to potential revenue declines, but there is little risk associated with lapping difficult comparable periods or investing in the fundamentals. Moments of uncertainty like these provide opportunities for us.

Although the near term may be lackluster, the long-term potential of our investment remains intact, and my focus now shifts to tracking execution against

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their plan over the coming years. This will be the core driver of our investment returns and I remain encouraged despite the likely near-term volatility.

Redbubble stands for something meaningful, has a tremendous growth runway, an exceptional business model, coupled with an attractive valuation. I hope and expect we will own this position for some time.

**Micron Technologies (Nasdaq: MU)**

Micron is a manufacturer of memory semiconductor chips. Micron appreciated 17.3% during the quarter.

With the semiconductor cycle in full swing, sentiment continued to improve for major DRAM and NAND suppliers. Spot pricing for DRAM continues its upward march due to supply shocks across the industry and sustained demand levels that continue to outstrip supply.

As a result, Micron showed improving results for the fiscal first quarter, raised guidance intra-quarter for the fiscal second quarter, and offered strong guidance for the fiscal third quarter in both growth and margins.

While the cyclical nature of DRAM hasn't changed, the cycles themselves continue to become more benign, leading to long-term economic improvement across these businesses. Micron is now continuously profitable, with industry players in a dramatically stronger position than even just five years ago.

The biggest negative surprise in the quarter came from Micron's exit from its 3D XPoint hybrid memory business. The company also announced its decision to sell its accompanying Utah fab. Fortunately, this development does not alter the investment thesis much since 3D XPoint was an option ticket for future growth. While it's unfortunate this product didn't pan out, now is an excellent time to sell a fab, so perhaps it is a blessing in disguise?

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**Travelsky Technology (HKEX: 0696)**

Travelsky is the leading provider of software and systems for airlines and airports in China. Travelsky shares declined -2.8% this quarter.

The company announced full-year 2020 results during the quarter, which were exceptional due to the pandemic grounding airfare for much of the year. Interestingly, Travelsky's March 2021 monthly domestic passenger volumes are now ahead of those from March 2019, signaling domestic air travel in China may grow in excess of pre-pandemic levels. Unfortunately, international travel is still at a standstill, so in aggregate, total volumes remain modestly below the 2019 high watermark. That said, it is encouraging to see a potential growth trajectory ahead for Chinese airfare, the core driver of Travelsky's business.

Travelsky remains in an unassailable position as the embedded operating system for virtually all Chinese airlines and airports for ticket reservations, seat selection, check-in, cargo tracking, and intra-airline fare accounting. The original investment thesis remains intact despite the pandemic disturbing the cadence and ultimate IRR we may realize.

**Pushpay (ASX: PPH)**

Pushpay is a leading provider of software and generosity solutions for the faith sector. Pushpay shares appreciated 7.0% during the quarter.

As mentioned earlier and in my last letter, I decided to trim our position in Pushpay due to declining confidence in the company's management and corporate governance. The straw that broke the camel's back in this case was the appointment of a new CEO who seems an unlikely choice to propel the company forward.

In my experience, it is unusual for a high-growth software/payment business to experience this issue. I rarely have gripes about professional backgrounds and tend to give new managers the benefit of the doubt (outside of histories of dishonest behavior). Although the new CEO has no blemishes of character that I can see, she lacks technical, strategic, and company-building experience. All or most of these things are essential to building a leading technology company, so I am perplexed.

I have not completely sold the position since I believe the new CEO deserves an opportunity to explain what she brings to the table. Unfortunately, there is a real chance that Pushpay will also fall into the mistake pile. I will always remain open and honest with you about my mistakes and hope that you in turn appreciate that **a willingness to fail is what allows us to succeed**.

From a learning perspective, this situation emphasized that I need to better align the Bonsai portfolio with great company leaders (not just great businesses) who operate as good stewards of our capital. If I hold high standards for myself and all of you as investors, these standards must also translate to our company managers, otherwise, the chain of good capital allocation breaks. Expect more from me on this subject in the future.

**LKQ (Nasdaq: LKQ)**

LKQ is the largest provider of alternative collision and mechanical automotive parts in the United States. In Europe, they are the leading distributor of general automotive maintenance parts and supplies. Its shares appreciated 20.1% during the quarter.

During the quarter, LKQ shared its fourth-quarter results: showing a slight revenue decline and a nearly 30% increase in quarterly profit Vs. the same period last year. COVID has proved a surprising catalyst for my investment thesis which revolves around optimizing their recent large acquisitions that were never efficiently integrated.

Admittedly, in addition to LKQ’s quarterly performance, thematically, there has been broad enthusiasm for "re-opening" trades, of which, LKQ has been a beneficiary. Most importantly, the prior overhang related to LKQ's debt burden is now all but behind us. Their net debt to EBITDA ratio now sits below 2x, a stark change from the near 3x leverage ratio before the pandemic. At that time, LKQ's leverage had the potential to spiral upward to nearly 4-5x if the business experienced a prolonged shutdown. It’s good to be past this issue.

**Taiwan Semiconductor (NYSE: TSM)**

Taiwan Semiconductor is the world's largest outsourced foundry of logic semiconductor chips. TSMC's shares appreciated 8.9% during the quarter.

Similar to last quarter, the supply-demand imbalance in semiconductor chips continues to benefit TSMC. To fuel new technological advances and meet the current supply imbalance, we see significantly increased capital spending across the industry over the coming years.

TSMC has an extraordinary track record of return on these large investments despite their rapid historical cadence of expansion. I remain hopeful that the large capital expenditure plan they now have ($100 billion of investment over the next three years) will be money well spent and not lead to industry oversupply in the medium term. Hopefully, future returns on these investments will look as good as those of the past.

**Illumina: (Nasdaq: ILMN)**

Illumina is the leading provider of genomic sequencing instruments and reagents. Illumina's shares appreciated 3.8%.

Similar to last quarter, this quarter was relatively quiet for Illumina. The company positively pre-announced earnings for the first quarter as catch-up demand for lab genomics was robust.

On the regulatory front, the Federal Trade Commission opposed Illumina's acquisition of GRAIL, which is ironic considering it was once a part of Illumina before it spun out. I have no way of knowing whether the deal will go through.

# Concluding Thoughts

For those investors with managed accounts who are also qualified clients, I will follow up with you over the coming weeks to begin the transition of your account into the fund. I appreciate your patience with this process.

As always, if you have questions or comments don't hesitate to reach out to me directly.

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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