Q2 2022 Investor Letter | *August 9, 2022*

Dear Investor,

For the three months ended June 30, 2022, Bonsai Partners Fund, LP, declined -17.3% net of fees and expenses. The S&P 500 Total Return Index declined -16.1% over this same period. Year-to-date returns are presented below.

Bonsai Partners Historical Returns Summary

	YTD 2022	2021	2020	2019	2018	Since Inception	Annualized *Since Inception*
Bonsai Gross Return	-31.7%	-13.9%	277.9%	60.3%	-17.6%	193.7%	33.9%
Bonsai Net Return	-32.0%	-14.8%	247.9%	56.1%	-17.7%	158.7%	29.4%
S&P 500 Return	-20.0%	28.7%	18.4%	31.5%	-8.6%	46.5%	10.9%

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.

So much has changed over the past six months. Today, we face war in Eastern Europe, heightened geopolitical tensions, significant inflation, rising interest rates, and signs of waning customer demand.

While the economic landscape has changed, know that our core tenets remain the same. Current events may cause us to recalibrate from time to time, but I do not see a need for us to dramatically change course.

Our objective remains the same: invest in companies highly likely to earn significantly more revenues, profits, and competitive advantages three, five, or ten

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years from now. If we can align ourselves to those opportunities – the right business models, the right leaders, the right company cultures, and the right prices – we will do well over the only time horizon that matters: the long term.

Although the last eighteen months presented significant challenges, our returns since inception are a reminder that our strategy can deliver attractive long-term results despite periods of underperformance.

Ho Nam at Altos Ventures once said that he imagines his investments are like metal springs. When stock prices fall, these springs compress, storing potential energy waiting to be released. Our portfolio today is filled with potential energy, and the recent volatility offers us a richer set of opportunities to build our portfolio. I remain excited about our future.

Our objective remains the same as it was before this correction. We will stay invested, partner with the right businesses, and not overpay. We will continue executing the plan until our core tenets no longer work. I do not see evidence that this is the case today. Our companies will endure, and our core operating principles remain intact.

Objectives for 2022

In 2022, our core objectives remain the same since the start of the year:

1. Hunt for and add attractive ideas to the portfolio

2. Simplify our operation and improve our operational infrastructure

3. Invest in our processes to improve the work we repeatedly do, both from an operational and investment perspective

On this second point, during this quarter, we selected Pillar Fund Services to provide outsourced CFO services to the Bonsai Partners Fund. We are currently integrating workflows with PFS and see this engagement as an important step in the development of our fund's infrastructure.

Portfolio Review

During the second quarter, we purchased two new positions: XPEL and Wise. We also sold the remainder of our modest LKQ position. I outline our XPEL thesis in the pages below and expect to share our Wise thesis in our third quarter letter.

I want to take a moment now to discuss our significantly reduced Redbubble position. How did Redbubble shift from such a large position at the end of 2020 to a modest one today? Further, why trim the position when Redbubble stock is roughly back to our original purchase price in 2019, given the company is now significantly larger and arguably better positioned?

It is remarkable how different the outlook for e-commerce is today relative to the end of 2020. At that time, Redbubble enjoyed rapid growth, expanding profitability, and a peak valuation of ~20x trailing EBITDA. For a company with a great business model and a long runway ahead, this struck me as attractive. The critical question then was whether e-commerce demand permanently pulled forward five years or if this was a temporary bump. If the growth trajectory remained intact, Redbubble was cheap, and if it was not, Redbubble was expensive. I believed the former, and we've experienced the latter.

I was incorrect to believe that e-commerce demand pulled forward, and we have since seen e-commerce return to its historical trendline as other parts of the economy re-opened. This shift caused Redbubble and most of the e-commerce landscape to go from cheap to overvalued in a heartbeat. Although I was bullish in late 2020 on e-commerce, I still decided to dramatically reduce our Redbubble exposure to improve the balance of ideas within our portfolio. In hindsight, this proved to be a wise choice.

However, more important than changes in macroeconomic trends, multiple other factors changed related to Redbubble. I've changed. The facts underlying the Redbubble thesis changed. And the opportunity set also changed.

Over the past three years, I've improved as an investor in ways that I couldn't have imagined when I first invested in Redbubble. While three years may not sound like a long time, trust me, those were dog years! As we improve, our investment criteria and portfolio also improve.

While Redbubble is a good business, and our thesis played out in some ways, it did not work as well in others. When I first invested in 2019, a core part of our investment thesis revolved around the company's ability to raise customer repeat purchase rates through improved systems and new product innovation. By cracking this piece of the puzzle, Redbubble would grow faster and more predictably than the historical trend while also adding resiliency in case of challenging operating environments. Fast forward to today, and unfortunately, the company made limited progress against this goal. This development is disappointing, and it offers a reminder of the importance of holding management accountable for their execution. I allowed "thesis creep" to get the better of me.

In addition, a new risk factor emerged as we studied the company. I was surprised to learn about a degree of legal risk hidden under the surface related to intellectual property infringement on their site. Redbubble is a digital platform, and as a platform, if members of their community upload infringing artwork, the company is shielded from liability due to the safe harbor provision within Section 512 of the Digital Millennium Copyright Act. However, as the winds of change swirl around the laws that regulate the platform economy, it seems possible, if not likely, that the protections that Redbubble historically enjoyed may not protect them against future claims. While I believe Redbubble can invest in systems and people to police their marketplace and eliminate this liability, management has not done enough. This has been an area of frustration despite my engagement on this issue.

Redbubble at these prices offers an attractive IRR as their underlying opportunity remains significant, and the competitive advantages I observed when I first invested remain intact. However, weak execution and emerging legal risks led me to reduce our position size further than just the goal of attaining better balance within the portfolio. I continue to monitor the company in the hope that they execute against these underlying areas. Such changes would allow me to consider a larger Redbubble position again in the future.

Finally, while Redbubble offers an attractive IRR, the opportunity set around us has dramatically improved. When we purchased Redbubble from 2019 through March

2020, Redbubble was the most compelling opportunity I could find. Today, Redbubble faces other competitive uses of our capital. While I believe Redbubble has the potential to be an excellent long-term investment, for the reasons mentioned, I have increasingly deployed our capital into other ideas.

New Investment: XPEL (Nasdaq: XPEL)

XPEL Overview

XPEL is a provider of high-performance automotive and architectural films. XPEL's films protect painted automotive surfaces as well as add tint to automotive and architectural windows. Paint protection film (PPF) represents a majority of XPEL's sales.

XPEL's end customers buy paint protection film to protect their cars from chips and scuffs caused by rocks and other debris. Rather than repaint a car's front end multiple times over its life, PPF offers an invisible layer of protection that absorbs these impacts to ensure a vehicle looks like new. Although customer awareness of PPF is still relatively low, the PPF market rapidly expanded over the past five years due to improved product performance and customer adoption reaching a tipping point.

Anyone who takes pride in the appearance of their vehicle is a potential customer of PPF. While protection film initially gained traction in high-end cars, today, some of XPEL's most common installations include mass-market models such as Toyota Corolla and Ford F-150.

Consumers who want to apply PPF to their vehicles typically purchase the product through an independent film installer. Installers are required for this product because PPF installation is labor intensive, and its application is highly technical. The variability of different car models makes defect-free installation a challenge for even the most experienced film installers. XPEL views its network of installers as its customer base since they are the direct buyers of XPEL products.

In addition to its line of films and coatings, XPEL also sells to installers its software and database of film patterns, known as their Design Access Program (DAP). The DAP offers installers the most extensive library of automotive patterns, with over 80,000 designs. This system allows a film installer to precisely print film cutouts that match the precise size and shape of most vehicle makes, models, and years. The Design Access Program offers XPEL a significant advantage over its PPF competition, which includes Eastman Chemical (through its Llumar and Suntek brands) and 3M. XPEL’s software is a key reason the company enjoys a leading position with installers.

XPEL earns money in three ways: 1) by selling films and coatings to its network of installers (~84% of revenue), 2) by collecting software access fees and "cutbank" credits (6%), and 3) by offering installation services directly through its self-owned installation centers (~10%).

Finally, XPEL developed a robust growth playbook to execute against, which includes: 1) authorizing more XPEL authorized dealers to open in North America, 2) introducing new product lines and increasing product utilization across their installer base, 3) expanding their presence outside of North America, 4) moving further upstream to sell their products through automotive OEMs and 5) acquiring existing installation shops or opening new XPEL branded installation centers. XPEL's growth runway remains significant as customer adoption of PPF remains in its early days.

What Makes XPEL an Enduring Business?

While XPEL primarily makes money selling performance films, do not be fooled; the properties of XPEL’s films are not their core differentiator. I view XPEL’s success in film as a byproduct of something else entirely: its ability to create the most valuable ecosystem for film installers.

While XPEL's performance films are market-leading products, comparing XPEL's films to competing products misses the bigger picture. While XPEL and Apple are not comparable, I don’t think one gains a good sense of Apple’s competitive advantage just by comparing the iPhone’s technical specifications against those of competing Android devices. The value of the iPhone lies in Apple’s ecosystem, and

Apple monetizes its ecosystem through smartphone sales and high-margin app store royalties. XPEL operates similarly: they monetize their ecosystem through performance film sales and high margin "cutbank" credits.

XPEL's ecosystem value originates from the company's leadership in three areas: marketing (brand awareness with end consumers), distribution (high-touch service to installers), and software (their proprietary library of designs).

XPEL's lead in marketing, distribution, and software allows the company to funnel the most high-value film jobs to its network of installers while also increasing the amount of profit its installers earn per job through technology and white glove service. By driving the most value to installers than anyone else, more installers want to work exclusively with XPEL, driving film and software sales back to the company. Let's discuss each of XPEL's three differentiators in turn.

On the marketing side, XPEL built the cognitive referent within the PPF industry. Put differently, what "Kleenex" is to tissues, XPEL is to paint protection film. Customers who want paint protection often don't know the term "paint protection film" at all. Instead, when they visit a film installer, they often ask installers to "XPEL" their car, regardless of the brand the installer is affiliated with.

While XPEL's product is an indistinguishable invisible film, the company did a remarkable job building an aspirational brand for auto enthusiasts. XPEL accomplished this by partnering with leading car brands, race clubs, and auto enthusiast groups. These organizations likely weren't interested in partnering with stodgy brands like Eastman Chemical or 3M, allowing XPEL to step in and become the aspirational product for protecting one's vehicle. By building the market-leading brand, more customers search for XPEL branded products and affiliated installers than any other. This makes XPEL's dealer locator tool quite valuable. More film installers want to work exclusively with XPEL due to their control of access to the customer from multiple angles.

From a distribution perspective, XPEL built a high-performance service organization. Rather than extract as much value possible from its installers, XPEL is service-focused, offering high in-stock availability, products delivered quickly, a leading warranty, and a direct line to resolve issues fast. XPEL would rather eat the cost of a problem installation than squeeze their installers for everything they are worth. This level of service helps installers service more cars in any given month while also delivering peace of mind that XPEL has their back. I discuss the importance of this attribute in more detail in the following section.

Finally, XPEL's software is essential to installers because they are forced to cut film by hand without it. This process of 'bulk cutting' creates significantly more film waste (paint protection film is expensive), wastes installer time, increases human error, and the installer might damage the vehicle underneath. XPEL's DAP software linked with a film printer ensures consistent film shapes, faster application times, and repeatable results due to their library of vetted designs that installers grow to trust.

As mentioned earlier, XPEL holds a clear advantage in its Direct Access Program library. The company stands out in this area because XPEL didn't start as a film company. Instead, XPEL began as a software company and only later in its life expanded outward to sell its own brand of film and other products. While XPEL engineers each of its products, they outsource virtually all of its manufacturing to third parties.

Due to their software focus, XPEL's library of patterns is the most extensive and accurate. This is difficult to replicate. While their well-capitalized competitors have tried, their design libraries are incomplete and inaccurate. It takes a significant investment to create designs for each new vehicle model and trim while also curating a catalog of historical models spanning decades. XPEL's competitors have too many other business lines to devote the resources necessary to compete in this niche industry effectively.

From our research, XPEL's competitors admit that after spending millions of dollars building new versions of their software, XPEL is still at least a decade ahead. Finally, since XPEL also runs some of its own installation shops, it can test new patterns and software features before releasing them to others. This arrangement allows XPEL to iterate faster while avoiding installer frustration.

In summary, by driving more leads to installers and offering a more efficient system to service those leads, PPF dealers earn the most money when they choose to partner with XPEL. As a result, XPEL's installer base is incredibly loyal and often ecstatic to join the XPEL network when offered. Importantly, this system creates a quasi-franchise business model for XPEL; they're not just a film supplier, but they earn film and software "royalties" on the customer leads they pass through to their installers.

I cannot overstate the importance of controlling distribution in the PPF industry. I explain this dynamic further in the section below.

The "Friendly" Installer

Under the right conditions, the seller of a product is the critical point of an industry's value chain. I find this occurs in ***infrequently purchased, high-value*** products. In these specific cases, customers tend to rely on expert opinions to avoid buyer's remorse. This dynamic creates a favorable environment for sellers since they hold considerable sway over which products the customer ultimately buys.

For example, an orthodontist not only installs braces but also acts as a salesperson that guides the patient to pick the "right" orthodontic system for them. By acting as a subject matter expert and salesperson simultaneously, customers rely heavily on the orthodontist's opinion, giving the dentist significant control over which products are purchased.

In the case of paint protection film, this dynamic also exists for film installers. A car owner is making a significant investment in their vehicle, often thousands of dollars, and to the naked eye, each film is indistinguishable. Customers want to know from the installer which product will best protect their automobile over its life. Film installers, therefore, exert significant influence over which film brand and SKU are sold. By cornering the PPF industry's installer base through the means mentioned above, installers recommend XPEL products more than any other.

While installers are highly interested in end customer satisfaction, they do not have a perfect alignment of incentives. To the installer, the best product is not just the film with the highest quality at the lowest price. Instead, installers also consider a product's commercial attributes: is the product the easiest and fastest to install? Is the product always in stock? Can I get the product delivered quickly? Will the company replace the product for free if something goes wrong? Etc. On these attributes, the scale tips heavily in XPEL's favor.

XPEL isn't just growing quickly because it has some of the best performing films (they do), but also because it offers the best platform for an installer to make money running an auto film business. Building deep alignment with installers gives XPEL control over the industry. XPEL has a long waitlist of installers clamoring to become an exclusive XPEL distributor, and this scarcity creates a sense of pride for those chosen to join their network.

If XPEL continues to deliver the most value to installers through its software, marketing, and distribution layers, its control over the fast-growing PPF industry will remain intact.

Conclusion

XPEL controls two customer chokepoints: they have the market-leading brand, and they maintain control over distribution. By cornering these channels of the PPF market, XPEL outfoxed its better-capitalized competition and now leads this fast-growing and attractive industry. I believe the arrangement they created with installers is enduring, and they will be able to execute their growth playbook for many years.

Closing Thoughts

Thank you again for your partnership. I'm continually amazed by our collection of long-term thinkers.

While I have never written in our letters that "now is a good time to invest in the fund," I believe that times like these offer opportunities to lean into the volatility as our portfolio grows increasingly attractive.

As I said last quarter, I appreciate your calm patience during these challenging months. If you have questions or comments, don't hesitate to contact me directly.

Fondly,

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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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